International Business Law

Text, Cases, and Readings

SIXTH EDITION

Ray August • Don Mayer • Michael Bixby

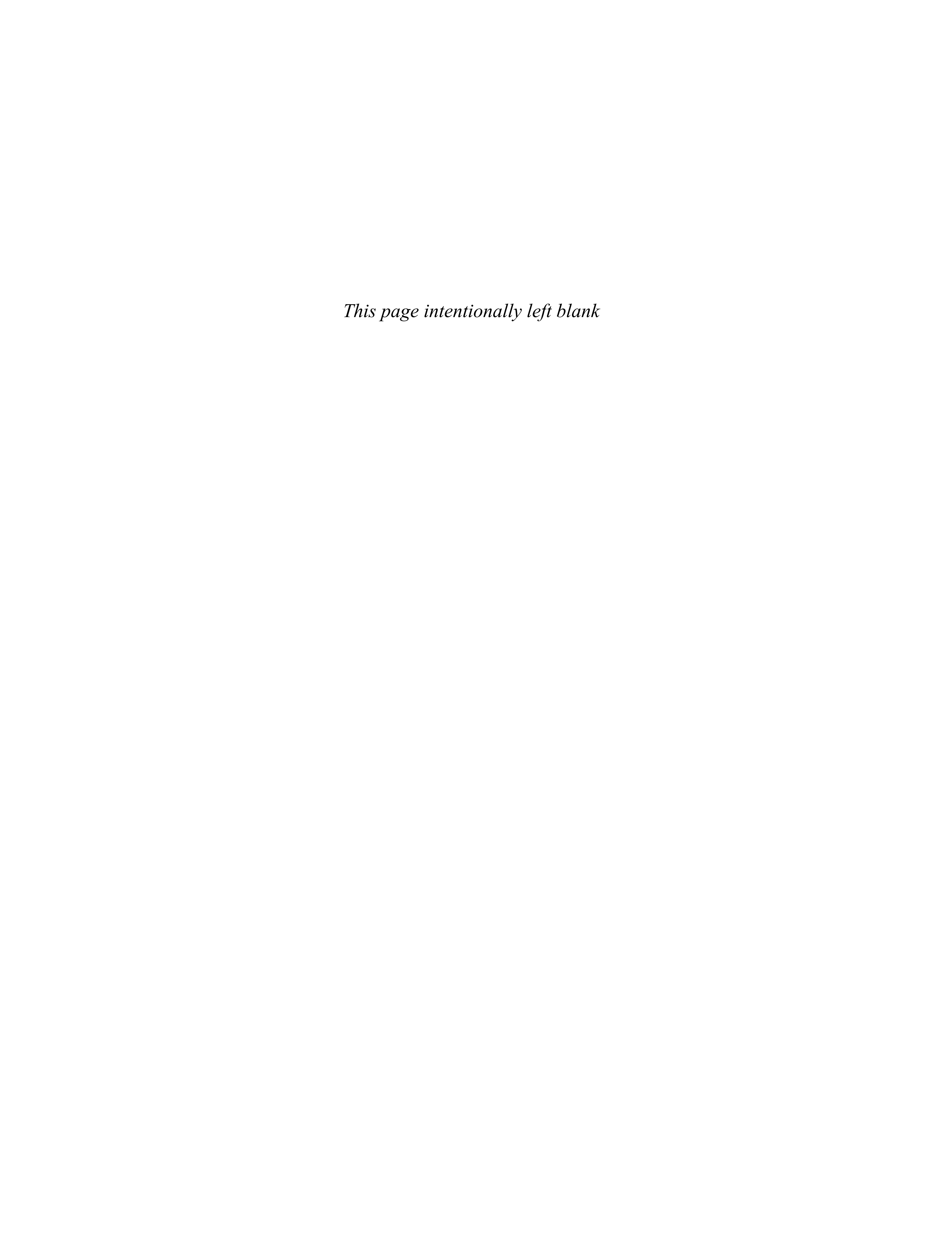
ALWAYS LEARNING

PEARSON

International Business Law

Text, Cases, and Readings

Sixth Edition


This page intentionally left blank

International Business Law

Text, Cases, and Readings

Sixth Edition

Ray August (1944–2004)

J.D., University of Texas at Austin; LL.M. in International Law, University of Cambridge; Ph.D. in American Legal History, University of Idaho

with revisions by

Don Mayer

Professor in Residence, Daniels College of Business, University of Denver; J.D., Duke University; LL.M. in International and Comparative Law, Georgetown University Law Center; Member, North Carolina State Bar

and

Michael Bixby

Professor, Legal Studies in Business, Boise State University; J.D., University of Michigan; Member, State Bar of Michigan

International Editions contributions by
Suryapratim Roy
Researcher in Behavioural Law and Economics, University of Groningen

PEARSON

Boston Columbus Indianapolis New York San Francisco Upper Saddle River Amsterdam
Cape Town Dubai London Madrid Milan Munich Paris Montreal Toronto Delhi Mexico City
Sao Paulo Sydney Hong Kong Seoul Singapore Taipei Tokyo

Editor in Chief: Donna Battista
Executive Editor: Stephanie Wall
Director Editorial Services: Ashley Santora
Senior Editorial Project Manager: Karen Kirincich
Editorial Assistants: Jane Avery, Lauren Zanedis
Marketing Manager: Jami Minard
Senior Managing Editor: Nancy Fenton
Associate Managing Editor: Karen Carter
Senior Manufacturing Buyer: Megan Cochran
Manager Central Design: Jayne Conte
Publisher, International Edition: Angshuman Chakraborty
Publishing Administrator and Business Analyst, International Edition: Shokhi Shah Khandelwal
Senior Print and Media Editor, International Edition: Ashwitha Jayakumar
Associate Acquisitions Editor, International Edition: Jayashree Arunachalam
Publishing Administrator, International Edition: Hema Mehta
Project Editor, International Edition: Daniel Luiz
Senior Manufacturing Controller, Production, International Editions: Trudy Kimber
Permissions Specialist: Jill Dougan
Image Lead Manager: Mike Lackey
Project Management and Page Makeup: Laserwords Private Limited
Cover Printer: Courier/Kendallville

Pearson Education Limited
Edinburgh Gate
Harlow
Essex CM20 2JE
England

and Associated Companies throughout the world

Visit us on the World Wide Web at:
www.pearsoninternationaleditions.com

© Pearson Education Limited 2013

The right of Ray August, Don Mayer and Michael Bixby to be identified as authors of this work has been asserted by them in accordance with the Copyright, Designs and Patents Act 1988.

Authorized adaptation from the United States edition, entitled International Business Law: Text, Cases, and Readings, 6th edition, *ISBN 978-0-132-71897-4, by Ray August, with revisions by Don Mayer and Michael Bixby, published by Pearson Education © 2013.*

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without either the prior written permission of the publisher or a license permitting restricted copying in the United Kingdom issued by the Copyright Licensing Agency Ltd, Saffron House, 6–10 Kirby Street, London EC1N 8TS.

All trademarks used herein are the property of their respective owners. The use of any trademark in this text does not vest in the author or publisher any trademark ownership rights in such trademarks, nor does the use of such trademarks imply any affiliation with or endorsement of this book by such owners.

Microsoft and/or its respective suppliers make no representations about the suitability of the information contained in the documents and related graphics published as part of the services for any purpose. All such documents and related graphics are provided "as is" without warranty of any kind. Microsoft and/or its respective suppliers hereby disclaim all warranties and conditions with regard to this information, including all warranties and conditions of merchantability, whether express, implied or statutory, fitness for a particular purpose, title and non-infringement. In no event shall Microsoft and/or its respective suppliers be liable for any special, indirect or consequential damages or any damages whatsoever resulting from loss of use, data or profits, whether in an action of contract, negligence or other tortious action, arising out of or in connection with the use or performance of information available from the services.

The documents and related graphics contained herein could include technical inaccuracies or typographical errors. Changes are periodically added to the information herein. Microsoft and/or its respective suppliers may make improvements and/or changes in the product(s) and/or the program(s) described herein at any time. Partial screen shots may be viewed in full within the software version specified.

Microsoft® and Windows® are registered trademarks of the Microsoft Corporation in the U.S.A. and other countries. This book is not sponsored or endorsed by or affiliated with the Microsoft Corporation.

ISBN 10: 0-273-76861-1
ISBN 13: 978-0-273-76861-6

British Library Cataloguing-in-Publication Data
A catalogue record for this book is available from the British Library

10 9 8 7 6 5 4 3 2 1
14 13 12 11 10

Typeset in Times LT Std by Laserwords Private Limited

Printed and bound by Courier Kendaville in The United States of America

The publisher's policy is to use paper manufactured from sustainable forests.

Brief Contents

Preface 17

Chapter 1 Introduction to International and Comparative Law 21

Chapter 2 State Responsibility and Environmental Regulation 71

Chapter 3 Dispute Settlement 127

Chapter 4 The Multinational Enterprise 183

Chapter 5 Foreign Investment 238

Chapter 6 Money and Banking 300

Chapter 7 Trade in Goods 358

Chapter 8 Services and Labor 429

Chapter 9 Intellectual Property 489

Chapter 10 Sales 559

Chapter 11 Transportation 609

Chapter 12 Financing 657

Case Index 702
Statutory Index 705
Topical Index 716

Contents

Preface 17

Chapter 1 Introduction to International and Comparative Law 21

What Is International Law? 21

CASE 1-1 Ignacio Sequihua v. Texaco Inc. et al. 23

The Making of International Law 25

Sources of International Law 25

Treaties and Conventions 25

Custom 27

General Principles and *Jus Cogens* 28

The Scope of International Law in Actual Practice 28

The Practice in International Tribunals 28

The Practice in Municipal Courts 29

CASE 1-2 Sei Fujii v. State of California 30

International Persons 32

States 32

Territorial Sovereignty 34

Negative Servitudes: Air and Water Pollution 34

CASE 1-3 The Trail Smelter Arbitration 35

International Organizations 39

READING 1-1 Overview of the UN Global Compact and the Millennium Development Goals, and the Ten Principles 44

READING 1-2 The End of the Euro? Fears of Financial Contagion 48

CASE 1-4 Commission of the European Communities v. Federal Republic of Germany 51

The Institutions of the European Union 54

The Rights of Individuals Under International Law 62

CASE 1-5 De Sanchez v. Banco Central De Nicaragua 63

Comparison of Municipal Legal Systems 65

The Romano-Germanic Civil Law System 65

The Anglo-American Common Law System 68

The Islamic Law System 69

Chapter Questions 70

Chapter 2 State Responsibility and Environmental Regulation 71

Introduction 71

State Responsibility 72

Doctrine of Imputability 72

Nonimputable Acts 72

CASE 2-1 Sandline International Inc. v. Papua New Guinea 73

CASE 2-2 Flatow v. The Islamic Republic of Iran 78

READING 2-1 State Responsibility, Corporate Responsibility, and Terrorism 83

Fault and Causation 87

Standard of Care 88

The National Standard of Care 88

The International Standard of Care 88
Expropriation 89
In Brief: CASE 2-3 Acsyngo v. Compagnie De Saint-Gobain (France) S.A. 90
Denial of Justice 93
CASE 2-4 Chattin v. United Mexican States 93
Objections 96
Lack of Standing 96
Lack of Nationality 96
Lack of a Genuine Link 97
Failure to Exhaust Remedies 97
CASE 2-5 The M/V *Saiga* Case (Merits) 98
Other Objections 103
Relief 103
Insurance 103
CASE 2-6 Re Letelier and Moffitt 104
Private Insurers 107
National Investment Guaranty Programs 107
Multilateral Investment Guaranty Programs 109
Environmental Protection 109
Regulation of Pollution 111
CASE 2-7 Southern Bluefin Tuna Cases: Provisional Measures 112
READING 2-2 The U.S. View and the "Basic" View on the Kyoto Protocol and its Renewal 120
Protection of Natural Resources 123
Liability for Environmental Damage 124
Chapter Questions 125

Chapter 3 Dispute Settlement 127
Settlement of Disputes Through Diplomacy 127
Negotiation 128
Mediation 128
Inquiry 128
Settlement of Disputes in International Tribunals 129
International Court of Justice 129
READING 3-1 Iran and the United States at the ICJ: Oil Platforms Case (Islamic Republic of Iran v. United States of America) 133
International Criminal Court 135
World Trade Organization Dispute Settlement Procedures 136
CASE 3-1 Japan—Taxes on Alcoholic Beverages 138
International Center for the Settlement of Investment Disputes 140
CASE 3-2 In the Matter of the Loewen Group Inc. and Raymond L. Loewen, Claimants/Investors v. United States of America Respondent/Party 145
Other Arbitration Tribunals 148
Settlement of Disputes in Municipal Courts 148
Jurisdiction in Criminal Cases 148
Jurisdiction in Civil Cases 149
Jurisdiction over Persons 149
CASE 3-3 Bumper Development Corp. Ltd. v. Commissioner of Police of the Metropolis and Others (Union of India and Others, Claimants) 150

CASE 3-4 Shell v. R. W. Sturge, Ltd. 154
Immunities of States from the Jurisdiction of Municipal Courts 159
Sovereign or State Immunity 159
READING 3-2 China and Sovereign Immunity 162
CASE 3-5 Abbott v. Republic of South Africa 163
Act of State Doctrine 167
CASE 3-6 W.S. Kirkpatrick Co., Inc. v. Environmental Tectonics Co. 167
Choosing the Governing Law 169
Agreement of the Parties 170
Statutory Choice of Law Provisions 170
Most Significant Relationship 171
CASE 3-7 Bank of India v. Gobindram Naraindas Sadhwani and Others 172
Governmental Interest 175
Refusal To Exercise Jurisdiction 176
Opposition to the Exercise of Jurisdiction 176
CASE 3-8 Jorge Luis Machuca Gonzalez et al. v. Chrysler Corporation et al. 177
Proving Foreign Law 180
Recognition of Foreign Judgments 181
Chapter Questions 181

Chapter 4 The Multinational Enterprise 183
Introduction 183
Strategies for Doing Business Globally 184
Exporting and Importing 184
Branches and Subsidiaries 184
READING 4-1 China Merchants Bank 185
Licensing Intellectual Property and Franchising 185
The Business Form 186
The Importance of the Separate Legal Identity of Juridical Entities 186
The Multinational Organization 186
The Parent Company 186
CASE 4-1 Case Concerning Barcelona Traction, Light and Power Co. (Second Phase) 187
The Subordinate Structure 192
International Regulation of Multinational Enterprises 193
READING 4-2 The ISO 26,000 Standard for Global Business Conduct 193
Bribery and Corruption Rules 196
Home State Regulation of Multinational Enterprises 196
Unfair Competition Laws 196
CASE 4-2 Metro Industries v. Sammi Corp. 200
In Brief: CASE 4-3 Airbus Industrie G.I.E. v. Patel 208
READING 4-3 F. Hoffman-La Roche Ltd. v. Empagran 209
Tort and Products Liability Laws 210
CASE 4-4 Dow Jones & Co. Inc. v. Gutnick 211
In Brief: CASE 4-5 World-Wide Volkswagen v. Woodson 217

CASE 4-6 Asahi Metal Industry Co., Ltd. v. Superior Court of California, Solano County United States Supreme Court 219

Sharp Practices 224

CASE 4-7 United States v. Blondek, Tull, Castle, and Lowry 225

READING 4-4 Current Events in International Law: The New Global Reach of Anti-Corruption Laws 229

Host State Regulation of Multinational Enterprises 231

Consent to the Jurisdiction of the Host State 231

Common Enterprise Liability 231

CASE 4-8 Touche Ross & Co. v. Bank Intercontinental, Limited 232

Piercing the Company Veil 236

Chapter Questions 236

Chapter 5 Foreign Investment 238

Foreign Investment Laws and Codes 239

READING 5-1 Pacific Rim Mining v. El Salvador: An ICSID Arbitration under the U.S.-Dominican Republic Central American Free Trade Agreement (DR-CAFTA) 240

National Foreign Investment Policies 243

Regional Investment Policies 245

Screening Foreign Investment Applications 246

Formal and Informal Application Processes 248

Approval of Foreign Investment Applications 249

In Brief: CASE 5-1 Arab Republic of Egypt v. Southern Pacific Properties, Ltd., et al. 249

Business Forms 250

Limitations on Foreign Equity 252

Sectoral Limitations 252

READING 5-2 Foreign Direct Investment in India 253

Geographic Limitations 257

CASE 5-2 Brady v. Brown 257

Free Zones 262

CASE 5-3 Nissan Motor Mfg. Corp., U.S.A. v. United States 264

Foreign Investment Guarantees 268

Supervision of Foreign Investment 270

Start-Up Standards 270

Operational Reviews 270

Modification of Foreign Investment Agreements 271

CASE 5-4 Arbitration Between Wintershall AG et al. and the Government of Qatar 271

Protection of Subsidiaries 274

CASE 5-5 The Bhopal Case 277

Penalties for Noncompliance 281

Securities Regulations 282

Securities 282

Trading in Securities 283

Securities Exchanges 283

Issuance of Securities 284

Clearance and Settlement Procedures 286

Insider Trading Regulations 287

CASE 5-6 Batchelder v. Kawamoto 288

Takeover Regulations 292

Enforcement of Securities Regulations Internationally 294
International Enforcement Cooperation 295
The Convention on Insider Trading 296
Extraterritorial Application of U.S. Securities Laws 297
Chapter Questions 298

Chapter 6 Money and Banking 300
Money 301
The Value of Money 301
The Choice of Money 302
Maintaining Monetary Value 302
CASE 6-1 Republic of Argentina et al. v. Weltover, Inc. et al. 303
The International Monetary Fund (IMF) 307
Origin of the IMF 307
READING 6-1 The U.S. Dollar as International Currency Reserve? 309
IMF Quotas 310
Organization of the IMF 310
READING 6-2 IMF Quota Reform is Inadequate; Reaction to IMFC Communiqué 311
READING 6-3 Calls for Debt Audit as IMF Austerity Fails 311
IMF Operations 313
Currency Exchange 313
Currency Exchange Obligations of IMF Member States 313
Enforcement of Exchange Control Regulations of IMF Member States 314
CASE 6-2 Wilson, Smithett & Cope, Ltd v. Terruzzi 315
Enforcement of Exchange Control Laws in the Absence of IMF Membership 319
CASE 6-3 Menendez v. Saks and Company 319
Enforcement of Other IMF Member State Currency Exchange Obligations 322
Exemptions for New Members from IMF Member State Currency Exchange Obligations 323
Currency Support 323
IMF Facilities 323
IMF Conditionality 324
Development Banks 324
Controversies at the World Bank 326
READING 6-4 The IMF and the World Bank: How Do They Differ? 328
The Bank for International Settlements 333
The Central Banks' Bank 334
Promoter of International Monetary Cooperation 334
Agent for International Settlements 335
BIS and Basel III 335
Regional Monetary Systems 336
National Monetary Systems 338
National Monetary Organizations 338
Bank Deposits 339
READING 6-5 Islamic Banking 340
Eurocurrency Deposits 342
The Interbank Deposit Market 342
The Foreign Exchange Market 343
Foreign Exchange Contracts 344

In Brief: CASE 6-4 Hunt et al. v. Alliance North American Government Income Trust, Inc. et al. 344

Arbitrage 346

The Transfer of Money 346

Branch Banking 346

CASE 6-5 In Re Sealed Case 347

Conflicts Between Host and Home State Regulations 351

CASE 6-6 Vishipco Line et al. v. Chase Manhattan Bank, N.A. 351

CASE 6-7 Libyan Arab Foreign Bank v. Bankers Trust Company 355

Chapter Questions 357

Chapter 7 Trade in Goods 358

History of Contemporary International Trade Law 359

Protectionism 360

The Bretton Woods System 362

The 1947 General Agreement on Tariffs and Trade 363

Multilateral Trade Negotiations 363

The Uruguay Round 364

The World Trade Organization 365

The WTO Agreement 367

Membership of the WTO 367

Structure of the WTO 369

Decision Making within the WTO 372

READING 7-1 The WTO from Seattle to Doha to Hong Kong to Geneva (and beyond) 372

Waivers 375

Dispute Settlement 375

Trade Policy Review 376

The 1994 General Agreement on Tariffs and Trade 376

Direct Effect 376

In Brief: CASE 7-1 Finance Ministry v. Manifattura Lane Marz Otto, SpA 378

Nondiscrimination 379

CASE 7-2 Japan—Taxes on Alcoholic Beverages 381

Protection Only Through Tariffs 385

Transparency 386

Regional Integration 386

Commodity Arrangements 387

Escape Clause 388

Exceptions 388

Export Controls 389

CASE 7-3 United States—Import Prohibition of Certain Shrimp and Shrimp Products 389

Other Multilateral Export-Control Programs 396

Multilateral Trade Agreements 398

Customs Valuation 399

Preshipment Inspection 400

Technical Barriers to Trade 400

Sanitary and Phytosanitary Measures 402

Trade-Related Investment Measures 402

CASE 7-4 Australia—Measures Affecting Importation of Salmon 403
Import-Licensing Procedures 408
Anti-dumping 409
CASE 7-5 Nippon Steel Corporation v. United States 410
Subsidies and Countervailing Measures 414
CASE 7-6 United States—European Communities—Measures Affecting Trade in Large Civil Aircraft 416
Safeguards 421
Agriculture 422
Textiles and Clothing 424
Rules of Origin 425
Chapter Questions 427

Chapter 8 Services and Labor 429
Introduction 429
General Agreement on Trade in Services 429
The Framework Agreement 430
CASE 8-1 European Communities—Regime for the Importation, Sale, and Distribution of Bananas 431
GATS Annexes 439
GATS Schedules of Specific Commitments 439
Regional Intergovernmental Regulations on Trade in Services 441
EU Law on Trade in Services 441
Provisions Governing Trade in Services in the North American Free Trade Agreement (NAFTA) 444
International Labor Law 445
International Labor Organization 445
READING 8-1 Equality at Work: Tackling the Challenges of Disability 447
The Human Rights of Workers 451
CASE 8-2 DUBERG v. UNESCO 452
Regional Intergovernmental Regulations on Labor 462
Employment Laws in the EU 462
Employment Standards of the Organization for Economic Cooperation and Development (OECD) 465
Protection of Workers' Rights by the Council of Europe 466
Transnational Organized Labor 468
Movement of Workers 468
Visas 469
CASE 8-3 State v. Nagami 470
READING 8-2 United States Visa Regulations 474
CASE 8-4 England and Another v. Attorney-General of St. Lucia 476
Regulation of Foreign Workers 479
CASE 8-5 Spiess et al. v. C. Itoh & Co. (America), Inc. 480
Application of Home State Labor Laws Extraterritorially 483
CASE 8-6 Morelli v. Cedel 483
Chapter Questions 487

Chapter 9 Intellectual Property 489
Introduction 490
The Creation of Intellectual Property Rights 490
Copyrights 490

CASE 9-1 Performing Right Society, Limited v. Hickey 494

CASE 9-2 Amar Nath Sehgal v. Union of India 499

Patents 504

CASE 9-3 Monsanto Co. v. Coramandal Indag Products, (P) Ltd. 507

Trademarks 512

READING 9-1 Starbucks and Ethiopia Dispute Coffee Trademark Issues 513

CASE 9-4 Experience Hendrix, L.L.C. v. Hammerton 516

Know-How 523

International Intellectual Property Organizations 524

World Intellectual Property Organization 524

Council for Trade-Related Aspects of Intellectual Property Rights 526

Intellectual Property Treaties 526

Comprehensive Agreements 527

Artistic Property Agreements 528

Industrial Property Agreements 531

The International Transfer of Intellectual Property 533

Licensing Regulations 534

Territorial Restrictions 536

Export Restrictions 539

CASE 9-5 L'Oréal v. eBay 540

Cartels 542

Exclusive Licenses 543

CASE 9-6 Ransome-Kuti v. Phonogram, Ltd. 543

Sales and Distribution Arrangements 545

Price-Fixing 546

Noncompetition Clauses 546

Challenges to Validity 547

Tying Clauses 547

Quantity and Field-of-Use Restrictions 548

Restrictions on Research and Development 550

Quality Controls 550

Grant-Back Provisions 551

Restrictions That Apply After the Expiration of Intellectual Property Rights 552

Restrictions That Apply After the Expiration of the Licensing Agreement 553

Compulsory Licenses 553

Patents 554

Copyrights 554

READING 9-2 Compulsory Licensing of Patents on Aids and other Drugs: WTO Rules and Actions by Certain Nations 555

Chapter Questions 558

Chapter 10 Sales 559

United Nations Convention on Contracts for the International Sale of Goods 560

Transactions Covered in CISG 560

Opting In and Out 562

CASE 10-1 Asante Technologies, Inc. v. PMC-Sierra, Inc. 562

Sales Defined 567

Goods Defined 567

Mixed Sales 568

Contractual Issues Excluded from the Coverage of CISG 569

Illegality and Incompetency 569
Third-Party Claims and Personal Injuries 570
Preemption 570
Interpreting CISG 572
The Convention 572
General Principles 574
Rules of Private International Law 574
Interpreting Sales Contracts 574
Statements and Conduct of the Parties 575
Negotiations 575
Practices and Usages 575
CASE 10-2 Treibacher Industrie, A.G. v. Allegheny Technologies, Inc. 576
Form 579
Formation of the Contract 580
The Offer 580
Effectiveness of an Offer 582
Acceptance 582
Acceptance with Modifications 584
CASE 10-3 Filanto, SpA v. Chilewich International Corp. 585
General Standards of Performance 587
Fundamental Breach 588
Avoidance 588
Requests for Specific Performance 588
Seller's Obligations 589
Place for Delivery 589
Time for Delivery 589
The Turning Over of Documents 589
Conformity of Goods 589
Buyer's Obligations 591
Payment of the Price 591
CASE 10-4 The Natural Gas Case 591
Taking Delivery 594
The Passing of Risk 594
Agreement of the Parties 595
CASE 10-5 Chicago Prime Packers, Inc. v. Northam Food Trading Co. 595
Means of Delivery 598
Breach of Contract 599
Remedies 599
Buyer's Remedies 599
CASE 10-6 The Shoe Seller's Case 600
Seller's Remedies 603
Remedies Available to Both Buyers and Sellers 604
Excuses for Nonperformance 606
Force Majeure 606
Dirty Hands 607
Chapter Questions 607

Chapter 11 Transportation 609
Trade Terms 609

CASE 11-1 St. Paul Guardian Insurance Company v. Neuromed Medical Systems & Support, GmbH 610
A Note on the Incoterms 614
"Free" Terms 615
FOB—Free on Board 615
FAS—Free Alongside Ship 616
CIF—Cost, Insurance, and Freight 616
CFR—Cost and Freight 616
CASE 11-2 Phillips Puerto Rico Core, Inc. v. Tradax Petroleum, Ltd. 616
FCA—Free Carrier 620
EXW—Ex Works 620
Transportation 620
Inland Carriage 621
Carriage of Goods by Sea 622
Common Carriage 623
The Bill of Lading 623
CASE 11-3 M. Golodetz & Co., Inc. v. Czarnikow-Rionda CO., Inc. (The Galitia) 629
Carrier's Duties Under a Bill of Lading 634
Carrier's Immunities 634
CASE 11-4 Great China Metal Industries Co. Ltd. v. Malaysian International Shipping Corp. 635
Liability Limits 640
CASE 11-5 Croft & Scully Co. v. M/V Skulptor Vuchetich et al. 640
Time Limitations 643
Third-Party Rights (Himalaya Clause) 644
READING 11-1 Cargo Theft Is Big Business 645
Charterparties 645
Voyage Charterparties 646
Time Charterparties 646
Charterparties and Bills of Lading 647
Maritime Liens 647
CASE 11-6 The Chinese Seamen's Foreign Technical Services Co. v. Soto Grande Shipping Corp., Sa 648
Maritime Insurance 650
Perils 651
CASE 11-7 Assicurazioni Generali (Underwriters) v. Black & Veatch 651
Average Clauses 653
Carriage of Goods by Air 654
Chapter Questions 656

Chapter 12 Financing 657

Introduction 658
Financing Foreign Trade 658
Bills of Lading 658
Bills of Exchange 658
The Law Governing Bills of Exchange 659
Types of Bills of Exchange 660
Promissory Notes 661

Negotiability of Bills and Notes 664
Unconditional Promise or Order to Pay 664
Definite Sum of Money or Monetary Unit of Account 665
Payable on Demand or at a Definite Time 665
Signed by the Maker or Drawer 666
The Negotiation and Transfer of Bills and Notes 666
Assignment 666
Negotiation 666
CASE 12-1 Miller v. Race 667
Forged Endorsements 670
CASE 12-2 Mair v. Bank of Nova Scotia 671
Limitations on the Excuses That Drawers and Makers Can Use to Avoid Paying Off a Bill or Note 674
Liabilities of Makers, Drawers, Drawees, Endorsers, and Accommodation Parties 675
CASE 12-3 Far East Realty Investment, Inc. v. Court of Appeals 676
The Role of Banks in Collecting and Paying Negotiable Instruments 678
CASE 12-4 Charles R. Allen, Inc. v. Island Cooperative Services Cooperative Association 679
Letters of Credit 682
Governing Law 683
Applying for a Letter of Credit 685
CASE 12-5 Trans Trust Sprl v. Danubian Trading Co., Ltd. 687
Documentary Formalities 689
Advising and Confirming Letters of Credit 689
The Obligations of Banks 692
CASE 12-6 Sztejn v. J. Henry Schroeder Banking Corp. 695
Rights and Responsibilities of the Account Party 696
Rights and Responsibilities of Beneficiaries 697
Financing Foreign Operations 697
Private Sources of Capital 697
Governmental Sources of Capital 697
Regional and International Development Agencies 698
Countertrade 699
Chapter Questions 700
Case Index 702
Statutory Index 705
Topical Index 716

Preface

This textbook is designed for business majors or programs in related disciplines and business people whose work relates to international business. The subject matter examined would be appropriate for both undergraduate and graduate courses in colleges of business, as well as professional development and executive education programs. This text gives students from many cultures and traditions a good look at the overall structure of the global "legal environment" in which business operates today. It should also prove useful for business people and legal practitioners who need an effective overview of nation-to-nation relations, multinational enterprises, dispute settlement across national borders, and rules for global trade in goods and services. Special treatment is given to global legal issues in intellectual property, foreign investment, money and banking, sales, transportation, and financing.

International Business Law, Sixth Edition provides a comprehensive look at critical issues and functions in the global legal environment. Business today is truly international. A business that remains domestic (confined to the laws and policies of one nation) cannot take advantage of the sea change in business that has taken place in the 21st century.

The goal of this book is to highlight the major issues confronting those individuals and companies who do business globally. No single legal system is emphasized; rather, materials and cases have been collected from many countries to show both the diversity and similarity of business and of the law.

New to this Edition

With this edition we have added the following items:

- ***New Cases***, including
  - United States—European Communities—Measures Affecting Trade in Large Civil Aircraft (the Airbus case)
  - *L'Oreal v. eBay*
  - *Assicurazioni Generali v. Black & Veatch*
- ***New Imagery*** Today's students are highly visual so we have added more graphics, charts, and photos.
- ***Internet Boxes*** Key Web sites are featured throughout the book.
- ***New Readings***
  - Eurozone crisis
  - The United Nations' Global Compact and Millenium Development Goals
  - Work of businesses and NGOs partnering with the UN, state responsibility and corporate responsibility with regard to terrorists (including Chiquita's payment to Colombian terrorist organizations)
  - The increasing use of ICSID investment arbitration
  - Ongoing global climate change negotiations to replace the Kyoto Protocol
  - China's refusal to accept the doctrine of restrictive sovereign immunity
  - The ISO 26,000 standards for corporate social responsibility
  - The growing trend toward anti-corruption legislation
  - The potential fall of the U.S. dollar as an international currency reserve
  - New developments in the World Bank
  - The United States–European Union Airbus dispute at the World Trade Organization
  - Developments in protection of intellectual property around the world
  - International labor and employment issues

The revised text adds information on important topics of current interest. The challenges of when to give diplomatic recognition to new governments in nations like Libya, the reorganization of the European Union, and international transboundary water pollution are all discussed in Chapter 1. Chapter 2 updates ongoing climate change negotiations and discusses corporate and state responsibility for terrorist acts. Chapter 3 relates new developments in the International Criminal Court and China's stance toward sovereign immunity. Chapter 4 introduces changes in anti-corruption laws, including the new U.K. Anti-bribery Act, and the new ISO standards for corporate social responsibility. Chapter 5 includes new material on China's foreign investment policies, the investment environment in India, and the growing collaboration between government to detect securities fraud. Chapter 6 includes new material on the Bank for International Settlements, the IMF voting structure, and the question of the U.S. dollar's continuing viability as an international currency reserve.

There are new and updated discussions and materials on all legal aspects of globalization in Chapter 7, including coverage of the stalled WTO Doha Development Agenda and analysis of the difficulties inherent in reaching the goals set out in the Doha agreement; several new readings examining the legal issues raised by the rise of China as a financial and exporting power, and some of the resulting WTO disputes; a new case and reading exploring the lengthy WTO disputes between the United States and the European Union over governmental subsidies provided to both Airbus and Boeing; new information regarding the number of times different countries have used WTO safeguard measures to protect domestic industries; and a specific example of the type of commitments a country agrees to make regarding the service sectors that it has opened to international market access under GATS (using Chile as an example).

Regarding labor and employment, this edition contains additional new material in Chapter 8 and elsewhere concerning how individual European Union member countries may retain certain national employment regulations, while also following general EU principles; a discussion of the most recent court interpretations of the Alien Tort Claims Act; new coverage of the set of "Guiding Principles for Business and Human Rights" adopted in 2011 by the United Nations Human Rights Council; and examination of the OECD's new "Guidelines for Multinational Enterprises," which contain the section "Employment and Industrial Relations" establishing norms for the employment of workers in both home and host countries.

Chapter 9 of the sixth edition includes new material regarding current issues in intellectual property such as piracy and its effects; analysis of the legal issues involved when copyrighted goods lawfully manufactured outside the United States are imported into the United States without the permission of the copyright holder; a recent decision of the European Court of Justice concerning the patentability of stem cell inventions; a "Recent International Developments" box detailing a trademark dispute in Israel between the owners of the marks "Miss Sixty" and "Miss Sexy"; and a new European Court of Justice case, *L'Oréal v. eBay*, concerning the liability of online auction sites when items sold over these sites are counterfeit or have been lawfully manufactured in one country but not intended or licensed to be sold in other countries.

Chapter 10, concerning the sale of goods and the CISG, includes "Recent International Developments" reporting on a case involving the issue of whether a contract for "enriched uranium products" dealt more with the sale of goods or "enrichment services," a new case where the goods became spoiled at some point in their journey from seller to buyer and the key issue was which party should bear the risk of loss under the CISG. Chapter 11 has been revised to include information about the new (2010) version of Incoterms, a set of trade and shipping terms published by the International Chamber of Commerce (ICC), which are used in international sales around the world by trade councils, courts, and international lawyers; a new reading examining the increasing amount of actual "piracy on the high seas" in which modern-day pirates with automatic weapons highjack ships; and a recent case in England dealing with charter parties. Chapter 12 includes a new reading concerning a situation in which the owner of a Miami company was sentenced to 46 months in prison for a scheme to defraud the U.S. Export-Import Bank; and a box discussing how forged bills of lading and other documents regarding the delivery of 30,000 bicycles to the Kenyan town of Mombasa led to the loss of $1.7 million.

For Instructors

Instructor's Manual Includes teaching outlines, case briefs, and reading summaries.

Test Item File Contains more than 1,000 objective questions keyed to the text plus essay questions for each chapter. It is available for download by instructors only at our Instructor's Resource Center at www.pearsoninternationaleditions.com/august.

PowerPoint Slides A ready-to-use PowerPoint slide show designed for classroom presentation. Use it as is or edit the content to fit your individual classroom needs. It is available for download by instructors only at our Instructor's Resource Center at www.pearsoninternationaleditions.com/august.

Acknowledgments

Professors Mayer and Bixby are honored to be able to carry on the work of Ray August. While we have added much new material and updated all important sections of this book to reflect the most important international business legal issues of the 21st century, we have tried to retain the high level of scholarship, thoroughness, and attention to detail that was the hallmark of Dr. August's work. Ray's untimely death in the fall of 2004 was a loss to students, faculty, and all international business scholars and practitioners. In addition, Ray's passing was a profound loss to the two of us, as Ray was a friend and mentor to both of us. The authors would like to acknowledge, with thanks, the individuals who made this text possible. For the sixth edition, Dr. Bixby would like to thank his wife Sharon for her continued support and encouragement, as well as MBA students Grant Band, Amanda Hundt, Katy Rallens, and Molly Haberl for their research assistance. Dr. Mayer thanks Andy Reger for his diligence and scholarship and Kevin O'Brien and Anna O'Brien Mayer for their continuing friendship and support. A very special thanks to Kathleen Adair for her unwavering encouragement. Both authors have appreciated the collegiality of working together on this text and would also like to thank the members of the Pearson editorial team, especially Karen Kirincich and Toni Z. Ackley for their guidance and assistance.

Reviewers

Patricia Abril, University of Miami
Carlos Alsua, University of Alaska-Anchorage
Albert Assibey-Mensah, Kentucky State University
Joan E. Camara, Bryant University
Katherine Hope Chew
Sandra Defebaugh, Eastern Michigan University
Janet Hale, Texas State University
John Lanham, Salem International University
Garold Lantz, Monmouth University
Lisa Johnson, Centura College
Samuel Kohn, New York Institute of Technology
Faith O'Reilly, Hamline University
Marisa Pagnattaro, Terry College of Business, University of Georgia
Gary Patterson, California State University-San Bernardino
Jeffrey D. Penley, Gardner-Webb University
Roger Reinsch, Northeastern Illinois University
Kurt Schulzke, Kennesaw State University
Karen J. Smith, Columbia Southern University
Janis Stamm, Edinboro University of Pennsylvania
Robert Viguerie, University of Louisiana at Lafayette

The publishers wish to thank Jhini Sinha Phira for reviewing the content of the International Edition.

About the Authors

Michael Bixby

Michael Bixby is Professor of Legal Studies in Business in the College of Business and Economics at Boise State University. He is a graduate of the University of Michigan Law School and practiced law in Michigan for 11 years prior to joining the Boise State faculty. During his years at Boise State, Dr. Bixby has written widely in academic and professional journals. He is the lead author of the textbook *The Legal Environment of Business* (5th ed., 2011), also published by Pearson. He authored the monograph *The Enron/Andersen Debacle: A Case Study with Legal Implications* (Prentice Hall, 2003). Dr. Bixby has received many honors for his teaching, including the highest teaching award at Boise State University, awarded to only one faculty member each year. Bixby has taught often internationally, including one semester each in Spain, Chile, Italy, and China during the past 15 years.

Don Mayer

Don Mayer is Professor in Residence at Daniels College of Business at the University of Denver, where he teaches law, policy, ethics, and sustainability. He has published often on issues of international law, business ethics, and environmental law and has received many awards for his writing. He is a Fellow at the Institute for Enterprise Ethics at the University of Denver. Dr. Mayer received his J.D. from Duke University and his LL.M. in International and Comparative Law from Georgetown University Law Center.

Introduction to International and Comparative Law

CHAPTER 1

Chapter Outline

A. What Is International Law?
B. The Making of International Law
C. Sources of International Law
  Treaties and Conventions
  Custom
  General Principles and *Jus Cogens*
D. The Scope of International Law in Actual Practice
  The Practice in International Tribunals
  The Practice in Municipal Courts
E. International Persons
  States
  Territorial Sovereignty
  Negative Servitudes: Air and Water Pollution
  International Organizations
  The Institutions of the European Union
F. The Rights of Individuals Under International Law
G. Comparison of Municipal Legal Systems
  The Romano-Germanic Civil Law System
  The Anglo-American Common Law System
  The Islamic Law System
Chapter Questions

A. What Is International Law?

International law deals with three kinds of international relationships: (1) those between states[1] and states, (2) those between states and persons, and (3) those between persons and persons. Traditionally, international law was all about the relationships between states. That is, the law of nations resolved issues between two or more states, and the legal relationships between and among states is what is generally called **public international law**. As transactions among private entities grew, the phrase **private international law** was applied to the laws governing conduct between people (and corporations) from different states. Examples of public and private international law are shown in Table 1.1.

For many, *international law* remains a contradiction in terms. There is no single world government to make and enforce laws, and no globally recognized forum in which to bring disputes between citizens of different nation-states. To those who see law as "the command of a sovereign," the more consensual nature of international law makes it "soft" law or no law at all. Moreover, the decline in the power of states relative to the private sector[2] poses new challenges to contemporary

[1]In international law, a country has traditionally been referred to as a *state, nation,* or *nation-state.* This book will generally use the word *state* to refer to nation-states.

[2]See Daniel Yergin and Joseph Stanlislaw, *The Commanding Heights: The Battle Between Government and Marketplace That Is Remaking the Modern World* (1998).

TABLE 1.1

Examples of public and private international law

Public International Law	Private International Law
Sources of international law	Torts
International personality	Inheritances
State territory	Money and banking
State succession	Intellectual property
State responsibility to aliens	Commercial
Law of the sea	Contracts and sales
International dispute settlement	Transportation
Law of war	Financing
	Securities regulations
	Antitrust
	Taxation

international law
The body of legal rules and norms that regulates activities carried on beyond the legal boundaries of a single state.

public international law
The division of international law that deals primarily with the rights and duties of states and intergovernmental organizations as between themselves.

private international law
The part of international law that deals primarily with the rights and duties of individuals and nongovernmental organizations in their international affairs.

comity
(From Latin *comitas:* "courteousness.") The practice or courtesy existing between states of treating each other with goodwill and civility.

international law. Today, the term *international law* applies to any conduct outside the boundaries of states, whether of a public or a private nature.

There are at least three ways of looking at international law. Cosmopolitans claim that international law is based on universal human rights. Thus, international law should restrain states from violating norms based on universal human rights, and the consent of a state is irrelevant. By contrast, Positivists focus on the sovereignty of states and their consent to limits on that sovereignty. Thus, Positivists claim that international law is based on (1) the sovereign equality of all states in the international system and (2) state consent to individual international laws, either through treaties or customs. Positivist international law can be seen as a series of contracts between states; international law becomes binding only through such explicit or implicit contracts. In contrast to either Cosmopolitans or Positivists, Hobbesians are more cynical, believing that states will make agreements and abide by international law only when it suits their self-interests.

Scholars, jurists, and politicians will rarely adopt one school or another with consistency, and combinations of these views can coexist among principal actors in the same nation-state. At a minimum, however, international law is understood to be more than just good manners or mutual respect between or among sovereign nation-states. **Comity**, for example, is the practice between states of treating each other with goodwill and civility. It is not law, however, because states do not regard it as something they are required to respect. For example, until it became a matter of legal obligation under Article 36 of the 1961 Vienna Convention on Diplomatic Relations, it was long considered to be a customary courtesy to allow foreign diplomats the privilege of importing goods they intended for their private use free of customs duties. This privilege was not a legal right guaranteed by international law, however, because states did not feel compelled to grant the privilege except as a courtesy.[3] Such courtesy can be seen as a kind of anticipatory reciprocity in which states do unto other states as they would hope to be treated in turn.

Comity is thus understood as an informal principle that nations will extend certain courtesies to other nations, particularly by recognizing the validity and effect of their executive, legislative, and judicial acts. This principle is most frequently invoked by courts, which will not act in a way that demeans the jurisdiction, laws, or judicial decisions of another country. In Case 1-1, the limits on a state's jurisdiction to make and enforce law are discussed in terms of the doctrine of comity.

Even where a state does not object to another state's taking jurisdiction of a dispute focusing on activities in the first state, self-imposed limitations abound. Courts in the United States, for example,

[3]Another example of comity is set out in *Republic of the Philippines v. Westinghouse Elec. Corp.*, *Federal Reporter, Third Series,* vol. 43, p. 65 (3rd Circuit Ct. of Appeals 1994). In this case, the appellate court overturned the U.S. trial court's order requiring the Philippine government to cease harassing witnesses in the Philippines. The appellate court held that the trial court could request compliance by a foreign sovereign as a matter of comity but that it could not order compliance as a matter of law.

CASE 1-1 Ignacio Sequihua v. Texaco Inc. et al.

United States District Court for the Southern District of Texas,
Houston Division, 847 F. Supp. 61 (1994)

MAP 1.1

Ecuador and the United States

Opinion of Judge Black

Plaintiffs, residents of Ecuador, filed this action in Texas state court asserting a variety of causes of action arising out of the alleged contamination of the air, ground, and water in Ecuador. In addition to monetary relief, Plaintiffs asked for an injunction requiring Defendants to return the land to its former condition and for a "trust fund" to be administered by the Court. The case was removed to federal court, and the Court finds that the removal was procedurally proper. In considering the defendants' motions to dismiss, the Court used "comity" to rule for defendants.

Under the doctrine known as comity of nations, a court should decline to exercise jurisdiction under certain circumstances in deference to the laws and interests of another foreign country. Section 403(3) of the Restatement (Third) of the Foreign Relations Law of the United States sets forth a number of factors to be considered in determining whether the comity of nations deference should be applied. The Ninth Circuit applied similar factors in *Timberlane Lumber Co. v. Bank of America National Trust and Savings Assn.,* 749 F.2d 1378 (9th Cir. 1984), to affirm a District Court's decision not to exercise jurisdiction. Consideration of these factors leads to the inescapable conclusion that the Court should decline to exercise jurisdiction over this case. The challenged activity and the alleged harm occurred entirely in Ecuador; Plaintiffs are all residents of Ecuador; Defendants are not residents of Texas; enforcement in Ecuador of any judgment issued by this Court is questionable at best; the challenged conduct is regulated by the Republic of Ecuador and exercise of jurisdiction by this Court would interfere with Ecuador's sovereign right to control its own environment and resources; and the Republic of Ecuador has expressed its strenuous objection to the exercise of jurisdiction by this Court. Indeed, none of the factors favor the exercise of jurisdiction. Accordingly, the case should be dismissed under the doctrine of comity of nations.

Casepoint

Under the doctrine known as comity, a court should decline to exercise jurisdiction under certain circumstances in deference to the laws and interests of another country.[4]

[4]The litigation over environmental damage to native lands in Ecuador has gone on for decades. For the latest developments, see Web sites from Chevron and also the NGO called Business and Human Rights at www.business-humanrights.org/Categories/Lawlawsuits/Lawsuitsregulatoryaction/LawsuitsSelectedcases/TexacoChevronlawsuitsreEcuador. The Chevron Web site is www.chevron.com/ecuador/.

will often avoid taking jurisdiction of a case where the defendant is a sovereign state,[5] where the foreign defendants do not have sufficient "contacts" with the United States,[6] where there is another judicial forum that is "more convenient,"[7] where Congress did not intend a U.S. statute to apply extraterritorially, or where deciding a case would require the court to render a judgment that an act of a sovereign state on its own territory violated international law.[8]

Despite all these limitations, it has been customary for courts in many states to hear and decide cases with international aspects. If a business incorporated in one state operates a manufacturing facility in another state and violates the law of the other state, the other state will have the well-recognized power under customary international law to hear and decide a case against the foreign defendant. This is known as a state's *territorial* basis for taking jurisdiction over a case involving foreign actors. A second well-known basis for jurisdiction exists: If U.S. companies do certain acts in other states, they may still be held accountable in U.S. courts under the principle of *nationality* jurisdiction. If foreign companies act in ways that directly affect a state other than their own, they may be held accountable by the other state. But this *objective territoriality* jurisdiction is more problematic and has been the subject of many judicial decisions, such as the *Timberlane* case noted in Case 1-1. As the Restatement (Third) of the Foreign Relations Law is relied upon in Case 1-1, it is worth some consideration here.

Section 403 of the Restatement provides that even if a nation has a basis for jurisdiction, such as conduct outside of the nation that has intended and actual effects in the nation, the nation "may not exercise jurisdiction to prescribe law with respect to a person or activity having connections with another state when the exercise of such jurisdiction is unreasonable." The Restatement then sets out a set of factors relevant to evaluating whether the exercise of jurisdiction is reasonable:

a. The link of the activity to the territory of the regulating state, that is, the extent to which the activity takes place within the territory, or has substantial, direct, and foreseeable effect upon or in the territory;
b. The connections, such as nationality, residence, or economic activity, between the regulating state and the person principally responsible for the activity to be regulated, or between that state and those whom the regulation is designed to protect;
c. The character of the activity to be regulated, the importance of regulation to the regulating state, the extent to which other states regulate such activities, and the degree to which the desirability of such regulation is generally accepted;
d. The existence of justified expectations that might be protected or hurt by the regulation;
e. The importance of the regulation to the international political, legal, or economic system;
f. The extent to which the regulation is consistent with the traditions of the international system;
g. The extent to which another state may have an interest in regulating the activity; and
h. The likelihood of conflict with regulation by another state.

Having one forum where all international civil cases could be resolved would eliminate the need for such balancing under the guise of reasonableness. There have been such proposals, but nothing of the kind is imminent. In the meantime, multilateral agreements such as the Hague Choice of Courts Agreements Convention are in place to minimize both the friction and the ambiguities that happen when state courts (often referred to as "municipal" courts) decide cases with parties from more than one state.[9]

---

[5]This is based on the historic recognition of the immunities of foreign sovereigns, codified in the United States in the Foreign Sovereign Immunities Act of 1976, which grants blanket immunity to foreign sovereigns, subject to a number of important exceptions. See Chapter 3, Section D, "Immunities of States from the Jurisdiction of Municipal Courts."

[6]See Chapter 3, Jurisdiction in Civil Cases (Jurisdiction Over Persons), and Chapter 4, Personal Jurisdiction Requirements of U.S. Products Liability Laws, at p. 129 and p.197.

[7]This is the doctrine known as *forum non conveniens.* See Chapter 3, Refusal to Exercise Jurisdiction, and Jorge Luis Machuca Gonazalez et al. v. *Chrysler Corporation et al.,*Case 3-8, p. 157.

[8]This is the Act of State Doctrine. See Chapter 3, p. 147.

[9]See 2005 Hague Choice of Court Agreements Convention at www.hcch.net/index_en.php?act=conventions.pdf&cid=98.

B. The Making of International Law

Within states, law is made by legislatures, courts, and other agencies of government. However, at the international level, no formal lawmaking machinery exists. In working together, the different states in the international community function in the roles of both lobbyists and legislators.

Under Positivist principles, international law comes into effect only when states consent to it. The general consent of the international community can be found in **state practice**, that is, in the conduct and practices of states in their dealings with each other. Statements or evidence of general consent can be found in the decisions of the International Court of Justice (ICJ) (or its predecessor, the Permanent Court of International Justice [PCIJ]), in resolutions passed by the General Assembly of the United Nations, in lawmaking **multilateral treaties**, and in the conclusions of international conferences. Sometimes, when a provision is repeated over and over in **bilateral treaties**, courts and law writers will regard the provision as having the general consent of the international community. In addition, legal writers often cite unratified treaties and reports of international agencies, such as those of the International Law Commission, as indicating a trend toward general consent.

state practice
The conduct and practices of states in their dealings with each other.

multilateral treaty
Treaty between more than two states.

bilateral treaty
Formal binding agreement between two states.

The particular consent of a state to be bound by an international law can be found in the declarations of its government, in its domestic legislation, in its court decisions, and in the treaties (both bilateral and multilateral) to which it is a party.

C. Sources of International Law

The sources of international law are what courts and other international tribunals rely on to determine the content of international law. Article 38(1) of the Statute of the ICJ lists the sources that the court is permitted to use. Most writers regard this list as being reasonably complete and one that other international courts should use as well. Article 38(1) provides that:

> The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:
>
> a. international conventions, whether general or particular, establishing rules expressly recognized by the contesting states;
> b. international custom, as evidence of a general practice accepted as law;
> c. the general principles of law recognized by civilized nations;
> d. subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as a subsidiary means for the determination of rules of law.

hierarchy
A group arranged according to rank or authority.

This listing implies a **hierarchy**, or order, in which these sources are to be relied on (see Figure 1.1). That is, treaties or conventions are to be turned to before custom, custom before general principles of law, and general principles before judicial decisions or publicists' writings. Strictly speaking, Article 38(1) does not require a ranking or hierarchy; but in practice the ICJ and other tribunals turn first to treaties. This is appropriate because treaties (especially those ratified by the states' parties involved in a dispute) are clear-cut statements of the rules the court should apply. Also, customary law, which is based on practice, is often more specific than general principles of law, which are usually found inductively by legal writers who have examined the long-standing practices of states.

treaty
(From Latin *tractare:* "to treat.") Legally binding agreement between two or more states.

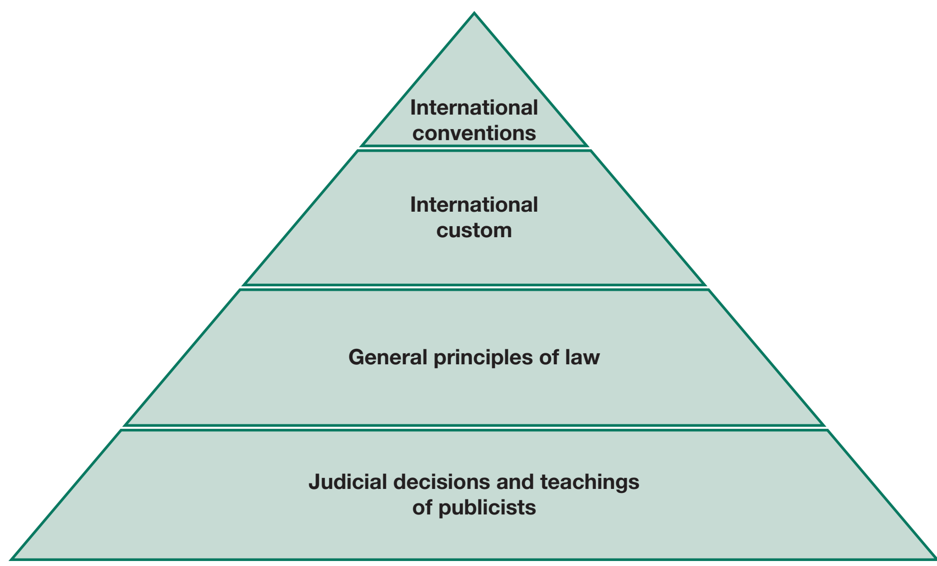
convention
(From Latin *convenire:* "to come together.") Legally binding agreement between states sponsored by an international organization.

Treaties and Conventions

In international law the equivalents of legislation are treaties and conventions. **Treaties** are legally binding agreements between two or more states. **Conventions** are legally binding agreements between states sponsored by international organizations, such as the United Nations. Both are binding upon states because of a shared sense of commitment and because one state fears that if it does not respect its promises, other states will not respect their promises.

FIGURE 1.1

The Hierarchy of the Sources Relied on by the International Court of Justice



Today, most of the customary rules that once governed treaties are contained in the Vienna Convention on the Law of Treaties,[10] which came into force in 1980. It only applies to treaties adopted after a party ratifies the agreement; nevertheless, its wide acceptance by states and its codification of customary rules have made it the usual standard for interpretation. Article 2(1)(a) of the Vienna Convention states that "'Treaty' means an international agreement concluded between states in written form and governed by international law, whether embodied in a single instrument or two or more related instruments and whatever its particular designation." This definition excludes certain agreements, such as oral promises, unilateral promises, agreements relating to international organizations, agreements governed by municipal law, and agreements that were clearly not intended to create a legal relationship.

Even so, the oral declaration of one state's government to an official of another state can potentially bind the declarant's state. This was seen in the case of *Denmark v. Norway,* decided by the PCIJ in 1933. (The PCIJ was the international judicial organ of the League of Nations.) In formal discussions leading up to the Paris Peace Talks, Denmark's ambassador told Norway's foreign minister that Denmark would not object to Norway's claim to Spitzbergen if Norway did not oppose Denmark's claim to the whole of Greenland at the Paris Peace Talks. After consulting with his government, the Norwegian foreign minister told the Danish ambassador "that the Norwegian Government would not make any difficulty in settling the question." In determining whether the oral commitment made by the foreign minister was binding on Norway, the PCIJ stated that Norway's foreign minister's declaration (even though it was expressed as a promise to do something in the future) concerned a matter within his competency and was binding on Norway. An authorized reply of a government minister to a request by the diplomatic representative of a foreign power, in regard to a question falling within his or her province, is binding upon the country to which the minister belongs. Norway, in short, had to give up its claims to Greenland.[11]

[10]Currently there are 111 states parties, including most of the developed world. See AudioVisual Library of International Law, available at http://untreaty.un.org/cod/avl/ha/vclt/vclt.html, "United Nations, Multilateral Treaties Deposited with the Secretary-General, Status as of 2006," posted at http://untreaty.un.org/ENGLISH/bible/englishinternetbible/partI/chapterXXIII/treaty1.asp.

[11]*Denmark v. Norway* raises all kinds of interesting questions. It is not clear that the PCIJ decided that there was a treaty between the two states, or that written treaties could be unwritten by oral declarations of public officials. Nor is it clear that in all domestic (noninternational) settings an oral declaration would be sufficiently binding. The case has sent a message to diplomats who might be negotiating on behalf of their states; Dean Rusk, Secretary of State between 1961 and 1969, recalled that after "a highball or two" he suggested to the foreign minister of Honduras that they "toss a coin" for the Swan Islands in the Caribbean, islands claimed by both Honduras and the United States. "Fortunately, he refused because the International Court of Justice seemed to say in the Greenland case that a government has a right to rely upon the statement of a Foreign Minister with respect to a territorial matter." Dean Rusk, "The Role and Problems of Arbitration with Respect to Political Disputes," in *Resolving Transnational Disputes Through International Arbitration* (Thomas E. Carbonneau, ed., 1984) at pp. 15, 18.

Custom

Some rules have been around for such a long time or are so generally accepted that they are described as **customary law**. International customary law, however, is hardly static. Simply because certain practices were once followed in the international community does not mean that they are still followed today. For example, rules that govern the "art" of war are revised at the end of practically every major conflict to reflect the circumstances of a changed world. The present rule that requires a soldier to fight only with combatants is decidedly outdated in today's world of terrorism and guerrilla warfare and will likely be changed in the near future. The rate of change for international commercial law is just as rapid. Much of this reflects developments in modern technology. Laws governing the flow of data across international borders (such as messages sent by satellite or transoceanic cable) are presently in a state that might best be described as "confused." Many countries want to regulate the movement of such information, others demand free and undisturbed movement, and still others want guarantees against invasions of privacy. At present, the regulation is left up to each government, and little "common" law exists.

custom
A long-established tradition or usage that becomes customary law if it is (1) consistently and regularly observed and (2) recognized by those states observing it as a practice that they must obligatorily follow.

To show that a customary practice has become customary law, two elements must be established—one behavioral and one psychological. The first—called **usus** in Latin—requires consistent and recurring action (or lack of action if the custom is one of noninvolvement) by states. Evidence of such action can be found in the official statements of governments, including diplomatic correspondence, policy statements and press releases, the opinions of legal advisors, executive decrees, orders to military or naval forces, comments on draft treaties, national court decisions, and even legislation of a subordinate government.

usus
(From Latin: "usage.") A consistent and recurring practice.

Consistent and recurring practice does not mean lengthy (as in "since time immemorial," which is sometimes given as the rule in municipal practice), nor does it mean that it must be followed by all states. On the other hand, it must be accepted by a reasonably large number of major states for a period long enough to be recognized by the courts as establishing constant and uniform conduct.

The second element in showing that a customary practice has become law is the requirement that states observing the custom must regard it as binding. That is, they must recognize the custom as being a practice that they must obligatorily follow, rather than one that they follow out of courtesy (i.e., comity) to other states. This is often referred to by the Latin phrase ***opinio juris sive necessitatis***. The PCIJ discussed this requirement in 1927 in the case of *The Lotus*. The case involved a collision on the high seas between a French steamer and a Turkish collier in which some Turkish crew members and passengers lost their lives. When the French ship docked in a Turkish port, the Turkish government began criminal proceedings against the French officers on watch at the time of the collision. The French appealed to the PCIJ, arguing that Turkey had violated international law because, France said, only the flag state has jurisdiction over criminal incidents on the high seas. The PCIJ said that the few cases France cited for this proposition "merely show that states had often, in practice, abstained from instituting criminal proceedings, and not that they recognized themselves as being obliged to do so; for only if such abstentions were based on their being conscious of a duty to abstain would it be possible to speak of an international custom."[12] Turkey was allowed to continue with its criminal prosecution.

opinio juris sive necessitatis
(From Latin: "of the opinion that it is a necessary law.") Maxim requiring a state to observe a customary practice only if it is one that international law requires the state to observe.

Even if the international community follows a practice and recognizes it as binding customary law, under some circumstances the rule will not apply to a particular state. This happens when a state **persistently objects** to a practice during its formative stages and thus never becomes a party to it.[13] This can also happen after a customary rule has become generally accepted, if a state is allowed by the international community to deviate from the general practice. In the *Anglo-Norwegian Fisheries Case,*[14] the United Kingdom sued Norway in the ICJ because Norway was not allowing British fishing vessels to enter what Norway claimed were its territorial waters and the British claimed were high seas. Norway was using a special rule for connecting rocks and islands in drawing its territorial boundaries that was contrary to the general rule followed by most countries. The ICJ endorsed Norway's action because Norway had been claiming the disputed waters since 1812 and because most

persistent objection
Active rejection of a customary practice from its first observance by other states.

[12] *Permanent Court of International Justice Reports,* vol. 1927, Series A, No. 10, p. 28 (1927).
[13] This view is succinctly set out in the concurring opinion of Judge Gross in the Nuclear Tests Cases, *International Court of Justice Reports,* vol. 1974, p. 286 (1974).
[14] *International Court of Justice Reports,* vol. 1951, p. 116 (1951).

Article 53

Treaties Conflicting with a Peremptory Norm of General International Law (*Jus Cogens*)

A treaty is void if, at the time of its conclusion, it conflicts with a peremptory norm of general international law. For the purposes of the present Convention, a peremptory norm of general international law is a norm accepted and recognized by the international community of States as a whole as a norm from which no derogation is permitted and which can be modified only by a subsequent norm of general international law having the same character.

countries of the world had never objected. Thus, by the acquiescence of other countries, Norway was excused from following a generally accepted customary rule of international law.

General Principles and *Jus Cogens*

general principles
Principles of law common to the world's legal systems.

When courts are required to decide international disputes, they frequently rely on the **general principles** of law that are common to the legal systems of the world. Indeed, although there are nearly 200 states in the world today,[15] there are, in practical terms, only two highly influential legal systems for international law: the Anglo-American common law system and the Romano-Germanic civil law system. The two are remarkably similar in their basic procedures and substantive rules. It is this similarity that provides courts with the general principles they can use in deciding many problems that arise in international disputes.

jus cogens
A peremptory norm of general international law, recognized by the international community of states as a norm from which no derogation is permitted.

Jus Cogens The idea of international ***jus cogens*** as a body of higher law for the international community has achieved some currency in the late twentieth century. In Latin, *jus cogens* means "higher law." First embodied in the 1969 Vienna Convention on the Law of Treaties, it was confirmed in Article 53 of the 1986 Vienna Convention on the Law of Treaties (see the box on Article 53). In its judgment in the *Nicaragua Case* in 1984, the ICJ affirmed *jus cogens* as an accepted doctrine in international law. The ICJ relied on the prohibition on the use of force as being "a conspicuous example of a rule of international law having the character of *jus cogens*."

The doctrine of international *jus cogens* was developed under the strong influence of natural law concepts. In contrast to Positivists, who base international law on freedom of contract, Cosmopolitans believe that states cannot be absolutely free in their contractual relations but must respect certain fundamental principles deeply rooted in the international community. At the 1969 Vienna Conference on the Law of Treaties, a number of states spoke of *jus cogens* having its origin in concepts of natural law. Natural law is the school of legal thought that emphasizes the need for statutes and constitutional laws to be based on universal principles.

At the same time, however, the contractual, consensual emphasis for international law is clearly seen in Article 38(1) of the Statute of the ICJ. Article 38(1) lists conventions, customary general practice, and general principles of law. In the case of conventions, Article 38(1) requires their express recognition by the contesting states. Article 38(1) holds that customary general practice should be "accepted as law." Moreover, "the general principles of law" should be "recognized" by civilized nations. This essentially contractual, consensual view of international law is confirmed and developed by abundant international practice and case law.

D. The Scope of International Law in Actual Practice

The Practice in International Tribunals

subservient
(From Latin *subservire:* "to serve under.") Subordinate in capacity or function.

International tribunals generally regard municipal law as **subservient** to international law. For example, in the *Greco-Bulgarian Communities Case,* the PCIJ said that "it is a generally accepted principle of international law that in the relations between [states] who are contracting parties to a treaty, the provisions of their municipal law cannot prevail over those of the treaty."

[15]The U.S. Department of State recognizes 195 states. For political reasons, it recognizes the People's Republic of China rather than Taiwan. With the addition of South Sudan, there are at least 197 states. With the addition of the Vatican, there are 198 independent states. See www.state.gov/s/inr/rls/4250.htm.

Not only do international tribunals treat international law as the superior law, but they also regard states as having a general obligation to bring their municipal law into compliance with international norms. In the *Exchange of Greek and Turkish Populations Case,* the PCIJ was asked to interpret a clause in the 1923 Treaty of Lausanne that required the parties to modify their municipal law to ensure that the treaty would be carried out. It said: "This clause . . . merely lays stress on a principle which is self-evident according to which a state which has contracted valid international obligations is bound to make in its legislation such modification as may be necessary to ensure the fulfillment of the obligations undertaken."

Given the nature of sovereignty and nationalism, however, it must be admitted that municipal courts may chafe at the notion that there is a law that is higher than the sovereign state's own law. In the United States, there are disagreements about whether Supreme Court justices should take international law or standards into account in deciding cases involving only U.S. states and citizens.[16]

The Practice in Municipal Courts

If a municipal court determines that a certain rule of international law could apply in a particular case, the major question for the court is whether the international law has been "received" into the local jurisprudence. How the court will answer this question depends on whether the law is based on customary practice or is contained in a treaty.

In most countries, customary international law is received in accordance with the **doctrine of incorporation**. That is, customary international law is treated as adopted to the extent that it is not inconsistent with prior municipal legislation or judicial decisions of final authority. A minority of courts (e.g., some courts in the United Kingdom and the British Commonwealth) apply the **doctrine of transformation**. This holds that customary international law is not applicable until clearly adopted by legislative action, judicial decision, or established local usage.

The reception rules found in treaties depend on two factors. One is the nature of the treaty, and the other is the constitutional structure of the ratifying state. Treaties may be either self-executing or non-self-executing. A **self-executing treaty** is one that has a provision stating that the treaty will apply to the parties without their having to adopt any domestic enabling legislation; a **non-self-executing treaty** has no such provision. *Sei Fujii v. State of California,* Case 1-2, examines this difference.

Any state's constitution may grant the responsibility for entering into treaties to one or more of its branches. In many countries, responsibility for adopting treaties is shared by the executive and legislative branches. For example, in the United States, the federal Constitution gives the president responsibility for negotiating treaties and the Senate responsibility for ratifying them (i.e., for giving its "advice and consent" to their adoption). Over the years, however, this cumbersome arrangement[17] has led the United States to develop two kinds of treaties: **constitutional treaties** and **executive agreements**. The first are made according to the Constitution's provisions (i.e., they are negotiated by the president and ratified by the Senate); the second are agreements made solely by the president (i.e., without the advice and consent of the Senate). As to other nations, both of these have the same effect (i.e., they are commitments that impose binding international obligations on the United States), but as to internal matters, they are different. Constitutional treaties that are self-executing are effective domestically; nothing more needs to be done to implement them. Executive agreements—and constitutional treaties that are non-self-executing—have no effect domestically; to obtain effect, implementing legislation must be adopted.[18]

Although the power to make treaties is shared by the executive and the legislature in the great majority of states, this is not the only model. In some countries—notably Britain and the British

doctrine of incorporation
Customary international law is part of domestic law to the extent that it is not inconsistent.

doctrine of transformation
Customary international law is applicable domestically only after it is adopted by legislation, court decision, or local usage.

self-executing treaty
A treaty containing a term that says that it is directly effective within the signatory states upon ratification.

non-self-executing treaty
A treaty that requires state parties to enact enabling legislation before it becomes effective domestically.

constitutional treaty
A treaty adopted according to the constitutional provisions of the ratifying state.

executive agreement
A treaty or international agreement entered into by a state's executive without following the state's constitutionally required ratification procedure. It is not effective domestically.

[16]Justice Anthony M. Kennedy noted in *Roper v. Simmons,* 543 U.S. 551 (2005), that the conclusion that the death penalty is too harsh for offenders under age 18 is confirmed by the "stark reality" that the United States stands alone in executing juveniles. The case considered not only the death penalty but also the proper role of foreign and international law in interpreting the U.S. Constitution. Six justices now clearly embrace comparative and international law as relevant to the "evolving standards of decency" for informing judgments on what are "cruel and unusual" punishments forbidden by the Eighth Amendment. But Justice Antonin Scalia, joined by Chief Justice William H. Rehnquist and Justice Clarence Thomas in dissent, objected in *Roper v. Simmons* to the majority's taking "guidance from the views of foreign courts and legislatures."

[17]It is cumbersome because often the political party in opposition to the president controls the Senate, and the two may not share the same view of international relations.

[18]Examples of American executive agreements that have no domestic effect are the many overseas military-basing agreements made by the U.S. government during the Cold War era of 1945 to 1990. See *Status of Forces Agreements (SOFAs)* posted at www.globalsecurity.org/military/facility/sofa.htm.

Commonwealth countries—only the executive (i.e., the crown or government) is able to make treaties. In these countries, moreover, only the executive is regarded as bound by the treaty because only the executive was a party to it. Even if a treaty is self-executing, it is only self-executing as to the executive. Neither the parliament nor the courts nor the citizens of the state are directly affected by the treaty (i.e., they have neither rights granted nor obligations imposed) until domestic enabling legislation is adopted.[19] Case 1-2 examines whether certain provisions of the United Nations Charter are self-executing or not.

CASE 1-2 Sei Fujii v. State of California

United States, Supreme Court of California, 1952
California Reports, Second Series, vol. 38, p. 718 (1952)

MAP 1.2

California (1952)

Mr. Sei Fujii, a Japanese alien, purchased real estate in California shortly after World War II. Because he was ineligible for citizenship under U.S. naturalization laws, a trial court held that his ownership of the land violated California's alien land law and that the land escheated to the state. Mr. Sei Fujii appealed; an intermediate appellate court held that the alien land law violated the United Nations Charter's human rights provisions and it reversed the decision of the trial court. The state of California appealed to the state supreme court.

Opinion by Chief Justice Gibson

Plaintiff, an alien Japanese who is ineligible for citizenship under our naturalization laws, appeals from a judgment declaring that certain land purchased by him in 1948 had escheated to the state. There is no treaty between this country and Japan that confers upon plaintiff the right to own land, and the sole question presented on this appeal is the validity of the California alien land law.

[19]This rule does not apply in the United Kingdom to European Union (EU) legislation. EU legislation is treated in U.K. courts as being directly effective even though there is no U.K. implementing legislation.

United Nations Charter

It is first contended that the land law has been invalidated and superseded by the provisions of the United Nations Charter pledging the member nations to promote the observance of human rights and fundamental freedoms without distinction as to race. Plaintiff relies on statements in the preamble and in Articles 1, 55, and 56 of the Charter. . . .

It is not disputed that the Charter is a treaty, and our federal Constitution provides that treaties made under the authority of the United States are part of the supreme law of the land and that the judges in every state are bound thereby. A treaty, however, does not automatically supersede local laws which are inconsistent with it unless the treaty provisions are self-executing. In the words of Chief Justice Marshall: a treaty is "to be regarded in the courts of justice as equivalent to an act of the Legislature, whenever it operates of itself, without the aid of any legislative provision. But when the terms of the stipulation import a contract—when either of the parties engages to perform a particular act, the treaty addresses itself to the political, not the judicial department; and the Legislature must execute the contract, before it can become a rule for the court."

In determining whether a treaty is self-executing, courts look to the intent of the signatory parties as manifested by the language of the instrument, and, if the instrument is uncertain, recourse may be had to the circumstances surrounding its execution. . . . In order for a treaty provision to be operative without the aid of implementing legislation and to have the force and effect of a statute, it must appear that the framers of the treaty intended to prescribe a rule that, standing alone, would be enforceable in the courts. . . .

It is clear that the provisions of the preamble and of Article 1 of the Charter which are claimed to be in conflict with the alien land law are not self-executing. They state general purposes and objectives of the United Nations Organization and do not purport to impose legal obligations on the individual member nations or to create rights in private persons. It is equally clear that none of the other provisions relied on by plaintiff is self-executing. Article 55 declares that the United Nations "shall promote . . . universal respect for all without distinction as to race, sex, language, or religion," and in Article 56, the member nations "pledge themselves to take joint and separate action in cooperation with the Organization for the achievement of the purposes set forth in Article 55." Although the member nations have obligated themselves to cooperate with the international organization in promoting respect for, and observance of, human rights, it is plain that it was contemplated that future legislative action by the several nations would be required to accomplish the declared objectives, and there is nothing to indicate that these provisions were intended to become rules of law for the courts of this country upon the ratification of the Charter.

The language used in Articles 55 and 56 is not of the type customarily employed in treaties which have been held to be self-executing and to create rights and duties in individuals. For example, [in many cases considered by the U.S. Supreme Court] . . . treaty provisions were enforced without implementing legislation where they prescribed in detail the rules governing rights and obligations of individuals or specifically provided that citizens of one nation shall have the same rights while in the other country as are enjoyed by that country's own citizens. . . .

It is significant to note that when the framers of the Charter intended to make certain provisions effective without the aid of implementing legislation they employed language which is clear and definite and manifests that intention. For example, Article 104 provides: "The organization shall enjoy in the territory of each of its members such legal capacity as may be necessary for the exercise of its functions and the fulfillment of its purposes." Article 105 provides: "1. The organization shall enjoy in the territory of each of its members such privileges and immunities as are necessary for the fulfillment of its purposes. 2. Representatives of the members of the United Nations and officials of the organization shall similarly enjoy such privileges and immunities as are necessary for the independent exercise of their functions in connection with the organization." In *Curran v. City of New York,* these articles were treated as being self-executory. . . .

The provisions in the Charter pledging cooperation in promoting observance of fundamental freedoms lack the mandatory quality and definiteness which would indicate an intent to create justiciable rights in private persons immediately upon ratification. Instead, they are framed as a promise of future action by the member nations. Secretary of State Stettinius, Chairman of the United States delegation at the San Francisco Conference where the Charter was drafted, stated in his report to President Truman that Article 56 "pledges the various countries to cooperate with the organization by joint and separate action in the achievement of the economic and social

objectives of the organization without infringing upon their right to order their national affairs according to their own best ability, in their own way, and in accordance with their own political and economic institutions and processes." The same view was repeatedly expressed by delegates of other nations in the debates attending the drafting of Article 56. . . .

The humane and enlightened objectives of the United Nations Charter are, of course, entitled to respectful consideration by the courts and Legislatures of every member nation, since that document expresses the universal desire of thinking men for peace and for equality of rights and opportunities. The Charter represents a moral commitment of foremost importance, and we must not permit the spirit of our pledge to be compromised or disparaged in either our domestic or foreign affairs. We are satisfied, however, that the Charter provisions relied on by Plaintiff were not intended to supersede existing domestic legislation, and we cannot hold that they operate to invalidate the alien land law.

Fourteenth Amendment of the Federal Constitution The next question is whether the alien land law violates the due process and equal protection clauses of the Fourteenth Amendment [of the United States Constitution]. . . .

. . . The California alien land law is obviously designed and administered as an instrument for effectuating racial discrimination, and the most searching examination discloses no circumstances justifying classification on that basis. There is nothing to indicate that those alien residents who are racially ineligible for citizenship possess characteristics which are dangerous to the legitimate interests of the state, or that they, as a class, might use the land for purposes injurious to public morals, safety or welfare. Accordingly, we hold that the alien land law is invalid as in violation of the Fourteenth Amendment.

The judgment of the intermediate appellate court was reversed in part and affirmed in part. Although the United Nations Charter established no rights that applied directly to the plaintiff, the due process and equal protection clauses of the Fourteenth Amendment of the U.S. Constitution forbade racial discrimination of the kind contained in the California alien land law.

Casepoint

(1) A U.S. state law that invalidates a land purchase by a noncitizen violates the goals and aspirations of the UN Charter (especially the principle of nondiscrimination based on national origin); but the UN Charter itself is not "self-executing"—that is, it does not automatically become part of U.S. law because it requires additional implementing legislation. (2) But the land does not become the property of the State of California through "escheat" because the California law is based on racial discrimination, and this violates the U. S. Constitution.

state
A political entity comprising a territory, a population, a government capable of entering into international relations, and a government capable of controlling its territory and peoples.

independent state
A state that is sovereign; one that operates independently internationally.

dependent state
A state that has surrendered its rights to conduct international affairs to another state. Dependencies of the United States include Puerto Rico, the Virgin Islands, Guam, and various other islands located in the Pacific Ocean.

inchoate
(From Latin *inchoare:* "to start work on.") Begun, but not completed; imperfectly formed or developed. For example, American Samoa is an unincorporated and unorganized territory of the United States, administered by the Office of Insular Affairs, U.S. Department of the Interior. Persons born in American Samoa are U.S. nationals but not U.S. citizens.

The text of the U.S. Constitution is posted at www.house.gov/house/Constitution/Constitution.html.

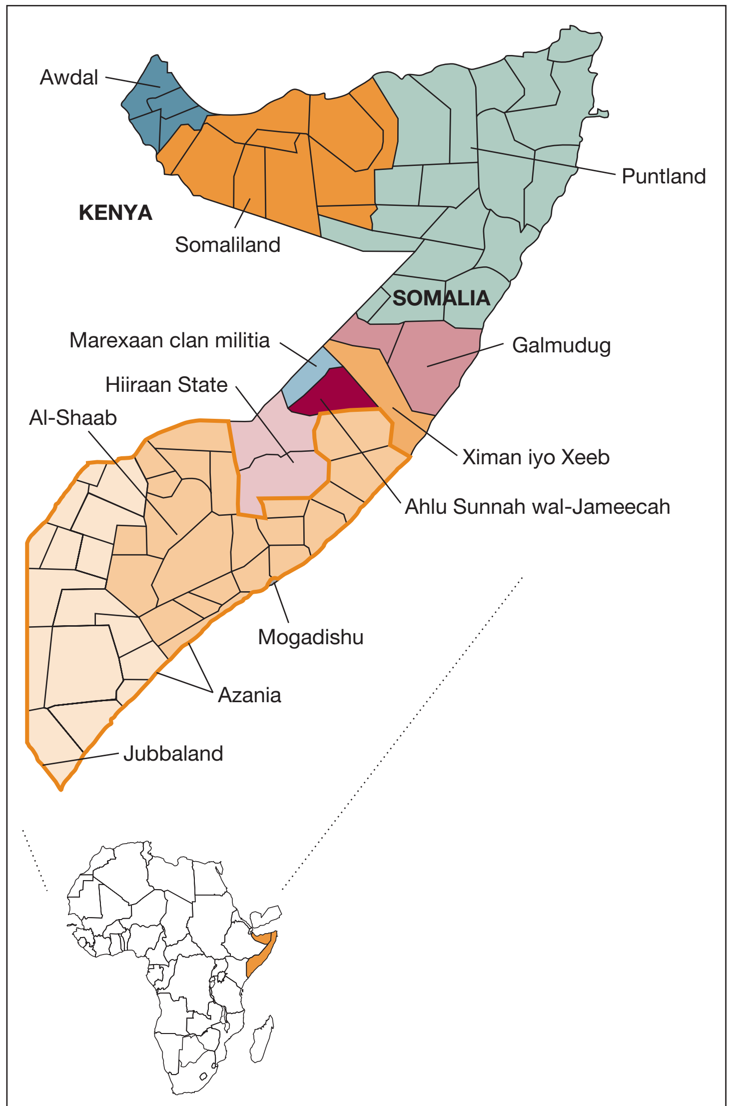
E. International Persons

The personalities of international law are states and their subdivisions, international organizations, businesses, and individuals.

States

States are political entities that have a territory, a population, a government capable of entering into international relations, and a government capable of controlling its territory and peoples. Included in this definition are three kinds of states: independent states, dependent states, and **inchoate states**.

Independent states are free from the political control of other states and free to enter into agreements with other international persons. **Dependent states** have formally surrendered some aspect of their political and governmental functions to another state. Some states that have achieved independence, and recognition by other states in the international community, may lose some control of substantial parts of its populace or parts of its territory. The concept of a "failed state" comes to mind with such nations as Somalia, where warring factions have long competed for control over substantial



MAP 1.3

Map of Somalia (as of July 2011)

parts of state that were formerly controlled by a central government (see Map 1.3). When no one is "in control" over a state's territory, the question of "recognizing" a government comes to the fore.

During the Arab uprisings of 2011, for example, the state of Libya became deeply fractured as armed insurrectionists demanded the ouster of Muammar el Qaddafi and his allies. States in the international community had to decide whether to maintain diplomatic relations with Qaddafi's government, to recall Ambassadors, or to withdraw recognition of his government entirely. One basic distinction is that a state may be recognized, but not its government; thus, while France might recognize the existence of Libya, it would not "recognize" Qaddafi's government as legitimate.

A formal definition of recognition posits that for a state to exist in the international community, it must be recognized by other states. **Recognition** comes about by a unilateral declaration, and it can be either explicit (express) or implicit (tacit). Once given, it implies that the recognized state or government is entitled to the rights and privileges granted by international law. Again, note that the recognition of a government is different from the recognition of a state. A state is recognized when an identifiable government, people, and territory first come into existence. If the government later changes, it may not be recognized as legitimate even though recognition of the state continues.

Two theories have been suggested as guidelines for when a government should be recognized: the **declaratory doctrine** and the **constitutive doctrine**. The first holds that the legal existence of a government happens automatically by operation of law whenever a government is capable of controlling a territory and its people. The second states that a government does not truly come into existence until such time as it is recognized by other states and participates in the international arena.

recognition
Formal acknowledgment or acceptance by a government of the independence and sovereignty of a newly created state or of a newly established government in another state, especially one established by revolution.

declaratory doctrine
The legal existence of a state or government happens automatically by operation of law.

constitutive doctrine
The legal existence of a state or government is dependent on recognition by other states.

It is important for a government to be recognized because recognition implies that the recognizing government wishes to have normal relations. And recognized governments are entitled, among other things, to diplomatic protection and sovereign immunity. Under the traditional view, states extended recognition only when a government exercised effective control over its territory, enjoyed the consent of its people, and was willing to fulfill its international legal obligations. Yet, some states have found that making distinctions about the "consent of the people" was difficult, especially when there were warring factions in a foreign country.

Estrada Doctrine
Doctrine that foreign governments will not be explicitly recognized.

In 1931, Mexico's Foreign Relations Secretary Genaro Estrada developed another important facet of nonintervention, eventually labeled the **Estrada Doctrine**. His objective was for Mexico to remain neutral in foreign controversies by rejecting the usual practice of states, namely "recognizing" foreign governments. Historically, European states and the United States used recognition to influence events in other states, so that domestic forces gained or lost influence in part because of another nation's recognition (or lack thereof). Mexico instead proclaimed that it would not judge or support any particular political actor in a foreign country.[20] The United States, by contrast, has often recognized governments on the basis that they exercise effective control over their territories, regardless of the consent of the people so governed.

Territorial Sovereignty

territorial sovereignty
The right of a government to exclusively exercise its powers within a particular territory.

For a state to exist, it must have **territorial sovereignty.** Sovereignty is the right to exercise the functions of a state within a territory. This right, however, may not be absolute. Other states may obtain **servitudes,** either by treaty or practice, to a limited use of certain territory. Commonly this is the exercise of rights-of-way, such as the rights of the ships of all nations to use the Suez and Panama canals.[21]

servitude
(From Latin *servitudo:* "slavery.") A right to the use of another's property.

Negative Servitudes: Air and Water Pollution

Servitudes can also be negative. That is, they may prevent one state from doing something within its territory that causes injury to a second state. Case 1-3 provides an example of a negative servitude based on air pollution affecting another state.

Transboundary pollution can also involve water pollution. Article X of the Helsinki rules adopted by the International Law Association at its Fifty-Second Conference espoused the principle of equitable utilization of the waters of an international drainage basin. The basic rule stipulates that a state:

a. must prevent any new form of water pollution or any increase in the degree of existing water pollution in an international drainage basin which would cause substantial injury in the territory of a co-basin State, and
b. should take all reasonable measures to abate existing water pollution in an international drainage basin to such an extent that no substantial damage is caused in the territory of a co-basin State.

"Water pollution" is defined as "any detrimental change resulting from human conduct in the natural composition, content, or quality of waters." Under the Helsinki rules, only material damage can be the basis of a state's liability in a case wherein activity lawful *per se* brings about the pollution of the waters of an international river basin.

The International Court of Justice has considered transboundary water pollution cases. See, for example, the dispute between Hungary and Slovakia (the Gabcíkovo-Nagymaros Project). This was a long-standing dispute about the construction and operation of a major system of dams on the river Danube, under a treaty signed in 1977 by Hungary and Czechoslovakia.

The ICJ's Web site about the case can be found at
www.icj-cij.org/docket/index.php?p1=3&p2=3&code=hs&case=92&k=8d.

[20]Ernesto Hernandez-Lopez, "International Migration and Sovereignty Reinterpretation in Mexico," *California Western Law Review,* vol. 43, pp. 203–233, at pp. 219–220.

[21]The 1888 Convention Respecting Free Navigation of the Suez Canal, also known as the Convention of Constantinople, declared the Suez Canal open to ships of all nations. The 1977 Panama Canal Treaty states that the canal "shall remain . . . open to peaceful transit by the vessels of all nations on terms of entire equality." Servitudes are usually created by treaty, but they can be created by custom as well.

CASE 1-3 The Trail Smelter Arbitration

United States v. Canada
American–Canadian Joint Commission, Arbitral Tribunal, 1938 and 1941
United Nations Reports of International Arbitral Awards, vol. 3, p. 1905

MAP 1.4

British Columbia and Washington (1941)

At the beginning of [the twentieth] century, a Canadian company built a lead and zinc smelting plant at Trail, British Columbia, about 10 miles north of the state of Washington border. Beginning in the 1920s, production was increased and by 1930 more than 300 tons of sulfur, including large quantities of sulfur dioxide, were being emitted daily. Some of the emissions were being carried down the Columbia River Valley and allegedly causing damage to land and other property in Washington. After negotiations between the United States and Canada, the latter agreed in 1928 to refer the matter to the American–Canadian Joint Commission that the two countries had established in the Boundary Waters Treaty of 1909. In 1931, the Commission's Arbitral Tribunal reported that damage had occurred in the amount of $350,000. Canada did not dispute its liability and agreed to pay this amount. The smelter continued to operate, however, and continued to emit pollutants into the air over Washington. In 1938, the United States claimed $2 million in damages for the years 1931 to 1937. The tribunal allowed the claim only in part, awarding damages of just $78,000. In 1941, the United States sought to have the operation of the smelter enjoined. The following question was submitted to the tribunal: "Whether the Trail Smelter should be required to refrain from causing damage in the state of Washington in the future and, if so, to what extent?"

1941 Report of the Tribunal

The first problem which arises is whether the question should be answered on the basis of the law followed in the United States or on the basis of international law. The Tribunal, however, finds that this problem need not be solved here as the law followed in the United States in dealing

with quasi-sovereign rights of the states of the Union, in the matter of air pollution, whilst more definite, is in conformity with the general rules of international law.

Particularly in reaching its conclusions as regards this question . . ., the Tribunal has given consideration to the desire of the high contracting parties "to reach a solution just to all parties concerned." As Professor Eagleton puts it: "A state owes at all times a duty to protect other states against injurious acts by individuals from within its jurisdiction." A great number of such general pronouncements by leading authorities concerning the duty of a state to respect other states and their territory have been presented to the Tribunal. . . . But the real difficulty often arises rather when it comes to determine what, *pro subjecta materie,*[22] is deemed to constitute an injurious act.

A case concerning, as the present one does, territorial relations, decided by the Federal Court of Switzerland between the Cantons of Soleure and Argovia, may serve to illustrate the relativity of the rule. Soleure brought a suit against her sister state to enjoin use of a shooting establishment which endangered her territory. The court, in granting the injunction, said: "This right (sovereignty) excludes . . . not only the usurpation and exercise of sovereign rights (of another state) . . . but also an actual encroachment which might prejudice the natural use of the territory and the free movement of its inhabitants." As a result of the decision, Argovia made plans for the improvement of the existing installations. These, however, were considered as insufficient protection by Soleure. The Canton of Argovia then moved the Federal Court to decree that the shooting be again permitted after completion of the projected improvements. This motion was granted. "The demand of the government of Soleure," said the court, "that all endangerment be absolutely abolished apparently goes too far." The court found that all risk whatever had not been eliminated, as the region was flat and absolutely safe shooting ranges were only found in mountain valleys; that there was a federal duty for the communes to provide facilities for military target practice and that "no more precautions may be demanded for shooting ranges near the boundaries of two Cantons than are required for shooting ranges in the interior of a Canton.". . . .

No case of air pollution dealt with by an international tribunal has been brought to the attention of the Tribunal nor does the Tribunal know of any such case. The nearest analogy is that of water pollution. But, here also, no decision of an international tribunal has been cited or has been found.

There are, however, as regards both air pollution and water pollution, certain decisions of the Supreme Court of the United States which may legitimately be taken as a guide in this field in international law, for it is reasonable to follow by analogy, in international cases, precedents established by that court in dealing with controversies between states of the Union or with other controversies concerning the quasi-sovereign rights of such states, where no contrary rule prevails in international law and no reason for rejecting such precedents can be adduced from the limitations of sovereignty inherent in the Constitution of the United States. . . .

The Tribunal, therefore, finds that the above decisions, taken as a whole, constitute an adequate basis for its conclusions, namely that, under the principles of international law, as well as the law of the United States, no state has the right to use or permit the use of its territory in such a manner as to cause injury by fumes in or to the territory of another or the properties or persons therein, when the case is of serious consequences and the injury is established by clear and convincing evidence.

The decisions of the Supreme Court of the United States which are the basis of these conclusions are decisions in equity and a solution inspired by them, together with the régime hereinafter prescribed, will, in the opinion of the Tribunal, be "just to all parties concerned," as long, at least, as the present conditions in the Columbia River Valley continue to prevail.

Considering the circumstances of the case, the Tribunal holds that the Dominion of Canada is responsible in international law for the conduct of the Trail Smelter. Apart from the undertakings in the Convention, it is, therefore, the duty of the government of the Dominion of Canada to see to it that this conduct should be in conformity with the obligation of the Dominion under international law as herein determined.

The Tribunal, therefore, answers [the question submitted] as follows: . . . So long as the present conditions in the Colombia River Valley prevail, the Trail Smelter shall be required to refrain from causing any damage through fumes in the state of Washington; the damage herein referred to and its extent being such as would be recoverable under the decisions of the courts

[22]From Latin "for the subject matter"; concerning the subject matter at hand.

of the United States in suits between private individuals. The indemnity for such damage should be fixed in such manner as the governments, acting under Article XI of the Convention, should agree upon.

Casepoint

"A state owes at all times a duty to protect other states against injurious acts by individuals from within its jurisdiction." The holding of the Trail Smelter arbitration can also be seen in international agreements such as the Stockholm Declaration, Principle 21, and Principle 2 of the Report of the United Nations Conference (the Rio Declaration).[23]

Report of the United Nations Conference on Environment and Development

(Rio de Janeiro, 3–14 June 1992)

ANNEX I

Rio Declaration On Environment And Development

Principle 2

States have, in accordance with the Charter of the United Nations and the principles of international law, the sovereign right to exploit their own resources pursuant to their own environmental and developmental policies, and the responsibility to ensure that activities within their jurisdiction or control do not cause damage to the environment of other States or of areas beyond the limits of national jurisdiction.

To have territorial sovereignty, a state must first acquire territory. This is done in several ways: (1) by the occupation of land not claimed by another sovereign, (2) by the voluntary transfer of territory from one sovereign to another, and (3) by the conquest and continued occupation of the territory of another sovereign.

The first situation noted above, seemingly the simplest, still has its ironies. When North and South America were populated by native tribes, Europeans used force of arms to displace or exterminate them. Christian churches were also engaged in bringing "civilization" and "religion" to the native peoples through missionary work; in South America, much of the missionary work was done by Catholics. There were no other sovereigns having significant military force that could effectively oppose this conquest, but there was opposition from Indian tribes in North America that were eventually given sovereignty over their reservation lands.

The third situation often results in continuing conflicts or resentments that may resurface years later or resolve into acceptance by the displaced sovereign.[24] In 1914, British troops occupied Basra after Turkey declared an alliance with Germany. In 1916, British and French officials secretly agreed that southern Mesopotamia, including Baghdad, would be handed over to Britain after World War I. In 1917, British troops occupied Baghdad and, in 1918, British troops occupied Mosul. In 1920, the San Remo conference granted Britain a mandate for governing Iraq, and the following months saw a widespread Iraqi revolt that was quelled by British troops and the Royal Air Force. What became of Iraq is now common knowledge, but the creation of modern Iraq (with its Shiite, Sunni, and Kurdish areas) has its origins in war and conquest.

[23]The decision in the Trail Smelter arbitration has had its share of critics. For example, see Gunther Handl, Territorial Sovereignty and the Problem of Transnational Pollution, 69 *American Journal of International Law* 50 (1975) and Karin Mickelson, Rereading Trail Smelter, 31 *Canadian Yearbook of International Law* 219 (1993).

[24]For example, between 1846 and 1848, two neighbors, the United States and Mexico, went to war. It was a defining event for both nations, By the war's end, Mexico had lost nearly half of its territory, the present American Southwest from Texas to California. History is replete with examples of empire (Roman, Ottoman, British) where territories of sovereign states were conquered and held for many years and, in some cases, centuries. India was under the rule of England for many years, though eventually Indian resentment became a full-fledged movement for independence led by Mahatma (Mohandas) Gandhi.

estoppel
(From Old French *estoupail:* "stopper" or "bung.") Legal rule that one cannot make an allegation or denial of fact that is contrary to one's previous actions or words.

dispositive treaty
A treaty concerned with rights over territory, such as boundaries and servitudes.

Merger Rule
Legal rule that the treaties in effect in a former state remain in effect in its territory when it becomes part of a new state.

Moving Boundaries Rule
Legal rule that the treaties of a state absorbing new territory become effective within the absorbed territory.

Clean Slate Doctrine
Doctrine that a new state coming into existence through decolonization is under no obligation to succeed to the treaties of its former colonial power.

Succession of States
Occurs when (1) two states agree to join and form a single state or (2) a state dissolves and its constituent states assume the role of independent states. Disputes between two sovereign states over state succession are not matters for municipal courts to decide.

Once territory is acquired, a state's title is affirmed either by the formal recognition of other states or by a process of **estoppel**. Estoppel arises when a state fails to speak up and object to another's exercise of sovereignty when it would be reasonable to do so. By failing to object, a state is tacitly recognizing the new status quo. This has the evident effect of making it difficult (but not impossible) for a state to change its position. To establish estoppel, some authorities (but not all) say that detrimental reliance must be shown. That is, the state claiming the territory must have made some improvement there (such as building roadways) that would be lost to it if recognition were denied. For example, a state that has, by its conduct, encouraged another state to believe in the existence of a certain legal or factual situation, and to rely upon that belief, may be estopped from asserting a contrary situation in its dealings.

Changes in Territorial Sovereignty When there is a change in sovereignty over territory, several legal consequences arise. As to treaty rights and obligations, successor states must observe treaties that implement general rules of international law, and they are bound by **dispositive treaties**—that is, treaties concerned with rights over territory, such as boundaries and servitudes.

The obligation of a successor state to observe other treaty commitments depends on whether it acquires a territory by a merger, partial absorption, or complete absorption or whether a seceding territory attains its independence through decolonization or dissolution. The **Merger Rule** governs the first of these cases. This rule presumes that when two states merge to form a new state (i.e., State A and State B merge and become State C), the preexisting treaties remain in force in the territories where they previously applied (i.e., State A treaties remain in force in the former territory of State A, and State B treaties remain in force in the former territory of State B). For example, when Egypt and Syria merged to form the United Arab Republic (1958–1961), the new republic declared that it was a single member of the United Nations, bound by the provisions of the UN Charter, and that all international treaties and agreements concluded by Egypt or Syria with other countries will remain valid where they were not in conflict.

There are, however, two exceptions to the Merger Rule. First, the new successor state and other states that are parties to a treaty with one of the predecessor states can agree to either terminate the treaty or extend it to the whole territory of the new state. (For example, when Tanganyika and Zanzibar merged in 1964, Zanzibar's treaties were given force throughout the new state of Tanzania.) Second, a treaty will terminate if its object and purpose can no longer be accomplished or if the conditions necessary to accomplish its object and purpose have radically changed. (For example, after the formation of the United Netherlands in 1815, the Dutch argued the new state was so different from its predecessors that a treaty with the United States had to be terminated.)

If territory from one state shifts to another (i.e., a province in State A becomes a province in State B), the law of state succession applies the **Moving Boundaries Rule**. This holds that the treaties of the absorbing state displace the treaties of the receding state in the territory where sovereignty has changed. Thus, when France took over Alsace-Lorraine after World War I, France's treaties displaced those of Germany in the annexed territory. Similarly, the Federal Republic of Germany's treaties displaced those of France when it regained control of the Saarland in 1957 and, in 1969, when the Netherlands transferred West New Guinea to Indonesia, Indonesia's treaties were extended over its new territory.

When a new state comes into being through decolonization, its obligation to observe the treaties made by its colonial parent state are determined by the **Clean Slate Doctrine**. That is, the ex-colony starts with no obligation to succeed to the treaties of its former colonial power.[25] Nevertheless, it is common practice for a newly independent ex-colony to announce its intention to continue to be bound by existing treaties.

When two states come into existence following the disintegration of a predecessor, the Clean Slate Doctrine does not apply. Rather, according to Article 34 of the Vienna Convention on the **Succession of States** in Respect of Treaties, both are bound by the predecessor's treaties to the extent that they are applicable within each of their territories. For example, when the Soviet Union broke

[25]Vienna Convention on the Succession of States in Respect of Treaties, Article 16. The Clean Slate Doctrine does not, however, affect the general rule that successor states are bound by dispositive treaties and treaties acknowledging a general rule of international law.

MAP 1.5

The Former Members of the Soviet Union

up into 12 republics in 1991, the international community insisted that each of the republics (shown in Map 1.5) acknowledge its obligation to observe the existing treaties of the Soviet Union, including arms control and human rights treaties, before it would be recognized. The United States, Great Britain, France, and China—the four remaining permanent members of the United Nations Security Council—relied on the same rule in announcing that Russia would automatically succeed to the Soviet seat on the Council.

Usually, the nationals of a territory that is acquired by a successor state will keep the nationality of the predecessor state. A different result, however, could be agreed to in a treaty of cession or by municipal legislation.

Public property located within a territory becomes the property of the successor state, while property located in a third state belongs to whichever government the third state recognizes. If a third state recognizes both states, however, the property will generally belong to whichever state is in actual possession.[26]

The private property rights of individuals do not lapse because of a change in government. A government, however, is always entitled to expropriate the property of its own nationals, so private property rights may well be adversely affected by a change in government. Similarly, a successor state is, as a general proposition, bound by the private contractual obligations of its predecessors; and to the extent that a successor acquires part or all of a territory, it is proportionately responsible for that territory's national debt.

International Organizations

According to the United Nations Charter, there are two kinds of international organizations: (1) public or intergovernmental organizations (IGOs) and (2) private or nongovernmental organizations (NGOs).[27]

Comprehensive information on IGOs is posted at
www.libsci.sc.edu/bob/IGOs.htm.

[26]See, e.g., *Arab Republic of Syria v. Arab Republic of Egypt,* Brazil Supreme Court, 1982, in *Revista Trimestral de Jurisprudenceia,* vol. 104, p. 889, and *International Law Reports,* vol. 91, p. 289 (1983).

[27]United Nations Charter, Article 71. The terminology used in the United Nations Charter assumes that the organizations are international and not domestic or municipal IGOs and NGOs. That same assumption is made here.

intergovernmental organization (IGO)
A permanent organization set up by two or more states to carry on activities of common interest.

Intergovernmental organizations (IGOs) are permanent organizations set up by two or more states to carry on activities of common interest.[28] Modern IGOs evolved from the European practice of convening conferences at the end of wars to draw new boundaries and sign peace treaties. Beginning in the nineteenth century, these conferences turned to sponsoring multilateral treaties and the setting up of organizations both to maintain the peace[29] and to carry on various other international activities of common interest, such as the delivery of mail[30] and the protection of industrial and literary property. The International Bureau of Industrial Property was set up in 1883 and the International Bureau of Literary Property in 1886. Both are now together known as the World Intellectual Property Organization.

The Web site of the World Intellectual Property Organization is
www.wipo.int.

Following World War I, the League of Nations was founded as the first organization that was both general in scope and universal in its intended membership. After World War II, the activities of the League were taken over and greatly expanded by the United Nations.

Since World War II, the number of IGOs has increased dramatically. Today there are some 400. Most significantly, IGOs have evolved from the simple meeting or conference of states to entities that have permanent structures and staffs, carry on a variety of activities, and, at least in the case of one IGO, have supranational powers.

charter
A document outlining the principles, functions, and organization of a juridical entity.

Unlike states, an IGO is created much in the fashion of a corporation. Its aims and objectives, internal structure, resources, and express powers are set out in a "constituent instrument," or **charter**, which is drafted and adopted by the organization's member states. The United Nations Charter, for example, gives the organization its name, sets out its purposes and principles, defines its membership, names its structural elements or "organs," describes the makeup and powers of those organs, sets out the rights and duties of its members, endows the organization with international personality, and describes the procedures for the charter's ratification and amendment.

The text of the United Nations Charter is posted at
www.un.org/aboutun/charter.

legal capacity
Qualification or authority, such as the qualification or authority to carry on international relations.

For an IGO to have the **legal capacity** to deal with other international persons—including the capacity to carry on diplomatic relations with a state or to sue or be sued in an international or municipal court—it must be recognized. With respect to its own state members, most authorities regard recognition as being implicit. In other words, by becoming a member of an IGO, a state automatically recognizes the IGO's international personality. This is not, however, the uniform rule. In the United Kingdom, the fact that the executive becomes a member of an IGO does not imply any internal recognition. Thus, the U.K. courts will not recognize the capacity of an IGO to sue or be sued in the United Kingdom unless the U.K. government specifically certifies that the IGO has such capacity.

As for establishing the legal capacity of an IGO vis-à-vis its nonmember states, recognition is also required. In some states, such as the United States, an IGO is essentially seen as an agency of its members and recognition of the IGO will be implied if its member states are recognized. In other countries, including the United Kingdom, recognition requires specific certification from the government.[31]

[28]Clive Archer defines an intergovernmental organization as "a formal continuous structure established by agreement between members (governmental and/or nongovernmental) from two or more sovereign states with the aim of pursuing the common interest of the membership." *International Organizations,* p. 35 (1983).

[29]The peace in nineteenth-century Europe was maintained informally through an arrangement known as the Concert of Europe. This arrangement involved regular consultations between the major powers (Austria, France, Great Britain, Prussia, and Russia), which acted together to recognize new states and to put down military uprisings in others.

[30]The Universal Postal Union was established in 1874. Its Web site is www.upu.int.

[31]See, e.g., *Arab Monetary Fund v. Hashim and Others (No. 3),* England, High Court, Chancery Division, 1989. *Weekly Law Reports,* vol. 1990, pt. 3 (1990); *International Law Reports,* vol. 83, p. 244 (1990).

The United Nations The most important IGO is the United Nations. Its charter, a multilateral treaty, came into force on October 24, 1945. (See Figure 1.2.) Its goals are the maintenance of peace and security in the world, the promotion of economic and social cooperation, and the protection of human rights. The drafters of the United Nations Charter had a philosophical belief in the efficacy of the rule of law to secure these rights. Several underlying principles underlie the charter's provisions. In particular, members are sovereign equals, disputes must be settled peacefully, and all members are obliged to fulfill their international obligations in good faith.

The United Nations Web site is at
www.un.org.

The **organs** of the United Nations are the General Assembly, the Security Council, the Secretariat, the International Court of Justice, the Trusteeship Council, and the Economic and Social Council (ECOSOC). The General Assembly is the main deliberative organ of the UN. It is a quasi-legislative body made up of representatives of all 193 member states. Its function is to discuss and vote on any question or matter within the scope of the charter. Decisions on important questions of peace and security, admission of new members, and budgetary matters require a two-thirds majority. Decisions on other matters are by simple majority. Each country has one vote.

organ
(From Greek *organon:* "tool" or "instrument.") An agency that carries on specific functions within a larger organization.

The Security Council is made up of representatives of 15 member states, 5 of which are permanent member states (China, the Russian Federation, the United States, France, and the United Kingdom). By election of the General Assembly, 10 nonpermanent states are given two-year terms. In 2011, the 10 nonpermanent members included Bosnia-Herzegovina, Brazil, Colombia, Gabon, Germany, India, Lebanon, Nigeria, Portugal, and South Africa. The Security Council is responsible for maintaining international peace and security, and it is the only United Nations organ with the authority to use armed force. Ten nonpermanent members are elected by the General Assembly for two-year terms and not eligible for immediate reelection.

Each Council member has one vote. Decisions on procedural matters are made by an affirmative vote of at least 9 of the 15 members. Decisions on substantive matters require nine votes, including the concurring votes of all five permanent members. This is the rule of "great Power unanimity," often referred to as the "veto" power.

Historically, the Security Council has often been deadlocked by the veto power. During the Cold War, the U.S.S.R. found it was in their strategic self-interest to veto proposed police actions. It was the absence of the U.S.S.R.—boycotting the Security Council—that led the Security Council to approve a UN "police action" in the Korean conflict of 1950–1953. Despite times of deadlock, the

From August through October 1944, representatives of China, the Soviet Union, the United Kingdom, and the United States met at Dumbarton Oaks, a mansion in Georgetown, near Washington, D.C., to draft proposals for a United Nations Charter. In April of the next year, delegates from 50 countries met in San Francisco at the United Nations Conference on International Organization to debate and refine the proposals. A final Charter was adopted unanimously on June 25, 1946, and signed the next day by the representatives of all 50 countries. Poland, which was not represented at the Conference, signed it later and became one of the original 51 United Nations member states.

The United Nations officially came into existence on October 24, 1945, when the Charter had been ratified by China, France, the Soviet Union, the United Kingdom, the United States, and by a majority of the other signatories. October 24 is now celebrated each year as United Nations Day.

FIGURE 1.2

The Inaugural Meeting of the Conference on Security Organization for Peace in Post-War World (the Dumbarton Oaks Conference), August 21, 1945.

Source: United Nations Photo Library

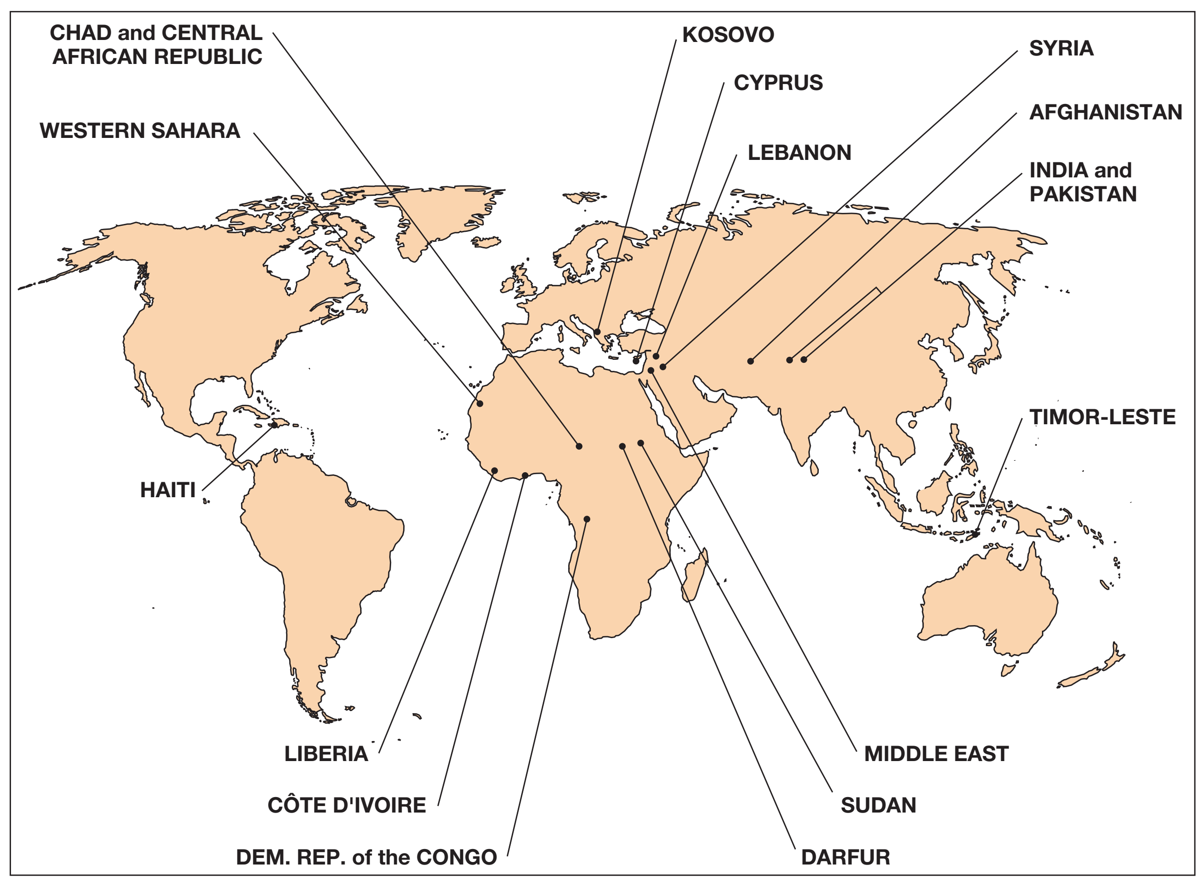


FIGURE 1.3

UN Peacekeeping Missions, as of July 2010

UN Web site notes that as of 2011 there were over 100,000 UN peacekeepers in various parts of the world (see Figure 1.3).

A secretary-general elected by the General Assembly heads up the United Nations Secretariat. The Secretariat is the administrative arm of the United Nations, responsible for making reports and recommendations to the General Assembly and the Security Council.

The International Court of Justice is the United Nations' principal judicial body. The Trusteeship Council, which no longer has a function, was set up at the end of World War II to supervise the world's non-self-governing territories. Finally, the Economic and Social Council, which comprises 54 member states elected by the General Assembly, is responsible for promoting economic, social, health, cultural, and educational progress as well as respect for human rights.

United Nations System
A group of autonomous organizations affiliated with the United Nations.

The **United Nations System** is the name given to various autonomous agencies (themselves IGOs) concerned with a wide range of economic and social problems that have entered into agreements with the United Nations to become United Nations specialized agencies (see Table 1.2). Specialized agencies are autonomous organizations working with the United Nations and each other through the coordinating machinery of the ECOSOC at the intergovernmental level, and through the Chief Executives Board (CEB) for coordination at the intersecretariat level. Additionally, two other organizations—the World Trade Organization (WTO) and the International Atomic Energy Agency (IAEA)—although not specialized agencies, have entered into similar relationships with the United Nations.

During the past 15 years, the United Nations has tried to engage the business community in partnering for a better world. Indeed, a very large number of companies collaborate to some degree or another with the United Nations. The UN suggests a number of ways that businesses can serve as partners.

TABLE 1.2

The specialized agencies of the United Nations

	Nonbanking Agencies		World Bank Group
FAO	Food and Agriculture Organization	IBRD	International Bank for Reconstruction and Development
ICAO	International Civil Aviation Organization		
		IDA	International Development Agency
IFAD	International Fund for Agricultural Development	IFC	International Finance Corporation
		MIGA	Multilateral Investment Guarantee Agency
ILO	International Labor Organization		
IMF	International Monetary Fund	ICSID	International Center for the Settlement of Investment Disputes
IMO	International Maritime Organization		
ITU	International Telecommunications Union		
UNESCO	United Nations Educational, Scientific and Cultural Organization		
UNIDO	United Nations International Development Organization		
UNWTO	United Nations World Tourism Organization		
UPU	Universal Postal Union		
WHO	World Health Organization		
WIPO	World Intellectual Property Organization		
WMO	World Meteorological Organization		

A printable version of the United Nations System can be found at www.un.org/aboutun/chart.html.

The UN has also sponsored a Global Compact for businesses to join in support of the Millenium Development Goals. Participation in the Global Compact is a means for many businesses to go "beyond the bottom line" and exercise social and environmental responsibility.

Partnering with the UN

Adapted from http://business.un.org/en/browse/collaboration.

Advocacy of global issues: Corporations and UN organizations can partner effectively to advance awareness of global issues (e.g., climate change, HIV/AIDS, poverty).

Business opportunities in low-income communities/countries: It is often assumed in the private sector that philanthropy is the only way of addressing global needs. And yet, there is a growing movement of businesses using their core competencies to support sustainable growth in developing nations. In this movement, those in developing countries are seen more as partners and clients, and less as recipients or aid beneficiaries.

Standards and guidelines development: Certain industry sectors need more robust international guidelines to ensure responsible and good practice. For example, in the construction industry, building codes are under current discussion to prevent, or minimize, the risk of disaster damage. Earthquakes, hurricanes, and other disasters can cause much greater harm in areas where structures are built on a substandard basis.

Project funding: There will always remain a need for funding for UN programs.

Provision of services/personnel: Increasingly, companies are strategically aligning their core competencies with global issues. The UN is interested in partnerships where corporate capacity is linked with key areas of interest.

Provision of goods: Donated goods may be utilized, with gratitude, by the UN. However, they can bring certain challenges to which all parties need to be sensitive.

Reading 1-1 Overview of the UN Global Compact and the Millennium Development Goals, and the Ten Principles

The UN Global Compact

The UN Global Compact is a strategic policy initiative for businesses that are committed to aligning their operations and strategies with 10 universally accepted principles in the areas of human rights, labor, environment, and anti-corruption. By doing so, business, as a primary driver of globalization, can help ensure that markets, commerce, technology, and finance advance in ways that benefit economies and societies everywhere.

As social, political, and economic challenges (and opportunities)—whether occurring at home or in other regions—affect business more than ever before, many companies recognize the need to collaborate and partner with governments, civil society, labor, and the United Nations.

This ever-increasing understanding is reflected in the Global Compact's rapid growth. With over 8,700 corporate participants and other stakeholders from over 130 countries, it is the largest voluntary corporate responsibility initiative in the world.

Endorsed by chief executives, the Global Compact is a practical framework for the development, implementation, and disclosure of sustainability policies and practices, offering participants a wide spectrum of workstreams, management tools, and resources—all designed to help advance sustainable business models and markets.

Overall, the Global Compact pursues two complementary objectives:

1. Mainstream the 10 principles in business activities around the world
2. Catalyze actions in support of broader UN goals, including the Millennium Development Goals (MDGs)

With these objectives in mind, the Global Compact has shaped an initiative that provides collaborative solutions to the most fundamental challenges facing both business and society. The initiative seeks to combine the best properties of the UN, such as moral authority and convening power, with the private sector's solution-finding strengths, and the expertise and capacities of a range of key stakeholders. The Global Compact is global and local; private and public; voluntary yet accountable.

The benefits of engagement include the following:

- Adopting an established and globally recognized policy framework for the development, implementation, and disclosure of environmental, social, and governance policies and practices.
- Sharing best and emerging practices to advance practical solutions and strategies to common challenges.
- Advancing sustainability solutions in partnership with a range of stakeholders, including UN agencies, governments, civil society, labor, and other nonbusiness interests.
- Linking business units and subsidiaries across the value chain with the Global Compact's Local Networks around the world—many of these in developing and emerging markets.
- Accessing the United Nations' extensive knowledge of and experience with sustainability and development issues.
- Utilizing UN Global Compact management tools and resources, and the opportunity to engage in specialized workstreams in the environmental, social, and governance realms.

A more detailed analysis of the benefits of participation in the Global Compact can be found in *The Importance of Voluntarism*—which also focuses on the importance of the Global Compact as a *complement* rather than substitute for regulatory regimes.

Finally, the Global Compact incorporates a transparency and accountability policy known as the Communication on Progress (COP). The annual posting of a COP is an important demonstration of a participant's commitment to the UN Global Compact and its principles. Participating companies are required to follow this policy, as a commitment to transparency and disclosure is critical to the success of the initiative. Failure to communicate will result in a change in participant status and possible expulsion.

In summary, the Global Compact exists to assist the private sector in the management of increasingly complex risks and opportunities in the environmental, social, and governance realms, seeking to embed markets and societies with universal principles and values for the benefit of all.

The Ten Principles

The UN Global Compact's 10 principles in the areas of human rights, labor, the environment, and anti-corruption enjoy universal consensus and are derived from:

- The Universal Declaration of Human Rights
- The International Labor Organization's Declaration on Fundamental Principles and Rights at Work
- The Rio Declaration on Environment and Development
- The United Nations Convention Against Corruption

The UN Global Compact asks companies to embrace, support, and enact, within their sphere of influence, a set of core values in the areas of human rights, labor standards, the environment, and anti-corruption:

Human Rights

- Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and
- Principle 2: make sure that they are not complicit in human rights abuses.

Labor

- Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
- Principle 4: the elimination of all forms of forced and compulsory labor;
- Principle 5: the effective abolition of child labor; and
- Principle 6: the elimination of discrimination in respect of employment and occupation.

Environment

- Principle 7: Businesses should support a precautionary approach to environmental challenges;
- Principle 8: undertake initiatives to promote greater environmental responsibility; and
- Principle 9: encourage the development and diffusion of environmentally friendly technologies.

Anti-Corruption

- Principle 10: Businesses should work against corruption in all its forms, including extortion and bribery.

The Millennium Development Goals

Adopted by world leaders in 2000 and set to be achieved by 2015, the millennium development goals provide concrete, numerical benchmarks for tackling extreme poverty in its many dimensions. The MDGs also provide a framework for the entire international committee to work together toward a common end—making sure the human development reaches everyone, everywhere. If these goals are achieved, world poverty will be cut by half, tens of millions of lives will be saved, and billions more people will have the opportunity to benefit from the global economy.

The eight MDGs break down into 21 quantifiable targets that are measured by 60 indicators.

Goal 1: Eradicate extreme poverty and hunger

Goal 2: Achieve universal primary education

Goal 3: Promote gender equality and empower women

Goal 4: Reduce child mortality

Goal 5: Improve maternal health

Goal 6: Combat HIV/AIDS, malaria, and other diseases

Goal 7: Ensure environmental sustainability

Goal 8: Develop a global partnership for development

Global Reporting Initiative

The Global Reporting Initiative (GRI)[32] is a network-based organization that produces a comprehensive sustainability reporting framework that is widely used around the world. In 2006, the UN Global Compact and the GRI united in a strategic alliance aimed at providing the private sector with a means and an opportunity to embrace strategies that are comprehensive and sustainable. Both said that they would advocate various partnership efforts to encourage corporate responsibility and to support the complementary platforms of the Compact and the GRI.

GRI is committed to the Framework's continuous improvement and application worldwide. GRI's core goals include the mainstreaming of disclosure on environmental, social, and governance performance. GRI's Reporting Framework is developed through a consensus-seeking, multi-stakeholder process. Participants are drawn from global business, civil society, labor, academic, and professional institutions.

The Reporting Framework sets out the principles and Performance Indicators that organizations can use to measure and report their economic, environmental, and social performance. The cornerstone of the Framework is the Sustainability Reporting Guidelines. The third version of the Guidelines—known as the G3 Guidelines—was published in 2006, and is a free public good.

Each of the Millenium goals has a more detailed set of targets. For example, goal seven (ensure environmental sustainability) offers the following targets:

Target 7a: Integrate the principles of sustainable development into country policies and programs; reverse loss of environmental resources

Target 7b: Reduce biodiversity loss, achieving, by 2010, a significant reduction in the rate of loss

Target 7a and 7b Indicators:

- 7.1 Proportion of land area covered by forest
- 7.2 CO2 emissions, total, per capita, and per $1 GDP (PPP)
- 7.3 Consumption of ozone-depleting substances
- 7.4 Proportion of fish stocks within safe biological limits
- 7.5 Proportion of total water resources used
- 7.6 Proportion of terrestrial and marine areas protected
- 7.7 Proportion of species threatened with extinction

Target 7c: Reduce by half the proportion of people without sustainable access to safe drinking water and basic sanitation

- 7.8 Proportion of population using an improved drinking water source
- 7.9 Proportion of population using an improved sanitation facility

Target 7d: Achieve significant improvement in lives of at least 100 million slum dwellers by 2020

- 7.10 Proportion of urban population living in slums

The GRI can be instrumental in measuring both public and private accomplishment for the seventh Millennium Development Goal.

The MDGs and the GRI together forge a new partnership between the global public institutions (such as the UN) and global private enterprises.

The European Union Another important intergovernmental organization is the **European Union (EU)**. Founded in 1951 by 6 states (Belgium, France, Germany, Italy, Luxembourg, and the Netherlands), its member states increased to 9 in 1973 (with the addition of Denmark, Ireland, and the United Kingdom), to 10 in 1981 (when Greece joined), to 12 in 1986 (when Portugal and Spain became members), to 15 in 1995 (when Austria, Finland, and Sweden were admitted), to 25 in 2004 (with the addition of the Czech Republic, Cyprus, Estonia, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia, and Slovakia), to 27 in 2007 (when Bulgaria and Romania joined). The EU, with 27 member states, covers a large part of the continent of Europe. The EU already has a population of over half a billion, the largest population in the world after China and India.

European Union (EU) An IGO that has as its goals the elimination of internal frontiers and the establishment of a political, economic, and monetary union.

The Web site of the EU is http://europa.eu/index_en.htm.

[32] www.globalreporting.org/AboutGRI/WhatIsGRI/.

The founding states created the EU in order to integrate their economies and political institutions. The process of integration began with the adoption of the European Coal and Steel Community (ECSC) Treaty, which the founding states signed in Paris in 1951. Although no longer in force—it expired in 2002—the ECSC created a common market for coal and steel and IGOs to oversee this original community. Building on the experience of the ECSC, the original member states adopted the Treaty Establishing the European Community (EC Treaty) and the European Atomic Energy Community (EAEC, or Euratom) Treaty, which they signed in Rome in 1957. Ten years later, the Merger Treaty of 1967 consolidated the separate institutional organizations that oversaw the three separate communities into a single structure. In 1992, in Maastricht, the member states signed the European Union (EU) Treaty.[33] The EU Treaty established a political union,[34] common citizenship for nationals of the member states, a Social Charter,[35] a monetary union, a Central Bank, and a common currency (the euro).[36] Then in 1997, the Treaty of Amsterdam eliminated all internal borders,[37] established a larger role for the European Parliament,[38] renamed the EEC Treaty as the Treaty Establishing the European Community (the EC Treaty), and consolidated and renumbered the articles of the EC and the EU treaties.

In 2000, the Intergovernmental Conference (IGC), in anticipation of the accession of new member states from Eastern and Southern Europe,[39] concluded a new treaty (the Treaty of Nice) that was signed in 2001 and ratified in 2002. The treaty established voting rights for new members and reallocated votes for existing members in the Council of Ministers.[40] The IGC postponed any decision on a new European Constitution, which was drafted in 2003 and signed in 2004. However, because it had to be ratified by all 27 member states before it could come into force, and because both France and the Netherlands voted "No" to the Constitution in 2005, EU leaders declared a "period of reflection" at that point. The Declaration on the opposite page (known as the Berlin Declaration) captured the EU—in 2007—at 50 years and in some uncertainty.

The text of the European treaties is posted at
http://europa.eu/abc/treaties/Index_en.htm.

Following the "period of reflection" that ended the stalled ratification process for the EU Constitution, the Lisbon Treaty amended the Maastricht Treaty (the Treaty on European Union) and the Treaty of Rome (the Treaty establishing the European Community). The effect was to reform the constitutional basis of the EU. Prominent changes included the move from required unanimity to *double majority* voting in several policy areas in the Council of Ministers, a more powerful European Parliament, a consolidated legal personality for the EU, and the creation of a long-term President of the European Council. The Treaty also made the Union's bill of rights, the Charter of Fundamental Rights, legally binding. The Lisbon Treaty was to have been ratified by the end of 2008, but a rejection in 2008 by the Irish electorate delayed ratification until 2009. More changes to the EU's legal arrangements may be coming, primarily because of the Eurozone crisis that began in 2011 (see Reading 1-2).

---

[33]The EU Treaty changed the names of the principal institutions of the EU to European Commission, European Council (formerly the Council of Ministers), European Parliament, European Court of Justice, European Economic and Social Committee, and European Court of Auditors.

[34]The EU's Commission is authorized to discuss both foreign policy and security issues.

[35]The Social Charter establishes uniform minimum social and economic standards for individuals.

[36]The United Kingdom, which objected to most of the changes in the Maastricht Treaty, obtained a special concession that allows it to avoid participating in the monetary union and that excuses it from the requirements of the Social Charter.

[37]Great Britain and Ireland will be temporarily exempted from this requirement.

[38]The treaty is posted at www.europarl.europa.eu/topics/treaty/pdf/amst-en.pdf.

[39]As of January 2012, there are 27 member states and six new applicants (Croatia, Turkey, Iceland, Montenegro, Serbia, and the former Yugoslav Republic of Macedonia).

[40]The Treaty of Nice can be found at http://eur-lex.europa.eu/en/treaties/dat/12001C/pdf/12001C_EN.pdf.

Declaration on the Occasion of the Fiftieth Anniversary of the Signature of the Treaties of Rome

For centuries Europe has been an idea, holding out hope of peace and understanding. That hope has been fulfilled. European unification has made peace and prosperity possible. It has brought about a sense of community and overcome differences. Each Member State has helped to unite Europe and to strengthen democracy and the rule of law. Thanks to the yearning for freedom of the peoples of Central and Eastern Europe the unnatural division of Europe is now consigned to the past. European integration shows that we have learnt the painful lessons of a history marked by bloody conflict. Today we live together as was never possible before. We, the citizens of the European Union, have united for the better.

I. In the European Union, we are turning our common ideals into reality: for us, the individual is paramount. His dignity is inviolable. His rights are inalienable. Women and men enjoy equal rights.

We are striving for peace and freedom, for democracy and the rule of law, for mutual respect and shared responsibility, for prosperity and security, for tolerance and participation, for justice and solidarity.

We have a unique way of living and working together in the European Union. This is expressed through the democratic interaction of the Member States and the European institutions. The European Union is founded on equal rights and mutually supportive cooperation. This enables us to strike a fair balance between Member States' interests.

We preserve in the European Union the identities and diverse traditions of its Member States. We are enriched by open borders and a lively variety of languages, cultures and regions. There are many goals which we cannot achieve on our own, but only in concert. Tasks are shared between the European Union, the Member States and their regions and local authorities.

II. We are facing major challenges which do not stop at national borders. The European Union is our response to these challenges. Only together can we continue to preserve our ideal of European society in future for the good of all European Union citizens. This European model combines economic success and social responsibility. The common market and the euro make us strong. We can thus shape the increasing interdependence of the global economy and ever-growing competition in international markets according to our values. Europe's wealth lies in the knowledge and ability of its people; that is the key to growth, employment and social cohesion.

We will fight terrorism, organised crime and illegal immigration together. We stand up for liberties and civil rights also in the struggle against those who oppose them. Racism and xenophobia must never again be given any rein.

We are committed to the peaceful resolution of conflicts in the world and to ensuring that people do not become victims of war, terrorism and violence. The European Union wants to promote freedom and development in the world. We want to drive back poverty, hunger and disease. We want to continue to take a leading role in that fight.

We intend jointly to lead the way in energy policy and climate protection and make our contribution to averting the global threat of climate change.

III. The European Union will continue to thrive both on openness and on the will of its Member States to consolidate the Union's internal development. The European Union will continue to promote democracy, stability and prosperity beyond its borders.

With European unification a dream of earlier generations has become a reality. Our history reminds us that we must protect this for the good of future generations. For that reason we must always renew the political shape of Europe in keeping with the times. That is why today, 50 years after the signing of the Treaties of Rome, we are united in our aim of placing the European Union on a renewed common basis before the European Parliament elections in 2009. For we know, Europe is our common future.

Supranational Powers Unlike most other intergovernmental organizations, the EU is endowed with **supranational powers**. That is, EU law within its scope of applicability is superior to the laws of the member states. This "supremacy principle" has two consequences: (1) the member states are required to bring their internal laws into compliance with EU law and (2) EU law is directly effective within the member states.

An example of the obligation of member states to bring their internal laws into compliance with the EU legal order is provided by the case of *Commission v. Belgium.* Taxes imposed by Belgium discriminated against lumber produced in other member states, contrary to Article 90 of the EC Treaty. In defending itself before the European Court of Justice in an action brought by the European Commission under Article 226, the government of Belgium said that it had introduced draft legislation in the Belgian Chamber of Representatives two years earlier but the legislation had not been passed. The government explained that the principle of separation of powers that applied in Belgium prevented the government from doing anything more. This excuse did not impress the Court of Justice. It said: "The obligations arising under Article 90 of the Treaty devolve upon states as such and the liability of a member state under Article 226 arises whatever the agency of the state whose action or inaction is the cause of the failure to fulfill its obligations, even in the case of a constitutionally independent institution."

supranational powers Powers surrendered by member states to an IGO. Such powers are superior to and preempt the laws and regulations of its member states. In exercising these powers, the organization may grant rights and privileges to the nationals of its member states, which those individuals may directly invoke.

Reading 1-2 The End of the Euro? Fears of Financial Contagion

From its inception as the European Economic Community to the European Union that we now know, the member nations have become more and more unified politically. The same cannot be said for its economic organization. The Euro, a common currency, was first introduced in 1999 but was only adopted by 17 EU member nations. Moreover, the currency's issuance was not matched by a corresponding set of common fiscal and monetary policies.

In the summer of 2009, the potential default of Greek "sovereign debt" deeply concerned other EU member nations, the European Central Bank, and investors worldwide. Subsequent fears of sovereign debt default by Ireland, Portugal, Spain, and Italy stoked fears of regional and even global "financial contagion." Banks and nations in the EU generally faced lingering recessions from the 2008 financial meltdown, and key banks in EU nations were also dealing with dubious balance sheets, often from real estate lending in "bubble" real estate economies (Spain, Ireland) or from holding sovereign debt from Portugal, Ireland, Italy, Greece, and Spain (the so-called PIIGS).

The Greek Debt Crisis

Although much attention was focused on Greece in 2011–2012, it is important to remember that economies of Italy and Spain are both far larger than Greece, and that national debt problems have plagued both Italy and Spain. During the first ten years of the Euro, the Greek government in Athens allowed its budgets to run unsustainable deficits. In part, the deficits were created by a failure to effectively collect taxes, especially on very wealthy Greek citizens, many of whom were happy to evade taxation. The accumulated debt amounted to upward of 150% of the nation's gross domestic product (GDP), almost twice the European average.

The fear has been that a Greek default on obligations to lenders would require it to exit the Euro and return to its national currency, the drachma. But the drachma would be a much devalued national currency. This could potentially lead to financial contagion because of the exposure of commercial banks in Germany, France, Netherlands, and the United Kingdom to Greek debt, as well as sovereign debt from Portugal, Ireland, Spain and Italy. On the other hand, Greek tourism would no doubt increase, as the price of a Greek vacation to Europeans would be far cheaper after the return to the drachma.

But propping up Greek or other sovereign debt by the more fiscally responsible nations in the EU is not politically popular; for example, the more fiscally prudent Germans are deeply averse to bailing out the perceived "profligacy" of Greece and others. Banks, investors, and the stronger Euro nations all were pushing the PIIGS to cut deficits and balance their budgets. But even the stronger European economies were in recessionary times, and credit ratings agencies like Standard and Poor's threatened France with a lower bond rating unless it restored budgetary balance. Cutbacks in many EU nations led to low growth and high unemployment, and by the spring of 2012 there was a lot of political pushback from polities tired of austerity, not only in Greece, but in France and even in Germany.

Balancing Risks and Benefits Between Greece and the Eurozone

At play in the Eurozone drama were the various member states of the "Eurozone," the 17 EU nations that had adopted the Euro, the European Central Bank (ECB), the IMF, and the banks that had high potential risks from holding Greek sovereign debt or non-performing real estate loans. The only economy given AAA credit during 2011 was Germany's, and the Germans were in no political mood to bail out its neighbors to the south.

By the summer of 2011, there was little doubt that Greece has failed economically in every sense of the word, except to in fact default. As a result, ratings agencies had downgraded Greece's bonds to a level just shy of default. The Greek economy ($310.3 billion) is about a fourth of the size of the Texas economy ($1.2 trillion). In August 2011, Greece was paying 15.5% on its 10-year bonds and 23% on its two-year notes. These borrowing costs worsened Greece's already difficult financial circumstances and prospects. By that time, all private lenders had headed for the exits, leaving only public institutions such as the ECB.

In May 2010 the ECB began buying sovereign debt (bonds) from Greece, Ireland, and Portugal. On August 8, 2011, it took the dramatic step of buying Italian and Spanish government bonds in the secondary market as global investors shied away from the risk. The move was dramatic on two counts. First, the Italian and Spanish economies are "whales" compared to the "minnows" of Greece, Ireland, and Portugal, and defaults there would be even more troublesome. The ECB intervened after Rome and Madrid promised accelerated austerity measures and policies to create more economic growth. Second, the intervention brought down yields on 10-year bonds, with uncertain effects on demand for further bond issues by both nations. Investors remained skeptical, especially after Italy's austerity program in early September 2011 avoided any tax increase on high earners and scaled back cuts to local authorities.

But the ECB was not originally designed to be involved in the fiscal policy of euro zone member states. The ECB wanted to transfer responsibility for bond purchases to the European Financial Stability Facility (EFSF), which is the chief emergency lending entity for Eurozone governments. By acquiring tens of billions of Euros of Italian and Spanish debt, on top of sovereign debt from Greece, Ireland, and Portugal, the ECB's rescue funds were stretched considerably.

Eurozone governments agreed on July 21, 2011, to let the EFSF acquire sovereign debt at a discount on the secondary market, to finance the recapitalization of banks, and to extend pre-emptive credit lines to countries under pressure in debt markets. These were intended as bold moves that would reassure low markets. Eurozone leaders agreed in late July 2011 to boost the effective size of the fund to €440 billion, or $635 billion. The German Finance Minister Wolfgang Schäuble said an expanded E.F.S.F. that would have powers to intervene in bond markets and provide precautionary credit lines to troubled member states would help the bloc "prevent contagion in good time."

During the latter half of 2011, various austerity plans were instituted, and the European Central Bank stepped in to make large loans to European banks who in turn bought sovereign debt while private investors sold. In summer of 2011, for example, the Greek government agreed to another deep round of spending cuts and tax increases and to sell off billions of dollars in public property, such as ports and other infrastructure. The Eurozone nations and banks then agreed to a $229 billion rescue package, cutting Greece's debt obligations. The moves included a "structured default," where bank bond holders agreed to extend the terms of loans, and at lower interest rates.

A Second Bailout, and Political Fallout in Greece and France

In March of 2012, Greece got a second (€130 billion) bailout program. Like the first, this bailout required Greece to get a grip on public spending and

tax collection while reforming a bloated bureaucracy and a tangle of laws that had rendered its economy globally uncompetitive.

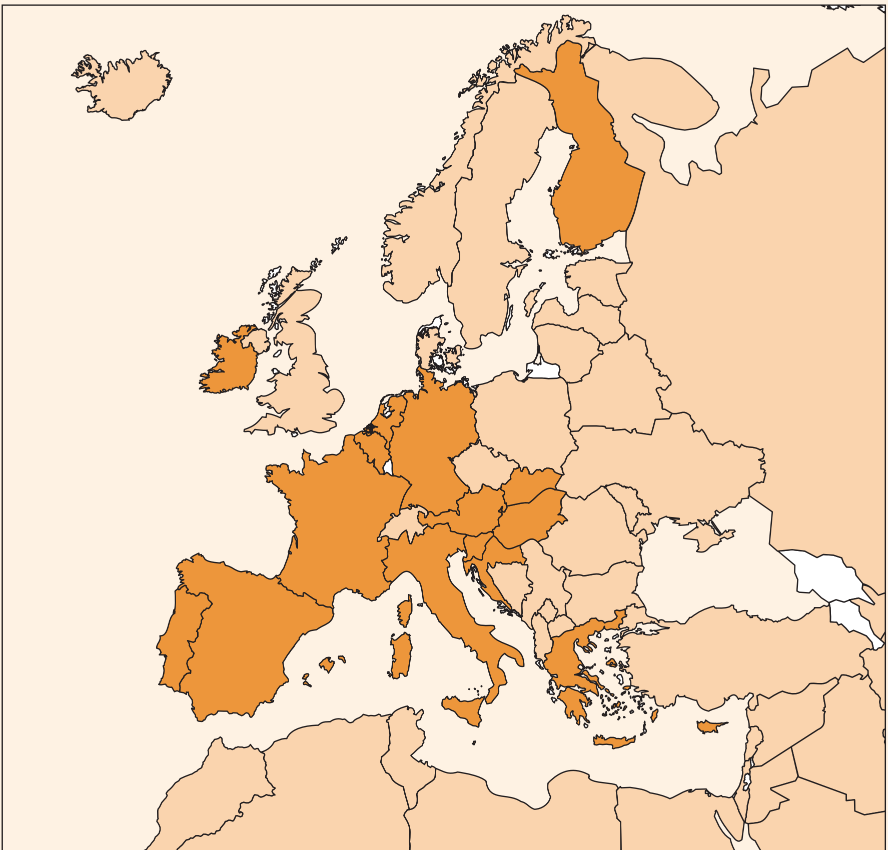
In May of 2012, elections in France and in Greece saw voters reject continued austerity measures. Under pressure of potentially losing its AAA credit rating, France (under Nicolas Sarkozy) had instituted two different austerity plans, cutting €112bn from its budget and imposing a 5% "super-tax" on big firms, a rise in VAT on restaurants and construction, and cuts on pensions, schools, health, and welfare. France was not the only nation to resort to fiscal belt-tightening. In general, public sector layoffs, cutbacks in pension payments and other austerity measures were helping to balance national budgets, but also served to further depress national economies, especially in Greece and Spain. Even the credits extended by the IMF and the ECB were still not sufficient to balance the budgets of Greece and Spain. And while that credit would not be extended without austerity measures, the citizenry's appetite for continued austerity was wearing thin by the spring of 2012.

Despite public's distaste for austerity, each country with severe debt problems was at risk of not being able to fully fund its operations, including all public sector jobs and pension payments. That is, the continued credit-worthiness of these governments was necessary in order to avoid a de-funding of the public sector. But that credit-worthiness could only be judged privately by the bond markets and publicly by institutions such as the IMF and the European Central Bank. The essence of any "bailout" by the public institutions is to provide credit where the private sector (the bond market) has withdrawn its trust. Thus, as of May of 2012, the main question was not what bondholders would do—they had already headed for the exits—but what the Eurozone nations were willing to do through the ECB, and, to a lesser extent, what the IMF was willing to do to keep Greek and Spanish debt viable.

Inherent Flaws in the Eurozone

Many observers have noted that the Euro project has been flawed from the start: there was monetary unio n but not fiscal union. That is, the institutions of the European Union were not empowered to impose fiscal discipline on Greece or Spain or Italy or Portugal to begin with. When easy credit for governments based on the strength of the euro came to an end in 2009–10, the ECB and the IMF had to come to the rescue, but with conditions reminiscent of many IMF loans. The role of Germany as a guarantor of further loans to Greece or Spain or Italy (the so-called "periphery") had become a delicate and difficult political matter within Germany. Most German voters are not especially keen on propping up "profligate" people and politicians in the "periphery," and German Prime Minister Angela Merkel has long insisted on austerity measures as a condition of bailouts by the ECB.

But after the Greek elections in May of 2012, it quickly became apparent that no effective governing coalition could be formed. This meant that new elections would have to take place, with no guarantees that those elections would form an effective governing coalition, either. Without a government that could actually agree on a plan for stabilizing government debt over time, neither the European Central Bank or the IMF would be willing to loan for the monies to Greece. Indeed, the ECB actually with-held some monies from Greece right after the May 2012 election in order to prod the



MAP 1.6

The Euro Zone Nations

Greek political parties to come to some agreement. Without an agreement, Greece would almost certainly default on its debts, would have to exit the euro zone, and would revert to using the drachma.

Classically, a sovereign state in Greece's situation would have its own currency, could print more, devalue it, and come to some sort of equilibrium with external buyers and investors. One of the reasons that credit flowed so easily to Greece before 2008 was that the indebtedness was denominated in Euros, which was regarded as a currency that would not be devalued in that way.

But even if Greece exits the Euro, it will have great difficulty getting credit on regional or global markets. In effect, Greece would still get the austerity that its population has become so tired of; leaving the euro would undermine Greece's banking sector, and it is unlikely that investors would buy Greek government bonds. The Greek default and exit from Euro but also lead investors to avoid any investments in Italy or Spain or Portugal. Finally, commercial contracts with companies now denominated in Euros would create further uncertainties, and fearing further devaluation, non-Greek companies might be less willing to conduct business in Greece unless payment was made in Euros.

The essence of the Greek problem, like Spain's problem, is that even if it stopped repaying all of its debt, the government would still be spending more than it takes in. The bailout money is now the only thing plugging that gap. Without a disciplined plan to reach budget equilibrium in the future, Greece will not attract further bailout money or private sector purchasers of its sovereign debt. Without such a plan, and with the restoration of the drachma, Greece's only option would be more painful cuts from the public sector.

After the election of François Hollande in May of 2012, it remained to be seen what kind of alliance could be struck between the French and German leaders. In response to elections in Greece and France in May of 2012 German Chancellor Angela Merkel reiterated that her government would not soften its demands for austerity, demands that were embodied in the Eurozone fiscal pact from March 2012. Mr. Hollande has advocated a revision to the European fiscal compact, which would move the country toward balanced budgets and less debt. However, Chancellor Merkel has expressed opposition to any changes in the compact.

It is possible that staying in most European countries (although not Greece) could tap financial markets for more money if they were to adopt constitutional pledges to run budget surpluses in good times. German borrowing costs are near record lows because Germany has already adopted such a constitutional amendment. But it does seem doubtful that political leaders would adopt truly binding debt limits. In the meantime, short-term remedies are likely to continue to come from European wide organizations such as the European bailout fund, the European Stability Mechanism or the European Central Bank.

After the fall of the Berlin wall, Eastern European nations that made painful changes to their labor codes and welfare protections were able to write size their budgets and allow the private sector to drive growth. Many observers believe that Mr. Hollande will come to that realization as well. But whether standing firm relative to the Euro periphery will prevent the breakup of the Eurozone remains to be seen.

The direct applicability of the supremacy principle is illustrated by the case of *Costa v. ENEL.* That case involved a challenge to Italy's decision in 1962 to nationalize its private electric generating companies. Mr. Costa, a shareholder in one of those companies, refused to pay his electric bill; and when he was sued by the National Electric Board (ENEL), he defended himself by arguing that the nationalization decree violated the European Community Treaty (then known as the European Economic Community Treaty). The trial court referred the matter to the European Court of Justice. There, ENEL argued that the Court of Justice's decision would be irrelevant because the trial court, being an Italian court, was obliged by Italian law to apply Italian law. The court disagreed, pointing out that some provisions of the EEC Treaty are directly effective and bestow rights on individuals that the agencies of the member states are obliged to respect. The court stated:

> By contrast with ordinary international treaties, the EEC Treaty has created its own legal system which, on the entry into force of the Treaty, became an integral part of the legal systems of the member states and which their courts are bound to apply.
>
> By creating a Community of unlimited duration, having its own institutions, its own personality, its own legal capacity and capacity of representation on the international plane, and, more particularly, real powers stemming from a limitation of sovereignty, or a transfer of powers from the states to the Community, the member states have limited their sovereign rights, albeit within limited fields, and have thus created a body of law which binds both their nationals and themselves.[41]

Thus, not only Mr. Costa but any other individual is entitled to directly invoke the EC Treaty in the courts of the EU member states.

Case 1-4 examines both the obligation of member states to bring their laws into accord with the EU treaties (in particular the European Community Treaty—then known as the EEC Treaty) and the direct effect of those treaties.

[41]Case 6/64, *European Court Reports,* vol. 1964, p. 585 at p. 593 (1964).

CASE 1-4 Commission of the European Communities v. Federal Republic of Germany

Court of Justice of the European Communities Case 274/87

MAP 1.7

The European Union (2011)

The Court

Composed of O. Due, President, T. Koopmans and R. Joliet (Presidents of Chambers), Sir Gordon Slynn, C. N. Kakouris, J. C. Moitinho de Almeida, G. C. Rodríguez Iglesias, M. Díez de Velasco and M. Zuleeg, Judges.

Judgment

By application lodged at the Court Registry on 16 September 1987, the Commission of the European Communities brought an action before the Court under the second paragraph of Article 169 of the EEC Treaty for a declaration that by prohibiting the importation and marketing in its territory of meat products from other Member States which do not comply with Paragraphs 4 and 5 of the Fleisch-Verordnung (Meat Regulation) of 21 January 1982 the Federal Republic of Germany has failed to fulfill its obligations under Article 30 of the EEC Treaty.

The regulation in question prohibits the marketing of meat products which contain ingredients other than meat, subject to exceptions in respect of specified products the composition of which is defined, with a requirement, in certain cases, for specific information to be shown on the packaging or displayed on signs. The ban on marketing those products is supplemented by Paragraph 47, subparagraph 1, of the Lebensmittel und Bedarfsgegenstaendegesetz (Law on foodstuffs and necessities) of 15 August 1974, which prohibits the importation of foodstuffs

which do not comply with German standards. Compliance with those rules is ensured by means of criminal or administrative penalties.

It should be noted at the outset that it is undisputed that the contested rules have a restrictive effect on imports of meat products legally manufactured and marketed in other Member States. The issue between the parties is whether or not the measures in question are justified on the grounds put forward by the German Government, that is to say the protection of health and mandatory requirements relating to consumer protection, fair trading and the common agricultural policy.

It should also be noted at the outset that the contested rules prohibit the marketing of the products concerned in German territory regardless of whether they are national or foreign products.

Justification Based on the Protection of Health Within the Meaning of Article 36 of the Treaty

Before considering the arguments put forward by the defendant Government in this regard, it must be pointed out that the Court has consistently held that, whilst human life and health are among the matters protected by Article 36 and it is therefore for the Member States to decide within the limits set by the Treaty the degree of protection which they wish to ensure, national rules restricting imports are compatible with the Treaty only in so far as they are necessary for the effective protection of human life and health and only if that objective cannot be achieved by measures less restrictive of intra-Community trade (judgments of 20 May 1976 in Case 104/75, *De Peijper* (1976) ECR 613 and of 4 February 1988 in Case 261/85, *Commission v. United Kingdom* (1988) ECR 547).

The German Government maintains that the contested prohibition of importation is justified on grounds relating to the protection of health within the meaning of Article 36 of the Treaty because it is necessary to ensure a sufficient intake of certain essential nutrients contained in meat, especially proteins.

It must be pointed out at once that that argument is contradicted by information which appears in reports on nutrition published in 1980 and 1984 by the German Government itself. Those reports show that protein intake levels in Germany are in general more than adequate and that even in the case of certain groups of the population, particularly young people, whose protein intake is lower than the recommended level, the lower intake poses no threat to health in view of the safety margins incorporated in the relevant recommendations.

It is also clear from those reports that some meat ingredients contain harmful substances such as purine, cholesterol and saturated fatty acids; the reports therefore express some concern about any future increase in the consumption of meat and meat products.

Finally, with regard to the German Government's argument that vegetable proteins have a lower nutritional value than animal proteins, it must be stressed that, as the Court has already stated in its judgment of 23 February 1988 in Case 216/84, *Commission v. France* (1988) ECR 793, a Member State may not invoke public health grounds in order to prohibit the importation of a product by arguing that its nutritional value is lower than another product already available on the market in question, since it is plain that the choice of foodstuffs available to consumers in the Community is such that the mere fact that an imported product has a lower nutritional value does not pose a real threat to human health.

It follows from the foregoing that the contested prohibition of importation may not be justified on grounds relating to the protection of health within the meaning of Article 36 of the Treaty.

Justification Based on Imperative Requirements Relating to Consumer Protection

The German Government maintains that the contested prohibition of importation is necessary for the effective protection of German consumers who, as a result of eating habits which date back several decades, have a clear idea about what they expect from meat products, that is to say that they must be composed exclusively or essentially of meat and comply with the quality standards laid down in Paragraphs 4 and 5 of the Fleisch-Verordnung.

In that regard, it must be borne in mind that, as the Court has repeatedly stressed (in particular in its judgments of 12 March 1987 in Case 178/84 *Commission v. Germany* (1987) ECR 1227 and of 14 July 1988 in Case 407/85 *Drei Glocken GmbH and Another v. Unità sanitaria locale Centro-Sud and Another* (1988) (ECR 4233)), although it is admittedly legitimate to seek to enable consumers who attribute specific qualities to certain products to make their choice in the light of the criteria

they consider essential, that possibility may be ensured by means which do not prevent the importation of products which have been lawfully manufactured and marketed in other Member States and, in particular, by the compulsory affixing of suitable labels giving the nature of the product sold.

It is true that, where meat products are concerned, the indication of all the ingredients may cause difficulties when the products are sold in bulk or listed on restaurant menus. It must nevertheless be observed that it is clear from Council Directive 79/112 on the labelling and presentation of foodstuffs, and particularly Article 12 thereof, that Member States may lay down detailed rules for the labelling of foodstuffs offered for sale to the ultimate consumer without pre-packaging, in order to provide the consumer with the information which is essential for the exercise of his choice and to avoid confusing him with too detailed information.

Moreover, as the Commission has rightly pointed out, the problem of labelling in such situations has already been dealt with in the Fleisch-Verordnung, in particular in Paragraph 5(2) thereof, which lays down special labelling rules for products exempt from the marketing ban when sold in bulk, particularly in restaurants or mass-catering establishments.

It follows that the contested ban on importation may not be justified on the ground of mandatory requirements relating to consumer protection.

Justification Based on Mandatory Requirements Relating to Fair Trading

The German Government further argues that the contested ban on importation constitutes a measure which is necessary in order to protect producers and distributors of pure meat products against unfair competition. Such competition might arise from the fact that some traders or producers could acquire a competitive advantage by using less expensive ingredients of poorer quality without the differences in manufacture being apparent to consumers.

It is sufficient to point out that that argument, based on the consumer's lack of information, has already been dismissed above.

It follows that the contested ban on importation may not be justified on the ground of mandatory requirements relating to fair trading.

Justification Based on Mandatory Requirements Relating to the Common Agricultural Policy

The German Government maintains, finally, that the contested ban on importation is necessary in order to meet certain mandatory requirements relating to the common agricultural policy, and in particular to the aim of stabilizing the market pursued by the common organizations of the markets in beef and veal and pig meat.

That argument cannot be accepted either. As the Court stated in its judgments in Cases 216/84 and 407/85, cited above, once the Community has established a common market organization in a particular sector, the Member States must refrain from taking any unilateral measure, even if that measure is likely to support the common policy.

It is also clear from those judgments that, even if they support a common policy of the Community, national measures may not conflict with one of the fundamental principles of the Community—in this case that of the free movement of goods—unless they are justified by reasons recognized by Community law. As found above, this is not the position with the provisions at issue in the present case.

It follows from all of the foregoing that the alleged breach of obligations under the Treaty has been established. It must therefore be declared that, by prohibiting the importation and marketing in its territory of meat products from other Member States which do not comply with Paragraphs 4 and 5 of the Fleisch-Verordnung, the Federal Republic of Germany has failed to fulfill its obligations under Article 30 of the EEC Treaty.

Casepoint

Article 30 of the Treaty of Rome states that "Quantitative restrictions on imports and all measures having equivalent effect shall, without prejudice to the following provisions, be prohibited between Member States." That prohibition is here read broadly, as the German law dealt with qualitative differences. Still, German law must conform to EU law and to the principle of free movement of goods embraced in Article 30.

The Institutions of the European Union

The main institutions of the EU are (1) the Council of the European Union and the European Council, (2) the European Parliament, and (3) the European Commission. Other important EU bodies include the European Court of Justice, the European Central Bank, the European Economic and Social Committee, the Court of Auditors, and the European Investment Bank.[42]

The Council of the European Union and the European Council

Council of the European Union Representative of the member state governments and the co-legislative body (with Parliament) of the EU.

Council of the European Union[43] The **Council of the European Union** is the main decision-making body of the EU. It exercises co-decision with the European Parliament on a wide array of community issues. Its role is to (1) adopt legislation[44] in conjunction with the Parliament,[45] (2) adopt an annual budget, also in conjunction with Parliament, (3) adopt international agreements, and (4) coordinate the economic policies of the member states.

The Council of the EU is made up of ministers, one from each member state. Each minister is empowered to commit his or her government, and is (accordingly) accountable to that state government. Like the commission, it has a presidency, which is rotated among the member state governments every six months. Participants in the council's meetings change according to the agenda, as there are nine *configurations* of issues that may meet once a month or just two to four times a year. Ministers in General Affairs and External Relations meet monthly, as do Economic and Financial Affairs and Agriculture and Fisheries. Other configurations include Justice and Home Affairs, Employment/Social Policy/Health and Consumer Affairs, Competitiveness, and Transport/Telecommunications/Energy.

Each member state presides over the Council for six months. The minister from the designated state presides (as president) and serves as the organizing force in all legislative and political decisions. The president represents the council and member states in dealing with non-EU states, and represents the Council before the EU Parliament.

European Council The European Council, a different body than the Council of the EU, consists of the heads of state of the member states, along with its own president and the president of the European Commission (nonvoting). It meets at least four times a year, and is charged under the Treaty of Lisbon with defining "the general political directions and priorities" of the Union. It is chaired by the president or prime minister of the EU country holding the presidency of the Council of the European Union at the time. The European Council acts as the principal initiator of overall policy for the EU; under the Maastricht Treaty, it was empowered to settle issues that the Council of the European Union could not agree on.

Unlike the Council of the EU, which is responsible for EU rule making, the European Council focuses on establishing general policies and goals for the EU. It also deals with urgent foreign policy issues through the common foreign and security policy (CFSP), which aims to allow the EU to speak with one voice on diplomatic matters. For example, in March 2011, the European Council imposed sanctions on the regime of Muammar el Qaddafi in Libya; these sanctions included freezing assets

---

[42]http://europa.eu/abc/12lessons/lesson_4/index_en.htm.

[43]The council's Web site is at www.consilium.europa.eu./homepage.aspx?lang=en.

[44]EU legislation is given various names. It is called a *regulation* when it applies directly; a *decision* when it is binding only on the member states, companies, or individuals to whom it is addressed; a *directive* when it lays down compulsory objectives but leaves it to the member states to translate these into national legislation; and a *recommendation* or *opinion* when it is not binding.

[45]The decisions of the Council of the EU may be made by simple majority, qualified majority, or unanimity, depending on the action it is taking. Most legislation is adopted by a qualified majority vote. A minimum of 255 votes out of 345 (73.9 percent) is required to reach a qualified majority. In addition,

- a majority of member states (in some cases two thirds) must approve the decision, and
- any member state may ask for confirmation that the votes cast in favor represent at least 62 percent of the EU's total population.

France, Germany, Italy, and the United Kingdom each have 29 votes; Spain and Poland have 27; Romania has 14; Belgium, Greece, Czech Republic, Hungary, and Portugal have 12; the Netherlands has 13; Austria, Bulgaria, and Sweden have 10; Denmark, Finland, Ireland, Lithuania, and Slovakia have 7; Luxembourg, Estonia, Cyprus, Latvia, and Slovenia have 4; and Malta has 3 votes. The cases in which a qualified majority voting procedure may be used include decisions relating to admitting new members to the EU, to research and technology, to regional policy issues, and to improvement of the working environment.

of numerous Libyan entities. In September 2011, after rebel forces gained control of the nation's capitol, Tripoli, the Council rescinded that order, freeing assets for 28 specified Libyan entities.

The home page of the European Council is at
www.european-council.europa.eu/home-page.aspx?lang=en.

European Commission The **European Commission** is the EU's executive branch, but also has some legislative functions.[46] That is, it drafts legislation for submission to the Council and the Parliament, and once the legislation is adopted it is responsible for its implementation. The commission also is responsible for overseeing the implementation of the treaties that establish the EU. Additionally, it represents the EU internationally.

European Commission The administrative and executive arm of the EU.

The commission is currently composed of 27 individuals appointed by Parliament for five-year terms (see Figure 1.4). The president of the commission—currently José Manuel Barroso of Portugal—is nominated by the European Council and approved by the Council of the European Union. The other commissioners are nominated by the member states in consultation with the president. The large states—Germany, France, Italy, Spain, and the United Kingdom—nominate two commissioners each and the small states one each. All of the commissioners must act only in the interest of the EU, and they are forbidden to receive instructions from any national government. Parliament can force the commission to resign by adopting a motion of censure.[47]

Commission decisions are made collegially, even though each commissioner is given responsibility for specific activities. The tasks of the commission are to (1) ensure that EU rules are respected (to do this, the commission has investigative powers, and it can impose fines on individuals or companies it finds to be in breach of the rules; it can also take member states that fail to respect their obligations before the European Court of Justice), (2) propose to the European Council measures likely to advance the development of EU policies, (3) implement EU policies, and (4) manage the funds that make up most of the EU budget.

The commission has an administrative staff of some 25,000 officials divided between 23 directorates-general that are located primarily in Brussels and Luxembourg. Of these officials, more than one in five are employed as translators (a reflection of the EU's use of 11 equally authoritative languages to carry out its business).

The European Parliament The **European Parliament** has 786 members elected every five years by universal suffrage. The number of members (786) elected by each state is shown in Table 1.3.

European Parliament The co-legislative body (with the Council of the EU) and the main supervisory institution of the EU.

Members are grouped by political affiliation rather than nationality. Nearly 100 political parties are represented in the Parliament, ranging from far left to far right. These are organized in a limited number of political groups. It holds most of its plenary sessions (session attended by all of its members) in Strasbourg, France. Other plenary sessions and committee meetings are held in Brussels, Belgium. Its staff, known as the General Secretariat, is located in Luxembourg.

FIGURE 1.4

The "Barroso II" Commission, February 2012

Source: Audiovisual Library of the European Commission, 2012

[46]Information about the commission is posted at http://ec.europa.eu/index_en.htm.

[47]The Parliament had never censured the commission, which requires the support of an absolute majority of members and two-thirds of the votes cast. In March 1999, however, following an investigation into allegations of mismanagement by a committee of independent experts mandated by Parliament, the commission chose to resign rather than face censure by Parliament.

TABLE 1.3

The number of members of the european parliament from each country

Germany	99	The Netherlands	27	Austria	18
France	78	Belgium	24	Denmark	14
Italy	78	Greece	24	Finland	14
United Kingdom	78	Portugal	24	Ireland	13
Spain	54	Sweden	19	Luxembourg	6
Bulgaria	18	Cyprus	6	Czech Republic	24
Estonia	6	Hungary	24	Latvia	9
Lithuania	13	Malta	5	Poland	54
Romania	36	Slovakia	14	Slovenia	7

Since its first election in 1979, Parliament has acquired increased powers. At first only a deliberative body, it now has three main roles: (1) it has oversight authority over all EU institutions, (2) it shares legislative power with the Council of the EU, and (3) it determines the EU's annual budget in conjunction with the Council of the EU.

Parliament's oversight authority extends beyond its power to appoint and censure the European Commission (discussed earlier). Most importantly, it has limited oversight authority over the Council of the EU. Its members may ask the council to respond to written and oral questions, and the president of the council attends the plenary sessions and takes part in important debates.

EU legislation is made jointly by Parliament and the Council of the EU. Prior to the adoption of the 1992 EU Treaty, the council could adopt legislation after consulting Parliament, regardless of Parliament's recommendations. Now most legislation is adopted through a process known as *co-decision.* This requires draft legislation prepared by the commission to be reviewed twice by Parliament and the council. If the two co-legislative bodies cannot agree, a *conciliation committee* made up of council and Parliament representatives, with the participation of the commission, attempts to reach a compromise draft. If a compromise draft is reached, it is submitted to Parliament and the council for a third review for its final adoption.

The co-decision process is used for adopting legislation governing the common internal market; the free movement of workers, research, and technological development; the environment; consumer protection; education; culture; and health.[48]

For certain kinds of legislation, Parliament only has a veto right: it may not amend or modify a commission proposal. This power, known as *assent,* applies to proposals for the accession of new members, to the adoption of certain international agreements, and to certain rules relating to the European Central Bank. If Parliament does not give its assent, the legislation cannot be adopted. For other legislation, notably for tax matters and the review of farm price supports, Parliament may only express an opinion.

The process by which the EU's annual budget is adopted is somewhat similar to the co-decision procedure. The commission submits a draft budget to Parliament and the council, each of which may review it twice. If they are unable to agree, the council makes the final decision on *compulsory expenditures* (mainly agricultural expenditures and expenditures related to international agreements with third countries). Parliament has the final say on *noncompulsory expenditures* and the final adoption of the budget in its entirety.

European Court of Justice
The supreme tribunal of the EU.

European Court of Justice The **Court of Justice**[49] is composed of 27 judges and 8 advocates-general. The judges and advocates-general are appointed from among lawyers whose independence is beyond question and who have the necessary qualifications for appointment in each of their countries to the highest judicial offices. The 27 judges elect a president for a renewable term of three years. The president directs the work of the staff and of the court and presides at hearings at the Full Court or the Grand Chamber.

Eight advocates-general assist the judges of the Court of Justice in carrying out their duties. An advocate-general is an official, commonly found in courts in civil law countries, who prepares a

[48]More details on the co-decision process may be found at http://ec.europa.eu/codecision/stepbystep/text/index_en.htm.

[49]The European Court of Justice's Web site is at http://europa.eu/about-eu/institutions-bodies/court-justice/index_en.htm.

detailed brief analyzing the arguments of the parties and suggesting how the court should decide the case. In many respects, an advocate-general's brief is similar to an opinion prepared by a judge in a common-law country. The reason is that the opinions handed down by civil law courts (including the European Court of Justice) generally do not engage in an extensive analysis of the issues; rather, they state a conclusion and a concise reason for their conclusion. Often, but not always, the court will adopt (sometimes in the fewest of words) the reasoning of the advocate-general.

The Court will sit as a full court, in a Grand Chamber of 13 judges or in Chambers of three or five judges. The Statute of the Court prescribes when a case must be considered by the full court, such as proceedings to dismiss the European Ombudsman or a member of the European Commission who has failed to fulfill his or her obligation, or where the Court considers that a case is of exceptional importance. The Court also sits in Grand Chamber when a member state or an institution that is a party to the proceedings so requests, and in particularly complex or important cases.

Other cases are heard by Chambers of three or five judges. The presidents of the Chambers of five judges are elected for three years, and those of the Chambers of three judges for one year.

The full Court will sit in "plenary sessions" for "contentious cases."[50] It hears four kinds of contentious cases: (1) appeals from the Court of First Instance; (2) complaints brought by the commission or by one member state against another member state for failure of the latter to meet its obligations under EU law; (3) complaints brought by a member state against an EU institution or its servants for failing to act or for injuries they may have caused; and (4) actions brought by a member state, the council, the commission, or Parliament seeking the annulment of an EU legal measure.[51] Preliminary rulings come about when a national court is hearing a case involving an EU law and the national court is in doubt as to the interpretation or validity of that law. In such a case, the national court may, and in some cases must, request a preliminary ruling from the Court of Justice.[52]

In addition to these four main institutions of the European Union are several other committees and bodies that influence the course of law and policy within the Union.

European Economic and Social Committee Before the Council of the EU can adopt a proposal, opinions first must be obtained from the Parliament and, in many cases, from the EU's **Economic and Social Committee.**[53] In essence, this consultative body is an institutionalized lobby. Its 222 members represent a wide range of special-interest groups, including employers, trade unions, consumers, farmers, and so on.

Economic and Social Committee
An EU consultative body made up of special-interest groups.

European Court of First Instance The **Court of First Instance**[54] is the EU's trial court for cases brought by member states against the European Commission, cases seeking compensation for damage caused by the European Community institutions or their staff, cases relating to community trademarks, cases where individuals challenge legislation or actions taken by the EU institutions or challenge an institution's failure to act,[55] and cases deciding employment disputes between EU institutions and their employees. The court consists of at least one judge from each member state (27 in 2007). The judges are appointed by agreement of the member state governments for a renewable term of six years. The judges appoint their president for a period of three years from among themselves. The court sits in chambers of three or five judges to decide most disputes, but it may sit in plenary session to decide important cases.

European Court of First Instance
The EU's trial court with jurisdiction over (1) disputes brought by private persons against an EU institution and (2) employment disputes between EU institutions and their employees.

[50] European Union Treaty, Article 165. Every three years there is a partial replacement of judges. Seven and eight are replaced alternatively. Id., Article 176.

[51] Articles 169–171 of the European Union Treaty provide for actions for infringement against a member state for failing to observe an EU treaty or a law derived from a treaty; Articles 173, 174, and 176 provide for an action to annul the acts taken by the Union's institutions in violation of the EU treaties; Articles 175 and 176 provide for action to compel an EU institution to take action; and Articles 178 and 215(2) provide for an action for damages arising from the noncontractual (i.e., tort) liability of the Union.

[52] The court will only hear requests (1) that involve a genuine issue of Union law and (2) that the referring court regards as being necessary to its ability to give a judgment.

[53] The European Economic and Social Committee's Web site is at http://eesc.europa.eu.

[54] For information on the European Court of First Instance, see www.eubusiness.com/topics/eulaw/court-first-instance/.

[55] Individuals may seek the annulment of a legal measure that is of direct and individual concern to them; they may bring actions to compel an EU institution to act; and they may seek damages for injuries caused by EU institutions or servants in the performance of their duties.

European Central Bank (ECB)
The central bank of the EU.

European Central Bank The **European Central Bank (ECB)**, which came into being on January 1, 1999, is responsible for carrying out the EU's monetary policy. The ECB's decision-making bodies are a governing council and an executive board. These oversee the European System of Central Banks (ESCB). The ESCB determines the amount of money in circulation, conducts foreign-exchange operations, holds and manages the member states' official foreign reserves, and ensures the smooth operation of payment systems. During 2011, the ECB experienced serious stress as the "Greek Debt Crisis" worsened (see Reading 1-2).

European Court of Auditors
The institution responsible for supervising the EU's budget.

European Court of Auditors The EU budget, which is funded from customs duties and agricultural levies on external imports and from a portion of the value-added tax (VAT) collected in the member states, is supervised by a **Court of Auditors**[56] made up of 15 individuals appointed by mutual agreement of the European Council for six-year terms. The Court of Auditors has wide-ranging powers to examine the legality and regularity of EU receipts and expenditures and to ensure the sound financial management of the budget.

Other IGOs IGOs can be categorized into two basic groups: (1) general IGOs that have competence in a wide variety of fields, including politics, security, culture, and economics, like the United Nations, and (2) specialized IGOs that limit their activities to a particular field.

General IGOs Three prominent regional general IGOs are devoted to political cooperation, security, and the promotion of economic, social, and cultural development. They are the Council of Europe,[57] the African Union (AU),[58] and the Organization of American States (OAS).[59] The oldest is the OAS, which was established in its present form in 1948. The Council of Europe was created in 1949, and the AU (which replaced the Organization of African Unity, founded in 1963) came into being in 2002. Each limits membership to states from its region. The Council of Europe further limits its membership to states committed to the rule of law and the enjoyment of human rights. Spain and Portugal, for example, were excluded from the council until the mid-1970s because they did not have democratic regimes. The OAS admits any independent American state except those involved in territorial disputes. Belize and Guyana were not admitted until 1993 because of this requirement. Any independent sovereign African state is eligible for membership in the AU with the exception of countries ruled by white minority regimes.

The institutional structure of all three of these organizations is quite similar. The Council of Europe is different in one important respect, however. It has a Parliamentary Assembly whose representatives are elected by the national parliaments of the member states and whose numbers vary in proportion to the population of each member. The representatives do not vote as a block representing

---

[56]The European Court of Auditors' Web site is at http://europa.eu/about-eu/institutions-bodies/court-auditors/index_en.htm

[57]As of August 2011, the Council of Europe had 48 members: Albania, Andorra, Armenia, Austria, Azerbaijan, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Georgia, Germany, Greece, Hungary, Iceland, Ireland, Italy, Latvia, Liechtenstein, Lithuania, Luxembourg, Macedonia, Malta, Moldova, Monaco, Montenegro, the Netherlands, Norway, Poland, Portugal, Romania, the Russian Federation, San Marino, Serbia, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey, Ukraine, the United Kingdom, and the former Yugoslav Republic of Macedonia. See the list of member states on the council's Web site at www.coe.int/lportal/web/coe-portal.

[58]The AU has as its goals the economic, political, and social integration and development of the African people. It is the successor to the Organization of African Union (OAU), which was founded in 1963 with the goals of eradicating all forms of colonialism in Africa and promoting the sovereignty, territorial integrity, and independence of its members. As of 2011, the AU had 53 members: Algeria, Angola, Benin, Botswana, Burkina Faso, Burundi, Cameroon, Cape Verde, the Central African Republic, Chad, Comoros, Republic of the Congo (Brazaville), Cote D'Ivoire, Democratic Republic of Congo, Djibouti, Egypt, Equatorial Guinea, Eritrea, Ethiopia, Gabon, Gambia, Ghana, Guinea, Guinea-Bissau, Kenya, Lesotho, Liberia, Libya, Madagascar, Malawi, Mali, Mauritania, Mauritius, Mozambique, Namibia, Niger, Nigeria, Rwanda, the Saharawi Arab Democratic Republic, Sao Tome and Principe, Senegal, Seychelles, Sierra Leone, Somalia, South Africa, Republic of Sudan (Khartoum), Swaziland, Tanzania, Togo, Tunisia, Uganda, Zambia, and Zimbabwe. The AU home page is at www.africa-union.org. For the history and structure of the AU, see the AU Summit 2002 page maintained by the South African Department of Foreign Affairs. The AU's Web site is at www.au.int/en/.

[59]The OAS has as its objectives "peace and justice, [and] promoting solidarity among the American states." It has 35 members: Antigua and Barbuda, Argentina, the Bahamas, Barbados, Belize, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Cuba (suspended from participating in OAS activities in 1962 but not from membership), Dominica, the Dominican Republic, Ecuador, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Saint Lucia, Saint Vincent and the Grenadines, Suriname, Saint Kitts and Nevis, Trinidad and Tobago, the United States of America, Uruguay, and Venezuela. See the list of member states on the OAS's Web site at www.oas.org/en/member_states/default.asp.

their states, but individually or as part of political parties that have formed within the assembly. This means that individuals influence the deliberations more than governments.

All three organizations seek to promote cooperation between their members in a variety of fields. But because of differing circumstances, each has a slightly different agenda. The Council of Europe has stressed legal, social, and cultural matters; the OAS has emphasized issues of peace and security; and the newly established AU is concentrating on political cooperation. Human rights are an important interest of all three. Individuals within member states of the Council of Europe may bring human rights cases directly to a European Court of Human Rights.[60] Within the OAS, individuals may submit complaints to an Inter-American Commission on Human Rights. After carrying out an independent investigation, the commission will either submit a report to the OAS's Council or, if the member state concerned has recognized the court's jurisdiction, will forward the complaint to the Inter-American Court of Human Rights. In Africa, the AU has a Human Rights Commission with investigatory powers similar to those of the Inter-American Commission. Ironically, the current form of the AU was conceived by Muammar el Qaddafi, the ex-Libyan leader. The union has plans for the future that include the establishment of a central bank, with a single currency by 2023, and of a human rights court. In addition to these three regional general IGOs, there are three notable nonregional general IGOs: the Commonwealth of Nations,[61] the Arab League,[62] and the Commonwealth of Independent States.[63] At one time the Commonwealth of Nations limited its membership to countries that were formerly part of the British Empire; the Arab League is open only to Arab nations; and the Commonwealth of Independent States is made up of former republics of the Soviet Union. Unlike other general IGOs, the Commonwealth of Nations has no charter (or, at least, no written charter) and, beyond a secretariat, no organs other than a biennial meeting of heads of government, annual meetings of finance ministers, and regular meetings of other ministers (especially those of education, law, and health). The Arab League has a council made up of representatives of each member state, several committees that assist the council, and a secretariat. In addition, Arab kings and presidents meet at regular Arab League summit conferences. The Commonwealth of Independent States was originally set up to provide for the orderly dissolution of the former Soviet Union. It now seeks to promote cooperation among the former Soviet republics. Each of these organizations encourages cooperation among its members but, unlike the Council of Europe or the OAS, which perform many service functions, they are primarily forum organizations.

Specialized IGOs There is a whole range of specialized IGOs that deal with a wide variety of issues of mutual interest to their members. Examples are the European Space Agency,[64] the International

---

[60]See the court's home page at www.echr.coe.int/echr/homepage_EN. See also a video on the Court at www.echr.coe.int/ECHR/EN/Header/The+Court/Introduction/Video+on+the+Court/.

[61]The Commonwealth of Nations was established in 1931 to promote cooperation among states that were once part of the British Empire and that recognize the British monarchy as their heads of state. All but two of the current Commonwealth countries (Mozambique and Rwanda) were formerly part of the British Empire. The member states agree to work within common values and goals as outlined in the Singapore Declaration. These values include the promotion of democracy, human rights, good governance, the rule of law, individual liberty, egalitarianism, free trade, multilateralism, and world peace.

The Commonwealth of Nations has 54 members: Antigua and Barbuda, Australia, the Bahamas, Bangladesh, Barbados, Belize, Botswana, Brunei, Cameroon, Canada, Cyprus, Dominica, Fiji, The Gambia, Ghana, Grenada, Guyana, India, Jamaica, Kenya, Kiribati, Lesotho, Malawi, Malaysia, the Maldives, Malta, Mauritius, Mozambique, Namibia, Nauru, New Zealand, Nigeria (suspended in 1995), Pakistan, Papua New Guinea, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Seychelles, Sierra Leone, Singapore, Solomon Islands, South Africa, Sri Lanka, Swaziland, Tanzania, Tonga, Trinidad and Tobago, Tuvalu, the United Kingdom, Uganda, Vanuatu, Western Samoa, Zambia, and Zimbabwe. The Republic of Ireland is associated with it for commercial purposes but is not a member. See the Commonwealth's home page at www.commonwealth-of-nations.org/Commonwealth-Home.

[62]Founded in 1945, the League of Arab States (Arab League) seeks to promote political, economic, cultural, and communication ties among its members and to mediate internal disputes. As of 2011 it had 22 members: Algeria, Bahrain, Comoros, Djibouti, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Qatar, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, the United Arab Emirates, Yemen, and the Palestine Liberation Organization.

[63]Established in 1991, its members are Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, the Russian Federation, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan. See the Commonwealth's home page at www.cisstat.com/eng/cis.htm.

[64]Founded in 1975, it has 19 state members. See the European Space Agency's home page at www.esa.int/esaCP.

TABLE 1.4

Customs unions in the developing world

ANCOM	Andean Common Market. Established in 1992 to create a free trade zone. A common external tariff was adopted in 1993. Members are Bolivia, Colombia, Ecuador, Peru, and Venezuela.
CACM	Central American Common Market. Established in 1997 to replace a common market of the same name that functioned from 1960 to 1969. Members are Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua.
CARICOM	Caribbean Community. Established in 1973, it replaced the Caribbean Free Trade Association created in 1965. Members are Antigua and Barbuda, the Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, and Trinidad and Tobago. In 1989, the community agreed to create a single market and economy (unofficially known as the Caribbean Common Market) by 1994.
COMESA	Common Market for Eastern and Southern Africa (formerly Preferential Trade Area for Eastern and Southern African States). Established in 1981 to create a common market. Members are Angola, Burundi, Comoros, Democratic Republic of the Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Sudan, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe.
ECCAS	Economic Community of Central African States. Established in 1981 to gradually create a common market. Members are Burundi, Cameroon, Central African Republic, Chad, Democratic Republic of the Congo, Republic of the Congo, Equatorial Guinea, Gabon, Rwanda, and São Tomé and Príncipe.
ECOWAS	Economic Community of West African States. Established in 1975 to promote economic development and gradually create a common market. Members are Benin, Burkina Faso, Cape Verde, Gambia, Ghana, Guinea, Guinea-Bissau, Ivory Coast, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone, and Togo.
SACU	Southern African Customs Union. Established in 1969 to promote free trade and cooperation in customs matters. Members are Botswana, Lesotho, Namibia, South Africa, and Swaziland.
SADC	Southern African Development Community. Established in 1979, it seeks to establish an economic union among its members: Angola, Botswana, Congo (Kinshasa), Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia, and Zimbabwe.
UDEAC	Central African Customs and Economic Union. Established in 1964 to promote the gradual and progressive creation of a common market. Members are Cameroon, Central African Republic, Chad, Republic of the Congo, Equatorial Guinea, and Gabon.

customs union
A group of states that have reduced or eliminated trade barriers among themselves and have established a common external tariff.

free trade area (FTA)
A group of states that have reduced or eliminated trade barriers among themselves but maintain their individual tariffs in dealing with other states.

Coffee Organization,[65] the International Criminal Police Organization (INTERPOL),[66] and the International Institute for the Unification of Private Law (UNIDROIT).[67]

One important group of specialized IGOs promotes economic cooperation and development. This group is made up of several types of organizations, the most developed of which are the common markets or customs unions, such as the EU. Customs unions are intended to eliminate trade barriers between their members and to establish common external tariffs. Aside from the EU, the success of other **customs unions** (see Table 1.4) has been limited for several reasons. First, the economies of their member states—all developing countries—tend to compete with, rather than complement, each other. Second, many of the member states only recently gained independence, and they are reluctant to surrender that independence to a central authority. Third, the economic gains made within these unions have often been unequal, prompting those states that have not shared fully to become discouraged and withdraw.

A second type of cooperative economic IGO is the **free trade area (FTA)**. FTAs are set up to eliminate trade barriers between member states without establishing a common external tariff. Examples

[65]Founded in 1963, it has 33 exporting state members and 32 importing state members (27 from the EU). See its home page at www.ico.org.

[66]Founded in 1923, it has 186 state members. See INTERPOL's home page at www.interpol.int.

[67]Founded in 1926, it has 61 state members. See UNIDROIT's home page at www.unidroit.org.

include the Association of Southeast Asian Nations Free Trade Area (ASEAN-FTA),[68] the Central European Free Trade Area (CEFTA),[69] the European Free Trade Association (EFTA),[70] the Southern Cone Common Market (MERCOSUR),[71] and the North American Free Trade Agreement (NAFTA).[72]

Finally, a third type of IGO involved in economic cooperation and development is the **economic consultative association**. The functions of a consultative association are to gather and exchange statistics and information, to coordinate the economic policies of member states, and to promote mutual trade cooperation. Examples are the Organization for Economic Cooperation and Development (OECD),[73] the Colombo Plan for Cooperative Economic and Social Development in Asia and the Pacific (Colombo Plan),[74] the Group of 77 (G-77),[75] and the Organization of Petroleum Exporting Countries (OPEC).[76]

economic consultative association
A group of states that exchanges information, coordinates economic policy, and promotes trade cooperation.

Nongovernmental Organizations **Nongovernmental organizations (NGOs)** include nonprofit and for-profit NGOs. **Nonprofit NGOs** serve as coordinating agencies for private national groups in international affairs. Examples of nonprofit NGOs are the International Air Transport Association,[77] the International Bar Association,[78] Amnesty International,[79] the International Committee of the Red Cross,[80] Greenpeace,[81] and Transparency International.[82]

nongovernmental organization (NGO)
An international organization made up of organizations other than states.

nonprofit NGO
An international organization that draws its members from among individuals and domestic organizations (sometimes including local governments, such as municipalities) who reside in two or more states.

---

[68]Established in 1992 to facilitate the free exchange of goods in Southeast Asia within 15 years. Its members are Brunei, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Cambodia, and Vietnam. See the Association of Southeast Asian Nations' Web site at www.aseansec.org.

[69]Established in 1993 to progressively create a free trade area by January 1, 2001. Its members are Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania, the Slovak Republic, and Slovenia. See its home page at www.cefta2006.com.

[70]Established in 1960, EFTA presently has only four members: Iceland, Liechtenstein, Norway, and Switzerland. In 1991, EFTA and the European Community (now the European Union) entered into a trade agreement (called the European Economic Area) that joined the EU and the three EFTA states to form the world's largest free trade area. See EFTA's home page at www.efta.int.

[71]MERCOSUR (the Mercado Común Sudamericano) was established in 1991. Its members are Argentina, Brazil, Paraguay, and Uruguay. Bolivia, Chile, Colombia, Ecuador, and Peru currently have associate member status. Venezuela signed a membership agreement on June 17, 2006. See the Uruguayan embassy Web site at www.sice.oas.org/trade/mrcsr/mrcsrtoc.asp for a description of MERCOSUR.

[72]Agreed to in 1993 by Canada, Mexico, and the United States, NAFTA came into effect January 1, 1994. See the U.S. Department of Commerce's NAFTA Web site at http://export.gov/FTA/nafta/index.asp. See also the NAFTA secretariat's home page at www.nafta-sec-alena.org.

[73]Established in 1961, OECD has 32 members: Australia, Austria, Belgium, Canada, Chile, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. The goals of OECD are to help "member countries promote economic growth, employment and improved standards of living through the coordination of policy" and to encourage "the sound and harmonious development of the world economy and improve the lot of developing countries, particularly the poorest." See the OECD home page at www.oecd.org.

[74]Established in 1959, the Colombo Plan for Cooperative Economic and Social Development in Asia and the Pacific seeks to aid the economic development of its Asian members. There are 26 members. Its Web site is at www.colombo-plan.org.

[75]Established in 1967 following the first meeting of the UN Conference on Trade and Development (UNCTAD). Originally, an ad hoc group of 77 developing countries that sought to coordinate their negotiating positions within UNCTAD, the Group of 77 now functions as a Third World negotiating block in its dealings with the developed world. The G-77 promotes mutual cooperation and the establishment of a "New Economic Order" (to give international negotiating power to the Third World). At present there are 133 members. See the Group of 77's home page at www.g77.org.

[76]Established in 1960, OPEC attempts to set world oil prices by coordinating the oil production of its member states. There are 12 OPEC members: Algeria, Angola, Ecuador, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, the United Arab Emirates, and Venezuela. See the OPEC home page at www.opec.org.

[77]Founded in 1945, the International Air Transport Association represents 230 airlines in promoting an economically viable international air transport industry. See the IATA home page at www.iata.org.

[78]Founded in 1947, the International Bar Association promotes the exchange of information, the discussion of legal issues, and the independence of the profession. It represents 195 member organizations and 30,000 individual members in 183 countries. See its home page at www.ibanet.org.

[79]Founded in 1961, Amnesty International undertakes campaigns to free prisoners of conscience, ensure fair and prompt trials for political prisoners, abolish cruel and unusual punishment, and end extrajudicial executions. It is made up of more than 4,300 local groups and approximately 3 million members and supporters in 150 countries. See its home page at www.amnesty.org.

[80]Founded in 1863, the International Committee of the Red Cross seeks to help all victims of war and internal violence by coordinating the activities of 175 national Red Cross and Red Crescent societies. See the ICRC home page at www.icrc.org.

[81]Greenpeace International is a prominent NGO that confronts polluters and works with people, governments, and corporations for the long-term stability of Earth's ecosystems (forests, oceans, soils) and opposes all forms of nuclear energy. See the Greenpeace International Web site at www.greenpeace.org/international/en/.

[82]Transparency International works with business, governments, and citizens to oppose bribery and corruption worldwide. TI maintains an active and influential ranking of the most corrupt governments in the world. Its Web site is at www.transparency.org.

multinational enterprise (MNE)
Business firm operating branches, subsidiaries, or joint ventures in two or more states.

For-profit NGOs, also known as *transnational corporations* or **multinational enterprises (MNEs)**, are businesses operating branches, subsidiaries, or joint ventures in two or more countries. The organizational structures of MNEs are as diverse as those of any national business. They may invest in other businesses abroad; they may establish physical plants with management, labor, and financing overseas; they may have a single central headquarters; or they may be loosely coordinated through contractual agreements.

States perceive MNEs both as necessities and as threats, and they have tried to work together to adopt international regulations both to control and to promote them. The International Chamber of Commerce, the Organization for Economic Cooperation and Development, the International Labor Organization, and the United Nations Commission on Transnational Corporations have each produced codes of conduct for MNEs. These codes' influence, however, has been limited because they are only suggested guidelines.

In particular, the MNEs have acquired the authority to enter into international agreements with states and to sue states in at least one international tribunal. The right to sue a state is granted in the Convention on the Settlement of International Disputes between States and Nationals of Other States, adopted in 1965. This Convention, sponsored by the World Bank,[83] is meant to encourage investment in developing countries. To do this, it allows MNEs to enter into agreements with developing countries, and it requires both the MNEs and the countries to resolve any disputes about their agreements using a mandatory mechanism of conciliation and **arbitration**. Currently, 126 states are parties to the convention.

arbitration
(From Latin *arbitrari:* "to give judgment.") The process by which parties to a dispute submit their differences to the judgment of an impartial third person or group selected by mutual consent.

F. The Rights of Individuals Under International Law

International law looks upon individuals in two different ways: (1) it ignores them or (2) it treats them as its subjects. The traditional view is to ignore them. This is based on the idea that international law (or, more particularly, the *law of nations*) applies only to states. Some writers still believe that this is the only proper way for international law to treat individuals. For example, the Chinese international law writer K'ung Meng has this to say:

> [A]ccording to the fundamental characteristics of international law (it is the law among states), individuals can only be subjects of municipal law and cannot be subjects of international law. In international relations, individuals are represented by their own countries and if rights and interests (such as entry, residence, employment, and property) are violated in a foreign country, individuals should negotiate with the state concerned through the organs of their home country. Only their home country enjoys the rights of diplomatic protection in international law.[84]

Even though individuals have no direct rights according to this traditional view, they do have derivative rights. That is, as K'ung Meng points out in the preceding excerpt, the state of which an individual is a national can seek redress on behalf of that individual from any foreign state that causes the individual injury. The rationale for allowing such action by the individual's state of nationality is based on the notion that an injury to a national is an injury to the state.

state responsibility
Liability of a state for the injuries that it causes to foreign persons.

The traditional international law concept that allows a state to seek compensation from other states for injuries done to its nationals is known as the law of **state responsibility**. Although it aims to protect individuals from virtually any kind of mistreatment by foreign states, the law of state responsibility gives individuals few rights to litigate in courts; generally, it does not give them the right to pursue their own claims or the right to protest the actions of their own national state. (The law of state responsibility is discussed more fully in Chapter 2.)

human rights
Basic rights intended to protect all people from cruel and inhumane treatment, threats to their lives, and persecution.

The second way in which international law looks upon individuals is to treat them as its subjects. This view—one developed only over the last half-century—regards individuals as having basic **human rights** and, significantly, the right to assert claims on their own behalf against states, including

[83]The World Bank's Web site is at www.worldbank.org.

[84]K'ung Meng, "A Criticism of the Theories of Bourgeois International Law Concerning the Subjects of International Law and Recognition of States," *Kuo-chi wen-tt'i yen-chiu,* no. 2, p. 44 (1960), translated in Jerome Cohen and Hungdah Chiu, *People's China and International Law: A Documentary Study,* vol. 1, p. 97 (1974).

TABLE 1.5

Comparison of the law of state responsibility and international human rights law

	Law of State Responsibility	International Human Rights Law
Basis of a claim	Any loss of property or personal injury	Injuries defined by treaty or statutes such as the U.S. Alien Tort Statute
Claimant	The state of which the injured individual is a national	The injured individual
Defendant	A foreign state	Any state

the state of their nationality. In comparison with the law of state responsibility, however, the kinds of claims that individuals can raise are limited. Historically, they could only be based on rights granted in treaties or in widely recognized international declarations. However, recent developments in U.S. law under the Alien Tort Statute (ATS) have allowed individuals to sue foreign sovereigns for violations of "the law of nations." (See Chapter 8 for discussion of recent ATS cases such as *Kiobel v. Royal Dutch Petroleum* [2011]). Table 1.5 compares the scope and nature of the law of state responsibility with that of international human rights law.

Case 1-5 examines the differences between the traditional law of state responsibility and international human rights law.

CASE 1-5 De Sanchez v. Banco Central De Nicaragua

United States, Court of Appeals, Circuit, 1985. *Federal Reporter, Second Series,* vol. 770, p. 1385 (1985); *International Law Reports,* vol. 88, p. 76 (1992).

MAP 1.8

Nicaragua (1985)

Opinion by Judge Goldberg

In July 1979, the Nicaraguan government of General Anastasio Somoza fell to the Sandinista revolutionaries. As usually occurs, members of the old regime fled the country to escape the reach of "revolutionary justice." But where defeated aristocracies once emigrated to London or Paris, now they seem to wind up in Miami. One of the emigres—Mrs. Josefina Navarro de Sanchez, the wife of President Somoza's former Minister of Defense—brought the present suit

to collect on a check for $150,000 issued to her by the Nicaraguan Central Bank (Banco Central de Nicaragua) shortly before Somoza's fall. Mrs. Sanchez was unable to cash this check after the new government assumed power and placed a stop-payment order on it.

[Mrs. Sanchez then brought suit against the Banco Central in a United States court seeking an order to make it honor the check (which was drawn on a U.S. bank). The trial court instead granted Banco Central's motion for a summary judgment and dismissed the suit. Mrs. Sanchez appealed. The central issue on appeal was whether an individual (Mrs. Sanchez) who is a national of a state (Nicaragua) can sue an agency of that state (the Banco Central) in another state's courts for an alleged contractual breach.] . . .

International law, as its name suggests, deals with relations between sovereign states, not between states and individuals. Nations, not individuals, have been its traditional subjects. Injuries to individuals have been cognizable only where they implicate two or more different nations: if one state injures the national of another state, then this can give rise to a violation of international law since the individual's injury is viewed as an injury to his state. As long as a nation injures only its own nationals, however, then no other state's interest is involved; the injury is a purely domestic affair, to be resolved within the confines of the nation itself.[85]

Recently, this traditional dichotomy between injuries to states and to individuals—and between injuries to homegrown and to alien individuals—has begun to erode. The international human rights movement is premised on the belief that international law sets a minimum standard not only for the treatment of aliens but also for the treatment of human beings generally. Nevertheless, the standards of human rights that have been generally accepted—and hence incorporated into the law of nations—are still limited. They encompass only such basic rights as the right not to be murdered, tortured, or otherwise subjected to cruel, inhumane, or degrading punishment; the right not to be a slave; and the right not to be arbitrarily detained. At present, the taking by a state of its national's property does not contravene the international law of minimum human rights. This has been held to be true in much more egregious situations than the present, including cases where the plaintiff had had his property taken pursuant to Nazi racial decrees. It is certainly true here. As the court noted in *Jafari v. Islamic Republic of Iran:*

> It may be foreign to our way of life and thought, but the fact is that governmental expropriation is not so universally abhorred that its prohibition commands the "general assent of civilized nations" . . . —a prerequisite to incorporation in the "law of nations." . . . We cannot elevate our American-centered view of governmental taking of property without compensation into a rule that binds all "civilized nations."[86]

The doctrine that international law does not generally govern disputes between a state and its own nationals rests on fundamental principles. At base, it is what makes individuals subjects of one state rather than of the international community generally. If we could inquire into the legitimacy under international law of Nicaragua's actions here, then virtually no internal measure would be immune from our scrutiny. Concomitantly, actions of the United States affecting the property of American citizens would become subject to international norms and hence reviewable by the courts of other nations. In the field of international law, where no single sovereign reigns supreme, the Golden Rule[87] takes on added poignancy. Just as we would resent foreign

[85]Potentially, an injury by a state to its own nationals might implicate international law if the injury occurred within another state's territory. In that event, the state where the injury occurred might have an interest if the injury affected its territorial sovereignty. International law would become involved not because of the status of the injured party but because of the location of the injury. In the present case, Mrs. Sanchez claims that her injury occurred in the United States, because that is where Banco Central's check was made payable. We need not decide here whether Banco Central's contractual obligations were "located" in the United States. Even if they were, the breach of these obligations was not of such a nature as to affront the territorial sovereignty of the United States. The situation might be different if Nicaragua had attempted to expropriate a piece of real property owned by Mrs. Sanchez in the United States. Then, Nicaragua's actions could be seen as literally challenging the authority of the United States over its own territory. We decide here only that takings of intangible property rights—including breaches of contract—do not violate international law where the injured party is a national of the acting state, regardless of the property's location.

[86]*Id.,* at p. 215.

[87]The Golden Rule is "Do to others as you would have them do to you." It is not, as Judge Goldberg seems to suggest, "Leave others alone out of fear that they might not leave you alone." *Ed.* The topic of foreign sovereign immunities will be covered in Chapter 3; the decision here is similar in that U.S. courts (among many other federal court systems) will not allow U.S. citizens or foreign citizens to sue a foreign sovereign in U.S. courts unless the sovereign has waived immunity, engaged in private/commercial acts that form that basis for the lawsuit, or committed a tort in the United States.

courts from telling us how we can and cannot rule ourselves, we should be reluctant to tell other nations how to govern themselves. Only where a state has engaged in conduct against its citizens that outrages basic standards of human rights or that calls into question the territorial sovereignty of the United States is it appropriate for us to interfere. Since this is not such a case, we decline to apply international law to Nicaragua's conduct. . . .

Affirmed.

Casepoint

An individual who is a national of a foreign state may not sue an agency of that foreign state in another state's courts for an alleged contractual breach. As long as a state injures only its own nationals, no other state's interest is involved, and the matter is regarded in international law as a purely domestic affair.

G. Comparison of Municipal Legal Systems

There are nearly 200 nations in the world today, and each has a different set of laws that govern its people and its relations with the rest of the world. Whereas international law governs relations between states, institutions, and individuals across national boundaries, municipal law governs these same persons (including the private or commercial conduct of foreign states) within the boundaries of a particular state. Although it would be impossible to describe the legal system of every nation, it is possible to describe the basic systems or "family groupings." The study, analysis, and comparison of the different municipal law systems is known as **comparative law**.

comparative law
The study, analysis, and comparison of the world's municipal law systems.

Comparative lawyers classify countries into legal families. The two most widely distributed families are the Romano-Germanic civil law and the Anglo-American common law. Another family that has become important internationally in recent years is Islamic law.

Of course, each of these families has many subfamilies; for example, within the Romano-Germanic family one finds the Romanist, Germanic, and Latin American subfamilies. In addition, many legal systems are hybrids. The Japanese and South African legal systems thus have elements of both civil and common law. Finally, some legal practices are unique to a particular country. This is especially so in some African countries that use tribal customary law to varying degrees. Drawing a "family tree," as a consequence, can become very complicated, and Map 1.8 should be considered as only a generalization.

It is important to understand that the legal system in one country can vary greatly from that in another country, even if both belong to one of the major legal families. This is because the values underlying a legal system can vary greatly among countries, depending on a country's history, language, religion, ethics, and other cultural factors. The importance of cultural differences, the way those differences affect the community of nations, and the effect they can have on international law are discussed in Reading 1-1.

The Romano-Germanic Civil Law System

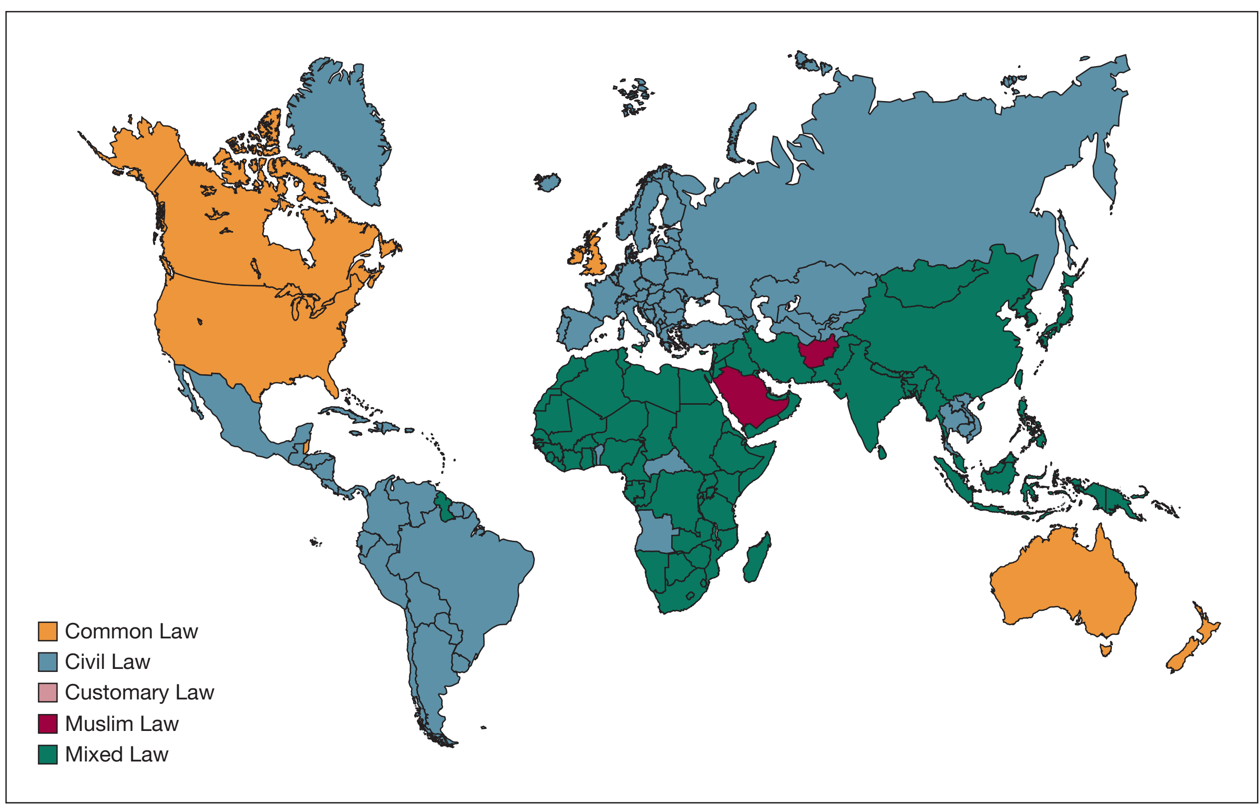
The oldest and most influential legal family is the Romano-Germanic legal system, commonly called the **civil law**. The civil law dates to 450 B.C., the traditional date when Rome adopted its Twelve Tables (a code of laws applicable to Romans). The most significant event in the historical development of the civil law, however, was the compilation and codification (i.e., the selection, arrangement, and simplification) of all Roman law under the direction of the Byzantine Emperor Justinian (483–565 A.D.). This code, known as the **Corpus Juris Civilis**, was compiled between 528 and 534 A.D. It was important because it preserved in written form the ancient legal system. The Roman law was displaced to some extent by the rules of the Germanic tribes when they overran the Western Roman Empire. Germanic tribal law, however, recognized the principle of personal (as opposed to territorial) law, so the former Roman subjects and their descendants were allowed to follow the Roman law. The medieval Roman Catholic Church also played an important role in preserving the ancient law. Canon law, the law used in the church's courts, was based on Roman law.

civil law
(1) The legal system derived from Roman and Germanic practice and set out in national law codes. (2) As distinguished from public law, the body of law dealing with the rights of private citizens.

Corpus Juris Civilis
(From Latin: "body of civil law.") Codification of Roman law completed about 534 A.D. at the order of Emperor Justinian that selected, arranged, and condensed the ancient laws.

With the revival of interest in classical culture in Western Europe in the eleventh and twelfth centuries, accompanied by the discovery of a copy of the long-lost Corpus Juris Civilis, active study of the ancient Roman law began in earnest. At universities in northern Italy—especially Bologna—the Corpus Juris Civilis was systematically analyzed, first by **glossators** (who added

glossator
One who makes a textual gloss or glossary (i.e., a brief note or explanation in the margins or between lines of a text as to the meaning of a difficult or obscure word or expression).



MAP 1.9

The World's Legal Systems

commentator
One who provides a systematic series of explanations or interpretations.

jus commune
(From Latin: "the common right.") Law based on Roman law, canon law, and the interpretations of glossators and commentators, and common to Europe at the beginning of the Renaissance.

notes—annotations—explaining its meaning) and later by **commentators** (who attempted to adapt it to the needs of their time). Students from throughout Europe who traveled to Italy to study returned to their own countries to establish the new profession of law. Not only did they set up new universities—in Paris, Oxford, Prague, Heidelburg, Kraków, and Copenhagen—but they also found work both in the church and as advisors to princes and municipalities. Their common background led to the creation of a new civil law, one based on the Roman law, canon law, and the huge body of writings created by the glossators and commentators. This was called the ***jus commune***, or the common law of Europe.

At the same time, Europe was emerging from a long period of economic stagnation. The newly founded towns gave rise to markets, fairs, and banks, and the rapid development of maritime and overland trade eventually led to large commercial centers that had a need for laws to govern their business transactions. The Germanic law, which at first had been adequate for the general needs of a rural, agrarian society, did not contain legal concepts that suited the needs of the commercial community. Nor did the Roman law, which presumed the presence of an extensive imperial government that no longer existed. The guilds and merchants' associations began to follow their own practices and set up their own courts (called *pepoudrous courts,* or literally "dusty feet" courts, but euphemistically referred to in English as *piepowder* courts). These courts worked out rules and procedures based on the customs of the merchants that were practical and fair. Soon these same rules were being applied both in governmental and church courts, and eventually the ***lex mercatoria*** (law merchant) became an international body of generally accepted commercial rules that transcended national boundaries. It proved to be more influential than even the civil law, spreading to England, where the legal community resisted the Roman law tradition. Today, many of the concepts contained in the law merchant are incorporated in modern commercial law codes, such as the United Nations Convention on Contracts for the International Sale of Goods.

In the sixteenth and seventeenth centuries, the centers of European legal scholarship moved to France and Holland. The new study of the *jus commune* was carried on by French Humanists and Dutch Naturalists. Using historical analysis and philology (i.e., the tracing out of the development of the usage of words), the humanists came to believe that the *jus commune* was only a product of history and that

the Corpus Juris Civilis was merely an ancient text (rather than a holy encapsulation of the "living law"). This desanctification of Roman law was continued by the Dutch naturalists, who developed the theory that law was based on a universal law of nature, and not on the contents of an ancient sacred book.

Along with the development of a theory of law, other events would eventually lead to the disappearance of the *jus commune* as the common law of Europe. The appearance of national states, with national literatures written in national languages (rather than Latin, as had been the case before), led to aspirations for systems of national law. In many of the states of continental Europe, legal nationalism found its embodiment in national codes. The first such codes appeared in Scandinavia in the seventeenth century. In the eighteenth century, the codes of France, Prussia, and Austria were the products of enlightened monarchs like Frederick the Great of Prussia (1712–1786) and Joseph II of Austria (1741–1790). As such, they attempted not only to bring about legal unity within a single kingdom, but also to express the political and philosophical ideals of the time.

Two national codes have had such widespread and lasting influence that they are now regarded as the basis of the modern civil law. Both the **French Civil Code** of 1804 and the **German Civil Code** of 1896 were models for most of the other contemporary civil codes. The French Civil Code is now followed in the Netherlands, Belgium, Poland, Spain, Portugal, Latin America, sub-Saharan Africa, Indochina, and Indonesia; the German Civil Code in Austria, Czechoslovakia, Greece, Hungary, Switzerland, Yugoslavia, Turkey, Japan, and South Korea.

French Civil Code
Law code promulgated in 1804 by Napoléon that collected, arranged, and simplified French law.

The French Civil Code is often referred to as the Code Napoléon, because of the extensive involvement of Napoléon Bonaparte (1769–1821) in its writing. Jean Jacques Cambacérès (1753–1824), second consul under Napoléon, and a commission of four jurists were the principal drafters. Most scholars rightfully regard it as the first modern code. Although organized structurally in much the same fashion as the Corpus Juris Civilis, it was not merely a restatement of prior law. It incorporated the principal ideas of the French Revolution, including the right to possess private property, the freedom to contract, and the autonomy of the patriarchal family. With regard to private property, the code's authors consciously attempted to break up the old feudal estates of the aristocracy by prohibiting restraints on the sale of land as well as restraints on its transfer in a will.

German Civil Code
Law code promulgated in 1896 that is based primarily on the Corpus Juris Civilis and is characterized by its detailed structure and its technical precision.

The French Civil Code, nevertheless, preserved much of the past. Because it was written in a remarkably short period of time—at the insistence of Napoléon—its authors relied heavily on the *jus commune,* French royal ordinances, academic writings, and customary law (especially the influential Custom of Paris, which had been transcribed in the sixteenth century). Like the authors of other seventeenth- and eighteenth-century codes, the draftsmen of the Code Napoléon looked on their work as putting all of the prior French law through a "sieve of reasons." Unlike the German Civil Code, however, the style and form of the French Civil Code are straightforward, easy to read, and understandable to everyone—in many respects, it reminds one of the U.S. Constitution. Also, as with the U.S. Constitution, the authors of the French Civil Code realized that they could not foresee every possible legal eventuality, so they set out flexible general rules rather than detailed provisions. Jean Portalis (1746–1807), one of the authors, said,

> We have equally avoided the dangerous ambition to regulate and foresee everything. . . . The function of law is to fix in broad outline the general maxims of justice, to establish principles rich in implications, and not to descend into the details of the questions that can arise in each subject.

The German Civil Code (Bürgerliches Gesetzbuch) was enacted almost a century later, partly because Germany first had to take shape as a nation and partly because of the influence of a group of German scholars known as **Pandectists**. The leader of the Pandectists, Friedrich Karl von Savigny (1779–1861), argued that a German code could not be adopted until extensive study of Germany's legal institutions had occurred. Rather than studying German legal materials, however, the Pandectists concentrated on the text of the Corpus Juris Civilis, with the aim of discovering its "latent" or underlying principles and organization. From these studies a highly structured and technically precise system was eventually devised for use in Germany.

Pandectists
(From Latin *pandect:* "all receiving.") Scholars who attempted to prepare a pandect, or complete and comprehensive treatise or digest of the law.

The drafting project itself was enormous, taking more than 20 years to complete. Issued finally in 1896, the German Civil Code's organization and form are extremely precise and technical. Special terminology was devised. Legal concepts were defined and then used the same way throughout the entire code. Sentence structure indicates which party has the burden of proof. Elaborate cross-references keep the code reasonably brief and make it a logical and unified system. Unlike the French Civil Code, which was intended to be a handbook for the citizen, the German Civil Code was meant for the use of trained experts.

Although the French and German codes are different in style and tone, they are more similar than dissimilar. Both are based on the *jus commune,* especially in their approach to the law of obligations and in their overall structure. They also rely on many of the same political and philosophical ideals, notably laissez-faire economics and the autonomous rights of individuals.

public law
Constitutional and administrative law. It is not included in civil law codes.

Separate and apart from the movement for codification of civil or private law was the development of **public law**. Civil law (*droit civil, Zivilrecht*) is, for civilian lawyers, only the law contained in the codes and its auxiliary statutes (i.e., the law of persons, family law, property law, the law of succession, the law of obligations, commercial law, and labor law). Opposed to this is public law (i.e., constitutional and administrative), which has been treated in a variety of ways in the civil law countries. Germany established a branch of administrative courts to review the acts of its government agencies, and France created a Council of State to protect individual rights and supervise the administrative processes of government (technically, however, the council is not a court). Austria has created a Constitutional Court to ensure that its legislation complies with the guidelines established in its Constitution, and similar courts have been established in many other countries. The civil law countries, however, have no consistent approach to public law, and many civilian lawyers still regard constitutional law as a form of political science.

In the twentieth century, especially in the years since World War II, changes in France and Germany—as well as in the other civil law countries—had profound effects on civil law. For one, there was a movement away from relying only on the civil code. Special legislation and judicial interpretations became more influential. There was also some revision of the codes themselves, especially in Germany. Also, with the advent of the EU, there is now a move toward harmonizing the laws of the Union's member states.

common law
The legal system of England and countries that were once English colonies. It is based primarily on court-made rules or precedent.

The Anglo-American Common Law System

The origins of the Anglo-American common law system can be traced back to the year 1066, when the Normans conquered England and William the Conqueror began to centralize the governmental administration of his new kingdom. The name **common law** is derived from the theory that the king's courts represented the common custom of the realm, as opposed to the local customary law practiced in the county and manorial courts.

supremacy of the law
Doctrine that all persons, including the sovereign, are subordinate to the rule of law.

equity
(From Latin *æquitas:* "even" or "fair.") Being just, impartial, and fair. Justice applied in circumstances not covered by rules of law.

Development of the enduring principles of the common law was largely the product of three courts created by Henry II (1133–1189). The Court of Exchequer settled tax disputes; the Court of Common Pleas dealt with matters that did not involve a direct interest of the king, such as title to land, enforcement of promises, and payment of debts; and the Court of King's Bench handled cases of direct royal interest, such as the issuance of *writs* (written decrees) to control unruly public officials. Eventually, the jurisdiction of the King's Bench was used to control abuses of power by the king himself, establishing a fundamental doctrine of the common law: the **supremacy of the law**. (Today, the doctrine of supremacy means not only that the king is subject to the law but also that the acts of ordinary government agencies can be reviewed in the courts.) Also, when the Court of Common Pleas began to charge large fees to hear cases, much of its jurisdiction was taken over by the King's Bench. The judges of the King's Bench did this by broadly interpreting the writ of trespass so that it took in virtually every kind of tort and by expanding the meaning of the writ of assumpsit so that it applied to most forms of contracts.

admiralty
The law and court with jurisdiction over maritime affairs in general.

An important aspect of the common law is the idea that it is based on the customary practice of the courts, and the term itself is often used to describe that part of English law that is not based on statutory law or legislation. In its narrow sense, the common law must also be distinguished from the law that evolved out of **equity** (principles of justice developed by the king's chaplain, or chancellor, to provide parties with a remedy when none was available in the king's courts) and out of **admiralty** (the law and court with jurisdiction over marine affairs in general) and from other specialized jurisdictions. The common law's basis in court decisions, or **precedent,** is also the principal factor distinguishing it from the Romano-Germanic civil law, where the grounds for deciding cases are found in codes, statutes, and prescribed texts.

precedent
(From Latin *præcedens:* "going before in time.") An act or instance that may be used as a model for later similar cases.

One limitation of early common law practice was its inflexibility. In 1285, the Statute of Westminster curtailed the creation of new writs that, until that time, the courts had been devising in an attempt to expand their jurisdiction. As a consequence, the courts soon could hear only cases that fit precisely within the parameters of the traditional writs. Also, as the scope of the courts' jurisdiction narrowed, the procedural rules they followed became more complex. Finally, with the exception of a few kinds of suits that involved the recovery of real or personal property, the only remedy the courts could give

was money for damages actually done. In part, the courts of equity—which had the power to order an injunction, restitution, or specific performance—were created to overcome these limitations.

Until the nineteenth century, there continued to be a sharp division between the common law and equity. Then New York enacted a code of civil procedure in 1848, drafted by David Dudley Field (1805–1894); the Field code merged law and equity into one jurisdiction. That is, it required lawsuits to be tried in a single class of courts, using a single procedure. It was soon adopted by most of the American states, by the American federal government, and eventually by England in the Judicature Acts of 1873 and 1875 and by many British colonies.

The way in which the common law spread around the world is different from the way in which the civil law was distributed. In each of the principal nations in which the common law developed—Australia, Canada, India, Ireland, New Zealand, and the United States—there was a direct political linkage to England. Although there was a linkage of sorts with Rome for the European and Latin American civil law countries, the connection with other civil law countries is more tenuous. Also, the civil law is the easier of the two legal traditions to be received. The civil law is encapsulated in convenient codes, and it deals primarily with private law that is of little threat to the local political system. Common law, on the other hand, is a matrix of case law and statutes; it uses the jury system and the doctrine of supremacy to limit the actions of the government; and it encompasses a complex terminology. See Table 1.6.

The Islamic Law System

Today, one person in four is a Muslim. Most Muslims live in states in the Middle East, North Africa, and Southern Asia. Islam is the principal religion of Saudi Arabia, Qatar, the United Arab Emirates, Oman, Yemen, Syria, Jordan, Kuwait, Kazakhstan, Uzbekistan, Kyrgyzstan, Tajikistan, Turkmenistan, Azerbaijan, Iran, Iraq, Afghanistan, Pakistan, Armenia, Turkey, Egypt, Sudan (Khartoum), Somalia, Libya, Algeria, Tunisia, Niger, Mali, Morocco, Mauritania, Bangladesh, Malaysia, and Indonesia. Islamic law is the principal source of law in Saudi Arabia, and it is followed, at least to some extent, in all of the other countries.

The Islamic legal system is known as **Shari'a**. It is derived from the following sources, in the order of their importance: (1) the Koran, (2) the Sunna or traditional teachings and practices of the Prophet Muhammad (570–632 A.D.), (3) the writings of Islamic scholars who derived rules by analogy from the principles established in the Koran and the Sunna, and (4) the consensus of the legal community.

Shari'a
(From Arabic: "jurisprudence.") The Islamic legal system. It is based on principles found in the Koran and related writings.

In the tenth century A.D., three centuries after the founding of Islam, the legal community decided that further improvement of the scholars' analysis of divine law was impossible. They decided at that time to "close the door of *ijtihad* (independent reasoning)," freezing the evolution of Islamic law. As a consequence, Shari'a judges and scholars may only apply the law as it was set down by the early writers. They may not change, modify, or extend that law.

The closing of the door of *ijtihad* has produced a legal system that is often at odds with the modern world. Many important figures in the Islamic world (including Saudi Arabia's King Fahd

TABLE 1.6

General characteristics of the world's two major legal systems

	Civil Law	Common Law
Ideological basis	Positive law; laissez-faire economics	Natural law
Status of law	Independent of government	Superior to government
Legal rules	Based on general principles	Based on specific circumstances
Content	Private law	Private law; public law
Basic source	Codes	Case law
Most influenced by	Law writers	Judges
Reasoning	Deductive	Inductive
Procedure	Inquisitorial	Adversarial
Fact finder	Judge	Jury
Use of case law as precedent	Respected	Required
Constitutional review by	Special agency or category of courts	Regular courts (no written constitution in England)
Review of government agencies	Special agency or category of courts	Regular courts

[1921–2005]) have recently advocated reopening the door of *ijtihad,* but this step has been vehemently opposed by traditionalists (including Iran's late Ayatollah Khomeini [1900–1989]). It is important to note that the Shari'a is primarily a moral code, more concerned with ethics than with the promotion of commerce or international relations. Nonetheless, many principles of the Shari'a are not unlike the principles found in the civil law and the common law.

Chapter Questions

Pacta Sunt Servanda

1. The Harvester Company entered into a contract with Country R to harvest lumber on government land in Country R for a period of 20 years. The contract provided that if there were any disputes, the matter was to be resolved by arbitration, with the International Chamber of Commerce appointing the arbitrator and the arbitrator applying the rules of international law, the general principles of law, and equity. Two years later, Country R told Harvester to cease operations and leave the country. Country R made no effort to recompense Harvester for the country's breach of the contract. Harvester has now initiated an arbitration proceeding. Country R claims that contracts between a state and a private person can be broken at any time by the state because to do otherwise would be to deny the state its sovereignty. Discuss.

Customary International Law

2. Several years ago, a multilateral treaty came into effect among some 45 countries, including most of the major developed countries of the world. The treaty, known as the Outer Space Treaty, forbids any member state from claiming "any planet, satellite, asteroid, or other celestial body" as part of the territory of the member state. State X, which is not a party to the treaty, recently sent a spacecraft to the Earth's Moon. The crew members of the craft unfurled the flag of State X and claimed a 1,000-square-kilometer surface area of the Moon to be part of the territory of State X. Several small buildings were constructed, including a radio transponder and a landing guidance system.

State Y, joined by the other member states of the Outer Space Treaty, has brought suit against State X in the ICJ. They ask the court to declare that State X's claim to the territorial annexation of part of the Moon be declared void. They argue that the provisions of the Outer Space Treaty forbidding such annexations are part of customary international law and that the treaty itself is an expression of the world community's *opinio juris.* State X argues that even if there is an *opinio juris,* none of the members of the world community have acted to prevent the annexation of parts of the surface of the Moon, and therefore there is no usus. How should the court rule? Discuss.

International Human Rights Law

3. Tvern, a governor of the Republic of X, broke into the house of Mr. Different. Tvern tortured him and seized his property for complaining about the state of the economy. Mr. Different illegally crossed the border and took refuge in the neighboring Republic of Y to recover. Republic of Y has a statute that allows its courts to invoke universal jurisdiction brought by a plaintiff for a violation of international law. Mr. Different brought a suit against Tvern for the torture and wrongful seizure of property. Discuss the possibility of Mr. Different's success.

Recognition of States

4. General Felix Raj is currently being prosecuted by the International Criminal Court (ICC) for various crimes against humanity committed in the Republic of A. General Raj has argued that he has merely been an agent of Armor Inc. in committing these crimes, as he had to do so in implementing various "development projects" financed by the company. Currently, the Rome Statute of the ICC does not extend to corporations or artificial persons. The Republic of A does not recognize corporate criminal responsibility in its national law and opposes it in all discussions at various international fora. While there might be a case for prosecuting General Raj under the ICC without having to prove Armor's liability, the chief prosecutor wonders if the company could be sued in any other forum, as the crimes violate *jus cogens* norms. What should the chief prosecutor do? Discuss.

State Responsibility for Transboundary Pollution

5. A river runs through State A and State B. State A is comparatively economically underdeveloped and has laws that its chemical industries have to process sewage before discharging the wastes into the river. Both states have recognized the jurisdiction of the ICJ to resolve disputes between them regarding breaches of international law. State B has brought a suit before the ICJ claiming that the sewage from State A may adversely affect its aqua culture and reduce the lifespan of the salmon found in the river. What should the court do? Discuss.

Boundaries and Treaties

6. State A and State B share a common border. State A has ratified the UN Convention on the Prevention and Punishment of the Crime of Genocide; State B has not. State A has entered into a treaty establishing commercial relations with State X and extending Most Favored Nation status to State X; State B has not. State A has a treaty with State Y that establishes the international border between State Y and State A's Western Province. Which of these treaties will continue to have effect in the changed territory if

a. State A cedes its Western Province to State B?
b. the Western Province obtains its independence?
c. State A and State B merge and become new State C?

State Responsibility and Environmental Regulation

CHAPTER 2

Chapter Outline

A. State Responsibility
- Doctrine of Imputability
- Nonimputable Acts
- Fault and Causation

B. Standard of Care
- The National Standard of Care
- The International Standard of Care
- Expropriation
- Denial of Justice

C. Objections
- Lack of Standing
- Lack of Nationality
- Lack of a Genuine Link
- Failure to Exhaust Remedies
- Other Objections

D. Relief

E. Insurance
- Private Insurers
- National Investment Guaranty Programs
- Multilateral Investment Guaranty Programs

F. Environmental Protection
- Regulation of Pollution
- Protection of Natural Resources
- Liability for Environmental Damage

Chapter Questions

Introduction

It has long been a basic principle of international law that a state that causes an injury to a foreign citizen (national) is responsible to the national's state for the harm done, but not to the national. This responsibility follows from the basic idea of international law as the "law of nations," and is derived from the general responsibility of one state to another for the injuries it may cause. The rationale is that an injury to a state's national is an injury to that state. As U.S. Secretary of State Elihu Root (see Figure 2.1) said in 1909:

> Each country is bound to give the nationals of another country in its territory the benefit of the same laws, the same administration, the same protection, and [the] same

FIGURE 2.1

Elihu Root, U.S. Secretary of State (1905–1909), Nobel Laureate (Peace Prize, 1912), U.S. Senator (1909–1915)

Source: Archive Pics/Alamy

> redress for injury which it gives to its own citizens, and neither more nor less: provided the protection which the country gives to its own citizens conforms to the established standards of civilization.
>
> There is a standard of justice, very simple, very fundamental, and of such general acceptance by all civilized countries as to form a part of the international law of the world. The condition upon which any country is entitled to measure the justice due from it to an alien by the justice which it accords to its own citizens is that its system of law and administration shall conform to this general standard. If any country's system of law and administration does not conform to that standard, although the people of the country may be content or compelled to live under it, no other country can be compelled to accept it as furnishing a satisfactory measure of treatment to its citizens.[1]

This notion of state responsibility is examined in this chapter. We consider when a state is responsible, what the standard of responsibility is, what defenses states have against allegations of mistreatment, and what steps aliens and foreign businesses can take to minimize potential losses. We also examine the insurance programs that states and IGOs have established to protect companies that invest internationally.

Finally, we examine the international legal obligations of states to protect the environment. In particular, we look at the responsibilities states have to curtail pollution and protect natural resources.

A. State Responsibility

To establish that a state is responsible for an injury to an alien or foreign business, there must be (1) "conduct consisting of an action or omission . . . attributable to the State under international law," and the conduct must (2) "constitute . . . a breach of an international obligation of the State."[2] But readers should bear in mind that all notions of **state responsibility** are set within the framework of an international legal system where sovereignty is the most basic principle. In the Positivist view of international law, responsibility adjudged by another state or an international tribunal can only be of consequence where a sovereign agrees that it is not the sole judge of its responsibility toward others.

state responsibility
Liability of a state for the injuries that it causes to aliens and foreign businesses.

Doctrine of Imputability

A theory known as the *doctrine of imputability* says that a state is only responsible for actions that are **imputable** (attributable) to it. The usual interpretation of this theory is that the state is responsible for acts done by officials within their apparent authority. This includes (1) acts within the scope of officials' authority and (2) acts outside their scope of authority if the state provided the means or facilities to accomplish the act.[3] Thus, states are responsible both for mistaken actions and even for actions done contrary to express orders or even the internal laws of the state, as Case 2-1 makes clear.

impute
(From Latin *imputare:* "to charge.") To attribute something done by one person, such as an act or crime, to another.

Nonimputable Acts

Because states are only responsible for actions taken by their officials, they are not responsible for the acts of private persons, acts of officials of other states or international organizations, or acts of insurrectionaries within their own territories. In the *Home Missionary Society Case,* for example, the American and British Claims Arbitration Tribunal held that governments are not responsible to international

---

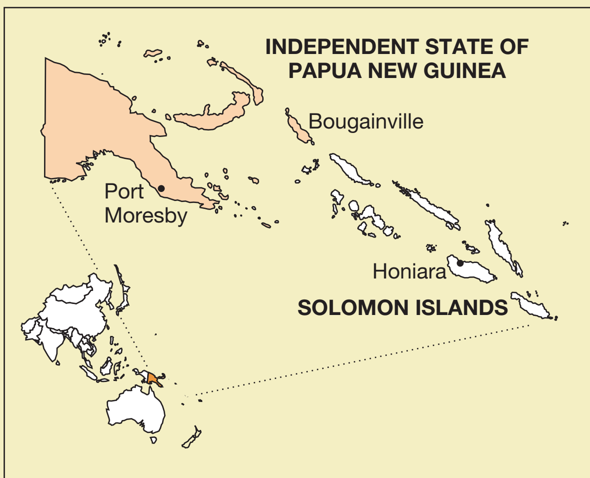
[1] *Proceedings of the American Society of International Law,* pp. 20–21 (1910).

[2] Article 3, *International Law Commission Draft Articles on State Responsibility,* 1979, in *Yearbook of the International Law Commission,* vol. 2, pt. 2, p. 90 (1979). The text of the draft is posted at http://untreaty.un.org/ilc/publications/yearbooks/Ybkvolumes%28e%29/ILC_1979_v2_p2_e.pdf.

[3] "The conduct of an organ of a State, a territorial governmental entity, empowered to exercise elements of the governmental authority, such organ having acted in that capacity, shall be considered as an act of the State under international law even if, in the particular case, the organ exceeded its competence according to international law or contravened instructions concerning its activity." Id., Article 10.

CASE 2-1 Sandline International Inc. v. Papua New Guinea

International Arbitration under the UNCITRAL Rules (October 1998)
International Law Reports, vol. 117, p. 552 (2000)
Rt. Hon. Sir Edward Somers, Rt. Hon. Sir Michael Kerr, and Hon. Sir Daryl Dawson.



MAP 2.1

Independent State of Papua New Guinea and the Solomon Islands (1997)

Background

The Panguna Copper Mine is situated on the island of Bougainville, which is part of the Independent State of Papua New Guinea (PNG). When it was operating, the mine employed some 4,000 people and provided 17 percent of the revenue of PNG. Late in 1998, a dispute arose between the Government of PNG and Bougainville landowners whose land had been resumed for the development of the mine. The dispute escalated in the following year when the landowners blew up power pylons, cutting off power to the mine and forcing it to shut down. A revolutionary movement subsequently grew out of the conflict, which was no longer confined to landowners, seeking the independence of Bougainville from PNG or, possibly, the union of Bougainville with the Solomon Islands. An armed struggle took place between the PNG Defense Force and a local force which had emerged and became known as the Bougainville Revolutionary Army (BRA). A number of persons, including civilians, were killed. The PNG Defense Force was unable to recover possession of the mine and the Government was forced to examine the military options for the resolution of the Bougainville problem. The PNG Defense Force lacked the necessary equipment, in particular, helicopter gunships, helicopter troop carriers and modern electronic warfare equipment. Consequently, the PNG Government looked for assistance outside PNG.

The 1997 Agreement

Negotiations took place between representatives of PNG and Sandline International Inc. (Sandline), a company incorporated in the Commonwealth of the Bahamas and carrying on business in the United Kingdom, which led to the conclusion of an Agreement dated 31 January 1997 between PNG and Sandline (hereinafter referred to as "the Agreement"). The nature of those negotiations is not material for present purposes, for it is not disputed that the Agreement was signed by Mr. Haiveta, the Deputy Prime Minister of PNG, on behalf of PNG, with the knowledge and approval of the Prime Minister and the Minister of Defense and pursuant to a resolution of the National Executive Council of PNG which "approved the use of PNG Special Forces Unit with Sandline International on operations in Bougainville" and "approved U.S. $36 million to engage Sandline International for the operations with the initial 50 percent [to] be paid and the remained to be settled once operations commence." Approval was given in identical terms by the PNG National Security Council.

Sandline was described in the Agreement as a company specializing in rendering military and security services of an operational, training and support nature, particularly in situations of internal conflict only for and on behalf of recognized Governments, in accord with international doctrines and in conformance with the Geneva Convention.

The Agreement recited that PNG was engulfed in a state of conflict with the BRA and required military assistance. It further recited that Sandline was contracted to provide personnel and related services and equipment to:

- train the State's Special Forces in tactical skills specific to the objective;
- gather intelligence to support effective deployment and operations;
- conduct offensive operations in Bougainville in conjunction with PNG defense forces to render the BRA military ineffective and repossess the Panguna mine; and
- provide follow-up operational support, to be further specified and agreed upon between the parties and is subject to separate service provision levels and fee negotiations.

For its part, PNG was to ensure full cooperation from within its organization and that of the PNG defense force.

Sandline's inclusive fee for the provision of personnel, equipment and services under the Agreement was specified as U.S. $36 million. U.S. $18 million was immediately due on the signing of the Agreement and was deemed "the initial payment." The balance of U.S. $18 million was payable within 30 days of the deployment by Sandline of a sixteen-man Command, Administration and Training Team in PNG. The initial payment of U.S. $18 million was paid by PNG. Notwithstanding that the required Command, Administration and Training Team was deployed in the first week of the contract and that certain equipment was duly delivered, the balance of U.S. $18 million was not, and has not been, paid.

* * *

The Breakdown of the Agreement

Until the evening of 16 March 1997, the parties were engaged in the performance of the Agreement in an apparently cooperative manner. On that evening, there was an insurrection or mutiny by members of the PNG Defense Force in Port Moresby, led by the Commander of the Force, General Singirok. The uprising was named "Operation Rausim Kwik." Sandline personnel were placed under arrest. The military forces involved were joined the next day by civilians and there were outbreaks of rioting and looting and something in the nature of a siege of the Parliament building. On 21 March 1997 Sandline personnel were, with one exception, flown out of PNG, the remaining member being allowed to leave shortly thereafter.

The Prime Minister of PNG "suspended" the Agreement and announced a judicial inquiry to establish the facts concerning the origins of the Agreement. A Commission of Inquiry reported about 29 May 1997 without questioning Sandline's effective engagement under the Agreement. But on 3 June PNG alleged that the Agreement had been frustrated on the ground that its performance was impossible.

* * *

Pursuant to the arbitration clause in the agreement, Sandline claimed from PNG payment of the sum of U.S. $18 million, being the second payment referred to in the Agreement. . . .

* * *

. . . PNG . . . plead[ed] that under the laws of PNG the contract was unlawful and that those who had purported to enter into [it] on behalf of PNG lacked the capacity to do so.

* * *

[PNG's answer to the Sandline claim] was that the agreement with Sandline was null and void, being at all times illegal and unlawful both in its formation and performance. The illegality alleged was that the Agreement and its performance were in contravention of §200 of the PNG Constitution. . . .

Sandline's reply [to PNG's answer] was twofold. First, it said that upon true construction of §200 of the Constitution, neither the agreement nor its intended performance was contrary to its provisions nor the provisions of any of the other statutes relied upon by PNG. Alternatively, Sandline said that English law, by which the contract was governed, included international law and that under such law, PNG could not, in the events which happened, rely upon §200 of the Constitution. . . .

***

The First Issue

. . . The proper construction of §200 of the PNG Constitution and its application in the circumstances of this case were the subject of argument before the Tribunal. However, the Tribunal is of the view that it is neither necessary nor desirable to express any final opinion upon the scope of the section, it being possible to reach a conclusion for the purposes of this Interim Award by assuming, without deciding the illegality or unlawfulness under the section for which PNG contends. The scope and intent of §200 is better left to the courts of PNG where knowledge and understanding of the local conditions give them a better and more accurate assessment of its effect. . . .

***

International Law

The rules of international law in this case are clearly established and their application causes no difficulty. PNG submits that they have no application because the agreement between it and Sandline, a private party, does not attract international law. However, it is incontrovertible that PNG is an independent state and purported to contract in that capacity. An agreement between a private party and a state is an international, not a domestic, contract. This Tribunal is an international, not a domestic, arbitral tribunal and is bound to apply the rules of international law. Those rules are not excluded from, but form part of, English law, which is the law chosen by the parties to govern their contract. PNG cited no authority to support its submission and there is ample authority to the contrary. The submission of PNG must be rejected.

In international law, in relation to contracts to which a state is a party and which are to be performed within the territory of that state . . . a state cannot rely upon its own internal laws as the basis for a plea that a contract concluded by it is illegal. It is a clearly established principle of international law that acts of a state will be regarded as such even if they are *ultra vires* or unlawful under the internal law of the state. Of course, a state is a juristic person and can only act through its institutions, officials or employees (commonly referred to in international law as organs). But the acts or omission when they purport to act in their capacity as organs of the state are regarded internationally as those of the state even though they contravene the internal law of the state. The Report of the International Law Commission of the United Nations[4] expressed the principle as follows:

The characterization of certain conduct of organs as acts of the state for the purpose of determining its international responsibility is completely independent of the characterization of the same conduct as acts of the state liable to incur administrative responsibility under internal law.

In *Southern Pacific Properties (Middle East) Ltd. v. Arab Republic of Egypt,*[5] the respondent submitted that it was not liable for certain acts of Egyptian official which it said were legally nonexistent or absolutely null and void according to Egyptian law. The Tribunal said of its award:

> The principle of international law which the Tribunal is bound to apply is that which establishes the international responsibility of the state when unauthorized or *ultra vires* acts of officials have been performed by state agents under cover of their official character. If such unauthorized or *ultra vires* acts could not be ascribed to the state, all state responsibility would be rendered illusory. For this reason . . . the

[4]*Yearbook of the International Law Commission,* vol. 2, p. 61 (1975).

[5]*International Centre for Settlement of Investment Disputes Reports,* vol. 3, p. 102.

> practice of states has conclusively established their international responsibility for state organs, even if accomplished outside the limits of their competence and contrary to domestic law.

It is unnecessary to cite further authority for the principle, but other examples of its application are to be found in [other cases referred to in this opinion].

The rules of international law referred to above are, of themselves, sufficient to dispose of the defense of illegality or unlawfulness raised by PNG. But there is the added rule that a party may not deny the validity of a contract entered into on its behalf by another if, by its conduct, it later consents to the contract. It is known as the doctrine of preclusion [or ratification] and, whether upon the concepts of acquiescence, estoppel or waiver, is well established in international law. In the end, the doctrine finds its justification in considerations of good faith and conscience which underlie the basic principle of international law: *pacta sunt servanda.*[6] . . .

***

Application of International Law

Upon the basis of the facts recited . . . above, there can be no doubt that in executing the agreement between Sandline and PNG, the Deputy Prime Minister, Mr. Haiveta, purported to act on behalf of the PNG. Not only did he purport to exercise the authority with which he was invested by his official position, but he did so after negotiations involving the Prime Minister and the Minister for Defense and with the approval of the National Executive Council. No question of illegality was raised with Sandline. In these circumstances, for the reasons given above, a valid contract was concluded between Sandline and PNG, notwithstanding any failure to observe the constitutional and other statutory provisions upon which PNG relies to establish the illegality or unlawfulness of the Agreement or lack of capacity to enter into it. Any such illegality or unlawfulness or lack of capacity arose, if it arose at all, under the internal laws of the PNG and not under international law which, for the purpose of determining the validity of a contract, disregards the internal laws of a contracting state. The agreement was not illegal or unlawful under international law or under any established principle of public policy. A political decision having been made by PNG to enter into it, its execution by a person with apparent authority to bind the state gave rise to a valid contract in the eyes of international law.

In addition, PNG participated in the performance of the contract before the events of 16 March 1997. It paid the first installment of U.S. $18 million due under the terms of the contract. It facilitated entry of Sandline personnel and equipment into PNG for the purpose of carrying out the contract. Even after the events of 16 March 1997, PNG affirmed rather than denied the existence of the contract by alleging that it had been frustrated by those and later events and counterclaiming on that basis. It was not until late in these proceedings that PNG abandoned the defense of frustration and raised the defense of illegality and unlawfulness. Although it is strictly unnecessary to do so . . . the Tribunal express the view that, in the events which occurred, PNG is precluded from denying the validity of its agreement with Sandline.

Conclusion

The Tribunal rejects the defense of illegality or unlawfulness raised by PNG. In the end that is the only defense raised, and it follows from its rejection that PNG is liable for its failure to perform the terms of the contract.

Casepoint

An agreement between a private party and a state is an international (not a domestic) contract. It is a clearly established principle of international law that acts of a state with regard to performing the terms of a contract will be regarded as legal even if they are *ultra vires* or unlawful under the internal law of the state.

---

[6]From Latin: "The agreement shall be observed."

persons or governments for harms done to property or person by insurrectionists or rebels, provided that the government has not been negligent or in bad faith in suppressing the insurrection.[7]

But to say that, in general, states are only responsible for actions taken by their officials and are not responsible for the acts of private persons overlooks the growing body of law and reality when it comes to state-sponsored or supported terrorism. It is to this current development that Case 2-2 (*Flatow v. The Islamic Republic of Iran*) and the reading that follows it is directed.

Terrorism **Terrorism** is the sustained clandestine use of violence—murder, kidnapping, threats, bombings, torture, or some combination of these—for a political purpose.[8] Because terrorism is politically motivated, the modern terrorist often seeks to create spectacular and horrible incidents that attract media attention. Terrorism does not require sponsorship by a state, but states have often sponsored terrorism. In the 1970s and 1980s, Middle Eastern terrorists benefited greatly from the support, training, or refuge provided by pro-Soviet states like Bulgaria, Cuba, and East Germany, as well as Middle Eastern states like Algeria, Iran, Iraq, Libya, South Yemen, Tunisia, and Syria. Examples of this type of state assistance include the 1985 hijacking of the Italian cruise ship *Achille Lauro* by Palestinians (see Figure 2.2), the murder of a U.S. passenger, and the subsequent release of one of the terrorists who was traveling under a diplomatic passport. Attacks by Libyan-supported terrorists on airports in Rome and Vienna in 1985 and on a discotheque in Berlin in 1986 led to a raid by American fighter jets against terrorist training camps and air defense sites in Libya. State terrorism can also include the clandestine kidnapping and murder of a state's own people by its government, as was the case in Nazi Germany in the 1930s and 1940s, in Argentina from 1972 to 1976 when a military junta was in power, and in many other countries since. Further confusing the picture, the United States has engaged in *extraordinary rendition*[9] and torture in its "war on terrorism" and has done so secretly, thus fitting the offered definition.

terrorism
(From Latin *terror:* "to frighten.") The sustained clandestine use of violence for a political purpose.

Efforts to deter terrorism have led to the adoption of the Tokyo Convention of 1963 and the Montreal Convention of 1971 on the hijacking and sabotage of civilian aircraft; to the 1973 Convention on crimes against diplomats and the 1979 Hague Convention on hostage taking; and, most recently, to the 1988 Convention for the Suppression of Unlawful Acts Against the Safety of Maritime

FIGURE 2.2

The Hijacking of the *Achille Lauro* Is an Example of TerrorIsts Benefitting from State Sponsorship

Source: Mirrorpix/Newscom

[7]Home Frontier and Foreign Missionary Society of the United Brethren in Christ (*United States v. Great Britain*) Claim, *United Nations Reports of International Arbitral Awards,* vol. 6, p. 42.

[8]Terrorism should be distinguished from attacks by fanatics on individuals (such as the assassination of Abraham Lincoln) or on military personnel in a war zone (such as the 1983 bombings of the U.S. Marine barracks and French Foreign Legion bunkers in Lebanon).

[9]Since September 11, 2001, the United States (through the Central Intelligence Agency) is widely thought to have seized terrorism suspects through a program of "extraordinary rendition," bringing the suspects to other countries for interrogation in which torture is practiced. A hundred or more terrorism suspects have disappeared worldwide since 9/11. Ian Fisher and Elisabetta Povoledo, "Italy Braces for Legal Fight Over Secret C.I.A. Program," *New York Times,* June 8, 2007.

Navigation. These conventions classify certain kinds of acts as *international crimes* that are punishable by any state regardless of the nationality of the criminal or the victim or the locality of the offense. They do not, however, impose liability on states that participate in state terrorism.

A summary of the 14 major conventions and protocols dealing with terrorism can be found at www.un.org/terrorism/instruments.shtml.

State responsibility for terrorism is often limited to helping other states bring terrorists to trial. For example, the United Nations Security Council adopted a resolution in 1992 demanding that Libya extradite to France, the United Kingdom, or the United States two alleged terrorists suspected of putting a bomb aboard the Pan American airliner that blew up over Lockerbie, Scotland, but it imposed no sanctions on Libya. A second resolution imposed limited sanctions, but they were meant only to encourage Libya to turn over the alleged terrorists and not as a punishment of the country itself. Most domestic terrorism legislation similarly does not impose liability on states for terrorism. The United Kingdom Terrorism Act 2000,[10] for example, applies only to nonstate organizations.

Information on the United Nations sanctions against Libya prior to 2008 is posted at www.globalpolicy.org/security-council/index-of-countries-on-the-security-council-agenda/libya.html

The U.S. act (the Anti-terrorism and Effective Death Penalty Act of 1996) grants U.S. federal courts jurisdiction to hear suits against foreign states and their officials and creates a private cause of action for personal injuries and death resulting from state-sponsored terrorist attacks. The application of the act is described in Case 2-2.

CASE 2-2 Flatow v. The Islamic Republic of Iran

United States District Court for the District of Columbia
Federal Supplement, vol. 999, p. 1 (1998)

MAP 2.2

Iran and Israel (1997)

[10]Terrorism Act 2000, chap. 11 (Eng.), posted at www.unifr.ch/ddp1/derechopenal/temas/t_20080528_88.pdf.

Judge Royce C. Lamberth

This is an action for wrongful death resulting from an act of state-sponsored terrorism. Defendants have not entered an appearance in this matter. This Court entered Defendants' default on September 4, 1997. Notwithstanding indicia of Defendants' willful default, however, this Court is compelled to make further inquiry prior to entering a judgment by default against Defendants. As with actions against the federal government, the Foreign Sovereign Immunities Act ("FSIA") requires that a default judgment against a foreign state be entered only after plaintiff "establishes his claim or right to relief by evidence that is satisfactory to the Court."[11]

Plaintiff brings this action pursuant to two recently enacted amendments to the FSIA, which grant jurisdiction over foreign states and their officials, agents and employees, and create federal causes of action related to personal injury or death resulting from state-sponsored terrorist attacks. Given these novel enactments . . . this Court has engaged in a systematic review of dispositive legal issues prior to making its determination that Plaintiff has established his claim and right to relief to the satisfaction of this Court.

Findings of Fact

Plaintiff has "established his claim or right to relief by evidence that is satisfactory to the Court" as required by United States Code, title 28, §1608(e). This Court finds the following facts to be established by clear and convincing evidence, which would have been sufficient to establish a *prima facie* case in a contested proceeding:

***

5. On April 9, 1995, decedent Alisa Michelle Flatow was a passenger on the number 36 Egged bus, which was traveling from Ashkelon, Israel, to a Mediterranean resort in the Gush Katif community. Testimony of Kesari Rusa.

6. At or about 12:05 P.M. local time, near Kfar Darom in the Gaza Strip, a suicide bomber drove a van loaded with explosives into the number 36 Egged bus, causing an explosion that destroyed the bus. Testimony of Kesari Rusa. . . .

***

14. . . . Alisa Michelle Flatow died at approximately 10:00 A.M. local time on April 10, 1995. . . . [T]estimony of Dr. Allan Fisher. . . .

***

16. The Shaqaqi faction of Palestine Islamic Jihad claimed responsibility for and in fact perpetrated the terrorist act which caused the death of Alisa Michelle Flatow. Palestine Islamic Jihad is a series of loosely affiliated factions rather than a cohesive group. The Shaqaqi faction is a terrorist cell with a small core membership. Its sole purpose is to conduct terrorist activities in the Gaza region, and its sole source of funding is the Islamic Republic of Iran.

***

18. In July 1996, Plaintiff Stephen M. Flatow and his counsel met with Ambassador Philip Wilcox, who then served as the Department of State's Coordinator for Counterterrorism. During that meeting, he informed Mr. Flatow that the Department of State was satisfied that the group which had claimed responsibility for the bombing, the Shaqaqi faction of Palestine Islamic Jihad, had in fact perpetrated the bombing, and that the Islamic Republic of Iran provided approximately two million dollars to Palestine Islamic Jihad annually in support of its terrorist activities. Affidavit of Stephen M. Flatow. . . .

19. Defendant the Islamic Republic of Iran is a foreign state and has been designated a state sponsor of terrorism pursuant to section 6(j) of the Export Administration Act of 1979[12] continuously since January 19, 1984. Defendant provides material support and resources to Palestine Islamic Jihad by supplying funds and training for the Shaqaqi faction's terrorist activities in the

---

[11]United States Code, title 28, §1608(e).

[12]www.heritage.org/Research/Reports/1979/06/The-Export-Administration-Act-S737—HR4034?query=The+Export+Administration+Act+%28S.737+-+H.R.4034%29.

Gaza Strip region. Testimony of Dr. Reuven Paz, testimony of Dr. Patrick Clawson, testimony of former FBI Deputy Assistant Director for Counterterrorism Harry Brandon.

20. Defendant the Islamic Republic of Iran sponsors the Shaqaqi faction's terrorist activities within the meaning of United States Code, title 28, §1605(a)(7) and §1605 note by providing it with all of its funding. Testimony of Dr. Reuven Paz; testimony of Dr. Patrick Clawson; testimony of former FBI Deputy Assistant Director for Counterterrorism Harry Brandon.

Conclusions of Law with Respect to Jurisdiction

A. The Foreign Sovereign Immunities Act Controls This Action

As this action is brought against a foreign state, its intelligence service acting as its agent, and three of its officials, acting in their official capacity, the Foreign Sovereign Immunities Act of 1976 ("FSIA"), as amended, controls this action.

***

The text of the Foreign Sovereign Immunities Act (FSIA) is given at http://uscode.house.gov/download/pls/28C97.txt.

1. **Recent Amendments to the Foreign Sovereign Immunities Act Create Subject Matter Jurisdiction and Federal Causes of Action for Certain Acts of State Sponsored Terrorism**. . . . In the Anti-terrorism and Effective Death Penalty Act of 1996, Congress [amended the FSIA and] lifted the immunity of foreign states for a certain category of sovereign acts which are repugnant to the United States and the international community—terrorism.[13] That Act created an exception to the immunity of those foreign states officially designated by the Department of State as terrorist states if the foreign state commits a terrorist act, or provides material support and resources to an individual or entity which commits such an act, which results in the death or personal injury of a United States citizen.

   Although the Antiterrorism Act created a forum competent to adjudicate claims arising from offenses of this nature, serious issues remained, in particular, the causes of action available to plaintiffs. Congressman Jim Saxton sponsored [a second] amendment to [the FSIA] with the intent to clarify this and other issues. In Congressman Saxton's experience as Chairman of the House Task Force on Counterterrorism and Unconventional Warfare and member of the House National Security Committee, in order for the exception for immunity to have the desired deterrent effect, the potential civil liability for foreign states which commit and sponsor acts of terrorism would have to be substantial. Therefore, the [second] amendment . . . expressly provided, *inter alia,* that punitive damages were available in actions brought under the state sponsored terrorism exception to immunity. This provision of law is commonly referred to as the "Flatow Amendment."

***

B. Subject Matter Jurisdiction

In order to establish subject matter jurisdiction pursuant to §1605(a)(7) [of the FSIA], a claim must contain the following statutory elements:

1. that personal injury or death resulted from an act of torture, extrajudicial killing, aircraft sabotage, or hostage taking; and
2. the act was either perpetrated by the foreign state directly or by a non-state actor which receives material support or resources from the foreign state defendant; and
3. the act or the provision of material support or resources is engaged in by an agent, official or employee of the foreign state while acting within the scope of his or her office, agency or employment; and

[13] *Id.*, §1605 (hereinafter "state sponsored terrorism exception").

4. that the foreign state be designated as a state sponsor of terrorism either at the time the incident complained of occurred or was later so designated as a result of such act; and
5. if the incident complained of occurred with the foreign state defendant's territory, plaintiff has offered the defendants a reasonable opportunity to arbitrate the matter; and
6. either the plaintiff or the victim was a United States national at the time of the incident; and
7. similar conduct by United States agents, officials, or employees within the United States would be actionable.

While elements (4)–(6) are pure questions of fact, elements (1)–(3) and (7) are mixed questions of law and fact, and, in the absence of settled precedent, require interpretation.

1. **A Suicide Bombing Is an Act of Extrajudicial Killing.** Plaintiff describes the cause of his daughter's death as an "extrajudicial killing" within the meaning of §1605(a)(7) [of the FSIA]. The state-sponsored terrorism exception to immunity expressly adopts the definition of extrajudicial killing set forth in the Torture Victim Protection Act of 1991.[14] That Act defines an "extrajudicial killing" as

> *a deliberated killing* not authorized by a previous judgment pronounced by a regularly constituted court affording all judicial guarantees which are recognized as indispensable by civilized peoples. Such term, however, does not include any such killing that, under international law, is lawfully carried out under the authority of a foreign nation. (emphasis added)

Deliberate is defined as:

> . . . Carried on coolly and steadily, especially according to a preconceived design; given to weighing facts and arguments with a view to a choice or decision; careful in considering the consequences of a step; . . . [15]
>
> Other courts have found that summary executions, for example, would be considered "extrajudicial killings." . . . In actions brought under the Alien Tort Statute[16] and the Torture Victim Protection Act, courts have suggested, in the context of command responsibility, that a course of indiscriminate brutality, known to result in deaths, rises to the level of "extrajudicial killings."[17]

***

As the state sponsored terrorism exception expressly incorporates a definition from the United States criminal code chapter on international terrorism, . . . [a] definition from that chapter is . . . apropos:

1. the term "international terrorism" means activities that—
   A. involve violent acts or acts dangerous to human life that are a violation of the criminal laws of the United States or of any State, or that would be a criminal violation if committed within the jurisdiction of the United States or of any State;
   B. appear to be intended—
      i. to intimidate or coerce a civilian population;
      ii. to influence the policy of a government by intimidation or coercion;
      iii. to affect the conduct of a government by assassination or kidnapping; and
   C. occur primarily outside the territorial jurisdiction of the United States, or transcend national boundaries in terms of the means by which they are accomplished, the persons

[14]http://thomas.loc.gov/cgi-bin/query/z?c102:H.R.2092.ENR.

[15]*Black's Law Dictionary,* pp. 426–427 (6th ed., 1990).

[16]United States Code, title 28, §1350.

[17]Extrajudicial punishment is physical punishment without the permission of a court or legal authority. Such punishment is usually done secretly, in order to avoid massive public outcry and international criticism that would reflect badly on the state. Extrajudicial punishment may be typical of totalitarian and other politically repressive regimes that use death squads for this purpose. But even self-proclaimed or internationally recognized democracies have been known to resort to extrajudicial punishment under certain circumstances.

> they appear intended to intimidate or coerce, or the locale in which their perpetrators operate or seek asylum; . . . [18]

Attempts to reach a fixed, universally accepted definition of international terrorism have been frustrated both by changes in terrorist methodology and the lack of any precise definition of the term "terrorism." Therefore, the United States characterizes rather than enumerates acts for the purposes of designating foreign state sponsors of terrorism and defining criminal terrorist offenses under federal law. Each of the acts listed in §1605(a)(7) [of the FSIA] fully conform with the foregoing definitions and provisions.

This Court concludes that a suicide bombing conforms with each of the foregoing provisions and definitions, and therefore is an act of "extrajudicial killing" within the meaning of United States Code, title 28, §1605(a)(7).

2. **The Routine Provision of Financial Assistance to a Terrorist Group in Support of Its Terrorist Activities Constitutes the Provision of Material Support or Resources within the Meaning of 28 U.S.C. §1605(a)(7).** The state-sponsored terrorism provision adopts the definition of "providing material support or resources" set forth in the federal criminal code. [As defined in the federal criminal code]:

   > . . . "material support or resources" means currency or other financial securities, financial services, lodging, training, safehouses, false documentation or identification, communications equipment, facilities, weapons, lethal substances, explosives, personnel, transportation, and other physical assets, but does not include humanitarian assistance to persons not directly involved in such violations.[19]

   This Court concludes that the routine provision of financial assistance to a terrorist group in support of its terrorist activities constitutes "providing material support or resources" for a terrorist act within the meaning of §1605(a)(7) [of the FSIA]. Furthermore, as nothing in [the preceding definition] indicates otherwise, this Court also concludes that a plaintiff need not establish that the material support or resources provided by a foreign state for a terrorist act contributed directly to the act from which his claim arises in order to satisfy §1605(a)(7)'s statutory requirements for subject matter jurisdiction. Sponsorship of a terrorist group which causes the personal injury or death of a United States national alone is sufficient to invoke jurisdiction.
3. **The Provision of Material Support and Resources to a Terrorist Group Is an Act within the Scope of a Foreign State's Agent's and High Officials' Agency and Offices**. The law of *respondeat superior* demonstrates that if a foreign state's agent, official or employee provides material support and resources to a terrorist organization, such provision will be considered an act within the scope of his or her agency, office or employment.

   ***

   . . . This Court concludes that if a foreign state's heads of state, intelligence service, and minister of intelligence routinely provide material support or resources to a terrorist group, whose activities are consistent with the foreign state's customs or policies, then that agent and those officials have acted squarely within the scope of their agency and offices within the meaning of §1605(a)(7) and §1605 note [of the FSIA].
4. **United States Officials Would Be Liable for Providing Material Support or Resources to a Terrorist Group Within the United States.** The Flatow Amendment clarifies that the liability of foreign states and their officials must be comparable to that of the United States and its agents, officials, and employees officials. This Court concludes that if officials of the United States, while acting in their official capacities, provide material support and resources to a terrorist group which executed a suicide bombing within the United States, those officials would not be immune from civil suits for wrongful death and personal injury.

***

[18] United States Code, title 18, §2331.

[19] *Id.*, §2339A(a).

Conclusion

This Court possess[es] subject matter jurisdiction over this action. . . . Plaintiff has established to this Court's satisfaction, pursuant to 28 U.S.C. §1608(e), and by clear and convincing evidence, that Defendants, the Islamic Republic of Iran, the Iranian Ministry of Information and Security, Ayatollah Ali Hoseini Khamenei, former President Ali Akbar Hashemi-Rafsanjani, and former Minister Ali Fallahian-Khuzestani, are jointly and severally liable for all damages awarded by this Court to Plaintiff Stephen M. Flatow, in his own right, as Administrator of the Estate of Alisa Michelle Flatow, and on behalf of decedent's heirs-at-law, for their provision of material support and resources to a terrorist group which caused the extrajudicial killing of Alisa Michelle Flatow.

Casepoint

The U.S. Antiterrorism and Effective Death Penalty Act of 1996 creates subject-matter jurisdiction and a federal cause of action for acts of state-sponsored terrorism. The elements of the cause of action are: (1) death due to extrajudicial killing, (2) carried out by an actor receiving resources or support from a foreign state, (3) the resources or support are provided by an official acting within his or her scope of employment, (4) the state was designated as a sponsor of terrorism by the U.S. government, (5) the plaintiff offered the defendant state the opportunity to arbitrate if the death occurred within the defendant state's territory, (6) the plaintiff or victim was a U.S. citizen at the time of the death, and (7) similar conduct by U.S. officials would be actionable.

Reading 2-1 State Responsibility, Corporate Responsibility, and Terrorism

A day after 9/11, the United Nations General Assembly adopted Resolution 56/1 without a vote:

> "The General Assembly, guided by the purposes and principles of the Charter of the United Nations . . . urgently calls for international cooperation to prevent and eradicate acts of terrorism, and stresses that those responsible for aiding, supporting or harbouring the perpetrators, organizers and sponsors of such acts will be held accountable."

The General Assembly, Security Council, and every major regional organization, including the Arab League, agreed that the September 11 hijackings and attacks on the World Trade Center and Pentagon were acts of terrorism in violation of international law (see Figure 2.3).

But what does the word "terrorism" mean? The word "terrorism" was first used in connection with the Jacobin "Reign of Terror," and was state-sponsored: in 1793, after the French Revolution and the execution of Louis XVI, the French state (under the control of Robespierre), executed approximately 17,000 presumed enemies of the state. Robespierre installed a dictatorship to stabilize the country, justifying his methods as a necessary step to transform the monarchy into a liberal Republic (see Figure 2.4).

Robespierre justified his methods as necessary in the transformation of the monarchy to a liberal democracy; this notion laid the groundwork for modern terrorists, who believe that violence is necessary to effect the transformation of a system they cannot abide. In the 19th Century, the Narodnaya Volya hoped to end Tsarist rule in Russia, and the Bolsheviks did not succeed in supplanting the Tsar through peaceful protest. In the 20th Century, the notion of terrorism as action by the state, as with Robespierre, had faded and the concept of terrorism as an attack on an existing political order become more prominent.

FIGURE 2.3

The September 11, 2001, Attacks on the World Trade Center in New York City Were in Obvious Violation of International Law

Source: Stacy Walsh Rosenstock/Alamy

FIGURE 2.4

The Guillotine Was a State-Sponsored Method of Execution After the French Revolution

Source: Photos.com

After World War I, the League of Nations drafted a convention called the Convention for the Prevention and Punishment of Terrorism, but the convention never entered into force. After the Second World War, the international community codified certain binding norms of international law in the United Nations Charter. The founders of the United Nations declared that its purpose was:

> to maintain international peace and security, and to that end: to take effective collective measures for the prevention and removal of threats to the peace, and for the suppression of acts of aggression or other breaches of the peace, and to bring about by peaceful means, and in conformity with the principles of justice and international law, adjustment or settlement of international disputes or situations which might lead to a breach of the peace . . .

Despite the international aspect of the U.N. declaration, a lot of what we call terrorism is domestic violence in response to perceived injustices at home. In the 1960s, the leftist group of "Weathermen" resorted to bombings. In 1974, the "Symbionese Liberation Army" took Patty Hearst as a hostage, then engaged in bank heists and threats of violence. In 1995, Timothy McVeigh, an anti-government ex-Army sergeant, bombed the federal building in Oklahoma City, killing 168 people and injuring 681 others. McVeigh was incensed over the federal government's assaults on the Branch Davidian compound in Waco, Texas, and the incident at Ruby Ridge, Montana, in which FBI agents killed Randy Weaver's wife, Vicki, and his son.[20]

McVeigh regarded these incidents as state-sponsored terrorism, and made a political statement in bombing the Alfred Murrah Federal Building (which also destroyed or damaged 324 buildings within a sixteen-block radius). His actions, and those of the Weathermen, or the Symbionese Liberation Army, used violence for political purposes, or to make a political statement. When the government acts with violence on innocent citizens, it is arguably terrorism, as for example with Hitler, Stalin, Pol Pot (in Cambodia), or, more recently, Bashar al-Assad in Syria. Such actions are now universallly condemned, and are no longer regarded as merely "internal disputes."

Still, modern use of the term "terrorism" is usually reserved for those who use violence for political purposes against an existing political order. By contrast, "piracy" is entirely mercenary: the Somali pirates active against commercial shipping near the Horn of Africa are not making a political statement so much as enriching themselves at others' expense.

As of 2011, the al Qaeda network, established and previously led by Osama bin Laden, was often considered the greatest threat to international peace and security in the post–Cold War world. The possibility of cyber-attacks across national boundaries is also widely viewed as a potential threat against multiple states that participate in global capitalism.[21] If China, the U.S., or Russia were actively and directly supporting a wholesale attack on the Internet through government agencies, there would be an argument that such activities amounted to acts of war; if any of these states were, on the other hand, providing material support for non-government groups to engage in cyber-attacks against non-state actors, it could be deemed "state-sponsored terrorism."

State-originated, state-sponsored or otherwise, terrorism continues to be a threat, and even flourish in some parts of the world, despite the post 9/11 declaration by President George W. Bush of a Global War on Terror [a phrase that has not been used much by the Obama Administration]. Although many international terrorists act without state support, states sometimes do encourage, finance, and even train groups to commit terrorist acts, or give terrorists asylum after such acts.

For example, when it controlled Afghanistan, the Taliban regime gave al Qaeda freedom to work and protection from prosecution. In Pakistan, the Pakistani militant group, Lashkar-e-Taiba (the "Army of the Pure"), has carried out a number of terrorist acts, including the deadly attacks on Mumbai in November of 2008; these attacks were allegedly accomplished with the support and encouragement of the intelligence service of the Pakistan government, Pakistan's Inter-Services Intelligence agency (ISI). There may also be Saudi support or funding for Lashkar-e-Taiba, whose sworn enemies include Israel, the United States; like Al Qaeda, Lashkar-e-Taiba works for Islamic rule in most of the Middle East and, in particular, in India.

State liability for sponsorship of terrorist acts, as we explore below, is premised on the underlying criminality of terrorist acts as violating either customary international law or treaty obligations. But adjudicating claims between states requires consent of the two states, and this is often not given. Still, claims between states have been made, such as in the Iranian Hostage Crisis of 1979–80, and in U.S. support of "Contras" in the war against the Sandanista regime in Nicaragua in the 1980s. Both claims were heard by the International Court of Justice, and both are discussed below.

Claims of Terrorism Between States

The International Law Commission (ILC), a body established by the U.N. General Assembly to make recommendations for the codification of customary international law, describes when terrorist conduct is attributed to states in its Draft Articles on Responsibility of States for Internationally Wrongful Acts. Article 8 is a classic formulation of the de facto agency principle: "the conduct of a person or group of persons shall be considered an act of a State under international law if the person or group of persons is in fact acting on the instructions of, or under the direction or control of, that State in carrying out the conduct."

The ILC posits that to meet this test, it must be proved "effectively" that the terrorist(s) "had really been charged by the state organs to carry out that specific act." By contrast, Article 11 of the Draft Articles does not require proof of a state's prior knowledge, and instruction or control of a terrorist

[20]Tony D. and Jackie J. Brown, *The First Canary: The Inside Story of Ruby Ridge and a Decade of Cover-Up* (2000).

[21]See Mark Bowden, *Worm: The First Digital World War* (2011).

act. Under this rule, "conduct which is not attributable to a State under the preceding articles shall nevertheless be considered an act of a State under international law if and to the extent that the State acknowledges and adopts the conduct in question as its own."

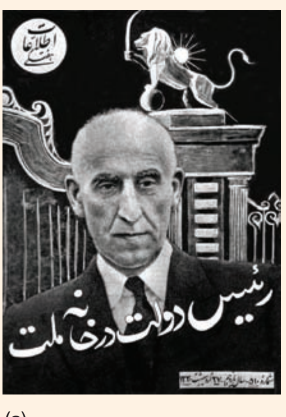
The Iranian Hostage Crisis

For an example of Article 11's application, consider the Iranian hostage situation. In November 1979, thousands of students and Islamic militants overran the U.S. Embassy in Tehran and took 52 people hostage and held them hostage for 444 days. The Iranian Revolution, which had taken place earlier in 1979, deposed Mohammad Reza Shah Pahlavi, who, with his father had largely ruled Iran since 1925. By way of background, consider that it is widely acknowledged that the U.K. and U.S., through the CIA, had intervened in Iranian affairs in 1953, when a democratically elected government headed by Dr. Mohammed Mossadegh (see Figure 2.5a)[22] was replaced in a relatively bloodless CIA coup that reinstalled the Shah of Iran (see Figure 2.5b), whose family had been supported by British interference in Iranian affairs for many years. The British had installed the Shah's grandfather many years earlier in order to secure highly beneficial access to Iranian oil.

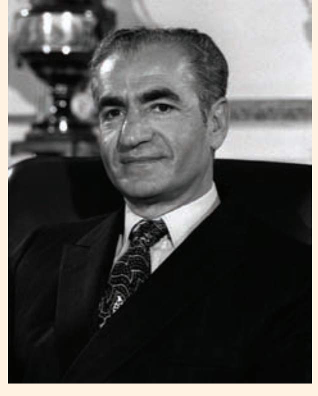
Demonstrations against the Shah had begun in October 1977, developing into a campaign of civil resistance that was partly secular and partly religious, and intensified in January 1978. Between August and December 1978, strikes and demonstrations paralyzed the country. The Shah left Iran for exile in mid-January 1979, and in the resulting power vacuum two weeks later Ayatollah Khomeini returned to Tehran to a greeting by several million Iranians.

The monarchy collapsed shortly after on February 11 when insurgents overwhelmed troops loyal to the Shah in armed street fighting. Iran voted by national referendum to become an Islamic Republic on April 1, 1979, and to approve a new theocratic constitution. Khomeini became Supreme Leader of Iran in December 1979.

After the Shah went into exile in 1979, he went to the U.S. for cancer treatment. In protest of the U.S. allowing the Shah into the U.S., and for the historic role of the U.S. in deposing Mossadegh, student militants entered the Embassy compound. Iranian security forces responsible for guarding the building left without a fight. The Iranian government refused to take action against the militants and "numerous Iranian authorities, including religious, judicial, executive, police, and broadcasting authorities" expressed approval of the hostage taking. The Ayattolah Khomeini, the top Muslim cleric and leader of Iran, stated: "The noble Iranian nation will not give permission for the release of the rest of them. Therefore, the rest of them will be under arrest until the American Government acts according to the wish of the nation." To the United States, the hostage taking was a direct violation of international law, which traditionally has afforded protection and immunity to diplomats and their agents.



(a)



(b)

FIGURE 2.5

Dr. Mohammed Mossadegh (a) Was Deposed by the CIA and Replaced by Mohammad Reza Shah Pahlavi (b)

Sources: Photos 12/Alamy and UK History/Alamy

In the case of United States Diplomatic and Consular Staff in Tehran, the International Court of Justice (ICJ) concluded that although the militants acted on their own initially, the state's approval and perpetuation of the hostage situation for more than a year transformed the acts of the militants into acts of the state of Iran. This clearly fits with the language of Article 11. Yet at the same time, the hostage situation was not over at the time Iran approved the actions on behalf of the state. Rather, the state continued the hostage situation for over a year under the state's authority, making it resemble an Article 8 situation.

Because of the hostage-taking, the U.S. government, primarily through President Carter, froze Iranian assets in the U.S. and imposed sanctions on U.S. companies that might do business with Iran. Over the years, sanctions against Iran (and businesses that would deal with Iranian entities) have increased. From the hostage crisis until recently, most Iranian financial institutions were barred from directly accessing the U.S. financial system, but were permitted to do so indirectly through banks in other states. Along with Iran's alleged development of a nuclear weapons program, U.S. government officials were concerned about money-laundering and support for terrorist networks.

In September 2006, the U.S. government targeted one Iranian bank, Bank Saderat Iran, barring it from dealing even indirectly with U.S. financial institutions. The move was announced by Stuart Levey, the undersecretary for treasury, who accused the major state-owned bank in Iran of transferring funds for certain groups, including Hezbollah, which has been named as a terrorist organization by the U.S. State Department. Levey said that since 2001 a Hezbollah-controlled organization had received 50 million U.S. dollars directly from Iran through Bank Saderat. The U.S. also sought to persuade European banks not to deal with Iran. By November of 2011, concerns over Iran's activities (primarily Iran's alleged pursuit of nuclear weapons but also for money-laundering for terrorist groups) led President Obama's administration to announce new prohibitions on U.S. corporate dealings with Iranian banks and petrochemical industries. Similar measures were undertaken by Canada and the U.K. All of these measures were denounced by Russia as "contrary to international law."

Nicaragua v. United States

In a different ICJ case, Military and Paramilitary Activities in and against Nicaragua, the Court ruled that the United States was not responsible for the rebel activities of Nicaraguan Contras because evidence was insufficient to establish that the United States directed the Contras each and every act. During the Cold War with the U.S.S.R., the U.S. was concerned about communism spreading to the Western Hemisphere; the 1962 Cuban Missile Crisis grew out of the Soviet Union's placing intermediate range ballistic missiles in Cuba, thought by the U.S. government to be a "client state" of the Kremlin.

In Nicaragua, where the Somoza family had ruled for many years, a popular revolution led by the Sandanistas ousted the last Somoza (Anastasio Somoza Debayle) in 1979. However, during the Reagan Administration (1980–1988), armed insurgents (the "Contras") based in El Salvador engaged in attacks against the Nicaraguan state, and also murdered, raped, mutilated, and terrorized Nicaraguan civilians for years, with crucial support

[22]For a brief biography of Dr. Mossadegh, see www.mohammadmossadegh.com/biography/.

from the Reagan Administration. (Ironically, these efforts were funded, at least in part, by the Central Intelligence Agency illegal sales of weapons to Iran. Thus, while Iran did some state-sponsored terrorism against the U.S. in the hostage crisis, the U.S. used Iran as a way to fund violence against the Sandanista regime in Nicaragua.)

Some U.S. lawyers assisted the Sandanista regime in challenging the U.S. government's sponsorship of the "Contras" and their acts of violence. The ICJ ruled that U.S. support for the contras infringed on Nicaragua's territorial sovereignty in contravention of international law, but concluded the evidence did not demonstrate the United States "actually exercised such a degree of control in all fields as to justify treating the contras as acting on its behalf." In order to attribute the actions of the contras to the United States, the ICJ required proof in each instance that operations launched by the contras "reflected strategy and tactics solely devised by the United States."

A significant number of commentators have been critical of the ICJ's "act by act" approach toward agency. It seems clear enough that U.S. support for the Contras was significant, if not crucial. But perhaps the ICJ gave an expansive look at the individuals who were motivated to unseat the Sandanista regime in Nicaragua as motivated by their own liberation and that of their country. Critics of the ICJ's reasoning in the Nicaragua decision believe it gives states a blank check to support any group involved in a struggle for self-determination, yet avoid responsibility for the actions of those groups. In the case of Pakistan's support for Lashkar-e-Taiba or the Hakkani network, there are likely to be mixed motives and multiple parties supporting each group, making it difficult for another state to make the case for state responsibility under Article 11.

Corporations and "Terrorism," Including Gross Violations of Human Rights

It is not only claims between states that businesses must pay attention to: individuals may sue foreign sovereigns for sponsoring terrorist acts (see Case 2-2), and corporations that support terrorist groups can be criminally prosecuted, as well as sued for civil damages (see below, Chiquita in Colombia). Further, terrorist acts or murders in which corporations may be complicit may create liability, as well (see Chapter 8, *Kiobel v. Royal Dutch Petroleum* and the discussion below). Even beyond legal liabilities, corporate collaboration with states that violently suppress peaceful protesters with legitimate grievances can find themselves subjected to lawsuits, or (more often) to reputational damage. Shell Oil discovered this in 1995 when it allowed the government of Nigeria to capture and execute some of those who were protesting Shell's degradation of the environment in the Ogoni Delta in Nigeria.

Corporate Support of Terrorism: Chiquita in Colombia

Since the 1990s, Chiquita Brands paid money to two types of terrorist organizations in Colombia, including a left-wing guerilla operation known as the Revolutionary Armed Forces of Colombia, or FARC, and a right-wing group called the United Self-Defense Forces, or AUC. It paid FARC money in the early 1990s when it was more powerful, and when its power waned, the company began making payments to AUC after it had taken control of parts of Colombia where Chiquita had its principal banana farm operations. The AUC has been described as "a coalition of paramilitary groups whose members have massacred peasants and murdered leftist activists for years."[23] Chiquita paid the AUC $1.7 million over a seven-year period, making about 50 payments prior to September 10, 2001, when it was declared a terrorist group by the U.S. State Department, and another 50 payments after that date.[24] Chiquita declared bankruptcy in 2002, and a new post-bankruptcy board was then appointed. Even after an internal counsel discovered the terrorist designation for AUC in February 2003, the company made two additional payments of $37,000 in February and March of that year. Moreover, after the audit committee chair Roderick Hills reported the payments to the full board on April 3, 2003, and then self-reported the payments to the Department of Justice on April 24, 2003, the company still made 10 more payments totaling about $134,000 between May and September, and another half dozen payments of more than $145,000 by February 2004.

Officials of Chiquita Brands have consistently maintained that the money given to both the left-wing terrorists in the early 1990s and to right-wing death squads from 1997 to 2004 were to protect the company's employees from murder and kidnapping. In short, the company claimed to have paid protection money that had been extorted by the terrorists. Eric Holder, then an attorney representing Chiquita, and later the U.S. Attorney General in the Obama administration, said the company faced "a moral dilemma of the highest order." He argued that "[u]nder the circumstances, the company did what it had to do to save the lives of its employees while disclosing fully its actions to U.S. authorities and appealing for their reason and guidance."

But Chiquita later paid a fine of $25 million on the threat of Justice Department prosecution, and faces several lawsuits from Colombian citizens whose relatives were allegedly killed or taken hostage by the AUC or the FARC, with "aid and support" from Chiquita. In one such case, a federal district court judge in Florida ruled in June 2011 that 4,000 family members of Colombians killed by paramilitaries would be allowed to move their case forward. Chiquita had argued that it was a victim of extortion by the paramilitary group AUC, and had nothing to do with the crimes committed by the paramilitary AUC that it had paid money to. The plaintiffs' claims against Chiquita are for torture and "crimes against humanity." The attorney representing the plaintiffs claimed that any company that pays a terrorist organization that kills thousands of people should be put out of business by punitive damages. Chiquita characterized the claims as false and without merit. In any case, cooperation with terrorist organizations has its reputational and even economic price for corporations. Another example of corporate cooperation with official acts of violence can be seen in the experience of Shell's operations in Nigeria.

Corporate Acquiescence in Violent State Oppression

In its Nigerian operations, in the Ogoni Delta near the Atlantic Ocean, Royal Dutch/Shell experienced numerous protests from the native Ogoni people. The Ogoni were incensed over decades of petroleum dumping, the fouling of their waters (used for fishing and other subsistence), and the lack of local jobs for native Ogoni. Noted Nigerian writer Ken Saro-Wiwa became the spokesperson for the Movement for the Survival of the Ogoni People (MOSOP) and led a nonviolent campaign against environmental degradation of the land and waters of Ogoniland.

He was also an outspoken critic of the Nigerian government, which he viewed as reluctant to enforce environmental regulations on the foreign petroleum companies operating in the area. The Nigerian government allegedly put down these protests with some degree of violence; villages were raided and protest leaders were arrested.

At the peak of his nonviolent campaign, Saro-Wiwa was arrested, hastily tried by a special military tribunal on charges that many observers viewed as politically motivated and factually baseless. He was executed in 1995 by the military government of General Sani Abacha. His hanging by

[23] Juan Forero, "Colombia May Seek Chiquita Extraditions." *Washington Post,* March 21, 2007, p. D1.

[24] Cohen, Laurie P., "Chiquita Under the Gun," *Wall Street Journal,* August 2, 2007, p. A1.

Nigerian authorities provoked outrage throughout the world; the Commonwealth of Nations suspended Nigeria from membership for over three years.

Human rights NGOs concluded that Shell was complicit in the trial and execution of Saro-Wiwa, for it fulfilled the corporate need to continue operations without interference from local objections. Shell denied any ties to military operations against the Ogoni in general, or Ken Saro-Wiwa in particular. Shell maintained that it asked the Nigerian government for clemency toward those found guilty but that its request was refused. Shell also suggested that MOSOP was an extortionary movement that advocated violence and secession, thus framing it as a terrorist organization.

Shell withdrew from its operations in Nigeria for awhile, and acknowledged in 2003 that the conflict in the Niger Delta made it difficult to operate with safety and integrity. Meanwhile, various lawsuits were filed against Shell for its actions (or inactions) in the Niger Delta, especially with regard to its alleged complicity with the Nigerian government's suppression of peaceful protests by violent means.

One of those lawsuits was filed in 1996 in U.S. federal court by Ken Wiwa (son of Ken Saro-Wiwa who was executed in 1995) and other members of the MOSOP. The plaintiffs alleged that the Nigerian military government and security forces committed human rights violations, including torture and summary execution of MOSOP members, to suppress MOSOP's activities and that Royal Dutch/Shell was complicit in the commission of these abuses. The plaintiffs won several pretrial rulings, and survived several motions by the defendants to dismiss the case.

In early June 2009, the parties announced that they had agreed to a settlement in the case for $15.5 million. The settlement provides compensation for the ten plaintiffs and covers a portion of the plaintiffs' legal costs. The settlement also establishes a trust for the benefit of the Ogoni people, a trust that will be governed by independent trustees for education, adult literacy, and support for local business enterprises.

A related lawsuit was filed by Esther Kiobel, the wife of Dr. Barinem Kiobel—an Ogoni activist who was executed at the same time as Ken Saro-Wiwa. The plaintiffs allege that Shell, through its Nigerian subsidiary Shell Petroleum Development Company of Nigeria (SPDC), provided transport to Nigerian troops, allowed company property to be used as staging areas for attacks against the Ogoni and provided food to the soldiers and paid them. The plaintiffs claimed the defendant companies were complicit in the commission of torture, extrajudicial killing, and other violations pursuant to the Alien Tort Claims Act (ATCA). The procedural history is long and complex, and the case is currently on appeal to the U.S. Supreme Court, which is considering an appeal from the dismissal of *Kiobel v. Royal Dutch Petroleum* by the Second Circuit Court of Appeals. (See Chapter 8 for a discussion of the ATCA, or Alien Tort Statute, and citations to *Kiobel v. Royal Dutch Petroleum* and related cases.)

Conclusion

The most basic principle of state responsibility is that a state is not absolutely liable for the actions of non-state entities, but is only responsible for conduct attributable to the state. In order to hold a state liable in damages for terrorist activities committed by private persons, it is necessary for the injured state to show the conduct of the private persons is *attributable* to the state under customary or conventional norms of international law.

Arguably, the terms "state sponsorship" and "state support" should be used to refer to two different kinds of state involvement in terrorism. State sponsorship of terrorism could be limited to situations where the state planned, directed, and controlled terrorist operations; state support of terrorism could include all other lesser forms of state involvement.

States will undoubtedly continue along the path of trying to hold other states responsible for supporting terrorism or terrorist acts. Bringing claims diplomatically, or before judicial tribunals such as the ICJ will gradually increase state accountability for international terrorism, and will also create opportunities to change and clarify international law as it relates to terrorism and state responsibility.

The United States and the European Union will likely increase the pressure on states to yield up terrorists that have taken asylum in other states, such as the pressure put on Libya to extradite the Lockerbie bombers. It is even likely that some states will argue for criminal sanctions on other states for sponsorship of terrorism, and for higher standards of diligence for other states to prevent and punish terrorism. But it will probably take a strong convention, with implied consent of the parties, to successfully start to curtail state sponsorship of terrorist activities. At the same time, businesses must be careful not to collaborate with terrorists (Chiquita), whether state-sponsored or not, and should avoid collaborating for profit with governments that use violence to quell legitimate human concerns or violate fundamental human rights (Shell).

Fault and Causation

The case law and most law writers suggest that a country is responsible for injuries regardless of fault. In other words, there is no requirement to show ***culpa*** (fault) by the country (either through knowledge or negligence).[25]

culpa
(From Latin: "fault or error.") Responsibility for wrongdoing.

[25]A different view was expressed by two dissenting judges in the *Corfu Channel Case (United Kingdom v. Albania) (Merits),* which involved a suit brought by the United Kingdom for injuries its warships suffered from striking mines in Albanian waters. The majority opinion stated as follows: "The court must examine . . . whether it has been established by means of indirect evidence that Albania has knowledge of the mine laying in her territorial waters independently of any connivance on her part in this operation. The proof may be drawn from inferences of fact, provided that they leave no room for reasonable doubt. . . . In fact, Albania neither notified the existence of the minefield, nor warned the British warships of the danger they were approaching. . . . In fact, nothing was attempted by the Albanian authorities to prevent the disaster. These grave omissions involve the international responsibility of Albania. . . ." Judge Krylov disagreed. In his dissent, he wrote: "Is it then possible to found the international responsibility of Albania on the notion of *culpa?* Can it be argued that Albania failed to exercise the diligence required of international law to prevent the laying of mines in the Corfu Channel? . . . In view of . . . the inadequacy of the evidence produced by the British, I am unable to reach the conclusion that Albania was responsible for the explosions. . . . One cannot condemn a State on the basis of probabilities. To establish international responsibility, one must have clear and indisputable facts. In the present case the facts are absent." And Judge Azevedo added: "The notion of *culpa* is always changing and undergoing a slow process of evolution; moving away from the classical elements of imprudence and negligence, it tends to draw nearer to the system of objective responsibility; and this has led certain present-day authors to deny that *culpa* is definitely separate, in regard to a theory based solely on risk." *International Court of Justice Reports,* vol. 1949, p. 2 (1949).

causation
(From Latin *causa:* "reason.") The act or agency that produces an effect, result, or consequence.

This rule reflects the difficulties of proving a lack of proper care by a state. Instead, courts look to **causation**. That is, did the state or its officials actually cause the injury? In the *Lighthouses* arbitration between France and Greece, a question arose about Greece's eviction of a French firm from its offices in Salonika and its responsibility for the loss of merchandise destroyed by a fire at the firm's temporary location. The Permanent Court of Arbitration said:

> Even if one were inclined . . . to hold that Greece is responsible for the consequences of that evacuation, one could not . . . admit a causal relationship between the damage caused by the fire, on the one part, and that following on the evacuation, on the other, so as to justify holding Greece liable for the disastrous effects of the fire. . . . The damage was neither a foreseeable nor a normal consequence of the evacuation, nor attributable to any want of care on the part of Greece. All causal connection is lacking, and in those circumstances Claim No. 19 must be rejected.[26]

B. Standard of Care

Once a court or other tribunal decides that a state is connected to an action, it has to determine the criteria it is to be judged by. Two criteria have appeared in the case law: the *international standard* (or sometimes the *international minimum standard*) and the *national standard.*

The National Standard of Care

national standard of care
Doctrine that a state must treat aliens the same way that it treats its own nationals.

Third World states (especially in Latin America before World War II and in Asia and Africa after World War II) have often pressed for a **national standard of care**. That is, a state should treat an alien exactly as it treats its own nationals—no better, no worse. But the critics point out that this is not protection for aliens if the nationals are ill-treated; and if the rule were carried to its extreme, it would mean that aliens should be given the same privileges (voting, health care, etc.) as nationals.

International support for the national standard or *equality of treatment* doctrine has fluctuated over the years.[27] Efforts by the Soviet Union to obtain support for a 1962 United Nations General Assembly resolution that would have established "the inalienable rights of peoples and nations to the unobstructed execution of nationalization, expropriation, and other measures" was defeated by a vote of 48 to 34, with 21 abstentions. Among those nations voting against the resolution were 16 Latin American states and 10 African and Asian states. Two Latin American and 19 African and Asian states abstained. In the debate leading up to the vote, the representatives of many developing countries sought to reassure the capital-exporting states of Western Europe and North America that they had no intention of confiscating foreign investments.

The role that foreign capital plays in development and the fear of offending states that extend economic and other kinds of assistance—matters frankly admitted to in the debates—were important factors in defeating the Soviet proposal. On the other hand, the less developed countries generally have been unwilling to reject the national treatment doctrine and sign treaties obliging them to pay just compensation if they expropriate foreign investments.

The International Standard of Care

international standard of care
Doctrine that a state is responsible for injuring an alien when the state's conduct violates international norms.

The standard of care favored by major Western countries is known as the **international standard of care**. This standard says that although a country has no obligation to admit aliens to its territory, once it does, it must treat them in a civilized manner. In the Neer Claim, the arbitrator held that the mistreatment of an alien constitutes a "delinquency" (and thus a violation of the international standard) if it "should amount to an outrage, to bad faith, to willful neglect of duty or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency."[28]

---

[26] *United Nations Reports of International Arbitral Awards,* vol. 12, pp. 217–218.

[27] The 1930 Hague Conference for the Codification of International Law was unable to formulate a draft convention on the responsibility of states because a large minority of delegates (17 of 40) favored the equality of treatment doctrine rather than the international standard doctrine. This minority was composed of the seven Latin American states that took part in the vote, four Asian and African states, five Eastern European states, and Portugal. Had all the Latin American states and the Soviet Union attended the conference, there probably would have been a majority in support of the national standard.

[28] *United Nations Reports of International Arbitral Awards,* vol. 4, p. 60 (1920).

Such delinquencies can be either crimes or torts. In its 1979 Draft Articles on State Responsibility, the International Law Commission suggested that state acts are international crimes if they seriously breach international peace, deny people the right of self-determination, or fail to safeguard human life and dignity (e.g., slavery, genocide, and apartheid).

Other breaches, according to the Draft Articles, are international torts.[29] The most common international tort is the expropriation or nationalization of aliens' and foreign businesses' property. Denial of justice is also a common tort. We look at both these torts in the materials that follow.[30]

Expropriation

expropriation
(From Latin *expropriare:* "to take away one's own.") Taking of private property by a government.

Expropriation or nationalization is the state's taking or deprivation of the property of foreigners. The right of states to expropriate foreign property is universally recognized; in municipal law, the right of a government to "take" property for public purposes is known as eminent domain. Western countries regard expropriation, much as they regard eminent domain, as proper so long as it is done for a legitimate public purpose and the state pays prompt, adequate, and effective compensation.

As with eminent domain cases, some controversy exists over whether the public-purpose element is required in expropriation cases. Some argue that it is,[31] others that it should be expressed only as a requirement not to discriminate against a particular class of foreigners. For example, in the *LIAMCO Case,* which involved the expropriation of an American oil company by Libya, the arbitrator stated:

> As to the contention that the said measures were politically motivated and not in pursuance of a legitimate public purpose, it is the general opinion in international theory that the public utility principle is not a necessary requisite for the legality of a nationalization. This principle was mentioned by Grotius and other later publicists, but now there is no international authority, from a judicial or any other source, to support its application to nationalization. . . .
>
> However, political motivation may take the shape of discrimination as a result of political retaliation . . . [and it] . . . is clear and undisputed that nondiscrimination is a requisite for the validity of a lawful nationalization. . . . Therefore, a purely discriminatory nationalization is illegal and wrongful.[32]

---

[29](1) An act of State which constitutes a breach of an international obligation is an international wrongful act, regardless of the subject matter of the obligation breached. (2) An internationally wrongful act which results from the breach by a State of an international obligation so essential for the protection of fundamental interests of the international community that its breach is recognized as a crime by that community as a whole, constitutes an international crime. (3) Subject to paragraph 2, and on the basis of the rules of international law in force, an international crime may result, *inter alia,* from: (a) a serious breach of an international obligation of essential importance for maintenance of international peace and security, such as that prohibiting aggression; (b) a serious breach of an international obligation of essential importance for safeguarding the right of self-determination of peoples, such as that prohibiting the establishment or maintenance by force of colonial domination; (c) a serious breach on a widespread scale of an international obligation of essential importance for safeguarding the human being, such as those prohibiting slavery, genocide, apartheid; (d) a serious breach of an international obligation of essential importance for the safeguarding and preservation of the human environment, such as those prohibiting massive pollution of the atmosphere or of the seas. (4) Any international wrongful act which is not an international crime in accordance with paragraph 2, constitutes an international delict." Article 19, International Law Commission Draft Articles on State Responsibility, 1979, in *Yearbook of the International Law Commission,* vol. 2, pt. 2, p. 90 (1979).

[30]International crimes are examined in the next chapter and in Ray August, *Public International Law: Text, Cases, and Readings* (1995).

[31]In the *BP Exploration Co. (Libya), Ltd. v. Libyan Arab Republic Case,* Libya nationalized a British Petroleum subsidiary operating in Libya but did not nationalize property belonging to other foreign oil companies. Libya was seeking to retaliate against the United Kingdom (which then owned a substantial share of BP) for the United Kingdom's refusal to help a Libyan ally in the Persian Gulf prevent Iran from occupying certain islands the ally claimed. The arbitrator held as follows: "The BP Nationalization Law, and the actions taken thereunder by the Respondent, do constitute a fundamental breach of the BP Concession as they amount to a total repudiation of the agreement and the obligations of the Respondent thereunder, and, on the basis of rules of applicable systems of law too elementary and voluminous to require or permit citation, the Tribunal so holds. Further, the taking by the Respondent of the property, rights and interests of the Claimant clearly violates public international law as it was made for purely extraneous political reasons and was arbitrary and discriminatory in character. Nearly two years have now passed since the nationalization, and the fact that no offer of compensation has been made indicates that the taking was also confiscatory." *International Law Reports,* vol. 53, p. 297 (1974).

[32]Because "Libya's motive for nationalization was its desire to preserve the ownership of oil," the arbitrator concluded that the expropriation was not discriminatory. Libyan American Oil Co. (LIAMCO) v. Government of the Libyan Arab Republic, *International Legal Materials,* vol. 20, p. 1 at p. 58 (1981).

For practical considerations (i.e., given the difficulty of defining a public purpose), this is probably the best rule, and the one most likely to be applied by tribunals.

The meaning that the major Western industrial powers give to the phrase "prompt, adequate and effective compensation" was succinctly stated by the plaintiff in its pleadings in the *Anglo-Iranian Oil Co. (United Kingdom v. Iran) Case.* The case involved the expropriation of British-owned oil companies in Iran. The plaintiff, the United Kingdom, stated:

> . . . it is clear that the nationalization of the property of foreigners, even if not unlawful on any other ground, becomes an unlawful confiscation unless the provision is made for compensation which is adequate, prompt and effective. By "adequate" compensation is meant "the value of the undertaking at the moment of dispossession, plus interest to the day of judgment"—per the . . . *Chorzów Factory Case.*
>
> . . . [Second, the requirement for] prompt compensation means immediate payment in cash. . . .
>
> The third requirement is summed up in the word "effective" and means that the recipient of the compensation must be able to make use of it. . . . Monetary compensation which is in blocked currency is not effective. . . .[33]

The adequacy of compensation, the meaning of discrimination, and the question of whether a nationalization decree can be applied extraterritorially are considered in Case 2-3.

In Brief: CASE 2-3 Acsyngo v. Compagnie De Saint-Gobain (France) S.A.

Belgium, Commercial Court of Namur, 1986

Revue pratique des sociétés, vol. 85 (1986); *International Legal Materials,* vol. 26, p. 1251 (1987); *International Law Reports,* vol. 82, p. 128 (1990)

MAP 2.3

France and Belgium (1986)

[33] *International Court of Justice Pleadings,* vol. 1952, p. 105 (1952).

Facts

France had nationalized the stock in the French conglomerate Compagnie de Saint-Gobain (CSG) in 1982. CSG, in turn, owned slightly more than half of the stock of Glaceries de Saint-Roch (GSR), a Belgian company. The shareholders of CSG who had had their shares nationalized formed a syndicate, ACSYNGO, and ACSYNGO then brought suit in Belgium to claim that it (rather than CSG) should be made the owner of the half interest in GSR. ACSYNGO argued that to do otherwise was to wrongfully give extraterritorial effect to a French nationalization decree.

Issues

(1) Was the nationalization decree expropriatory or discriminatory? (2) Is a foreign nationalization decree illegal if it has extraterritorial effects? (3) Does this nationalization decree violate the public policy of Belgium?

Holdings

(1) A nationalization decree is not expropriatory if it provides for fair and adequate compensation. It is not discriminatory if it differentiates between different economic sectors. (2) Belgium does not recognize the theory of *Spaltgesellschaft* (that a splinter company would automatically come into existence when one state nationalizes a company with assets in another state). (3) The appropriation of foreign assets of a private person is lawful if it does not violate the public policy of the state where the assets are located.

Explanation

(1) Fair market price was paid. The only discrimination was between economic sectors. (2) A shareholder who receives adequate compensation would be acting in bad faith to invoke the theory of *Spaltgesellschaft.* (3) It would violate Belgian public policy to separate GSR from the CSG group, as this would decrease its value to the harm of its Belgian shareholders.

Order

Case dismissed.

Casepoint

Where one nation nationalizes a company based in that nation, and the company has assets in another nation, shareholders of the nationalized company in the other nation cannot invoke the theory of *Spaltgesellschaft* so that a separate company is created. In effect, if fair and adequate compensation has been paid, the nationalization decree of one nation can have extraterritorial effect in another nation.

Many former colonies of industrialized nations object to the requirement of adequate compensation when, as the Western nation-states would have it, it is for full market value. They argue that factors (such as colonial domination) should be taken into consideration, and two United Nations General Assembly Resolutions have taken that viewpoint. Western commentators, however, have interpreted the resolutions as only setting out a long-term goal and not expressing the current status of customary international law.

Possibly the best statement of the "Third World" position was given in Barcelona Traction and Light, a case between Belgium and Spain heard in the ICJ in 1970.[34] (See Map 2.4). Barcelona Traction, Light, and Power Company, Ltd. (Barcelona Traction) manufactured and supplied electricity in Spain. Although doing business in Spain, it was incorporated in Canada and maintained its headquarters

[34]*International Court of Justice Reports,* vol. 1970, p. 3 (1970).

MAP 2.4

Spain and Belgium (1948)

in Toronto. The company issued corporate bonds to investors outside of Spain. During the Spanish Civil War (1936–1939), the government of Spain refused to allow Barcelona Traction to transfer currency from Spain to pay interest to the bondholders. The interest payments were never resumed.

In 1948, several Spaniards purchased some of the bonds and then brought suit in a Spanish court asking it to declare Barcelona Traction bankrupt because it had failed to pay the interest on the bonds. The court did so and, following several motions and appeals, all of the assets in Spain belonging to the company were finally sold by public auction in 1952. The proceeds from the sale were distributed to creditors and only a very small sum was to be paid to shareholders.

The shareholders then sought the assistance of their home states in seeking to obtain a larger settlement. Canada, among other states, complained to Spain of denials of justice and of the violation of certain treaties it alleged were applicable. Canada, however, eventually agreed that Spain had acted properly in denying Barcelona Traction the right to transfer currency abroad and later in declaring the company bankrupt.

Belgium took an interest in the matter because Belgians owned 88 percent of the shares in Barcelona Traction. It disagreed that Spain had acted properly and after Spain became a member of the United Nations in 1955, Belgium filed a complaint before the ICJ in 1958. The proceedings were suspended and then discontinued while representatives of the private interests concerned carried on negotiations. When the negotiations failed, Belgium submitted a new application to the Court in 1962.

Spain promptly objected that Belgium could not sponsor Barcelona Traction's or its shareholders' complaints because Barcelona Traction was a Canadian company. The Court set forth the general duty of state responsibility toward the investments of foreign nationals as follows:

> When a State admits into its territory foreign investments or foreign nationals, whether natural or juristic persons, it is bound to extend to them the protection of the law and assumes obligations concerning the treatment to be afforded them. . . .

In a separate opinion, Judge Padilla Nervo of Mexico set forth the view of most developing states with colonial histories. He wrote that "[t]he history of the responsibility of States in respect to the treatment of foreign nationals is the history of abuses, illegal interference in the domestic jurisdiction of weaker States, unjust claims, threats and even military aggression under the flag of exercising rights of protection, and the imposing of sanctions in order to oblige a government to make the reparations demanded." That is, in the long history of foreign investment, principle has often given way to unjust

claims and threats by stronger states against weaker ones. Investors seeking profit away from their home states must respect the differing laws and institutions of the host state.

The Court concluded that Belgium lacks legal standing (*jus tandi*) to bring claims against Spain on behalf of Belgian shareholders, a conclusion to which Judge Nervo agreed.

Denial of Justice

A **denial of justice** is said to exist "when there is a denial, unwarranted delay or obstruction of access to courts, gross deficiency in the administration of judicial or remedial process, failure to provide those guarantees which are generally considered indispensable to the proper administration of justice, or a manifestly unjust judgment. An error of a national court which does not produce a manifest injustice is not a denial of justice."[35]

denial of justice
A gross deficiency in the administration of justice.

As with the expropriation cases, the states that advocate the application of a national standard emphasize that notions of justice are relative to each society and that whether or not there has been a denial of justice with respect to a particular case requires an understanding of the judicial system of the society where the case arose.

Both the international standard and the national standard are illustrated in Case 2-4.

CASE 2-4 Chattin v. United Mexican States

Mexico–United States General Claims Commission, 1927
United Nations Reports of International Arbitral Awards, vol. 4, p. 282
Presiding Commissioner Van Vollenhoven

MAP 2.5

Sinaloa and Nayarit, Mexico (1911)

This claim is made by the United States of America against the United Mexican States on behalf of B.E. Chattin, an American national. Chattin, who since 1908 was an employee (at first freight conductor, thereafter passenger conductor) of the Ferrocarril Sud-Pacifico de Mexico (Southern Pacific Railroad Company of Mexico) and who in the Summer of 1910 performed his duties in the State of Sinaloa, was on July 9, 1910, arrested at Mazatlán, Sinaloa, on a charge of embezzlement; was tried there in January 1911, convicted on February 6, 1911, and sentenced to two years imprisonment; but was released from the jail at Mazatlán in May or June 1911, as a consequence of disturbances caused by the Madero revolution. He then returned to the United States. It is alleged that the arrest, the trial, and the sentence were illegal, that the treatment in jail was inhuman, and that Chattin was damaged to the extent of $50,000, which amount Mexico should pay. . . .

[35]Harvard Draft Convention on the Responsibility of States for Damage Done in Their Territory to the Person or Property of Foreigners, 1929, Article 9.

. . . On or about July 8, 1910, one Cenobio Ramírez, a Mexican employee (brakeman) of the [Southern Pacific Railroad Company] . . . was arrested at Mazatlán on a charge of fraudulent sale of railroad tickets of the said company, and in his appearance before the District Court in that town he accused the conductor Chattin—who since May 9, 1910, had charge of trains operating between Mazatlán and Acaponeta, Nayarit—as the principal in the crime with which he, Ramírez, was charged; whereupon Chattin also was arrested by the Mazatlán police, on July 9 (not 10), 1910. On August 3 (not 13), 1910, his case was consolidated not only with that of Ramírez, but also with that of three more American railway conductors (Haley, Englehart, and Parrish) and of four Mexicans. After many months of preparation and a trial at Mazatlán, during both of which Chattin, it is alleged, lacked proper information, legal assistance, assistance of an interpreter and confrontation with the witnesses, he was convicted on February 6, 1911, by the said District Court of Mazatlán as stated above. The case was carried on appeal to the Third Circuit Court at Mexico City, which court on July 3, 1911, affirmed the sentence. In the meantime (May or June 1911) Chattin had been released by the population of Mazatlán which threw open the doors of the jail in the time elapsing between the departure of the representatives of the Diaz regime and the arrival of the Madero forces. . . .

Irregularity of Court Proceedings

. . . For undue delay of the proceedings . . . there is convincing evidence in more than one respect. The formal proceedings began on July 9, 1910. Chattin was not heard in court until more than one hundred days thereafter. The stubs and perhaps other pieces of evidence against Chattin were presented to the Court on August 3, 1910; Chattin, however, was not allowed to testify regarding them until October 28, 1910. Between the end of July and October 8, 1910, the judge merely waited. . . . Another remarkable proof of the measure of speed which the Judge deemed due to a man deprived of his liberty, is in that, whereas Chattin appealed from the decree of his formal imprisonment on July 11, 1910—an appeal which would seem to be of rather an urgent character—"the corresponding copy for the appeal" was not remitted to the appellate Court until September 12, 1910; this Court did not render judgment until October 27, 1910; and though its decision was forwarded to Mazatlán on October 31, 1910, its receipt was not established until November 12, 1910. . . .

The allegation . . . that the accused had not been duly informed regarding the charge brought against him is proven by the record, and to a painful extent. The real complainant in this case was the railroad company, acting through its general manager; this manager, an American, not only was allowed to make [a] full statement to the Court . . . without ever being confronted with the accused and his colleagues, but he was even allowed to submit to the Court a series of anonymous written accusations. . . . Were they made known to the conductors? . . . [O]n August 3, 1910, they were ordered added to the court record; but that same day they were delivered to a translator; and they did not reappear on the court record until after January 16, 1911, when the investigations were over and Chattin's lawyer had filed his briefs. . . .

The allegation . . . that the accused lacked counsel and an interpreter are disproven by the records of the court proceedings. . . .

The allegation . . . that the witnesses were not sworn is irrelevant, as Mexican law does not require an "oath" (it is satisfied with a solemn promise, protesta, to tell the truth), nor do international standards of civilization. . . .

The allegation . . . that the hearings in open court lasted only some five minutes is proven by the record. This trial in open court was held on January 27, 1911. It was a pure formality, in which only confirmations were made of written documents, and in which not even the lawyer of the accused conductors took the trouble to say more than a word or two. . . .

Conviction on Insufficient Evidence

. . . From the record there is not convincing evidence that the proof against Chattin, scanty and weak though it may have been, was not such as to warrant a conviction. . . . The allegation that the Court in this matter was biased against American citizens would seem to be contradicted by the fact that, together with four Americans, five Mexicans were indicted as well, four of

whom had been caught and have subsequently been convicted—that one of these Mexicans was punished as severely as the Americans were—and that the lower penalties imposed on the three others are explained by motives which, even if not shared, would seem reasonable. . . .

Mistreatment in Prison

The allegation of the claimant regarding mistreatment in the jail at Mazatlán refers to filthy and unsanitary conditions, bad food, and frequent compulsion to witness the shooting of prisoners. . . . The statement made in the Mexican reply brief that "a jail is a place of punishment, and not a place of pleasure" can have no bearing on the cases of Chattin and his colleagues, who were not convicts in prison, but persons in detention and presumed to be innocent until the Court held the contrary. On the record as it stands, however, inhuman treatment in jail is not proven.

Conclusion

Bringing the proceedings of Mexican authorities against Chattin to the test of international standards . . . , there can be no doubt of their being highly insufficient. Inquiring whether there is convincing evidence of these unjust proceedings . . . , the answer must be in the affirmative. Since this is a case of alleged responsibility of Mexico for injustice committed by its judiciary, it is necessary to inquire whether the treatment of Chattin amounts even to an outrage, to bad faith, to willful neglect of duty, or to an insufficiency of governmental action recognizable by every unbiased man . . . ; and the answer here again can only be in the affirmative.

An illegal arrest of Chattin is not proved. Irregularity of court proceedings is proven with reference to absence of proper investigations, insufficiency of confrontations, withholding from the accused the opportunity to know all of the charges brought against him, undue delay of the proceedings, making the hearings in open court a mere formality, and a continued absence of seriousness on the part of the Court. Insufficiency of evidence against Chattin is not convincingly proven; intentional severity of the punishment is proven, without its being shown that the explanation is to be found in the unfairmindedness of the Judge. Mistreatment in prison is not proven. Taking into consideration, on the one hand, that this is a case of direct governmental responsibility, and on the other hand, that Chattin, because of his escape, has stayed in jail for eleven months instead of for two years, it would seem proper to allow in behalf of this claimant damages in the sum of $5,000 without interest.

Dissenting Opinion of Commissioner Fernandez Macgregor

. . . All the criticism which has been made of these proceedings, I regret to say, appears to arise from lack of knowledge of the judicial system and practice of Mexico, and, what is more dangerous, from the application thereto of tests belonging to foreign systems of law. For example, in some of the latter the investigation of a crime is made only by the police magistrates and the trial proper is conducted by the judge. Hence the reluctance in accepting that one same judge may have the two functions and that, therefore, he may have to receive in the preliminary investigation (*instrucción*) of the case all kinds of data, with the obligation, of course, of not taking them into account at the time of judgment, if they have no probative weight. It is certain that the secret report, so much discussed in this case, would have been received by the police of the countries which place the investigation exclusively in the hands of such branch. This same police would have been free to follow all the clues or to abandon them at its discretion; but the Judge is criticized here because he did not follow up completely the clue given by Ramírez with respect to Chattin. The same domestic test—to call it such—is used to understand what is a trial or open trial imagining at the same time that it must have the sacred forms of common law and without remembering that the same goal is reached by many roads. And the same can be said when speaking of the manner of taking testimony of witnesses, of cross-examination, of holding confrontations, etc.

In view of the above considerations, I am of the opinion that the claim should be disallowed.

Casepoint

Assessing Mexico's treatment of Chattin by international standards, the majority concludes that there was undue delay in allowing him to respond and in forwarding his appeal to the appellate court. There was evidence that Chattin had not been informed of the charges brought against him or allowed to face his accusers. The railroad manager submitted anonymous written accusations that were included in the record after the investigations were over and Chattin's lawyer had filed his briefs. There was evidence that the hearing was only a formality that lasted only five minutes. This constituted treatment amounting to an outrage, to bad faith, to willful neglect of duty, or to an insufficiency of governmental action that is recognizable by every unbiased man. [Note, however, the dissent.]

C. Objections

States can raise several objections to complaints brought against them, including lack of standing, lack of nationality, lack of a genuine link, and failure to exhaust remedies.

Lack of Standing

lack of standing
Objection that may be made to an international tribunal's exercise of jurisdiction when a plaintiff is not qualified to appear before the court.

A common objection states raise to being sued in international tribunals is **lack of standing**. If a plaintiff is not qualified to appear before the particular court, the case must be dismissed. In most international tribunals, such as the ICJ, only a state can file a complaint. If a private person or company were to appear as a plaintiff, the case would be dismissed for want of standing.[36] In these tribunals, the only way for the matter to be heard is for a state to sponsor the suit of its national.

Lack of Nationality

lack of nationality
Objection that may be made to an international tribunal's exercise of jurisdiction when the state bringing suit is doing so on behalf of a person who is not a national of that state.

An objection related to lack of standing is **lack of nationality**. Although a state may bring a complaint in an international tribunal on behalf of one of its own nationals, it may not do so on behalf of any other person.

This rule is easily applied with respect to persons with a single nationality and to stateless persons (the first have a claim if they are sponsored by the state of their nationality; the second cannot be sponsored by any state). Its application becomes more complex, however, with dual nationals. The traditional rule is that either state can complain to a third state; but between the two, neither can complain.[37] In the *Canevaro Case,* a person who had both Italian and Peruvian nationality sought the sponsorship of Italy in a complaint against Peru. The Permanent Court of Arbitration said:

> And whereas, as a matter of fact, Raphael Canevaro has on several occasions acted as a Peruvian citizen, both by running as a candidate for the Senate, where none are admitted except Peruvian citizens, and where he went to defend his election, and also especially by accepting the office of Consul General of the Netherlands, after soliciting the authorization of the Peruvian Government and then of the Peruvian Congress; And whereas, under these circumstances, whatever Raphael Canevaro's status may be in Italy with respect to his nationality, the Government of Peru has a right to consider him as a Peruvian citizen and to deny his status as an Italian claimant.[38]

Following World War II, however, a new rule evolved that allows the state of which the individual has the *master* nationality (i.e., the one with which he or she has the most links) to complain against

[36]The lack of standing objection would obviously not apply in tribunals such as the International Center for the Settlement of Investment Disputes or the European Court of Human Rights, where the right of private persons to bring actions against a state is allowed.

[37]The rule can be found in the 1930 Hague Convention on Certain Questions Relating to the Conflict of Nationality Laws, *League of Nations Treaty Series,* vol. 179, p. 189. Article 4 provides: "A State may not afford diplomatic protection to one of its own nationals against a State whose nationality such person also possesses."

[38]Award of the Permanent Court of Arbitration, 1912. An English translation is found in the *American Journal of International Law,* vol. 6, p. 746 (1912).

the other. Thus, in the *Mergé Claim,* where the injured individual was both an Italian and an American citizen, the Italian–United States Conciliation Commission recognized that the United States had the right to sponsor a complaint against Italy. It stated:

> In view of the principles accepted, it is considered that the government of the United States of America shall be entitled to protect nationals before this Commission in cases of dual nationality, United States and Italian, whenever the United States nationality is the effective nationality. In order to establish the prevalence of the United States nationality in individual cases, habitual residence can be one of the criteria of evaluation, but not the only one. The conduct of the individual in his economic, social, political, civic and family life, as well as the closer and more effective bond with one of the two States, must be considered.

Effect of an Injured Person's Waiver on the Right of His National State to Bring Suit on His Behalf Because the right to sue in most international tribunals belongs only to the state, the state has full control over the action. It can refuse to bring the complaint, it can abandon it, or it can settle it adversely to the interests of its national. But this being so, can the state bring the complaint over the objection of its own national? This question comes up because of something known as the **Calvo Clause**.[39] The Calvo Clause requires an investor who seeks to establish a business operation in a foreign country to agree, in advance, that he, she, or it will not ask for its home state to intervene in any dispute with the host state. In the *Barcelona Traction Case,* the ICJ expressed the view that Calvo Clauses are ineffective. It said, "[A] claim belongs to a state and not to an individual; therefore, any attempt of waiver by the individual is ineffective."[40]

As a practical matter, however, Calvo Clauses do have some impact. The U.S. Department of State, for example, does take into consideration a waiver when it determines its willingness to espouse a claim and the effort it will expend in seeking compensation.

Calvo Clause
A clause in an agreement between a host state and a foreign investor that says that the investor will not seek the diplomatic assistance of his, her, or its home state in resolving disputes with the host state.

Lack of a Genuine Link

A person whose suit is being sponsored by a state in an international tribunal must be a real and bona fide national of that state. That is, the person's nationality must be genuine and not based on a token relationship. If it is based on a token or insignificant relationship, the opposing state can raise an objection of a **lack of a genuine link** to the sponsoring state. In the famous *Nottebohm Case,* the ICJ held that an individual who went to Liechtenstein for three weeks to acquire that state's nationality and then returned abroad did not establish a real or effective link that would justify Liechtenstein in bringing a complaint against another state for depriving that individual of his property.[41]

For companies, the ability of a state to sponsor a complaint depends on the particular company's nationality. States have a wide variety of national rules that define the nationality of a company. Regardless of these tests, international tribunals now require that a company have a genuine link with its sponsoring state.

lack of a genuine link
Objection that may be made to an international tribunal's exercise of jurisdiction when there is no real and bona fide relationship between the state bringing the suit and the person on whose behalf the suit is brought.

Failure to Exhaust Remedies

Before an individual or business firm can seek the help of its home state in supporting a complaint of mistreatment by a foreign state, the individual or firm must exhaust all of the local remedies

[39] A provision in an agreement between a private individual and a foreign state that says, in effect, that "aliens are not entitled to rights and privileges not accorded to nationals, and that, therefore, they may seek redress for grievances only before local authorities." Under the Calvo Clause, a claimant waives the right to apply to his or her government or to another forum for protection if a claim is denied by local authorities.

[40] Case Concerning Barcelona Traction, Light, and Power Company, Ltd. (Preliminary Objections), *International Court of Justice Reports,* vol. 1964, p. 6 (1964).

[41] Nottebohm, a resident of Guatemala, realized in 1939 that his German citizenship might be a disadvantage if Guatemala entered World War II on the side of the Allies. He therefore went to Liechtenstein for a few weeks with his brother, acquired Liechtenstein citizenship, and automatically gave up his German citizenship. After Guatemala declared war on Germany, he was arrested, confined, and his property confiscated. Liechtenstein brought an action in 1951 seeking restitution. The ICJ held that there has to be a genuine link between the claimant state and its national and that no such link existed in this case. *International Court of Justice Reports,* vol. 1955, p. 4 (1955).

failure to exhaust remedies
Objection that may be made to an international tribunal's relief from the defendant state.

available to it within the foreign state.[42] **Failure to exhaust remedies** is thus an objection that the foreign state may raise in an international tribunal. As is the case in municipal law, the requirement that complainants must exhaust their local remedies serves to resolve problems at the lowest level and with the least use of a sovereign's time.

There are exceptions to the rule, of course. If an adequate remedy is clearly unavailable,[43] if the requirement to exhaust a person's remedies is waived by treaty, if the injury was done directly to a state (rather than to a private person), or if the defendant state has delayed excessively in granting a remedy, the requirement is excused. With regard to this last point—excessive delay—one has to recognize that ordinary court cases in many countries often take years to resolve, so this may well be an ineffective exception to the basic rule. For example, the *Interhandel Case* involved a situation where a Swiss firm had spent nine years in American courts attempting to recover assets the U.S. military had seized during World War II. The firm had lost at the trial court level, and its appeals had been denied. When the U.S. State Department advised Switzerland that the firm's chances of success in obtaining a new trial were nonexistent, the Swiss government lodged a complaint on the firm's behalf in the ICJ. In the meantime, however, the U.S. Supreme Court ordered a new trial. The ICJ then dismissed the Swiss claim, stating that the firm's local remedies had not been exhausted.[44]

In Case 2-5, the defendant objected to an international tribunal's assumption of jurisdiction on the grounds that there was no genuine link, no exhaustion of remedies, and the parties affected did not possess the nationality of the plaintiff state.

CASE 2-5 The M/V *Saiga* Case (Merits)

Saint Vincent and the Grenadines v. Guinea
International Tribunal for the Law of the Sea
Case No. 2, 1999, posted at www.itlos.org

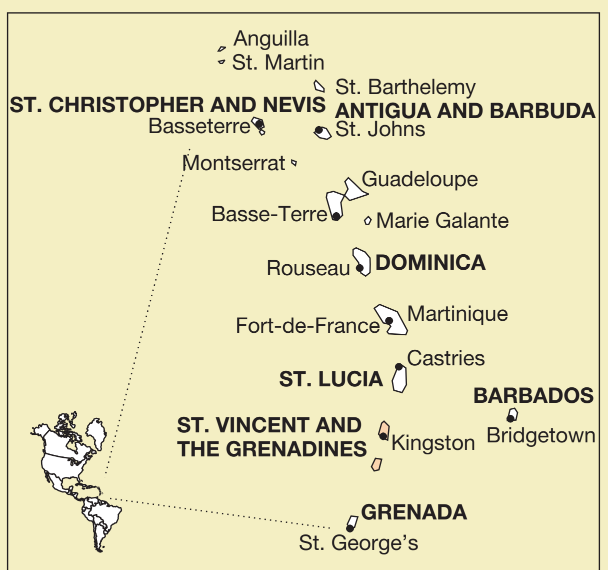
MAP 2.6

Guinea (1997)

[42]In the Ambatielos Arbitration (1956), a Greek, who had contracted to buy ships from the British government, accused the British of breaking the contract and brought suit in the English High Court. He failed to call a key witness there and lost; and he lost for the same reason in the Court of Appeal. Greece then made a claim on his behalf. The arbitrators held that Ambatielos had failed to exhaust all local remedies by not calling the witness and by not appealing to the House of Lords. *International Law Reports,* vol. 23, p. 306 (1956).

[43]In the *Robert E. Brown Case* (1923), an arbitral tribunal found that Brown was not required to exhaust his local remedies in South Africa because "all three branches of the government conspired to ruin his enterprise. . . . The judiciary, at first recalcitrant, was at length reduced to submission and brought into line with a determined policy of the Executive . . . ." It said: "[I]n the frequently quoted language of an American Secretary of State: 'A claimant in a foreign State is not required to exhaust justice in such State where there is no justice to exhaust.'" *United Nations Reports of International Arbitral Awards,* vol. 6, pp. 120, 129.

[44]Switzerland v. United States, *International Court of Justice Reports,* vol. 1959, p. 6 (1959).



MAP 2.7

Saint Vincent and the Grenadines (1997)

On October 27, 1997, the M/V *Saiga*, an oil tanker, was engaged in selling "gas oil" to fishing and other vessels within Guinea's exclusive economic zone. The next day, the Guinean Navy boarded the *Saiga* just beyond Guinea's exclusive economic zone and the master, crew, and the ship were arrested. The government of Guinea charged the master with importing "without declaring it, merchandise that is taxable on entering national Guinean territory, in this case diesel oil" and brought criminal proceedings against him for "committing the crimes of contraband, fraud, and tax evasion."

At the time of the arrest, the vessel was owned by Tabona Shipping Company Ltd. of Nicosia, Cyprus, managed by Seascot Shipmanagement Ltd. of Glasgow, Scotland, and under charter to Lemania Shipping Group Ltd. of Geneva, Switzerland. It had been provisionally registered in Saint Vincent and the Grenadines (SVG) on March 12, 1997. The master and crew of the ship were all of Ukrainian nationality. The owner of the cargo of gas oil on board was Addax BV of Geneva, Switzerland.

On November 13, 1997, the SVG submitted a request to the International Tribunal for the Law of the Sea (ITLOS) for an order that would direct Guinea to release the *Saiga* and its crew. ITLOS issued an order on December 4 calling for Guinea to release the vessel and its crew upon the posting by SVG of a U.S. $400,000 letter of credit.

On December 17, a Guinean trial court convicted the master of the *Saiga* of the criminal charges that had been brought against him, and the Guinean Court of Appeal affirmed the conviction on February 3, 1998. The court of appeal imposed a suspended sentence of six months imprisonment, a fine of 15,354,040,000 Guinean francs, and ordered that all fees and expenses be paid by him. It also ordered the confiscation of the cargo—4,941 metric tons of gas oil—and the seizure of the vessel as a guarantee for payment of the fine.

On December 22, 1997, SVG sent notice to Guinea that it was instituting arbitral proceedings before ITLOS in accordance with the UN Convention of the Law of the Sea, a treaty to which both states are parties. On January 13, 1998, SVG filed a copy of the notice with ITLOS and it asked the tribunal to prescribe provisional measures concerning the arrest and detention of the crew of the *Saiga*.

On February 20, 1998, Guinea agreed to submit to the proceedings before ITLOS, and on February 28 it released the ship, the master, and those members of the crew who had not previously been released.

On March 11, ITLOS issued a provisional measure calling on Guinea to refrain from taking or enforcing any measures against the *Saiga*, or its master, crew, owners, or operators. In June, both parties submitted memorials to ITLOS. SVG asked the tribunal to declare that "the actions of Guinea (*inter alia* the attack on the 'M/V *Saiga*' and her crew in the exclusive economic zone of Sierra Leone, its subsequent arrest, its detention and the removal of the cargo of gas oil, its filing of charges against St. Vincent and the Grenadines, and its subsequently issuing a judgment against them) violate the right of St. Vincent and the Grenadines and vessels flying its flag to enjoy freedom of navigation and/or other internationally lawful uses of the sea related to the freedom of navigation." Guinea responded with a motion to dismiss the proceeding. Guinea contended, in part, that the proceeding ought to be dismissed because there was no genuine link between SVG and the

Saiga, because the master had not exhausted all of his local remedies within Guinea, and because the master, the crew, and other interested persons were not nationals of SVG, so SVG could not bring this action on their behalf.

The Tribunal . . . Delivers the Following Judgment

***

The next objection to admissibility raised by Guinea is that there was no genuine link between the *Saiga* and Saint Vincent and the Grenadines. Guinea contends that "without a genuine link between Saint Vincent and the Grenadines and the M/V '*Saiga*', Saint Vincent and the Grenadines' claim concerning a violation of its right of navigation and the status of the ship is not admissible before the Tribunal vis-à-vis Guinea, because Guinea is not bound to recognize the Vincentian nationality of the M/V '*Saiga*', which forms a prerequisite for the mentioned claim in international law."

Article 91, paragraph 1, of the [United Nations Convention on the Law of the Sea (the Convention)] provides: "There must exist a genuine link between the State and the ship." Two questions need to be addressed in this connection. The first is whether the absence of a genuine link between a flag State and a ship entitles another State to refuse to recognize the nationality of the ship. The second question is whether or not a genuine link existed between the *Saiga* and Saint Vincent and the Grenadines at the time of the incident.

With regard to the first question, the Tribunal notes that the provision in Article 91, paragraph 1, of the Convention, requiring a genuine link between the State and the ship, does not provide the answer. Nor do Articles 92 and 94 of the Convention, which together with Article 91 constitute the context of the provision, provide the answer. The Tribunal, however, recalls that the International Law Commission, in article 29 of the Draft Articles on the Law of the Sea adopted by it in 1956, proposed the concept of a "genuine link" as a criterion not only for the attribution of nationality to a ship but also for the recognition by other States of such nationality. After providing that "ships have the nationality of the State whose flag they are entitled to fly," the draft article continued: "Nevertheless, for purposes of recognition of the national character of the ship by other States, there must exist a genuine link between the State and the ship." This sentence was not included in Article 5, paragraph 1, of the Convention on the High Seas of 29 April 1958 (hereinafter "the 1958 Convention"), which reads, in part, as follows:

> There must exist a genuine link between the State and the ship; in particular, the State must effectively exercise its jurisdiction and control in administrative, technical and social matters over ships flying its flag.

Thus, while the obligation regarding a genuine link was maintained in the 1958 Convention, the proposal that the existence of a genuine link should be a basis for the recognition of nationality was not adopted.

The Convention follows the approach of the 1958 Convention. Article 91 retains the part of the third sentence of article 5, paragraph 1, of the 1958 Convention which provides that there must be a genuine link between the State and the ship. The other part of that sentence, stating that the flag State[45] shall effectively exercise its jurisdiction and control in administrative, technical and social matters over ships flying its flag, is reflected in Article 94 of the Convention, dealing with the duties of the flag State.

Paragraphs 2 to 5 of Article 94 of the Convention outline the measures that a flag State is required to take to exercise effective jurisdiction as envisaged in paragraph 1. Paragraph 6 sets out the procedure to be followed where another State has "clear grounds to believe that proper jurisdiction and control with respect to a ship have not been exercised." That State is entitled to report the facts to the flag State which is then obliged to "investigate the matter and, if appropriate, take any action necessary to remedy the situation." There is nothing in Article 94 to permit a State which discovers evidence indicating the absence of proper jurisdiction and control by a flag State over a ship to refuse to recognize the right of the ship to fly the flag of the flag State.

[45]The flag State is the State of the flag which the vessel flies. In IMO Conventions, the flag State is sometimes referred to as the "Administration."

The conclusion of the Tribunal is that the purpose of the provisions of the Convention on the need for a genuine link between a ship and its flag State is to secure more effective implementation of the duties of the flag State, and not to establish criteria by reference to which the validity of the registration of ships in a flag State may be challenged by other State

***

In the light of the above considerations, the Tribunal concludes that there is no legal basis for the claim of Guinea that it can refuse to recognize the right of the *Saiga* to fly the flag of Saint Vincent and the Grenadines on the ground that there was no genuine link between the ship and Saint Vincent and the Grenadines.

With regard to the second question, the Tribunal finds that, in any case, the evidence adduced by Guinea is not sufficient to justify its contention that there was no genuine link between the ship and Saint Vincent and the Grenadines at the material time.

For the above reasons, the Tribunal rejects the objection to admissibility based on the absence of a genuine link between the *Saiga* and Saint Vincent and the Grenadines.

Exhaustion of Local Remedies

Guinea further objects to the admissibility of certain claims advanced by Saint Vincent and the Grenadines in respect of damage suffered by natural and juridical persons as a result of the measures taken by Guinea against the *Saiga.* It contends that these claims are inadmissible because the persons concerned did not exhaust local remedies, as required by Article 295 of the Convention.

In particular, Guinea claims that the Master did not exhaust the remedies available to him under Guinean law by failing to have recourse to the Supreme Court (*cour suprême*) against the Judgment of 3 February 1998 of the Criminal Chamber (*chambre correctionnelle*) of the Court of Appeal of Conakry. Similarly, the owners of the *Saiga,* as well as the owners of the confiscated cargo of gas oil, had the right to institute legal proceedings to challenge the seizure of the ship and the confiscation of the cargo, but neither of them exercised this right. . . .

Before dealing with the arguments of the parties, it is necessary to consider whether the rule that local remedies must be exhausted is applicable in the present case. Article 295 of the Convention reads as follows:

> **Article 295** *Exhaustion of Local Remedies*
>
> Any dispute between States Parties concerning the interpretation or application of this Convention may be submitted to the procedures provided for in [section 2 of Part XV] only after local remedies have been exhausted where this is required by international law.

It follows that the question [of] whether local remedies must be exhausted is answered by international law. The Tribunal must, therefore, refer to international law in order to ascertain the requirements for the application of this rule and to determine whether or not those requirements are satisfied in the present case.

***

As stated in Article 22 of the Draft Articles on State Responsibility adopted on first reading by the International Law Commission, the rule that local remedies must be exhausted is applicable when "the conduct of a State has created a situation not in conformity with the result required of it by an international obligation concerning the treatment to be accorded to aliens. . . ." None of the violations of rights claimed by Saint Vincent and the Grenadines [including the right of freedom of navigation and the right not to be subjected to the customs and contraband laws of Guinea] can be described as breaches of obligations concerning the treatment to be accorded to aliens. They are all direct violations of the rights of Saint Vincent and the Grenadines. Damage to the persons involved in the operation of the ship arises from those violations. Accordingly, the claims in respect of such damage are not subject to the rule that local remedies must be exhausted.

***

The Tribunal, therefore, rejects the objection of Guinea to admissibility based on the non-exhaustion of local remedies.

Nationality of Claims

In its last objection to admissibility, Guinea argues that certain claims of Saint Vincent and the Grenadines cannot be entertained by the Tribunal because they relate to violations of the rights of persons who are not nationals of Saint Vincent and the Grenadines. According to Guinea, the claims of Saint Vincent and the Grenadines in respect of loss or damage sustained by the ship, its owners, the Master and other members of the crew and other persons, including the owners of the cargo, are clearly claims of diplomatic protection. In its view, Saint Vincent and the Grenadines is not competent to institute these claims on behalf of the persons concerned since none of them is a national of Saint Vincent and the Grenadines. During the oral proceedings, Guinea withdrew its objection as far as it relates to the shipowners, but maintained it in respect of the other persons.

In opposing this objection, Saint Vincent and the Grenadines maintains that the rule of international law that a State is entitled to claim protection only for its nationals does not apply to claims in respect of persons and things on board a ship flying its flag. In such cases, the flag State has the right to bring claims in respect of violations against the ship and all persons on board or interested in its operation. Saint Vincent and the Grenadines, therefore, asserts that it has the right to protect the ship flying its flag and those who serve on board, irrespective of their nationality.

In dealing with this question, the Tribunal finds sufficient guidance in the Convention. The Convention contains detailed provisions concerning the duties of flag States regarding ships flying their flag. Articles 94 and 217, in particular, set out the obligations of the flag State which can be discharged only through the exercise of appropriate jurisdiction and control over natural and juridical persons such as the Master and other members of the crew, the owners or operators and other persons involved in the activities of the ship. No distinction is made in these provisions between nationals and non-nationals of a flag State. Additionally, Articles 106, 110, paragraph 3, and 111, paragraph 8, of the Convention contain provisions applicable to cases in which measures have been taken by a State against a foreign ship. These measures are, respectively, seizure of a ship on suspicion of piracy, exercise of the right of visit on board the ship, and arrest of a ship in exercise of the right of hot pursuit. In these cases, the Convention provides that, if the measures are found not to be justified, the State taking the measures shall be obliged to pay compensation "for any loss or damage" sustained. In these cases, the Convention does not relate the right to compensation to the nationality of persons suffering loss or damage. Furthermore, in relation to proceedings for prompt release under Article 292 of the Convention, no significance is attached to the nationalities of persons involved in the operations of an arrested ship.

The provisions referred to in the preceding paragraph indicate that the Convention considers a ship as a unit, as regards the obligations of the flag State with respect to the ship and the right of a flag State to seek reparation for loss or damage caused to the ship by acts of other States and to institute proceedings under Article 292 of the Convention. Thus the ship, every thing on it, and every person involved or interested in its operations are treated as an entity linked to the flag State. The nationalities of these persons are not relevant.

***

In the light of the above considerations, the Tribunal rejects the objection to admissibility based on nationality of claim.

***

Reparation

It is a well-established rule of international law that a State which suffers damage as a result of an internationally wrongful act by another State is entitled to obtain reparation for the damage suffered from the State which committed the wrongful act and that "reparation must, as far as possible, wipe out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed."

***

In the view of the Tribunal, Saint Vincent and the Grenadines is entitled to reparation for damage suffered directly by it as well as for damage or other loss suffered by the *Saiga,* including all persons involved or interested in its operation . . . .

Casepoint

(1) The UNCLOS (United Nations Convention on the Law of the Sea) requirement that there must be a genuine link between the ship and its flag state does not allow other states to challenge the validity of the flag state's registration. (2) A state does not have to exhaust remedies to bring a suit when its own interests are harmed. (3) A flag state has jurisdiction over all persons (whether its own or foreign nationals) aboard its flagged ships. UNCLOS looks at a ship as a unit. The master and crew are part of that unit.

Other Objections

A defendant state may also argue that a claimant delayed too long in bringing a claim (this is called **laches**) or that the complainant is tainted with **dirty hands**. For example, in the *I'm Alone Case,* a U.S. Coast Guard cutter sank a ship smuggling liquor into the United States in 1934. The ship was flying the British flag, and its owners got Britain to assert a claim against the United States in an arbitration tribunal. The arbitrators held that the sinking was illegal, but they refused to award damages to the *I'm Alone*'s owners. They did so because the ship had been involved in smuggling and therefore had dirty hands. Even so, the tribunal required the United States to apologize to the British government and to pay it $25,000 for the insult done to the British flag.

laches
(From Latin *laxus:* "loose" or "lax.") Negligent delay in asserting a right or a claim.

dirty hands
The plaintiff took inappropriate steps in attempting to recoup a loss prior to bringing a claim.

D. Relief

Several kinds of relief can be obtained from states for injuring an alien. International tribunals have awarded **restitution in kind**,[46] **satisfaction**,[47] and **compensatory damages**. An award of relief is discussed in Case 2-6.

restitution in kind
The item taken is to be returned.

satisfaction
The honor of the injured state is to be restored.

compensatory damages
Money is to be paid for the cost of the injury suffered.

E. Insurance

Insurance is the contractual commitment by an insurer to indemnify an insured against specific contingencies and perils. For multinational enterprises, the contingencies and perils of operating abroad include those common to domestic businesses—such as property losses, casualty losses, and losses suffered by employees—as well as special losses arising from political violence and political instability.

Both domestically and internationally, insurance is an important business tool that can either supplement or take the place of litigation. For example, should a court find a firm liable for an injury to a customer, supplier, investor, competitor, or a government agency for whatever reason, liability insurance can pay the award. Similarly, if a foreign government nationalizes a multinational firm's property and refuses to pay compensation or to honor an award in a domestic or international court, political risk insurance can cover the firm's loss.

A variety of insurance products for multinational enterprises are available from private insurers, governments, and intergovernmental agencies. These include international property insurance, international casualty insurance, coverage for overseas employees, and special coverages. Table 2.1 describes the particular forms of these coverages.

insurance
The contractual commitment by an insurer to indemnify an insured against specific contingencies and perils.

[46]In the *Temple of Preah Vihear Case (Cambodia v. Thailand),* Thailand was ordered to return religious objects it had illegally taken from a temple in Cambodia. *International Court of Justice Reports,* vol. 1962, p. 6 (1962).

[47]The *Borchgrave Case* involved an incident where a member of Belgium's Madrid embassy staff was found dead on a roadside in Spain in 1936. The PCIJ noted: "In consequence, proceeding on the principles of international law relating to the responsibility of States, the Belgian Government demanded as reparation: (1) an expression of the Spanish government's excuses and regrets; (2) transfer of the corpse to the port of embarkation with military honors; . . . and (4) punishment of the guilty." *Permanent Court of International Justice Reports,* Series A/B, No. 72, p. 165 (1937).

CASE 2-6 Re Letelier and Moffitt

Chile—United States International Commission, 1992
International Law Reports, vol. 88, p. 727 (1992)

MAP 2.8

Washington, D.C. (1976)

In 1976, Orlando Letelier, a former foreign minister of Chile, was killed by a car bomb in Washington, D.C. The bomb also killed Ronni Moffitt and seriously injured her husband, Michael Moffitt, both of whom had been riding in the car with Señor Letelier. Letelier had been targeted for assassination by the Pinochet regime, and the Moffitts were (by chance) getting a ride from Señor Letelier on the morning of the assassination. Letelier had been the Chilean ambassador to the U.S. during the socialist regime of Salvador Allende, a regime that was upended by the military coup led by Gen. August Pinochet. After his exile to the U.S., Letelier continued to be an active critic of the Pinochet regime, and was, ultlimately, silenced by his assassination.

Letelier's estate and various relatives of the two persons killed then brought suit in the United States alleging that the government of Chile had been responsible for the killings. The U.S. trial court held that Chile was not entitled to sovereign immunity, having committed a tort within the U.S., and when Chile refused to participate in the proceeding, it awarded the plaintiffs a default judgment of approximately U.S. $5 million.

Because the plaintiffs were unsuccessful in collecting on the judgment in Chile (hardly surprising, given the government's non-participation in the federal court proceeding), the U.S. government intervened on their behalf and made an international claim against the government of Chile. Later, the United States invoked the 1914 Treaty for the Settlement of Disputes That May Occur between the United States and Chile (popularly known as the Bryan-Suárez Mujica Treaty). Chile denied responsibility for the car bombing, but it did express its willingness to make an ex gratia[48] payment to the U.S. government to be received on behalf of the victims' families. In 1990, the United States and Chile concluded a compromis[49] establishing a commission pursuant to the 1914 treaty and Chile agreed to make an ex gratia payment in an amount to be determined by the commission.

[48]From Latin: "out of grace" or "as a matter of grace." Used to indicate an action taken as a favor, in contrast to one taken *ex debito,* "as a matter of right."

[49]From French: "a mutual promise" or "a compromise." An agreement to abide by the decision of an arbitrator.

Award of the Commission

It is necessary to remember, first of all, that according to . . . the *Compromis,* the Commission is to determine the amount of the *ex gratia* payment to be made by the government of Chile in conformity with the applicable principles of international law, as though liability were established.

In this regard, the judgment handed down by the Permanent Court of International Justice in the *Chorzów Factory Case,* cited by the United States and Chile in their respective written presentations, may be taken as enunciating a general rule. The pertinent portion of this judgment reads verbatim as follows:

> [R]eparation must, as far as possible, wipe out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed.

The Commission has also kept in mind the need to apply the same rules to the members of the families of Orlando Letelier and of Ronni Moffitt, with no differentiation whatever by reason of their nationality. . . .

We will start with the Letelier family by first of all examining the amount of the compensation to be paid for the loss of financial support suffered by Mr. Letelier's widow and children.

[*The Commission then considered the various career paths of Mr. Letelier, inlcuding salary and fringe benefits, along with life expectacy. It excluded potential income from lectures and publications and the value of his household services to his family.*]

Allowing for the uncertainties which must surround any attempt to predict the course which Mr. Letelier's life would have taken, the Commission decided in all the circumstances to award a sum of one million two hundred thousand dollars (U.S. $1,200,000) as compensation for loss of financial support suffered by Mrs. Isabel Morel de Letelier and her sons as the result of the murder of Orlando Letelier.

The Commission agreed on the payment of one hundred sixty thousand dollars (U.S. $160,000) in moral damages to Mrs. Isabel Morel de Letelier and eighty thousand dollars (U.S. $80,000) to each of the couple's four children: Christian, Francisco, Jose, and Juan Pablo. In setting this figure, the Commission took into account, by way of comparison, the amounts granted for moral damages by jurisdictional organs of the inter-American system and those ordered, also in recent years, by arbitration or judicial tribunals. Needless to say, in making these comparisons, the factual differences between the cases that served as a guide in setting these amounts were borne in mind.

Lastly, the Commission awarded Mrs. Isabel Morel de Letelier, as reimbursement of medical expenses for health problems resulting from the attack, the amount of sixteen thousand four hundred dollars (U.S. $16,400).

. . . [*The Commission then made similar determinations with respect to the Moffitt family.*] . . .

All the figures mentioned above amount to a total of two million six hundred and eleven thousand eight hundred and ninety two dollars (U.S. $2,611,892), which is the final amount of compensation to be paid by the State of Chile.

Casepoint

If state officials are responsible for ill treatment, the state must be ready to provide reparation to the victims. Victims should be treated at all times with respect, and reparations should take into account their needs and wishes as far as possible. The reparation must, as far as possible, wipe out all consequences of the illegal act and restore the victim's situation to the way it existed prior to committal of the act.

In a concurring opinion, Professor Francisco Orrego Vicuna notes that punitive damages are not accepted as a recognized principle under international law. Note that in the *Letelier/Moffitt Case,* the tribunal had jurisdiction only because of the active intervention of the U.S. government in making a claim diplomatically on the government of Chile, with which it had generally friendly relations. The invocation of the 1914 Bryan-Suarez Mujica Treaty placed the matter before an international commission, but if Chile was determined to deny its treaty obligations, the commission would not have met and no *ex gratia* payment would have been made.

TABLE 2.1

International insurance products

International Property Insurance

- **Foreign Commercial Property Insurance** covers financial losses from damage to an insured's overseas buildings and their contents, damage to the facilities of an overseas supplier or customer, loss of property in the custody of a salesperson, and loss of income from foreign royalties.
- **Marine Cargo Insurance** protects goods in transit, whether by land, sea, or air.
- **Comprehensive Dishonesty, Disappearance, and Destruction Insurance** is a form of fidelity and commercial crime insurance that covers losses from employee dishonesty (such as the loss of money, securities, or other property because of an employee's fraudulent or dishonest acts); losses inside an insured's premises due to actual destruction, disappearance, or misappropriation; losses outside an insured's premises while property is being transported by a messenger or armored vehicle; losses from "good faith" acceptance of counterfeit paper currency or money orders; losses from the forgery or alteration of checks, bank drafts, promissory notes, credit cards, or similar financial instruments; and losses from computer fraud.

International Casualty Insurance

- **Foreign Commercial General Liability Insurance** protects against financial loss stemming from third-party lawsuits brought against an insured because of its overseas business activities.Third parties include customers, suppliers, investors, government agencies, and competitors who bring suits for such things as bodily injury, property damage, product liability, contractual liability, personal injury, and advertising injury.
- **Foreign Voluntary Workers' Compensation Insurance** protects employers from claims involving work-related injuries and endemic diseases incurred by overseas employees.
- **Employer's Liability Insurance** covers an employer for the legal costs resulting from bodily injury or death of overseas employees.
- **Excess Repatriation Expense Insurance** reimburses an employer for expenses in excess of normal transportation costs for the repatriation of injured, sick, or deceased employees.
- **Foreign Commercial Automobile Liability Insurance** provides coverage for an insured's overseas automobiles, whether they are owned, hired, or borrowed.

Coverage for Overseas Employees

- **Foreign Accident and Health Insurance** covers employees and their family members traveling overseas.
- **Accident and Sickness (Medical) Insurance** covers employees in the event of accident, injury, or sickness abroad.
- **Accidental Death and Dismemberment Insurance** pays an employee involved in an accident resulting in dismemberment or the employee's dependents in the event of death.
- **Emergency Medical Evacuation Insurance** pays for an employee's transportation to a proper medical facility for treatment.
- **Repatriation of Remains Insurance** pays for the cost of repatriating an employee's remains to his home country.

Specialty Coverages

- **Kidnap, Ransom, and Extortion Insurance** covers losses resulting from kidnapping, wrongful detention, bodily injury extortion, property damage extortion, product contamination extortion, trade secret extortion, hijacking, and blackmail.
- **Sabotage and Terrorism Insurance** covers losses to an insured's overseas facilities and operations caused by saboteurs and terrorists.
- **Political Risk Insurance** covers losses from the unexpected, discriminatory, or arbitrary acts by foreign governments, such as confiscation, expropriation, or nationalization of assets; currency inconvertibility; war and political violence; contract repudiation; and the wrongful calling of "on demand"guarantees.

This list is based on descriptions in the American International Underwriters' *Worldrisk* brochure, posted on the Internet at www.aiu.aig.com/aiu/aiu36.htm.

Private Insurers

Private insurers who offer international insurance include the Exporters Insurance Company of Bermuda, the Dutch and British Nederlandsche Credietverzekering Maatsschappij, the French Compagnie Française d'Assurance pour le Commerce Exterieur,[50] and the following U.S. firms: Foreign Credit Insurance Association,[51] American International Group Global Trade & Political Risk Insurance Co.,[52] and CNA Credit.[53] Most of these insurers provide the full range of insurance products listed in Table 2.1. However, specialty coverage, especially political risk insurance, is often expensive or unavailable in designated high-risk countries.

National Investment Guaranty Programs

Because private international insurance is usually unavailable for companies doing business in high-risk countries, most government-sponsored insurance agencies concentrate on providing just such coverage. That is not to say that they provide coverage for all high-risk countries. Rather, they target their insurance offerings in order to promote domestic exports to certain favored countries.

Nations with government agencies that offer international insurance include the United States, Canada, and most Western European and many Latin American countries.[54] An example of such an agency is the United States Overseas Private Investment Corporation.

The United States Overseas Private Investment Corporation American political risk investment insurance dates back to the 1948 Marshall Plan, which offered limited assistance to private American companies investing in war-ravaged Europe. In the 1950s, the focus of the U.S. overseas investment program shifted from Europe to less developed countries (LDCs) in Africa, Asia, and Latin America. At the same time, the investment guarantees were increased to protect against expropriation, transfer risks, and risks associated with political violence. This program was run by the Agency for International Development (AID) until 1969, when Congress created the Overseas Private Investment Corporation (OPIC) as an independent government agency in corporate form. OPIC began doing business in 1971.

See OPIC's Internet home page at
www.opic.gov.

OPIC's mission is to "mobilize and facilitate the participation of United States private capital and skills in the economic and social development of less developed friendly countries and areas, thereby complementing the development assistance objectives of the United States. . . ."[55] To that end, OPIC runs two basic programs: a political risk insurance program and a finance program. The discussion here focuses on the first (and by far the larger) of them. It is important, nevertheless, to note that OPIC functions as a bank as well as an insurer.[56]

[50]Internet home page: www.coface.fr.

[51]Internet home page: www.fcia.com. The Foreign Credit Insurance Association is a voluntary association formed in 1961 by some 50 U.S. insurance companies and sponsored by the Export–Import Bank.

[52]Internet home page: www.aig.com.

[53]Internet home page: http://www.cna.com.

[54]The International Trade Center (a UN agency operated jointly by UNCTAD and the WTO) lists the following countries as providing international insurance through state-run insurance agencies: Argentina, Australia, Austria, Bangladesh, Barbados, Belgium, Brazil, Cameroon, Canada, Chile, Colombia, Cyprus, the Czech Republic, Denmark, Ecuador, Egypt, Finland, France, Germany, Greece, Hong Kong, Hungary, India, Indonesia, Ireland, Israel, Italy, the Ivory Coast, Jamaica, Japan, Lesotho, Liberia, Luxembourg, Malaysia, Malta, Mexico, Morocco, the Netherlands, New Zealand, Nigeria, Norway, Pakistan, Peru, the Philippines, Poland, Portugal, the Republic of Korea, Romania, Russia, Saudi Arabia, Senegal, Singapore, Slovakia, Slovenia, South Africa, Spain, Sri Lanka, Swaziland, Sweden, Switzerland, Taiwan, Thailand, Trinidad and Tobago, Tunisia, Turkey, the United Kingdom, the United States, Uruguay, Venezuela, Zambia, and Zimbabwe. See www.intracen.org.

[55]Foreign Assistance Act, United States Code, Title 22, §2191 (1982).

[56]OPIC's finance program is designed to let OPIC participate as a medium- to long-term project lender. For small businesses involved in small projects, OPIC can participate as a direct lender. For larger investors involved in larger projects, OPIC can facilitate commercial lending by providing investment guarantees for commercial bank loans.

The political risk insurance program covers the political risk of expropriation, currency inconvertibility, and various kinds of risks associated with political violence.

Expropriation In OPIC's early years, expropriation coverage (or coverage against nationalization or other noncompensated taking by a foreign government) was the primary insurance sought by American companies investing overseas. This is no longer the case. Expropriation claims have declined significantly, with the last notable series of claims spawned by the Iranian Revolution of the mid-1970s. Demands for expropriation coverage have correspondingly declined.

Few of the recent expropriation claims have been for outright confiscation or nationalization. Instead, most claims are now for **creeping expropriation**—that is, expropriation through a series of acts that individually might be seen as administrative actions or general health, safety, or welfare measures undertaken by the host government.

creeping expropriation A series of administrative acts that in combination result in depriving persons of their property.

This trend is attributable to at least three factors. First, most LDC governments need to attract foreign investment, and they are reluctant to take any action that might discourage investment in their countries. Second, LDC governments have become much more sophisticated. Instead of using outright nationalization with all of its undesirable repercussions, they achieve the same political or economic objectives through other means (e.g., creeping expropriation). Third, international transactions no longer consist mainly of agreements with a host government for the extraction of minerals or other resources. Instead, international investments typically take the form of a joint venture or some other form of cooperative dealing that involves both the host country government and private host country nationals.

Claims for creeping expropriation, in contrast to overt nationalization, present OPIC with a significant problem: defining *de facto,* or creeping, expropriation. OPIC has defined it "as any act, or series of acts, for which the State is responsible, which are illegal under domestic or international law, and which have a substantial enough adverse effect on either the enterprise or the investor's rights under the enterprise."[57]

This definition, of course, leads to the question of how much is "substantial enough." In general, OPIC answers by looking at what happened to the entire investment. OPIC does not insure against partial expropriation or for some diminishment in the value of an investment. Thus, unless an investor is willing to give up all claims to its entire investment, OPIC does not regard the expropriation as being substantial enough.

Currency Inconvertibility OPIC offers insurance that guarantees that an investor will be able to convert local currency into dollars, an important guarantee because most American investors have to pay their obligations (e.g., loans, dividends) in dollars. OPIC's coverage, however, only insures an existing legal right to convert. In the absence of such a right, OPIC cannot offer this form of coverage. If there is a legal right to convert, however, OPIC will insure that right against an outright denial or any adverse change in conditions (such as a change in banking procedures) that would effectively make convertibility impossible.

Political Violence Finally, OPIC offers insurance against losses due to political violence. *Political violence* losses cover risks associated with wars, revolutions, civil strife, and terrorism (see Figure 2.6). This coverage is different from OPIC's expropriation or inconvertibility coverage because the risk is different. Unlike the other risks, this one is generally beyond the control of the host government. In addition, when there is a claim, OPIC's ability to salvage its losses is greatly reduced. Ordinarily, OPIC will get subrogation rights against the host government from the insured (i.e., it can bring a claim to recover the money it pays out to the firms it insures). But subrogation rights are of little practical value, however, against a government that is unable to control insurgent violence.

OPIC protects itself both by charging higher insurance rates for countries that are more susceptible to political violence and by requiring investors to take actions to manage perceived risks. Of course, OPIC will decline to insure a project that it perceives is a bad risk. OPIC also limits its exposure in any one country to no more than 10 percent of its total risk.

[57]See Robert Shanks, "Insuring Investment and Loans Against Currency Inconvertibility, Expropriation and Political Violence," *Hastings International and Comparative Law Review,* vol. 9, p. 425 (1986).

FIGURE 2.6

The Operations of Oil Companies Had to Be Suspended in Libya During That Country's Revolution

Source: Paul Conroy/Alamy

Multilateral Investment Guaranty Programs

In addition to private insurance and U.S.-sponsored insurance such as OPIC, foreign direct investment can be insured through the World Bank's Multilateral Investment Guaranty Agency (MIGA).[58] Since its inception in 1988, MIGA has provided political risk insurance guarantees to private sector investors and lenders. Its shareholders include most of the world's nation-states. Part of MIGA's mission is to share its research and knowledge about risk in a variety of sectors and geographic locations, with particular emphasis on investments in "difficult operating environments" and in places where it can make the greatest difference. For example, MIGA will emphasize insurance in states eligible for assistance from the International Development Association (i.e., the world's poorest countries), conflict-affected environments, complex transactions in infrastructure and extractive industries, and "south to south" investments (from one developing country to another). Since 1988, it has issued over $24 billion in political risk insurance for a wide variety of projects in diverse locations around the world.

MIGA professes to support only those investments that are developmentally sound and meet high social and environmental standards. A Council of Governors and a Board of Directors represent the member countries and guide the programs and activities of MIGA. MIGA's corporate powers are vested in the Council of Governors, which delegates most of its powers to a Board of Directors. Voting power is weighted according to the share of capital each director represents. The directors meet regularly at the World Bank[59] headquarters in Washington, D.C., where they review and decide on investment projects and oversee general management policies.

F. Environmental Protection

Contemporary efforts to comprehensively protect the environment date back only to 1968, when the United Nations adopted Resolution 2398 convening the Stockholm Conference on the Human Environment. In 1972, the Conference issued the **Stockholm Declaration**,[60] adopting a list of principles that define both new human rights and new state responsibilities. Two of these are especially noteworthy. Principle 1 proclaims:

> Man has the fundamental right to freedom, equality, and adequate conditions of life, in an environment of a quality that permits a life of dignity and well-being.

And Principle 21 states:

> States have, in accordance with the Charter of the United Nations and the principles of international law, the sovereign right to exploit their own resources pursuant to their

Stockholm Declaration Issued by the United Nations Conference on the Human Environment in Stockholm in 1972. It asserts, among other things, that a healthy environment is a human right and that states have a responsibility not to damage the environment of other states.

[58]MIGA's Internet home page is at www.miga.org.

[59]The World Bank's Internet home page is at www.worldbank.org.

[60]Formally the "Declaration of the United Nations Conference on the Human Environment (1972)." The text of the declaration is posted on the Internet at www.unep.org/Documents.multilingual/Default.asp?DocumentID=97&ArticleID=1503.

> own environmental policies, and the responsibility to ensure that activities within their jurisdiction or control do not cause damage to the environment of other states or of areas beyond the limits of national jurisdiction.

Among the recommendations of the Stockholm Conference was a proposal that the United Nations General Assembly create a United Nations Environment Program (UNEP).[61] This is what the Assembly did in December 1972.[62] Since its beginning, UNEP has been active in monitoring Earth's environment, drafting international and regional treaties, and adopting recommended principles and guidelines.[63]

Twenty years after the Stockholm Convention, the United Nations Conference on the Environment and Development (UNCED) convened in Rio de Janeiro in June 1992. The **Rio Declaration** reaffirmed the principles set forth in the Stockholm Declaration.[64] In addition, it linked protection of the environment and development as related goals (a concept that had been hotly debated in 1972). Principle 4 of the Rio Declaration states:

Rio Declaration
Issued by the United Nations Conference on the Environment and Development at Rio de Janeiro in June 1992. It links protection of the environment to the need for sustainable development.

> In order to achieve sustainable development, environmental protection shall constitute an integral part of the development process and cannot be considered in isolation from it.

Many other new principles were agreed to as well, such as (1) the recognition of a "right of development,"[65] (2) an assertion that "each individual shall have appropriate access to information concerning the environment that is held by public authorities,"[66] (3) the promotion of a "supportive and open international economic system . . . to better address the problems of environmental degradation,"[67] (4) adoption of the **precautionary approach** to protecting the environment (i.e., where there are "threats of serious or irreversible damage," action to correct the problem should not be delayed merely because there is a "lack of scientific certainty" that injury will result),[68] and (5) a statement that all states have an obligation to prepare an "environmental impact assessment" whenever activities are proposed by a governmental agency that "are likely to have a significant adverse impact on the environment."[69]

precautionary approach
Maxim that states should not delay in taking action to correct a threat of serious or irreversible damage to the environment merely because there is a lack of scientific certainty that injury will result.

UNCED also adopted a statement designating objectives and priority actions for the international community for the years leading up to the year 2000 and beyond (called **Agenda 21**).[70] This agenda includes both developmental and environmental goals. The former are to promote sustainable and

Agenda 21
A schedule of developmental and environmental goals for the period leading up to the year 2000 and beyond. These include the promotion of sustainable and environmentally friendly growth, the elimination and prevention of pollution, and the protection and conservation of the earth's natural resources.

[61] UNEP's Internet home page is at www.unep.org.

[62] Resolution 2997 (XXVII), United Nations, General Assembly Official Records, 27th Session, Supp. no. 30, p. 43 (December 15, 1972).

[63] UNEP consists of a Governing Council composed of 58 member states elected by the UN General Assembly. Its Secretariat is headquartered in Nairobi and headed by an undersecretary-general of the UN who serves as UNEP's executive director. As part of its monitoring activities it runs Earthwatch, which assesses the state of the earth's environment through its Global Environment Monitoring System, its International Environmental Information System, and its International Register of Potentially Toxic Chemicals. Other activities of UNEP include (1) implementation of the World Plan of Action on the Ozone Layer, (2) climate research and assessment, (3) development of rules to control the international movement of hazardous wastes, (4) implementation of a marine environment action plan, (5) the management of water resources, (6) coordination of an action plan to combat desertification, (7) assessment of the world's forests, (8) maintenance of biological diversity, (9) encouraging cleaner industrial production through better technology, (10) assessment of the impact of the use of energy on the environment, (11) preparation of environmental guidelines for urban development, (12) the protection of human health and well-being, (13) assessing and combating threats to the lithosphere, (14) determination of the risks of specific chemicals to the environment, (15) maintenance of an international register of environmental treaties, (16) development of educational programs on the environment, and (17) assisting environmental planners and policymakers to prepare long-range environmental plans.

[64] The text of the Rio Declaration is posted on UNEP's Web site at www.unep.org/Documents.Multilingual/Default.asp?documentid=78&articleid=1163.

[65] Rio Declaration on Environment and Development, Principle 3.

[66] *Id.,* Principle 10.

[67] *Id.,* Principle 12.

[68] *Id.,* Principle 15.

[69] *Id.,* Principle 17.

[70] The name, in part, honors Principle 21 of the Stockholm Declaration. To monitor and review the development goals of Agenda 21, the states that participated in UNCED agreed to establish a new UN Commission for Sustainable Development (as a companion agency to the existing UN Environment Program). This will be an intergovernmental body reporting to the UN Economic and Social Council. For information about the Commission, see the UN Web site at www.un.org/esa/sustdev.

environmentally friendly growth.[71] The latter are, in essence, to prevent pollution and to conserve and protect Earth's natural resources.

The environmental goals are not new. They have been the main objectives of the international community since the Stockholm Conference. To implement them, states have become parties to various multilateral, regional, and bilateral treaties. In the materials that follow, we look at some of the more important multilateral arrangements that exist today.

For the texts of the various multilateral, regional, and bilateral environmental treaties, see the Environmental Treaties and Resource Indicators (ENTRI) Web site at http://sedac.ciesin.org/entri.

Regulation of Pollution

Efforts to minimize pollution have taken two approaches: a sectoral approach regulating particular sectors of the environment and a product approach regulating particular pollutants.

Sectoral Regulations The main environmental sectors subject to international regulations are the marine environment and the atmosphere.

Marine Pollution The 1982 United Nations Convention on the Law of the Sea (UNCLOS)[72] imposes on all states the obligation "to protect and preserve the marine environment."[73] Article 194(1) states:

> States shall take, individually or jointly as appropriate, all measures consistent with this Convention that are necessary to prevent, reduce, and control pollution of the marine environment from any source, using for this purpose the best practicable means at their disposal and in accordance with their capabilities, and they shall endeavor to harmonize their policies in this connection.

In particular, states are to take measures to minimize to the fullest possible extent (1) the release of toxic, harmful, or noxious substances from land-based sources, (2) pollution from vessels, (3) pollution from the installations and devices used in the exploration or exploitation of the seabed and its subsoil, and (4) pollution from other installations and devices operating in the marine environment.

Other duties incumbent on states are (1) not to pollute the environment of neighboring states, (2) not to transfer damage or hazards from one area to another or to transform them from one type of pollution to another, (3) not to intentionally or accidentally introduce alien or new species into the marine environment, (4) to notify other affected states when the marine environment is in imminent danger of being damaged or has been damaged by pollution, and (5) to monitor and assess the risks and effects of pollution and to publish the results of those studies.

To carry out these duties, states are required to "adopt laws and regulations" and "take other measures" to "prevent, reduce, and control pollution." Once adopted, these rules may be enforced by (1) flag states with regard to vessels flying their flag, (2) port states concerning vessels voluntarily within their ports, and (3) coastal states as to vessels navigating within their territorial sea or exclusive economic zone or vessels that are found to be dumping materials onto their continental shelf.

UNCLOS provides that disputes between states are to be resolved by negotiation or mediation. If no resolution is possible by these means, then either party may submit the dispute to the International Tribunal for the Law of the Sea, established by the convention, or to the ICJ or a mutually agreeable arbitration tribunal.[74]

[71]For a thorough review of the preliminary negotiations and preparatory meetings leading up to the adoption of Agenda 21 and to the UNCED meeting in Rio, see Nicholas A. Robinson, ed., *Agenda 21 and the UNCED Proceedings* (3 vols., 1992), and Shanna L. Halpern, *The United Nations Conference on Environment and Development: Process and Documentation* (1992), which is posted on the Consortium for International Earth Science Information Network Web site at www.ciesin.org/docs/008-585/unced-intro.html.

[72]See the UN Web site at www.un.org/Depts/los/convention_agreements/convention_agreements.htm.

[73]United Nations Convention on the Law of the Sea, Article 193 (1982). The text of the convention is posted on the Internet at www.un.org/depts/los/convention_agreements/texts/unclos/unclos_e.pdf.

[74]The first application submitted to ITLOS to resolve a dispute was received by the tribunal on November 11, 1997. The dispute was between Saint Vincent and the Grenadines and Guinea. See the *M/V* Saiga *Case* (Case 2-5).

In Case 2-7, the International Tribunal for the Law of the Sea was asked to apply provisional measures (restraining orders pending a decision on the merits) in a case of an alleged violation of the UNCLOS.

CASE 2-7 Southern Bluefin Tuna Cases: Provisional Measures

New Zealand v. Japan; Australia v. Japan (Case Nos. 3 and 4) 1999
International Tribunal for the Law of the Sea
Posted at www.itlos.org

MAP 2.9

Australia, Japan, and New Zealand (1999)

On August 27, 1999, Australia and New Zealand initiated proceedings in the International Tribunal for the Law of the Sea against Japan alleging that a unilateral experimental fishing program undertaken by Japan was contrary to the United Nations Convention on the Law of the Sea (UNCLOS), the 1993 Convention for the Conservation of Southern Bluefin Tuna (CCSBT), and customary international law. Australia and New Zealand simultaneously sought provisional measures (i.e., restraining orders pending a decision on the merits) under UNCLOS Article 290(5).

Judgment of the Tribunal

***

63. Considering that, in accordance with article 290 of the [United Nations] Convention [on the Law of the Sea], the Tribunal may prescribe provisional measures to preserve the respective rights of the parties to the dispute or to prevent serious harm to the marine environment;

***

70. Considering that the conservation of the living resources of the sea is an element in the protection and preservation of the marine environment;

71. Considering that there is no disagreement between the parties that the stock of southern bluefin tuna is severely depleted and is at its historically lowest levels and that this is a cause for serious biological concern;

***

73. Considering that, in the view of the Tribunal, the parties should in the circumstances act with prudence and caution to ensure that effective conservation measures are taken to prevent serious harm to the stock of southern bluefin tuna;

***

80. Considering that, although the Tribunal cannot conclusively assess the scientific evidence presented by the parties, it finds that measures should be taken as a matter of urgency to preserve the rights of the parties and to avert further deterioration of the southern bluefin tuna stock;

***

90. For these reasons, THE TRIBUNAL,

1. Prescribes, pending a decision of the arbitral tribunal, the following measures:

a. Australia, Japan, and New Zealand shall each ensure that no action is taken which might aggravate or extend the disputes submitted to the arbitral tribunal;

***

b. Australia, Japan, and New Zealand shall each refrain from conducting an experimental fishing program involving the taking of a catch of southern bluefin tuna, except with the agreement of the other parties or unless the experimental catch is counted against its annual national allocation. . . .

Separate Opinion of Judge Shearer

***

The ineluctable fact proved before the Tribunal is that Japan, for the past two years, has been conducting an experimental fishing program without the consent of the other two parties to the CCSBT in excess of its annual quota as last agreed by the Commission. "Experimental fishing" is not a concept recognized, as such, either by the CCSBT or by the United Nations Convention on the Law of the Sea. The expression is not a term of art. It can be characterized, in theory, as one of a number of means of testing the recovery of fish stocks in various places and at various stages of their growth. To that extent it was within the powers of the Commission established under the CCSBT to approve an experimental fishing program as part of its scientific studies aimed at obtaining more accurate data concerning southern bluefin tuna stocks. But agreement on experimental fishing in 1998 and 1999 was not forthcoming in view of the failure of the parties to agree upon a change to the previously agreed total annual catch (TAC) and the catches for experimental fishing that would be allowed in addition to the annual national allocations of the TAC.

***

. . . Since the Commission under the CCSBT was established in 1994, Australia and New Zealand have taken a precautionary approach and have been unwilling to increase the TAC, despite Japan's arguments that the scientific evidence supported the sustainability of an increase. Because the Commission operates on the unanimity principle, no change in the TAC or national allocations could be effected. There is thus stalemate in the Commission on this issue.

***

The Precautionary Principle/Approach

The difficulties of applying the precautionary principle to fisheries management have been well explained in a recent work of persuasive authority.[75] There is a considerable literature devoted to the emergence of the precautionary principle in international law generally,[76] but whether that principle can of itself be a mandate for action, or provide definitive answers to all questions of environmental policy, must be doubted. As Professor Orrego Vicuna has remarked, "Scientific uncertainty is normally the rule in fisheries management and a straightforward application of the precautionary principle would have resulted in the impossibility of proceeding with any activity relating to marine fisheries."[77] Hence, there is a preference by some to use the word "approach" rather than "principle." That this is so, particularly in the case of fisheries management, is confirmed by the wording of Article 6 of the Agreement for the Implementation of the Provisions of the United Nations Convention on the Law of the Sea Relating to the Conservation and Management of Straddling Fish Stocks and Highly Migratory Fish Stocks, December 4, 1995,[78] which obliges states parties to apply "the precautionary approach." Annex II to the Agreement lays down "guidelines" for the application of the precautionary approach. This Agreement, which has not yet entered into force, was signed by all three parties to the present dispute. It is thus an instrument of important reference to the parties in view of its probable future application to them, and in the meantime, at least, as a set of standards and approaches commanding broad international acceptance.

The Tribunal has not found it necessary to enter into a discussion of the precautionary principle/approach. However, I believe that the measures ordered by the Tribunal are rightly based upon considerations deriving from a precautionary approach.

***

Separate Opinion by Judge Lai

***

The Tribunal's Order does not refer to the "precautionary principle." Instead, in the recitals it chronicles the opposing views of the Applicants and Respondents about the condition of the stock in view of the allegations about the impact thereon of utilization. It also recites that "the parties should in the circumstances act with "prudence and caution" to ensure that effective conservation measures are taken to prevent serious harm to the stock." It further notes the scientific disagreement about appropriate measures to conserve the stock and the non-agreement of the parties about whether the measures actually taken have led to improvement. This aspect of the recitals states the Tribunal's conclusion about the need for article 290–type of measures despite the Tribunal's inability conclusively to assess the scientific evidence. In my view, these statements are pregnant with meaning. . . .

Background on Environmental Precaution

The notion of environmental precaution largely stems from diplomatic practice and treaty-making in the spheres, originally, of international marine pollution, and now of biodiversity, climate change, pollution generally and, broadly, the environment. Its main thesis is that, in the face of serious risk to or grounds (as appropriately qualified) for concern about the environment, scientific uncertainty or the absence of complete proof should not stand in the way of positive action to minimize risks or take actions of a conservatory, preventative or curative nature. In addition to scientific uncertainty, the most frequently articulated conditions or circumstances are concerns of an intergenerational nature and forensic or proof difficulties, generally in the context of rapid change and perceived high risks. The thrust of the notion is

[75] Francisco Orrego Vicuna, *The Changing International Law of High Seas Fisheries* (1999).

[76] See, for example, David Freestone and Ellen Hay (eds.), *The Precautionary Principle and International Law: The Challenge of Implementation* (1996).

[77] *The Changing International Law of High Seas Fisheries,* p. 157 (1999).

[78] www.oceansatlas.org/world_fisheries_and_aquaculture/html/govern/instit/intlinstr/unfsa.htm.

vesting a broad dispensation to policy makers, seeking to provide guidance to administrative and other decision-makers and shifting the burden of proof to the State in control of the territory from which the harm might emanate or to the responsible actor. The notion has been rapidly adopted in most recent instruments and policy documents on the protection and preservation of the environment.[79]

Even as questioning of the acceptability of the precautionary notion diminishes, challenges increase regarding such specifics as: the wide potential ambit of its coverage; the clarity of operational criteria; the monetary costs of environmental regulation; possible public health risks associated with the very remedies improvised to avoid risk; diversity and vagueness of articulations of the notion; uncertainties about attendant obligations, and the imprecision and subjectivity of such a value-laden notion.[80] Nevertheless, the notion has been "broadly accepted for international action, even if the consequence of its application in a given situation remains open to interpretation."[81]

Nevertheless, it is not possible, on the basis of the materials available and arguments presented on this application for provisional measures, to determine whether, as [Australia and New Zealand] contend, customary international law recognizes a precautionary principle.

Precaution in Marine Living Resource Management

However, it cannot be denied that UNCLOS adopts a precautionary approach. This may be gleaned, *inter alia,* from preambular paragraph 4, identifying as an aspect of the "legal order for the seas and oceans" "the conservation of their living resources." . . . Several provisions in Part V of the Convention, e.g. Articles 63–66, on conservation and utilization of a number of species in the exclusive economic zone, identify conservation as a crucial value. So do Article 61, specifically dealing with conservation in general, and Article 64, dealing with conservation and optimum utilization of highly migratory species (such as tuna). Article 116, on the right to fish on the high seas, *inter alia* reiterates the conservation obligation on nationals of non-coastal/distant fishing States while fishing in the exclusive economic zone of other States. Article 117 explicitly articulates the duty of all States "to take, or to co-operate with other States in taking, measures for their respective nationals as may be necessary for" conservation of living resources in the high seas. Article 118 requires inter-State cooperation in the conservation and management of high seas living resources. Such cooperation is to extend to negotiations leading to the establishment of subregional or regional fisheries organizations. And Article 119, entitled "conservation of the living resources of the high seas," deals with the allocation of allowable catches and "establishing other conservation measures."

Although paragraph 1(a) refers to measures, based on the best scientific evidence, for production of the maximum sustainable yield, the conservatory thrust of this article is vigorously reaffirmed by the treatment, in paragraph (b), of the effects of management measures on associated or dependent species the populations of which should be maintained or restored "above levels at which their reproduction may become seriously threatened." Article 116, in association with the Part V articles mentioned above, has been stated to point to the precautionary "principle" of fisheries management, while Article 119 has been said to reflect a precautionary "approach" "when scientific data is not available or is inadequate to enable comprehensive decision-making."[82]

---

[79]Of note is ¶ 17.21 of Agenda 21, adopted at the 1992 Rio Conference on the Environment and Development. Paragraph 17.1 also calls for "new approaches to the marine and coastal area management and development, at the national, regional and global levels, approaches that are integrated in context and are precautionary and anticipatory in ambit. . . ." Paragraph 15 of the Rio Declaration, adopted at the same Conference, provides that "In order to protect the environment, the precautionary approach shall be widely applied by States according to their capabilities. Where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation." . . .

[80]Philippe Sands in *The Precautionary Principle and International Law: The Challenge of Implementation,* p. 134 (D. Freestone and E. Hey, eds., 1996); Don Mayer, "DDT and the Precautionary Principle," *South Carolina Environmental Law Review,* vol. 9, no. 2 (Spring 2002), pp. 135–179.

[81]A. D'Amato and K. Engel, *International Environmental Law Anthology,* p. 22 (1996).

[82]*United Nations Convention on the Law of the Sea 1982: A Commentary* (hereafter *Virginia Commentary*), vol. 4, pp. 288, 310 (Shabtai Rosenne and Louis B. Sohn, eds., 1989).

Most of these are the very provisions before this Tribunal today. Strikingly, also, Article 290:1's reference to serious harm to the marine environment as a basis for provisional measures also underscores the salience of the approach.

***

My conclusions . . . are bolstered by such recent precedents as paragraph 17.21 of Agenda 21. It is also reinforced by various provisions in articles 6 and 7 of the Code of Conduct for Responsible Fisheries of the Food and Agriculture Organization and articles 5(c) and 6 of the Straddling Stocks Agreement, with detailed requirements for the application of the precautionary approach. In the present context, it matters little that the former is a voluntary Code and the latter is not yet in force. With some cogency, these developments were judicially presaged by the International Court of Justice in 1974:

> [E]ven if the Court holds that Iceland's extension of its fishery limits is not opposable to the Applicant, this does not mean that the Applicant is under no obligation to Iceland with respect to fishing in disputed waters in the 12-mile to 50-mile zone. On the contrary, both States have an obligation to take full account of each other's rights and of any fishery waters. It is one of the advances in maritime international law, resulting from the intensification of fishing, that the former *laissez-faire* treatment of the living resources of the sea in the high seas has been replaced by a recognition of a duty to have due regard to the rights of other States and the needs of conservation for the benefit of all. Consequently, both Parties have the obligation to keep under review the fishery resources in the disputed waters and to examine together, in the light of scientific and other available information, the measures required for the conservation and development, and equitable exploitation, of those resources, taking into account any international agreement in force between them. . . .

Casepoint

The precautionary approach requires the parties to an environmental protection convention to act with "prudence and caution." While customary international law does not adopt the precautionary principle, UNCLOS clearly does, as is implied by the language requiring the parties to conserve the marine environment. Each party to a convention is to refrain from participating in experimental programs unless it obtains consent of the others.[83]

In addition to the 1982 UN Convention, several other international conventions and instruments deal with more particular problems of ocean pollution. Among these are the 1954 Convention for the Prevention of Pollution of the Sea by Oil; the 1969 Convention Relating to Intervention on the High Seas in Case of Oil Pollution Casualties; the 1972 Convention on the Prevention of Marine Pollution by Dumping of Wastes and Other Matter; the 1973 Convention for the Prevention of Pollution from Ships; the 1974 Convention on the Prevention of Marine Pollution from Land-Based Sources; the 1989 Convention on Salvage; and the 1990 Convention on Oil Pollution Preparedness, Response, and Cooperation.

For more information on multilateral environmental treaty data, go to http://sedac.ciesin.columbia.edu/entri.

Atlantic bluefin tuna are also in danger of overfishing. The World Wildlife Fund has monitored catches in the Atlantic and the Mediterranean and issued a warning to the EU in 2006 (see Figure 2.7).

[83]For more on the precautionary principle, see www.psrast.org/precaut2.htm.

FIGURE 2.7

World Wildlife Fund Press Release

Source: "Bluefin Tuna Fishery Ravaged by Illegal Fishing, Warns World Wildlife Fund," press release from World Wildlife Fund website, June 30, 2006. Copyright © 2006 by World Wildlife Fund. Reprinted with permission.

BLUEFIN TUNA FISHERY RAVAGED BY ILLEGAL FISHING

Press Release, World Wildlife Fund, June 30, 2006

WASHINGTON—Bluefin tuna stocks in the East Atlantic and Mediterranean are being stripped bare by illegal and unscrupulous fishing, warns a new World Wildlife Fund report. WWF demands an immediate closure of the fishery.

"Without cooperation from the European Union, U.S. efforts to save bluefin tuna populations in the Atlantic will be unsuccessful," said Tom Grasso, director, Marine Conservation Policy, World Wildlife Fund.

An independent study commissioned by WWF, The plunder of bluefin tuna in the Mediterranean and East Atlantic in 2004 and 2005—Uncovering the real story, reveals the full extent of illegal, unreported and unregulated (IUU) fishing for bluefin tuna.

Fleets from the European Union (mainly France), Libya and Turkey are the main offenders. These countries are greatly exceeding their fishing quotas and deliberately failing to report much of their massive catches, thereby also avoiding paying taxes and bypassing sensible management.

The 42 nation International Commission for the Conservation of Atlantic Tunas—where the EU plays a major role—is responsible for regulating the fishery. However, the annual fishing quota of 32,000 tons, set by ICCAT, was smashed by more than 40 percent in 2004 with a catch of 44,948 tons, rising to 45,547 in 2005. Real catches are likely to amount to well over 50,000 tons—a figure confirmed by the ICCAT scientific committee.

"The European Commission risks bearing witness to the collapse of this centuries-old fishery," said Grasso. "We urge EU Fisheries Commissioner Borg to show leadership and call for an immediate total closure of the fishery, and request that he supports strong management measures at this November's ICCAT meeting that guarantee a future for the fishery."

The report also reveals deliberate misreporting and laundering of bluefin tuna catches. Unreported tuna catches are increasingly slaughtered and processed at sea before being shipped out on board enormous vessels destined for the lucrative Japanese market.

"Atlantic bluefin tuna stocks risk imminent commercial collapse," said Roberto Mielgo Bregazzi, report author and CEO of Advanced Tuna Ranching Technologies. "In the race to catch shrinking tuna stocks, industrial fleets are switching from traditional fishing grounds to the last breeding refuges in the eastern Mediterranean and Libyan waters."

In addition to calling for an immediate closure of the fishery, WWF urges ICCAT members to adopt a sustainable recovery plan for Atlantic bluefin tuna which must include a dramatic reduction in tuna fishing and farming capacity, improved enforcement and reporting.

Source: Images & Stories/Alamy

A news report in May 2006 indicated that EU officials were prepared to ban bluefin tuna fishing within EU waters. "The failure of France, Italy and Spain to observe EU limits on tuna catches and to prevent illegal fishing has finally exhausted the patience of officials across Europe."[84] The EU commission concluded that fishing opportunities for bluefin tuna were "exhausted," and that member states (especially France, Italy, and Spain) had failed to take "appropriate measures" to protect the

[84]Bruno Waterfield and Charles Clover, "EU to Ban Bluefin Fishing," *Daily Telegraph,* May 31, 2007.

bluefin fisheries. The proposed ban would affect only EU member states, some of whom were thought likely to block the ban.[85]

Some restrictions did take effect, however. In 2007, the EU fisheries ministers created a 15-year plan aimed at saving tuna. Fishing quotas will be cut by 10 percent, fishing boats will be limited to six months at sea, and the minimum size of tuna allowed to be fished has been raised from 10 kilos (22 pounds) to 30 in the hope that these measures will help them to reproduce. The measures are expected to impact France, Italy, and Spain the most, as those are the EU countries with the largest tuna fishing industries. The EU measure is considered part of a global effort to protect tuna that was already agreed to in Japan in January 2007. Much of the overfishing is driven by the increasing popularity worldwide of sushi, which makes tuna fishing a lucrative industry, especially for developing countries that export to Japan, which consumes 80 percent of the world's bluefin tuna.[86]

Environmentalists and some member states were not happy with the plan, however. Britain and Ireland both registered a protest vote against the decision. These countries noted that EU rules require any overfished stock to be paid back in future years, yet these rules were not going to be invoked against France and Italy, estimated to have exceeded their quotas by as much as 30 percent in 2005 and 2006. Yet, payback rules were being invoked against British and Irish fishermen for overfishing mackerel, a population not listed as threatened.[87] Moreover, the WWF claimed that the plan will allow bluefish fishing at twice the level that international scientists say is needed to prevent stock collapse.[88]

The issues involving bluefin tuna reflect the difficulties of international law in protecting common areas, such as fisheries, the atmosphere, or outer space. In a "macro" version of the "tragedy of the commons,"[89] the international order of sovereign states is often without an effective regulatory framework, which means that some states will be tempted to exploit the commons for maximum gain, resulting in loss to others and/or depletion of common resources. Perhaps the most prominent example of the difficulties international law has governing the commons is in matters affecting the atmosphere, particularly the regulation of human-created greenhouse gases.

Climate and Air Pollution The principal international treaty dealing with the problem of global warming is the **United Nations Framework Convention on Climate Change (UNFCCC)**.[90]

United Nations Framework Convention on Climate Change (UNFCCC) Multilateral convention adopted in 1992 and in force since 1994. It seeks to stabilize and diminish greenhouses gases in the atmosphere.

[85]"There are still concerns that Italy or France might try to block the ban and that Europe's fishing ministers might clash on the measure at a meeting in Luxembourg on June 12." *Id.*

[86]Chris Hogg, "Farming Endangered Blue-fin Tuna," BBC News, http://news.bbc.co.uk/2/hi/asia-pacific/6189975.stm. As of 2007 the base price for bluefin tuna is 30 to 40 dollars (23 to 31 euros) per kilo, while in Japan the price easily reaches 100 dollars and top-quality bluefin can even fetch 500 dollars per kilo.

[87]Charles Clover, "Bluefin Tuna Quotas Doubled," *Daily Telegraph,* June 11, 2007.

[88]*Id.* The International Convention for the Conservation of Atlantic Tunas, which has 43 member countries, crafted an agreement in January 2007 that set annual bluefin quotas at 29,000 tons a year in the Mediterranean. Scientists say that the maximum annual quota should be 15,000 tons. The EU's share, set provisionally by the ICCAT at 9,000 tons for 2007, was increased to 16,000 tons under the EU plan.

[89]Garret Hardin's classic article on the "tragedy of the commons" can be found at http://dieoff.org/page95.htm and at www.sciencemag.org/cgi/content/full/162/3859/1243. In a much quoted passage, Hardin writes:

> Picture a pasture open to all. It is to be expected that each herdsman will try to keep as many cattle as possible on the commons. . . . As a rational being, each herdsman seeks to maximize his gain. Explicitly or implicitly, more or less consciously, he asks, "What is the utility *to me* of adding one more animal to my herd?" . . . 1. The positive component is a function of the increment of one animal. Since the herdsman receives all the proceeds from the sale of the additional animal, the positive utility is nearly + 1. 2. The negative component is a function of the additional overgrazing created by one more animal. Since, however, the effects of overgrazing are shared by all the herdsmen, the negative utility for any particular decisionmaking herdsman is only a fraction of −1. Adding together the component partial utilities, the rational herdsman concludes that the only sensible course for him to pursue is to add another animal to his herd. And another. . . .
>
> . . . But this is the conclusion reached by each and every rational herdsman sharing a commons. Therein is the tragedy. Each man is locked into a system that compels him to increase his herd without limit—in a world that is limited. Ruin is the destination toward which all men rush, each pursuing his own best interest in a society that believes in the freedom of the commons. Freedom in a commons brings ruin to all.

[90]The convention's secretariat maintains a home page at http://unfccc.int/2860.php.

Adopted in 1992 at the UN Conference on the Environment and Development in Rio de Janeiro and in force since 1994, the convention establishes objectives and principles, commitments for different groups of countries, and a set of institutions to enable its member states to monitor the convention's implementation and to continue discussions on how best to deal with the problem.

The ultimate objective of the UNFCCC is the "stabilization of atmospheric concentrations of greenhouse gases at levels that would prevent dangerous anthropogenic interference with the climate system. . . ." (*Anthropogenic* means "arising from human activities.") Although the convention does not define *dangerous,* it does state that ecosystems should be allowed to adapt naturally, the food supply should not be threatened, and economic development should be able to proceed in a sustainable manner.

The principles adopted by the convention are meant to address two main political problems: (1) how to distribute the burden of reducing emissions among different countries and (2) how to deal with scientific uncertainty. The principles of *equity* and *common but differentiated responsibilities* address the first of these. In other words, the convention recognizes that industrialized countries have historically been the main source of the problem and have more resources to address it, and that the developing countries are more vulnerable to its adverse effects and have the fewest resources to address the problem. It therefore requires industrialized countries to take the lead in modifying long-term emission trends, and it calls on the richest countries to provide financial and technological resources to help developing countries stabilize their greenhouse gas emissions.

To deal with the second political problem, that of scientific uncertainty, the convention adopts the precautionary principle. This principle, also incorporated in the Rio Declaration, responds to the dilemma that, while there are many uncertainties still surrounding climate change, waiting for full scientific certainty before taking action is almost certain to be too late to avert its worst impacts. Article 3(3) of the convention, accordingly, calls for member states to adopt "precautionary measures" to combat climate change, stating that "where there are threats of serious or irreversible damage, lack of full scientific certainty should not be used as a reason for postponing such measures."

The convention divides its member countries into two main groups. Developed countries—currently 41 are members[91]—are known as *Annex I* countries (because they are listed in the convention's Annex I). Other member countries are known as *non–Annex I* countries.

Article 4 says that both groups of member countries have general obligations. These include the obligations to (1) promote programs to address greenhouse gas emissions; (2) protect carbon *sinks* and *reservoirs* (forests and other natural systems that remove carbon from the atmosphere); (3) assess the environmental impact of their social and economic policies; (4) develop and share climate-friendly technologies and practices; (5) promote education, training, and public awareness of climate change; and (6) submit reports (known as *national communications*) on the actions they are taking to implement the convention. In addition, Annex I countries have an obligation to adopt climate change policies and measures with the "aim" of returning their greenhouse gas emissions to 1990 levels. This aim was supposed to have been achieved by the year 2000, but it proved to be too ambitious, especially as it was a nonbinding commitment.

The institutional structure set up by the convention consists of a Conference of the Parties, two subsidiary bodies (the Subsidiary Body for Scientific and Technological Advice and the Subsidiary Body for Implementation), and a secretariat. The Conference of the Parties meets annually to review the national communications and to negotiate substantive new commitments; the two subsidiary bodies carry out preparatory work for the Conference of the Parties; and the secretariat, with a staff of 150, provides support.

At the Conference of the Parties meeting in Kyoto, Japan, in 1997, the member countries drafted the **Kyoto Protocol** to the United Nations Framework Convention on Climate Change.[92] The Kyoto Protocol would legally bind the developed Annex I countries to reduce the amount of their greenhouse gas emissions by 5.2 percent below 1990 levels during the five-year period

Kyoto Protocol
Supplemental agreement to the UN Framework Convention on Climate Control drafted in 1997. It requires developed member countries of the convention to reduce greenhouse gas emissions by 5.2 percent below 1990 levels.

[91]http://unfccc.int/parties_and_observers/parties/annex_i/items/2774.php.

[92]The text of the Kyoto Protocol is posted at http://unfccc.int/resource/docs/convkp/kpeng.html.

between 2008 and 2012. The objective is the "stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system."

For the Kyoto Protocol to come into force, it had to be ratified or acceded to by (1) 55 percent of all member countries and (2) Annex I parties accounting for 55 percent of that group's carbon dioxide emissions in 1990.[93] As of December 2006, a total of 169 countries and other governmental entities had ratified the agreement (representing over 61.6 percent of emissions from Annex I countries). Notable exceptions include the United States and Australia. The only developed Annex I country to indicate that it is not a party to the Kyoto Protocol is the United States. The reasons for the U.S. refusal to participate are described in Reading 2-2.

Reading 2-2 The U.S. View and the "Basic" View on the Kyoto Protocol and its Renewal

The Kyoto Protocol was favored by the Clinton–Gore administration, but was never submitted to Congress for approval; neither Clinton nor Vice President Gore believed that it would pass muster in the U.S. Senate. In June of 2001, President Bush was critical of the Kyoto Protocol's "dual-track" approach, binding developed nations like the U.S. to targeted greenhouse gas emissions, and leaving out developing nations like India and China.[94] Here are some of his remarks:

Good morning. I've just met with senior members of my administration who are working to develop an effective and science-based approach to addressing the important issues of global climate change.

***

The issue of climate change respects no border. Its effects cannot be reined in by an army nor advanced by any ideology. Climate change, with its potential to impact every corner of the world, is an issue that must be addressed by the world.

The Kyoto Protocol was fatally flawed in fundamental ways. But the process used to bring nations together to discuss our joint response to climate change is an important one. That is why I am today committing the United States of America to work within the United Nations framework and elsewhere to develop with our friends and allies and nations throughout the world an effective and science-based response to the issue of global warming.

***

There are only two ways to stabilize the concentration of greenhouse gases. One is to avoid emitting them in the first place; the other is to try to capture them after they're created. And there are problems with both approaches. We're making great progress through technology but have not yet developed cost-effective ways to capture carbon emissions at their source, although there is some promising work that is being done.

And a growing population requires more energy to heat and cool our homes, more gas to drive our cars, even though we're making progress on conservation and energy efficiency and have significantly reduced the amount of carbon emissions per unit of GDP.

Our country, the United States, is the world's largest emitter of man-made greenhouse gases. We account for almost 20 percent of the world's man-made greenhouse emissions. We also account for about one-quarter of the world's economic output. We recognize the responsibility to reduce our emissions. We also recognize the other part of the story—that the rest of the world emits 80 percent of all greenhouse gases. And many of those emissions come from developing countries.

This is a challenge that requires a 100 percent effort; ours, and the rest of the world's. The world's second-largest emitter of greenhouse gases is China. Yet, China was entirely exempted from the requirements of the Kyoto Protocol.

India and Germany are among the top emitters. Yet, India was also exempt from Kyoto. These and other developing countries that are experiencing rapid growth face challenges in reducing their emissions without harming their economies. We want to work cooperatively with these countries in their efforts to reduce greenhouse emissions and maintain economic growth.

***

Kyoto is, in many ways, unrealistic. Many countries cannot meet their Kyoto targets. The targets themselves were arbitrary and not based upon science. For America, complying with those mandates would have a negative economic impact, with layoffs of workers and price increases for consumers. And when you evaluate all these flaws, most reasonable people will understand that it's not sound public policy.

That's why 95 members of the United States Senate expressed a reluctance to endorse such an approach. Yet, America's unwillingness to embrace a flawed treaty should not be read by our friends and allies as any abdication of responsibility. To the contrary, my administration is committed to a leadership role on the issue of climate change.

We recognize our responsibility and will meet it—at home, in our hemisphere, and in the world. My Cabinet-level working group on climate change is recommending a number of initial steps and will continue to work

[93] Kyoto Protocol, Article 25.

[94] http://georgewbush-whitehouse.archives.gov/news/releases/2001/06/20010611-2.html.

on additional ideas. The working group proposes [that] the United States help lead the way by advancing the science on climate change, advancing the technology to monitor and reduce greenhouse gases, and creating partnerships within our hemisphere and beyond to monitor and measure and mitigate emissions.

***

I've asked my advisors to consider approaches to reduce greenhouse gas emissions, including those that tap the power of markets, help realize the promise of technology and ensure the widest possible global participation. As we analyze the possibilities, we will be guided by several basic principles. Our approach must be consistent with the long-term goal of stabilizing greenhouse gas concentrations in the atmosphere. Our actions should be measured as we learn more from science and build on it.

Our approach must be flexible to adjust to new information and take advantage of new technology. We must always act to ensure continued economic growth and prosperity for our citizens and for citizens throughout the world. We should pursue market-based incentives and spur technological innovation.

And, finally, our approach must be based on global participation, including that of developing countries whose net greenhouse gas emissions now exceed those in the developed countries.

FIGURE 2.8

Smoke Discharged from the Shougang or Capital Iron and Steel Factory in Shijingshan District, China, February 18, 2008

Source: Lou Linwei/Alamy

The Bali Conference

In December 2007, the government of Indonesia hosted a United Nations Climate Change Conference in Bali that included representatives of over 180 nations, along with many observers from the media, NGOs, and IGOs. Over 10,000 people participated in various meetings, including Conference of the Parties sessions under the UNFCCC, and meetings of the parties to the Kyoto Protocol. The Bush administration was criticized internationally for its positions during the early stages of the conference.[95] Still, the conference culminated in the adoption of a road map charting the course for a new negotiating process to be concluded in 2009. The intention was to have a post-2012 agreement on climate change, as the original Protocol ended developed nations' committments at the end of 2012.[96]

2007 to 2011—From Bali to Cancun to Copenhagen: Little Progress in the COP Negotiations

The 2007 Bali Climate Change Conference (COP 13) culminated in the adoption of the Bali Road Map, which consists of a number of forward-looking decisions that represent the various tracks that are essential to reaching a secure climate future. The Bali Road Map includes the Bali Action Plan, which charts the course for a new negotiating process designed to tackle climate change, with the aim of completing this by 2009, along with a number of other decisions and resolutions. But the discrepancy between the two groups grew even wider during the round of climate change talks that ended in Bonn, Germany, in May of 2008.

Expectations were high for the conference of the parties in Copenhagen in December of 2009 (COP 15). The Copenhagen Climate Conference was originally set as the time and place for another major agreement that would replace the Kyoto Protocol, which more or less failed because the U.S. rejected it. U.S. President Barack Obama arrived in Copenhagen at the Conference of the Parties with commotion in the streets and discord in the rooms. In the midst of large protests in the Danish capital, ongoing disputes took place between the developed nations and the developing nations as to who should be taking the lead on emissions curbs.

Bolivian President Evo Morales noted that the U.S. had shown the inability to pass this otherwise universally approved-of treaty, and said this was a sticking point and was indicative of the United States' willingness to cooperate. To others, the sticking point was China, which had risen to almost-superpower status from its position as a poor, developing nation. While it is still a developing nation, it is now the second largest carbon-emitter, and has 16 of the world's 20 most polluted cities (see Figure 2.8).

Obama spoke to the gathering, but most observers were disappointed that there was no clear indication of cooperation between the U.S. and China on the "two-track" issue. The COP process went on, of course, with subsequent meetings in Cancun in November of 2010, and in Bonn in June of 2011. Some of the developed countries opposed the Second Commitment Period at talks in Cancun, and the meeting in Bonn further underlined basic differences.

The Fate of the Kyoto Protocol: The Durban Conference of the Parties

In November of 2011, a summit of climate change officials from the parties to the Kyoto Protocol were to meet in Durban, South Africa, to address the fact that the first commitment period under the Protocol was set to expire at the end of 2012, twenty years from the creation of the UNFCCC in Rio in 1992.

A month in advance of the Durban conference, climate-change ministers from Brazil, South Africa, India and China (also known as the BASIC

[95]"Disappointments on Climate," editorial, *New York Times,* Dec. 17, 2007 (describing the U.S. negotiators as being in "full foot-dragging mode").

[96]See http://unfccc.int/meetings/cop_13/items/4049.php.

countries), reached a consensus on a range of issues—including the Second Commitment Period of the Kyoto Protocol.

China's top climate change official, Xie Zhenhua, said that "[t]here must be a Second Commitment Period of the Kyoto Protocol," after the Ninth BASIC Ministerial Meeting on Climate Change in Beijing on in October of 2011. [Xie was deputy director of the National Development and Reform Commission, the country's top economic planning group.]

Because developed countries are subject to binding targets on greenhouse gas emissions under the Protocol, while developing economies make their cuts on a voluntary basis, Japan, Russia, and Canada have rejected an extension of the Kyoto agreement. The United States does not favor an extension, either. On behalf of China, however, Xie said that all decisions should be based on the common understandings that the countries have reached in the past 20 years and the principles of equal, common, but differentiated, responsibility. "Differentiated responsibility" preserves the very notion that the Bush Administration rejected.

The BASIC ministers emphasized that financing will be another pressing priority in the negotiations when they meet in Durban. They agreed that the conference should decide to initiate the operation of the Green Climate Fund, thereby ensuring adequate financial support for developing countries, and they urged the developed countries to capitalize the fund from their public resources.

The developed countries have already committed to provide a combined $30 billion as "fast-start" funding for the project and then to increase that figure to $100 billion annually between 2013 and 2020 to avoid a funding gap.

Martin Khor, executive director of the South Centre think tank, said the months in late 2011 would be critical for the future of the Kyoto Protocol. "Developed countries think they have done and offered enough, but actually have not," Khor said, adding it would be "ugly" for developed countries to walk away from their compulsory responsibilities.

Yang Fuqiang, a senior consultant on climate change and energy at the U.S.-based Natural Resources and Defense Council, said that a regulatory gap is unlikely to be avoided, because even if the countries reach a deal at Durban in late 2011, it will take time for governments to ratify the agreement.

"There are only 18 months left before the first commitment of the Kyoto Protocol expires at the end of 2012. It will be a huge challenge to bridge the differences in time," said Yang.

Developing countries are already pledging greater cuts in greenhouse gas emissions than developed countries, according to a recent study published by the international Charity organization Oxfam. The report estimates that at least 60 percent of emission cuts by 2020 currently on the table are likely to be made by developing countries. In June of 2011, Xie stated that noting that developed countries have strong economies and advanced low-carbon technologies, while developing countries have neither of these things. "Developed countries should fulfill their commitment to provide financial support and technological transfers in order to help developing nations tackle climate change and promote low-carbon development," said Xie in June of 2011.

In June of 2011, the UN's top climate official said that after three years of talks, countries would not agree in time to a "full deal" to follow on from the Kyoto targets that bind nearly 40 industrialised nations to emissions cuts in 2008–2012. Even if the talks in Durban in November of 2011 were successful, the states would have to ratify any new deal in national parliaments for it to have equal legal force with the Kyoto Protocol.

Prior to the Durban meeting, many thought that such ratification would be well-nigh impossible. The earliest a deal could be agreed is in Durban at the end of this year, said Christiana Figueres, head of the UN's climate secretariat, speaking on the first day of the June 6–17 climate talks in Bonn, Germany. "Even if they were able to agree on a legal text for a second commitment period (of Kyoto), that requires an amendment to the Kyoto Protocol, it requires legislative ratifications on the part of three-quarters of the parties, so we would assume that there's no time to do that between Durban and the end of 2012," Figueres told reporters.

"Countries have realized this, that they actually stand before the potential of a regulatory gap, and are involved in constructive negotiations as to how they're going to deal with that," she said.

As of November 2011, a deal in Durban was widely viewed as unlikely. The European Union's chief climate negotiator told reporters that 2014 or 2015 was now a more realistic target for a full legal framework. "Let's say 2014, 2015 is a broadly realistic time, but if parties could agree to do that earlier the EU would be happy to do so," said Artur Runge-Metzger. He said such a timetable would dovetail with the publication of the next major report by the UN panel of climate scientists in 2014, and a review from 2013–2015 of existing, voluntary commitments.

Other international treaties dealing with the climate and air pollution are the 1979 Geneva Convention on Long-Range Transboundary Air Pollution, the 1985 Vienna Convention for the Protection of the Ozone Layer with its 1987 Montreal Protocol on Substances That Deplete the Ozone Layer, and Annex 16 on Environmental Protection to the 1944 Chicago Convention on International Civil Aviation.

The text of international treaties dealing with climate and air pollution is posted at www.ciesin.columbia.edu.

Product Regulations The principal product areas subject to international environmental regulation are toxic waste and nuclear materials.

Toxic Waste Toxic and other wastes are regulated by the 1989 Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal, which came into force in 1992.[97] The convention forbids the export of "hazardous wastes and other wastes" to nonstates parties and to states parties unwilling or incapable of safely accepting them, and it forbids states parties to import wastes unless they can safely manage them. It also requires states parties to take appropriate actions to minimize their own production of hazardous wastes.

Nuclear Materials The **International Atomic Energy Agency (IAEA)** is the primary IGO responsible for supervising the use of fissionable materials.[98] Its Statute (a multilateral convention that came into force in 1957)[99] makes the IAEA responsible for setting up safety standards for the protection of health and for minimizing injury to life and property. It also gives the IAEA responsibility for promoting the peaceful use of atomic energy, for ensuring that its own nuclear materials and assistance are not misused, and for overseeing the nuclear devices and materials of certain "non–nuclear weapons" states to ensure that they are not diverted to military uses.

International Atomic Energy Agency (IAEA)
IGO responsible for supervising the use of fissionable material, developing safety standards, and promoting the peaceful use of atomic energy.

One of the IAEA's main functions is to oversee compliance with the 1968 Treaty on the Non-Proliferation of Nuclear Weapons. In doing so, the IAEA carries out inspections at nuclear facilities in some 60 non–nuclear weapons states. In July 1991, the IAEA determined that Iraq had not been submitting nuclear materials and certain of its facilities to inspection, and it adopted a resolution of noncompliance that it forwarded to the UN Security Council. Following the Gulf War and Iraq's expulsion from Kuwait, Iraq agreed to allow the IAEA to conduct special inspections of its nuclear materials and facilities, including an examination of documents showing how and from whom it had obtained equipment that it intended to use for the production of nuclear weapons. In mid-1994, North Korea similarly refused to allow IAEA inspectors to examine its nuclear facilities. At one point, North Korea announced that it was withdrawing from the Non-Proliferation Treaty, but it later said that it would continue its membership after the United States and South Korea agreed to high-level negotiations over the normalization of relations between the three countries.

Protection of Natural Resources

In October 1982, the United Nations General Assembly adopted the **World Charter for Nature**.[100] The charter declares, simply, that "[n]ature shall be respected and its essential processes shall not be impaired." In this regard, the charter states that "living resources shall not be utilized in excess of their natural capacity for regeneration" and that all "ecosystems and organisms, as well as the land, marine, and atmospheric resources that are utilized by man, shall be managed to achieve and maintain optimum sustainable productivity . . . [without endangering] those other ecosystems or species with which they coexist."

World Charter for Nature
UN General Assembly Resolution 37/7, adopted October 28, 1982. It states that all states have a duty to respect the essential processes of nature and not to impair them.

Principle 11 of the World Charter for Nature also declares that states need to establish procedures to control "activities which might have an impact on nature." In particular, it calls upon states to (1) avoid activities that are likely to cause irreversible damage to nature, (2) conduct "exhaustive" examinations to demonstrate that the expected benefits outweigh the potential damage to nature before proceeding with activities that are likely to pose a significant risk, and (3) prepare

[97]http://sedac.ciesin.org/entri/texts/basel.transboundary.hazardous.wastes.1989.html, http://sedac.ciesin.columbia.edu.

[98]The IAEA's home page is at www.iaea.org.

[99]Statute of the International Atomic Energy Agency, adopted in October 1956, in force July 1957. The text is in *United Nations Treaty Series,* vol. 276, p. 3, and on the Internet at www.iaea.org/About/statute_text.html. As of January 2007, there were 143 states parties. The IAEA is an agency within the United Nations system. It consists of a General Conference of all states parties that meets annually. A Board of Governors (made up of 35 states members, 22 of which are elected by the General Conference and 12 of which are designated by the board itself) meets about six times a year to carry out the functions of the Agency. A director-general, who heads up the agency's secretariat, assists the board. See *Id.*

[100]www.un.org/documents/ga/res/37/a37r007.htm.

environmental impact studies that include plans for minimizing potentially adverse effects before undertaking activities that may disturb nature.

Over the years, a variety of conventions have been adopted that seek to protect both terrestrial living resources[101] and marine living resources and, in effect, to carry out the objectives of the World Charter for Nature. At the 1992 Rio Conference, a new wide-reaching conservation convention was signed: the Convention on Biological Diversity.[102] This convention calls for states parties to identify and monitor biological diversity; develop strategies, plans, and programs for conserving biological diversity; and undertake environmental impact assessments of activities that adversely affect biological diversity.

Links to international nature and biodiversity treaties and conventions are available on the Pace University School of Law Web site at www.pace.edu/school-of-law/centers-and-special-programs.

The Rio Conference's Declaration on Environment and Development attempted to reconcile the different and sometimes antagonistic needs of protecting the environment and promoting development. It called upon states parties, and the international community as a whole, to make environmental protection "an integral part of the development process" and not to consider the two in isolation from each other.

Liability for Environmental Damage

There are a few conventions that impose liability on persons who cause damage to the environment. These conventions, in general, define the nature of the liability, the persons who are liable, and the extent of their liability. Thus, with respect to damage resulting from the use of nuclear materials, the operators of nuclear installations are made "absolutely and exclusively" liable for any damage they cause. This includes continuing liability for damage that occurs while nuclear materials are being transported by ship from one installation to another.[103] States parties are allowed to set liability limits, but these can be no less than 5 million U.S. gold-based dollars.[104]

Similar rules apply to marine oil pollution. The operators of oil tankers or other ships that pollute the ocean with oil are liable "regardless of fault or negligence" up to a maximum limit of 59.7 million Special Drawing Rights (about U.S. $76.5 million), depending on the tonnage of the ship.[105] Victims who suffer damages exceeding this amount can seek additional compensation from an International Fund for Compensation of Oil Pollution Damage. The fund provides compensation of up to 950 million gold-based French francs for a single incident.[106]

[101]http://sedac.ciesin.org lists the international conventions protecting terrestrial living resources, among which are the 1950 International Convention for the Protection of Birds, the 1971 Convention on Wetlands of International Importance (Especially as Waterfowl Habitat), the 1972 Convention for the Protection of Antarctic Seals, the 1972 Convention Concerning the Protection of the World Cultural and Natural Heritage, the 1973 Convention on International Trade in Endangered Species of Wild Fauna and Flora, the 1976 Agreement on the Conservation of Polar Bears, the 1979 Convention on the Conservation of Migratory Species of Wild Animals, the 1980 Convention on the Conservation of Antarctic Marine Living Resources, and the 1983 International Tropical Timber Agreement.

[102]The Secretariat for the Convention maintains a Web site at www.biodiv.org. In January 2000, the Conference of the Parties to the Convention on Biological Diversity adopted a supplementary agreement to the convention known as the Cartagena Protocol on Biosafety. The protocol seeks to protect biological diversity from the risks posed by genetically modified organisms. To do so, it establishes an advance informed agreement (AIA) procedure so that countries are provided with the information necessary to make informed decisions before agreeing to import such organisms into their territory. The text of the protocol is at www.biodiv.org/biosafety/protocol.asp.

[103]The 1971 Convention Relating to Civil Liability in the Field of Maritime Carriage of Nuclear Material (text at www.admiraltylawguide.com/conven/carriagenuclear1971.html).

[104]Convention on Civil Liability for Nuclear Damage, Article V. States can also provide for a limitation period in which an injured party can apply for compensation, but this period can be no less than 10 years.

[105]International Convention on Civil Liability for Oil Pollution Damage (text at www.admiraltylawguide.com/conven/civilpol1969.html Article V).

[106]The 1971 International Convention on the Establishment of an International Fund for Compensation of Oil Pollution Damage, Article V (text at www.admiraltylawguide.com/conven/protooilpolfund1992.html).

Chapter Questions

Imputable Acts and Nonimputable Acts

1. Cue Co., a large multinational enterprise incorporated and headquartered in Country Q, owns and operates a banana plantation in Chiquitaland, a small and less developed country. Rebels, with whom the Chiquitaland government has been engaged in a civil war for several years, made a raid on the plantation, destroying most of its banana plants and all of its buildings and killing the manager, a citizen of Country Q. Q and Chiquitaland State are parties to an Arbitration Treaty, and they agree to submit the dispute to arbitration. Is Chiquitaland liable for the injuries to Cue Co.'s plantation and for the death of the manager? Discuss.
2. G, a cabinet minister of the Republic of V, defects to the Republic of Y. Here he discloses that General A of the Republic of V has been ordered to kidnap the President of Y's daughter. G also discloses that the terrorist organization Peace, operating within the territory of V, is planning on executing the eldest sons of the President of Y and the Premier of V in the hope of fostering anarchy. The following day, Peace executes the two eldest sons and General A kidnaps the President of Y's daughter. In the ICJ, the President of Y sues the Premier of V for the death of his sons and kidnapping of his daughter. Both Y and V have recognized the ICJ's jurisdiction to hear international disputes. How should the ICJ proceed? Discuss.
3. The Republic of Tavern and the Democratic Republic of Pub had been engaged in armed conflict when a small fishing vessel was captured just outside Pub's exclusive economic zone by a Pub warship and kept in custody. The fishing vessel was captained by Dr. Martyr and consisted of five crew members (including his wife). Everyone aboard was a citizen of Tavern. A small quantity of opium was discovered aboard the vessel and a crew member confessed that he had intended to smuggle it into Pub. Pub officials press criminal charges and Dr. Martyr and his vessel continue to be detained even after the armed conflict ends. Dr. Martyr suffers a heart attack and Mrs. Martyr dies out of shock. The Republic of Tavern submits a request to the International Tribunal for Law of the Sea for an order that would direct Pub to release Dr. Martyr's vessel and his crew. They have also asked the ITLOS for exemplary damages for Mrs. Martyr's death. Discuss.

Expropriations

4. The Big Co. is incorporated and headquartered in Country K, but the majority of shares are owned by shareholders who are nationals of Country M. In 1980, the Big Co. obtained an oil concession in Ruraltania that was valid for 40 years. The concession contained a "stabilization" clause providing that the concession could not be altered except by the consent of both parties. To exploit the concession, Big Co. set up a local subsidiary, Little Co., that was incorporated in Ruraltania but wholly owned by Big Co. Two years ago, a major political change occurred in Ruraltania. A new government terminated all foreign-owned concessions, including that of Big Co., but excluded one Japanese offshore oil concession. By decree, the new minister for oil was authorized to fix the compensation—if any—due to foreign companies. The ordinary courts were abolished and replaced by revolutionary tribunals.

   The manager of Little Co., himself a national of Country K, criticized the new policy in a television interview, and the next day a group of university students took over Little Co.'s offices, burning and destroying files and other property and injuring the manager. It took nearly two weeks for the Ruraltanian authorities to evict the students. Country K and Ruraltania are parties to an Arbitration Treaty, and they agree to submit the dispute to arbitration. Country K files a claim for the following: (a) the reinstatement of the concession, or (b) compensation to cover the full cost of all assets and installations, lost profits for the next 20 years, interest on the above effective from the date when the concession was terminated, and, in either case, (c) compensation to cover the property damages to Little Co. and the injuries suffered by the manager. How should the arbitration tribunal rule? Discuss.
5. In the preceding question, assume that Country K decides not to assert any claims on behalf of either Big Co. or Little Co. May Country M do so? Discuss.

Creeping Expropriation

6. MNF, Inc., a large multinational firm incorporated and headquartered in Country C, entered into an investment agreement with Needyland, a small less developed country. MNF agreed to set up a mine to extract copper ore, a refinery, and a plant to manufacture electrical wiring. Needyland agreed to give MNF a 20-year tax holiday (i.e., MNF would not have to pay any local taxes for 20 years). Finally, MNF agreed that "MNF, Inc. will not seek the diplomatic assistance of Country C in resolving any dispute it may have with Needyland." After MNF completed construction of the mine, refinery, and plant, and just as it began to make a profit on its investment, the government of Needyland changed. The new government enacted a statute that imposed a "nontax operating fee" of 30 percent on the annual earnings of all businesses involved in the mining, refining, or processing of copper. MNF was the only such firm. MNF complained to the new government, with no result, that this "fee" violated its investment agreement. The local courts dismissed MNF's request for an injunction as baseless. MNF then sought the diplomatic assistance of Country C.

   Country C and Needyland are parties to an Arbitration Treaty, and they agree to submit the dispute to arbitration. Needyland argues that MNF had no right to seek the diplomatic assistance of Country C and, therefore, Country C has no right to seek compensation from Needyland on behalf of MNF. Is Needyland correct? Discuss.
7. Assume in the preceding case that MNF, Inc., had purchased political risk insurance from an agency of Country C. Assume, as well, that the Country C insurance program is identical to that offered by the United States Overseas Private Investment Corporation (OPIC). Has the MNF operation in Needyland been ruined by creeping expropriation? Must the Country C insurance program pay MNF for its losses? Discuss.

Objections

8. A Crocodonian business firm chartered an airplane owned by the Republic of Crocodonia to fly cargo to Country U. The cargo was a load of crocodile skins that are legal to own and sell in Crocodonia but that are considered contraband in Country U. The business firm, knowing this, mislabeled the cargo as cowhides. When the plane landed in Country U, Country U's Contraband Enforcement Agency seized both the plane and its cargo. The cargo was destroyed and the plane was sold in accordance with a Country U anti-racketeering statute. The government of Crocodonia was incensed. It sent a diplomatic message to Country U protesting that its national honor had been sullied by Country U's actions. Crocodonia and Country U are parties to an Arbitration Treaty, and they agree to submit the dispute to arbitration. Crocodonia seeks compensation for the airplane and, on behalf of the Crocodonian business firm, compensation for the destroyed cargo. What will the arbitration tribunal decide? Discuss.

Law of the Sea: Precautionary Principle

9. There are divided opinions on the actions that need to be taken, if at all, on global climate change. The United Colonies of Remedia had signed the Kyoto Protocol but has now withdrawn from it. Remedia argues that there is no scientific evidence that carbon dioxide is the pollutant that causes global climate change. The Security Council of the UN has approached the ICJ, requesting the court to enjoin Remedia to reduce its emissions, given the ICJ's substantial historical and present contribution to total emissions. In its submissions, the Security Council argues that adequate precaution needs to be taken despite the fact that Remedia is not a signatory to the Kyoto Protocol. What should the court's decision be? Discuss.

CHAPTER 3

Dispute Settlement

Chapter Outline

A. Settlement of Disputes Through Diplomacy
- Negotiation
- Mediation
- Inquiry

B. Settlement of Disputes in International Tribunals
- International Court of Justice
- International Criminal Court
- World Trade Organization Dispute Settlement Procedures
- International Center for the Settlement of Investment Disputes
- Other Arbitration Tribunals

C. Settlement of Disputes in Municipal Courts
- Jurisdiction in Criminal Cases
- Jurisdiction in Civil Cases
- Jurisdiction over Persons

D. Immunities of States from the Jurisdiction of Municipal Courts
- Sovereign or State Immunity
- Act of State Doctrine

E. Choosing the Governing Law
- Agreement of the Parties
- Statutory Choice of Law Provisions
- Most Significant Relationship
- Governmental Interest

F. Refusal to Exercise Jurisdiction

G. Opposition to the Exercise of Jurisdiction

H. Proving Foreign Law

I. Recognition of Foreign Judgments

Chapter Questions

A. Settlement of Disputes Through Diplomacy

Diplomacy is the process of getting parties to a disagreement to an understanding through negotiation, mediation, or inquiry. The word "diplomacy" is formally applied only to disputes between states, but the same processes can be applied to disputes involving institutions and individuals as well, where it is often referred to as *alternative dispute resolution*.

diplomacy
A form of international dispute settlement that attempts to reconcile parties to a disagreement by use of negotiation, mediation, or inquiry.

negotiation
(From Latin *negotiari:* "to carry on business.") The process of reaching an agreement by conferring or discussing.

mediation
(From Latin *mediates:* "to be in the middle.") Bringing about a peaceful settlement or compromise between parties to a dispute through the benevolent intervention of an impartial third party.

good offices
A third party who provides the means by which two disputing parties may communicate with each other.

conciliation
(From Latin *conciliare:* "to call or bring together.") The process by which an impartial third party makes an independent investigation and suggests a solution to a dispute.

Negotiation

Negotiation is the process of reaching an agreement through discussion between two parties to a dispute. Negotiation is the most important tool in the process of dispute settlement. It is used not merely to resolve disputes but also to prevent them from arising in the first place. Negotiation can also lay the groundwork for other forms of dispute settlement.

Negotiations between states are most commonly conducted on an *ad hoc*[1] basis, but sometimes the procedure is more formal. In such cases, states negotiate through normal diplomatic channels, through the use of competent authorities, through the establishment of mixed or joint commissions, or even through summit meetings. Summit meetings have been popular in recent years because they can be an effective way to bypass the official bureaucracy of the participating states. At other times, summits are staged to gain political capital out of an agreement already finalized through negotiations between the states' bureaucracies.

Mediation

Mediation involves the use of a third party who transmits and interprets the proposals of the principal parties and sometimes advances independent proposals. When mediators provide a channel of communications only, it is said that they are offering their **good offices**. When they make a formal investigation and present a formal proposal, they are involved in a **conciliation**.[2]

The process of mediation can start with a request from one or more of the parties, but not infrequently, an outsider offers to serve as a mediator. For example, during the 1982 Falklands War between Argentina and the United Kingdom, both U.S. Secretary of State Alexander Haig and UN Secretary-General Javier Pérez de Cuellar tendered their good offices. And in a dispute between Pakistan and India over the Kashmir in 1965, the U.S.S.R., a major Asiatic power, helped obtain a ceasefire between these two Asiatic countries.

Mediation can occur only if all the parties to a dispute consent to it. Thus, South Africa's policy of apartheid[3] could not be mediated because South Africa regarded it as an internal matter. And during Nigeria's war with the secessionist state of Biafra (1967–1970), Nigeria refused all offers of mediation because it regarded the war as an internal affair.

The mediator, in particular, must be acceptable to both parties. In the Falklands War, Argentina objected to Secretary Haig because the United States was a NATO ally of the United Kingdom and was providing logistical support for the British task force. (In fact, Secretary Haig's offer of mediation antagonized the Argentines.) Because Secretary-General Pérez de Cuellar had remained impartial, he was acceptable to both sides.

Inquiry

An **inquiry** is a process used to determine a disputed fact or set of facts. Unlike a mediation, which tries to resolve an entire dispute, an inquiry focuses only on a particular incident. The Hague Convention for the Pacific Settlement of International Disputes of 1899 called for the use of commissions of inquiry to determine factual questions of an international nature. However, fearing that commissions of inquiry might threaten national sovereignty, the convention limited the use of inquiries to disputes "involving neither honor nor essential interests" of the parties. The limitation proved unnecessary, however, as the 1904 *Dogger Bank Inquiry* made clear. That commission, made up of representatives from Russia, Britain, France, Austro-Hungary, and the United States, was asked to determine whether a Russian fleet on its way to the Orient during the Russo-Japanese War had cause for opening fire on a group of British trawlers fishing on the Dogger Bank. The Russian admiral in

[1]From Latin: "for this." Something done for a specific purpose, circumstance, or case.

[2]Article 1 of the Institute of International Law's model Regulation on the Procedure of International Conciliation defines conciliation as "a method for the settlement of international disputes of any nature, according to which a Commission is set up by the parties, either on a permanent basis or an ad hoc basis to deal with the dispute, proceeds to the impartial examination of the dispute and attempts to define the terms of a settlement susceptible of being accepted by them, or of affording the parties, with a view to its settlement, such aid as they may have requested."

[3]From Afrikäans (South African Dutch): *apart* "apart" and *heid* "hood." Racial discrimination against blacks and others of non-Caucasian descent.

charge of the fleet had said that he feared attack by Japanese torpedo boats. The commission found that there had been no torpedo boats in the area and the Russian admiral was not, therefore, justified in opening fire. It diplomatically added, however, that these findings were not "of a nature to cast any discredit upon the military qualities or the humanity of Admiral Rojdestvensky or the personnel of his squadron." Both parties accepted the report, and Russia paid Britain £65,000 in damages.[4]

In 1907, a second Hague Convention for the Pacific Settlement of International Disputes devised more extensive and less limiting rules for commissions of inquiry. For instance, it said that parties could agree in advance to be bound by the decision of the commission. This happened in the *Tubantia Incident* of 1916, in which Germany was held responsible for the sinking of a neutral Dutch ship during World War I.

Several treaties setting up commissions of inquiry were signed and ratified during the 1910s and 1920s, most notably the Taft Treaties negotiated by the United States, the United Kingdom, and France, and the Bryan Treaties between the United States and several Latin American countries. Despite these treaties, only one inquiry has been conducted since 1922.[5] Matters that inquiries might have considered have been resolved instead by negotiation, mediation, or investigations conducted by independent international organizations. For example, the staff of the International Civil Aviation Organization investigated the downing of a Korean Air Lines jet in 1983 by the military forces of the U.S.S.R.

inquiry
(From Latin *inquirere:* "to seek after" or "to search for.") The process by which an impartial third party makes an investigation to determine the facts underlying a dispute without resolving the dispute itself.

B. Settlement of Disputes in International Tribunals

An international dispute is settled in much the same way that a domestic dispute is settled. Parties usually try diplomacy first. If diplomacy fails, it is common to turn to the courts. If a dispute is between states or intergovernmental organizations (IGOs), they may be able to take their case to an international tribunal, such as the International Court of Justice (ICJ) or a dispute resolution panel of the World Trade Organization, or, in the alternative, to arbitration. If a dispute is between private persons or between a private person and a state or between a private person and an IGO, the dispute will normally end up in arbitration or in a municipal court. Arbitration between private persons and states, and between persons and persons, is commonly arranged through a permanent arbitration tribunal (or *facility*) such as the International Center for the Settlement of Investment Disputes.[6]

International Court of Justice

The ICJ is the principal judicial organ of the United Nations. Its seat is at the Peace Palace in The Hague, The Netherlands (see Figure 3.1). It began work in 1946, when it replaced the Permanent Court of International Justice, which had functioned in the Peace Palace since 1922. It operates under a statute largely similar to that of its predecessor, which is an integral part of the United Nations Charter.

Functions The ICJ has a dual role: to settle in accordance with international law the legal disputes submitted to it by states, and to give advisory opinions on legal questions referred to it by duly authorized international organs and agencies.

Composition The ICJ is composed of 15 judges elected to nine-year terms of office by the United Nations General Assembly and Security Council sitting independently of each other. The members of the Court do not represent their governments but are independent magistrates.[7]

[4] *The Hague Court Reports*, p. 410 (James B. Scott, ed., 1916).

[5] Red Crusader Incident (1962), *International Law Reports*, vol. 35, p. 485 (1963).

[6] This dispute settlement process is outlined in Article 33(1) of the United Nations Charter as follows: "The parties to any dispute, the continuance of which is likely to endanger the maintenance of international peace and security, shall, first of all, seek a solution by negotiation, inquiry, mediation, conciliation, arbitration, judicial settlement, resort to regional agencies or arrangements, or other peaceful means of their own choice." The United Nations Charter is posted on the UN Web site at www.un.org/aboutun/charter.

[7] The present composition of the ICJ is as follows: Antonio Augusto Cançado Trinidade (Brazil), Christopher Greenwood (United Kingdom); Awn Shawkat Al-Khasawneh (Jordan); Xue Hanquin (China); Abdul G. Koroma (Sierra Leone); Joan Donoghue (United States); Hisashi Owada (Japan); Bruno Simma (Germany); Peter Tomka (Slovakia); Ronny Abraham (France); Kenneth Keith (New Zealand); Bernardo Sepúlveda Amor (Mexico); Mohamed Bennouna (Morocco); Leonid Skotnikov (Russian Federation); and Abdulqawi Ahmed Yusuf (Somalia).

FIGURE 3.1

The Peace Palace Is the Home of the International Court of Justice

Source: John Elk III/Alamy

The home page of the ICJ is at www.icj-cij.org.

The United Nations Charter declares that all the member states of the United Nations are automatically parties to the Statute of the International Court of Justice, which is included as an annex to the charter. Nonmembers may adhere to the statute, but to do so, they must agree to respect the Court's decisions and to help cover the court's expenses.[8]

jurisdiction (From Latin *jurisdictio:* "administration of the law.") The authority or power of a court or tribunal to hear a particular case or dispute.

contentious jurisdiction The power of a court to hear a matter that involves a dispute between two or more parties.

Optional Clause jurisdiction A unilateral grant of jurisdiction by a state to the ICJ that allows the Court to resolve disputes involving that state.

The ICJ has the **jurisdiction** to hear two kinds of cases:[9] (1) those between states (based on the court's **contentious jurisdiction**)[10] and (2) those requested by organs or specialized agencies of the United Nations (based on the Court's *advisory* jurisdiction).[11] The ICJ has no authority to hear cases involving individuals or entities other than those just mentioned.[12]

Contentious Jurisdiction Before the ICJ can hear a contentious case, all of the states parties to the proceeding must have recognized the court's contentious jurisdiction. This is most commonly done on an *ad hoc* basis; that is, parties to an existing dispute negotiate a special agreement to let the ICJ decide the case.[13] Sometimes these agreements are made permanent by being included in a bilateral treaty (Article 36(1)). A less common and more controversial means by which the court can acquire jurisdiction is through unilateral declarations made by each of the parties.

Optional Clause Jurisdiction Article 36(2) of the Statute of the Court—known as the Optional Clause—allows states to make a unilateral declaration recognizing "as compulsory *ipso facto*[14] and

[8]Security Council Resolution 9 (October 15, 1946) provides: "The International Court of Justice shall be open to a state which is not a party to the Statute of the International Court of Justice, upon the following condition, namely, that such state shall previously have deposited with the Registrar of the Court a declaration by which it accepts the jurisdiction of the Court in accordance with the Charter of the United Nations and with the terms and subject to the conditions of the Statute and the Rules of the Court, and undertakes to comply in good faith with the decision or decisions of the Court and to accept all the obligations of a member of the United Nations under Article 94 of the Charter." The only non-UN member is the Vatican.

[9]The opinions of all of the Court's decisions are posted on the Internet at www.icj-cij.org/docket/index.php?p1=3&p2=2.

[10]Statute of the International Court of Justice, Articles 34 and 36. The statute is posted at www.wcl.american.edu/. . . /icj/ICJ. . . /ICJ-Statute.pdf.

[11]*Id.*, Article 65(1); United Nations Charter, Article 96. *Id.*, Article 65(1); United Nations Charter, Article 96.

[12]Before West Germany became a member of the United Nations and while its status as a state was still at issue, it was allowed to participate in the *North Sea Continental Shelf Cases, International Court of Justice Reports*, vol. 1969, p. 3 (1969), under a declaration accepting the Court's jurisdiction. The parties did not raise its status as a state, nor did the court consider it.

[13]Sometimes a special agreement is negotiated even though there is already another basis for jurisdiction. Thus, in the *Arbitral Award (Honduras v. Nicaragua) Case, International Court of Justice Reports*, vol. 1960, p. 160 (1960), the parties used a special agreement to refer a case involving the validity of an arbitral award made by the king of Spain even though the parties already were subject to the Court's jurisdiction under the Optional Clause.

[14]From Latin: "by that very fact."

without special agreement, in relation to any other state accepting the same obligation, the jurisdiction of the Court in all legal disputes."

Many states have recognized the Court's jurisdiction under the Optional Clause. A few have put no restrictions on the kinds of cases they will respond to. For example, Uganda's Optional Clause declaration states:

> I hereby declare on behalf of the government of Uganda, that Uganda recognizes as compulsory *ipso facto* and without special agreement, in relation to any other state accepting the same obligation, and on condition of reciprocity, the jurisdiction of the International Court of Justice in conformity with paragraph 2 of Article 36 of the Statute of the Court.
>
> New York, 3 October 1963
>
> (Signed) APPOLLO K. KIRONDE
>
> Ambassador and Permanent Representative of Uganda to the United Nations

Unrestricted Optional Clause declarations, however, are rare. Most states have added a wide variety of restrictions on the kinds of suits they are willing to let the Court hear without a special arrangement. An excellent example is the American Optional Clause declaration of 1946, even though it is no longer in force.[15] It states:

> I, Harry S. Truman, President of the United States of America, declare on behalf of the United States of America, under Article 36, paragraph 2, of the Statute of the International Court of Justice, and in accordance with the Resolution of 2 August 1946 of the Senate of the United States of America (two-thirds of the Senators present concurring therein), that the United States of America recognizes as compulsory *ipso facto* and without special agreement, in relation to any other state accepting the same obligation, the jurisdiction of the International Court of Justice in all legal disputes hereafter arising concerning—
>
> a. the interpretation of a treaty;
> b. any question of international law;
> c. the existence of any fact which, if established, would constitute a breach of an international obligation;
> d. the nature or extent of the reparation to be made for the breach of an international obligation;
>
> Provided, that this declaration shall not apply to—
>
> a. disputes the solution of which the parties shall entrust to other tribunals by virtue of agreements already in existence or which may be concluded in the future; or
> b. disputes with regard to matters which are essentially within the domestic jurisdiction of the United States of America as determined by the United States of America; or
> c. disputes arising under a multilateral treaty, unless (1) all parties to the treaty affected by the decision are also parties to the case before the Court, or (2) the United States of America specially agrees to jurisdiction; and
>
> Provided further, that this declaration shall remain in force for a period of five years and thereafter until the expiration of six months after which notice may be given to terminate this declaration.
>
> (Signed) HARRY S. TRUMAN
>
> Done at Washington this twenty-sixth day of August 1946.[16]

Article 36(2) requires that a state respond to a suit brought against it only if the state bringing the suit has also accepted the jurisdiction of the Court. This is known as the **rule of reciprocity**. When both states have limited the jurisdiction that they will recognize, the ICJ has power to decide a case

rule of reciprocity
A state has to respond to a suit brought against it before the ICJ only to the extent to which the state bringing the suit has also accepted the jurisdiction of this court.

[15]On October 7, 1985, the United States informed the secretary-general that it was terminating its Optional Clause declaration. *Id.*, p. 27.

[16]*International Court of Justice Yearbook,* p. 77 (1976–1977).

only to the extent that both states have agreed to the same sort of matters. For example, in the *Norwegian Loans Cases* (*France v. Norway*), Norway objected to the Court taking jurisdiction on several grounds, including the lack of reciprocity in the declarations of the two parties. The Court said: ". . . since two unilateral declarations are involved, such jurisdiction is conferred upon the Court only to the extent to which the two declarations coincide in conferring it. A comparison between the two declarations shows that the French declaration accepts the Court's jurisdiction within narrower limits than the Norwegian declaration; consequently the common will of the parties, which is the basis of the Court's jurisdiction, exists within these narrower limits indicated by the French reservation."[17]

self-judging reservation
A reservation that allows a state to exclude from the jurisdiction of the ICJ any dispute that it determines is a domestic matter.

Self-Judging Reservations One questionable device that states have used to recognize the Court's jurisdiction under the Optional Clause but to still have a way out if they decide they do not want to respond to a particular suit is known as a **self-judging reservation** or *Connally Reservation*.[18] Such a clause allows a state to exclude from its acceptance of Optional Clause jurisdiction any matter that it later determines is within its own domestic jurisdiction. This can be a double-edged sword, however, because the principle of reciprocity allows would-be defendants to invoke the plaintiff's self-judging reservation. In fact, this happened in 1957 in a suit brought by the United States against Bulgaria after Bulgaria shot down an American aircraft that had strayed into Bulgaria's air space. Bulgaria let it be known that it would invoke the self-judging reservation contained in the United States' Optional Clause declaration. To avoid embarrassment, the United States promptly withdrew its suit.[19]

The validity of self-judging reservations has been a matter of some speculation among legal writers. It seems to violate Article 36(6) of the Statute of the Court, which says that "in the event of a dispute as to whether the Court has jurisdiction, the matter shall be settled by the decision of the Court." The ICJ itself, however, has never definitively answered the question.[20]

The ICJ seldom decides cases that have direct commercial implications, though from time to time the Court has settled border disputes, investment disputes, and disputes over fishing grounds. In the following reading, however, commerce played a part in the Court's decision over a dispute between Iran and the United States.

advisory jurisdiction
The power of the ICJ to give opinions about issues of international law at the request of the United Nations or one of its specialized agencies.

Advisory Jurisdiction The ICJ's **advisory jurisdiction** exists so that the Court may give opinions about issues of international law at the request of the United Nations or one of its specialized agencies. But the Court will reject a request for such an opinion, if it has the effect of making a state a party to a dispute without that state's consent.

Judgments A case can be concluded in one of three ways: (1) If the parties tell the Court that they have reached a settlement, the Court will issue an order removing the case from its list; (2) if the applicant state withdraws its suit, the Court will order the case to be removed from its list; or (3) the Court will deliver a judgment.

---

[17]*International Court of Justice Reports*, vol. 1957, p. 9 (1957). Because the narrower of these two declarations "excludes from the jurisdiction of the Court the dispute which has been referred to it," the Court declined to hear the case. *Id*.

[18]It is called the Connally Reservation after the U.S. senator who introduced an amendment to include a self-judging reservation in the American Optional Clause declaration when the declaration was being debated in the U.S. Senate. Actually, however, it was the brainchild of U.S. Secretary of State John Foster Dulles.

[19]Aerial Incident of July 27, 1955 (*United States v. Bulgaria*), *International Court of Justice Reports*, vol. 1960, p. 146 (1959).

[20]It has had the opportunity on several occasions. In Interhandel (*Switzerland v. United States*), *International Court of Justice Reports*, vol. 1957, p. 77 (1957), the United States asserted its self-judging reservation in a suit brought by Switzerland, both at the hearing for interim measures and at the hearing on jurisdiction. The Court sidestepped the issue by holding that Switzerland had not exhausted all local remedies. In separate opinions, Judges Lauterpacht, Spender, and Klaestad commented on the reservation. All three agreed that the reservation violated Article 36(6). Judge Klaestad added: "These considerations have led me to the conclusion that the Court, both by its Statute and by the Charter, is prevented from acting upon that part of the Reservation which is in conflict with Article 36, paragraph 6 of the Statute, but that this circumstance does not necessarily imply that it is impossible for the Court to give effect to the other parts of the Declaration of Acceptance which are in conformity with the Statute." In the Case Concerning Right of Passage over Indian Territory (*Portugal v. India*) (Preliminary Objections), *International Court of Justice Reports*, vol. 1957, p. 125 (1957), India sought to escape the ICJ's jurisdiction by arguing that the reservation in Portugal's Optional Clause declaration violated the basic principle of reciprocity. The Court stated: "[India has] contended that the condition [i.e., reservation] offends against the basic principle of reciprocity underlying the Optional Clause inasmuch as it claims for Portugal a right which in effect is denied to other signatories who have made a declaration without appending any such condition. The Court is unable to accept that contention. It is clear that any reservation notified by Portugal . . . becomes automatically operative against it in relation to other signatories of the Optional Clause."

Reading 3-1 Iran and the United States at the ICJ: Oil Platforms Case (Islamic Republic of Iran v. United States of America)[21]

In September 1980, Iraqi military forces invaded Iran, beginning a war that lasted almost eight years and killed or wounded half a million Iranians. The land war between Iraq and Iran spread to the Persian Gulf in 1984 when Iraq began attacking oil tankers on their way to and from Iranian ports. The ensuing "Tanker War" did not end until the general ceasefire in August 1988. While it lasted, Iran retaliated against Iraqi attacks by attacking and mining neutral-flag ships coming from or going to ports in Saudi Arabia and Kuwait. Iraq also did its share of attacks on neutral shipping. The attacks by both Iran and Iraq violated time-honored rules of international law regarding neutral shipping and naval warfare.

In October 1987, a Kuwaiti oil tanker that had been sailing under an American flag was hit by a missile near Kuwait Harbor. The tanker *Sea Isle City* had been "reflagged" to carry a U.S. flag in order to provide protection from attack. In a separate 1988 incident, a U.S. Navy escort ship—the U.S.S. *Samuel B. Roberts*—struck a mine in international waters near Bahrain.

The United States blamed Iran for both incidents. Claiming that Iran used oil platforms to monitor Gulf shipping and to stage attacks, the U.S. military soon retaliated by destroying two offshore oil production facilities owned and operated by the National Iranian Oil Company (see Figure 3.2). All the incidents and reprisals were fairly minor, given the usual consequences of warfare; while some sailors were injured, no one on the ships or the oil platforms was killed.

FIGURE 3.2

An Iranian Oil Platform Destroyed During a U.S. Bombing Attack

Source: United States Department of Defense

Iran claimed that Iraq was to blame for both the missile and the mine, and brought a claim to the ICJ in November 1992 accusing the United States of unlawfully attacking and destroying the oil platforms. These attacks (in October 1987 and April 1988) allegedly violated the 1955 Treaty of Amity, Economic Relations, and Consular Rights between the United States of America and Iran[22] by impeding the freedom of commerce between the parties. The ICJ can rule only when both parties have consented to its jurisdiction. In this case, the only basis for its jurisdiction was the 1955 treaty, which declares in Article X, paragraph 1 that "Between the territories of the two High Contracting Parties there shall be freedom of commerce and navigation."[23]

Coming to the ICJ in 1992, Iran claimed that the destruction of its oil platforms violated this provision, and also that the ICJ had jurisdiction based on a clause in Article XXI(2) of the treaty that selected the ICJ as the forum for disputes arising out of the treaty, unless "the High Contracting Parties agree to dispute resolution by some other pacific means."

In preliminary objections filed in 1993, the United States sought dismissal, arguing that the treaty did not apply to questions concerning the use of force in self-defense. The ICJ rejected the U.S. position in its judgment of December 1993, finding that the destruction of the Iranian oil platforms was capable of having an adverse effect upon the freedom of commerce guaranteed by Article X(1) of the treaty. Thus, a dispute arising out of the use of force could end up before the ICJ if the force allegedly violated the freedom of commerce granted in a treaty between two nations.

The Court's principal aim after that preliminary decision was to determine if the United States had violated its Article X(1) freedom of commerce obligations in destroying the two Iranian oil platforms. Yet, it chose first to examine whether the U.S. actions were justified under Article XX(1)(d) of the treaty. Indeed, the United States in its defense had cited Article XX, paragraph (d) of the 1955 treaty, which provided that the parties could take measures ". . . necessary to protect its essential security interests, as interpreted in light of international law."

The Court ruled that the "essential security interests" clause must be interpreted in light of general international law on the use of force. Therefore, the United States had to show that it was the victim of an "armed attack" by Iran, that it acted in self-defense, and that its attacks on the oil platforms were "necessary" and "proportional."

But five members of the Court would have dismissed both the Iranian claim and the U.S. counterclaim without reaching the self-defense issue at all. They found that under the terms of the 1955 treaty, no commerce was involved in this case because none of the vessels allegedly damaged by Iranian attacks was engaged in commerce or navigation between the two countries, the two oil platforms were down for repairs, and in 1988 the United States had imposed an embargo on Iranian oil. Nor did the Iranian actions make the entire Persian Gulf unsafe for commercial shipping between

[21]The judgments in the *Oil Platforms Case* were issued in November 2003 and are available at www.icj-cij.org/docket/index.php?p1=3&p2=3&k=0a&case=90&code=op&p3=4.

[22]8 U.S.T. 899; T.I.A.S. 3853; 284 U.N.T.S. 93 (the 1955 Treaty).

[23]The treaty is an example of a friendship, commerce, and navigation (FCN) treaty that the United States historically entered into with various nations for bilateral trade purposes. In recent years, the FCN treaty has given way to the more modern bilateral investment treaty (BIT). The United States has concluded dozens of BITs, mostly with developing nations. These treaties usually select ICSID or some other arbitration process for dispute resolution, not the ICJ.

the two countries. The ruling on the absence of a commerce connection (and thus, the possible jurisdiction of the Court) should have ended the case.

But U.S. State Department lawyers told the Court that it could choose to address either the commerce or the security issue first. Given the background of the U.S. unilateral use of force in Iraq in 2003, some of the ICJ judges were keen on having the Court issue a warning on the use of force. The judgment thus includes important statements regarding the legal limits on the use of force, including the criteria of necessity and proportionality.

Confirming the applicability of the international law criteria of necessity and proportionality in relation to the use of force in alleged self-defense, the Court was not satisfied that the U.S. attacks of 1987–1988 were necessary to respond to the shipping incidents in the Gulf and constituted a proportionate use of force in self-defense. On the issue of necessity, the Court placed the burden on the United States to show that the attacks on its vessels "were of such a nature as to be qualified as 'armed attacks' within the meaning of that expression in Article 51 of the United Nations Charter, and as understood in customary law on the use of force" (Paragraph 51 of the judgment).

On the issue of proportionality, the Court noted that if the U.S. response to the 1987 missile attack on the *Sea Isle City* had been shown to be necessary, it might have been considered proportionate. But the same could not be said for the U.S. response to the 1988 mining of the U.S.S. *Samuel B. Roberts* because it was part of the more extensive "Operation Praying Mantis," which involved not only the attack on the oil platforms, but also the destruction of two Iranian frigates and a number of other naval vessels and aircraft (Paragraph 77 of the judgment). The Court concluded that the attacks against Iranian oil installations carried out by U.S. forces in 1987–1988 could not be justified under Article XX(1)(d) of the treaty (as being "necessary to protect the essential security interests of the U.S.") and did not fall within the category of measures contemplated by that provision.

The ICJ also rejected the U.S. counterclaim. The United States had requested the Court to adjudge and declare that, in attacking vessels in the Persian Gulf with mines and missiles and otherwise engaging in military actions that were dangerous and detrimental to commerce and navigation between the territories of Iran and the United States, Iran had breached its obligations to the United States under Article X(1) of the treaty and had to make full reparation to the United States. In the Court's view, to succeed on its counterclaim, the United States had to prove two things. First, it had to demonstrate that its freedom of commerce or of navigation "between the territories of the High Contracting Parties" to the treaty was actually infringed. Second, it had to prove that the acts that allegedly impaired one or both of those freedoms were attributable to Iran.

The Court concluded that neither the *Sea Isle City* nor the U.S.S. *Samuel B. Roberts* was engaged in commerce or navigation "between the territories of the High Contracting Parties" to the treaty. Therefore, the U.S. counterclaim failed on the first requirement, and the Court did not need to decide if Iraq or Iran had attacked either U.S. vessel.

The case concluded in November 2003 after being initially filed by Iran in 1992. The ICJ Web site in 2011 listed fifteen cases pending, the oldest of which was filed in 1998.[24]

Effect of Judgments "The decision of the Court has no binding force except between the parties and in respect of that particular case" (Article 59). The court's decisions, accordingly, have no precedential value (i.e., the doctrine of *stare decisis*[25] does not apply). It is free to depart from its earlier decisions, but it seldom does so, often citing earlier cases for authority in later opinions. The parties to a suit, however, are bound by the Court's decision. "The judgment is final and without appeal" (Article 60).

Compliance with ICJ Judgments Most states have voluntarily complied with the judgments handed down by the Court. There have been exceptions, of course. Albania refused to pay the damages awarded the United Kingdom by the Court for the injuries suffered by the United Kingdom's ships in the Corfu Channel in 1946; Iran refused to comply with the Court's judgment in the *United States Diplomatic and Consular Staff in Teheran Case;* and the United States ignored the Court's decision in the *Nicaragua Case*.[26]

There is no way to force a state to comply with a judgment. The United Nations Charter says that if a party refuses to comply with a judgment, "the other party may have recourse to the Security Council, which may, if it deems necessary, make recommendations or decide upon measures to give effect to the judgment."[27] This has never been done.

[24]www.icj-cij.org/docket/index.php?p1=3&p2=1.

[25]Latin: "let the decision stand." The Anglo-American common law doctrine that rules or principles laid down in earlier judicial decisions will be followed unless they contravene ordinary principles of justice.

[26]*Military and Paramilitary Activities in and Against Nicaragua* (*Nicaragua v. U.S.*), 1986 ICJ. 14 (Merits Judgment of June 27); see also James P. Rowles, "Nicaragua versus the United States: Issues of Law and Policy," *International Lawyer*, Fall 1986, p. 1245. "Notwithstanding the Court's holdings that the United States had committed a number of violations of fundamental norms of international law, that it must pay reparation to Nicaragua, and that the U.S. 'is under a duty to immediately cease and to refrain from all such acts' violative of these legal norms, the United States has continued to finance and support the Nicaraguan contras (from the Spanish word *contrarevolucionario*, "counterrevolutionary"). By July 1986, a presidential request for an additional $100 million in overt military and other assistance to the contras had been approved by both the Senate and the House, and seemed assured of final passage by the Congress. As a result, there appeared to be a substantial likelihood that the United States would not, at least initially, comply with the World Court's Judgment of June 27, 1986. Such action would contravene Article 94(1) of the United Nations Charter, which provides: "Each Member of the United Nations undertakes to comply with the decision of the International Court of Justice in any case to which it is a party."

[27]United Nations Charter, Article 94(2).

International Criminal Court

The International Criminal Court (ICC) is an independent, permanent court of last resort that tries persons accused of the most serious crimes affecting the international community. As a court of last resort, it will not act if a municipal judicial system is investigating or prosecuting the case. The jurisdiction and functioning of the ICC are governed by the Rome Statute, adopted in Rome, Italy, in 1998 by the United Nations Diplomatic Conference of Plenipotentiaries on the Establishment of an International Criminal Court. The Rome Statute is binding only on those states that formally express their consent to be bound by its provisions. The statute entered into force on July 1, 2002, when 60 states agreed to become parties. As of 2012, 104 states have become parties. The states parties meet in the Assembly of States Parties, which is the management oversight and legislative body of the court.[28]

The court may exercise jurisdiction over individuals accused of genocide, crimes against humanity, and war crimes, as well as those assisting in the commission of these crimes. This includes military commanders and other superiors whose responsibility is defined in the statute. But the court's jurisdiction is not universal: (1) the accused must be a national of a state party or a state otherwise accepting the jurisdiction of the court, (2) the crime took place on the territory of a state party or a state otherwise accepting the jurisdiction of the court, or (3) the United Nations Security Council has referred the situation to the prosecutor, irrespective of the nationality of the accused or the location of the crime. The court's jurisdiction is limited to events taking place since July 1, 2002.[29] Finally, a case will be inadmissible if it has been or is being investigated or prosecuted by a state with jurisdiction. However, a case may be admissible if the investigating or prosecuting state is unwilling or unable to carry out the investigation or prosecution.

One recent example of the Court's reach is found in the prosecution of Laurent Koudou Gbagbo (see Figure 3.3).

In fall of 2011, Gbagbo, the former President of Côte d'Ivoire, was transferred to the ICC detention center in the Netherlands. On November 23, 2011, Pre-Trial Chamber III had issued an arrest warrant for his alleged individual criminal responsibility for crimes against humanity (including murder, rape and other forms of sexual violence, persecution, and other inhuman acts) allegedly committed in Côte d'Ivoire between December 2010 and April 2011. On November 29, 2011, national authorities of Côte d'Ivoire surrendered Gbagbo to the ICC.

Less than two months before Gbagbo's arrest and surrender to the tribunal, Pre-Trial Chamber III granted the Prosecutor's request to open an investigation into the situation in Côte d'Ivoire to investigate alleged crimes against humanity and war crimes allegedly committed by pro-Gbagbo and pro-Ouattara forces. Reviewing the Prosecutor's request, the Pre-Trial Chamber III concluded that there are reasonable grounds to believe that pro-Gbagbo forces attacked civilians in the aftermath of the presidential elections in Côte d'Ivoire. While Côte d'Ivoire is not party to the Rome Statute, it accepted the Court's jurisdiction on April 18, 2003, and reaffirmed it on two subsequent occasions.

FIGURE 3.3

Former Ivorian President Laurent Koudou Gbagbo (*center*) Appears Before the International Criminal Court for the First Time After Being Accused of Crimes Against Humanity

Source: European Pressphoto Agency (EPA)/Alamy

[28]Following the adoption of the Rome Statute, the United Nations convened the Preparatory Commission for the International Criminal Court. As with the Rome Conference, all states were invited to participate in the Preparatory Commission. Among its achievements, the Preparatory Commission reached consensus on the Rules of Procedure and Evidence and the Elements of Crimes. These two texts were subsequently adopted by the Assembly of States Parties. Together with the Rome Statute and the Regulations of the Court adopted by the judges, they comprise the court's basic legal texts, setting out its structure and basic functions.

[29]In addition, if a state joins the court after July 1, 2002, the court only has jurisdiction after the statute entered into force for that state. Such a state may nonetheless accept the jurisdiction of the court for the period before the statute's entry into force.

World Trade Organization Dispute Settlement Procedures

World Trade Organization (WTO) International intergovernmental organization responsible for implementing and enforcing international rules regulating trade between nations.

Much more will be said about the **World Trade Organization (WTO)** and its dispute settlement procedures in Chapter 7. Briefly, however, the WTO is responsible for implementing and enforcing the rules of international trade between nations. The rules themselves are found in a wide-ranging collection of WTO agreements, including the General Agreement on Tariffs and Trade, the General Agreement on Trade in Services, and the Agreement on Trade-Related Aspects of Intellectual Property Rights. Each of these agreements has three main objectives: to help trade flow as freely as possible, to achieve further liberalization gradually through negotiation, and to set up an impartial means of settling disputes. The WTO's dispute settlement process itself is governed by an agreement known as the Understanding on Rules and Procedures Governing the Settlement of Disputes (the Dispute Settlement Understanding, or DSU). This is a unified process that applies to all disputes arising under the WTO agreements.[30]

The WTO's Web site is at
www.wto.org.
The DSU is posted on the WTO's Web site at
www.wto.org/english/tratop_e/dispu_e/dsu_e.htm.

Consultation and Third-Party Participation

The DSU encourages member states to resolve disputes through consultation with each other. Indeed, a member is obliged to enter into a consultation within 30 days of being asked to do so. If a member fails to respond within 10 days of a request or fails to consult within 30 days, or within a period agreed upon, the requesting member can seek the establishment of a WTO Dispute Settlement Panel.[31] Also, if no solution is reached within 60 days after a request for consultation is made, the complaining party can ask for the establishment of a panel.

Besides consulting, the parties to a dispute may, if each of them agrees, seek the assistance of third parties in resolving their differences. Such assistance can take the form of good offices, conciliation, or mediation, and it may be sought at any time during the course of a dispute. If the parties agree, good offices, conciliation, and mediation may continue while a Dispute Settlement Panel is considering a complaint.

Dispute Settlement Organs

The organs charged with administering and carrying out the DSU are (1) the Dispute Settlement Body, (2) the Dispute Settlement Panels, and (3) the Appellate Body.

Dispute Settlement Body

The Dispute Settlement Body (DSB) is actually the WTO General Council convened under its own chairman and following its own rules of procedure.[32] It is responsible for establishing panels, adopting their reports and those of the Appellate Body, monitoring implementation of rulings and recommendations, and authorizing the suspension of concessions and other obligations in appropriate cases.

Dispute Settlement Panel

Should a Dispute Settlement Panel[33] (i.e., an *ad hoc* tribunal) be needed, it will be made up of three panelists unless the parties agree within 10 days of its establishment that it should consist of five panelists. The WTO Secretariat will nominate individuals to be panelists, and the parties must have "compelling reasons" to object to their appointment. If no agreement is reached within 20 days on the makeup of a panel, the WTO director-general, in consultation with the chairman of the DSB and the relevant council or committee, will appoint the panelists, keeping in mind, after consulting with the parties, any special or additional considerations relevant to the particular case.[34]

---

[30] A separate WTO Trade Policy Review Mechanism exists to encourage WTO member states to liberalize their trade policies. The mechanism is a political rather than a legal process, however, so the DSU does not apply to it.

[31] Understanding on Rules and Procedures Governing the Settlement of Disputes (1994), para. 4.3. If a case is a matter of urgency, such as one involving perishable goods, consultations must be held within 10 days of a request; and, if they fail, a request for a panel may be made within 20 days. *Id*., para. 4.8.

[32] Agreement Establishing the World Trade Organization (1994), Article IV, para. 3. See the Marrakesh Declaration of April 15, 1994, posted at www.wto.org/english/docs_e/legal_e/marrakesh_decl_e.htm.

[33] For an excellent summary of the dispute settlement process, see the chart on the WTO's Web site at www.wto.org/english/thewto_e/whatis_e/tif_e/disp1_e.htm.

[34] *Id*., para. 8.7. Whenever feasible, a single panel will be established whenever there are multiple complaints dealing with the same issue. *Id*., para 9.1. However, "[i]f more than one Panel is established to examine complaints related to the same matter, to the greatest extent possible the same persons shall serve as panelists on each of the separate Panels and the timetable for the panel process in such disputes shall be harmonized." *Id*., para. 9.3.

Panelists serve in their individual capacities and not as representatives of any government or organization. Individuals who are citizens of one of the state parties to a dispute are generally not eligible to serve on a panel concerned with that dispute, although the parties to the dispute agree otherwise. If a dispute is between a developed member state and a developing member state, at least one of the panelists must be from a developing state if the developing member state party so requests.

The function of a Dispute Settlement Panel is to assist the DSB by making an objective assessment of the matter referred to it, including the facts of the case, the applicability of and conformity with the pertinent WTO agreements, and by making findings that will help the DSB to make recommendations and rulings to resolve the dispute. So that a panel may do its job properly, the party requesting its establishment must identify the specific matters that are in dispute. Chapter 7 has several WTO decisions that illustrate this.

A panel report is adopted automatically by the DSB within 60 days after it has been circulated, even if a special meeting has to be convened for the purpose, unless (1) one of the parties to the dispute notifies the DSB that it is going to appeal or (2) the DSB decides by consensus not to adopt the report. If there is an appeal, the DSB will not consider the report until the appeal is completed.

Appellate Body The Appellate Body is an appeals board made up of seven persons, three of whom will serve on any one case. The seven must be persons of recognized authority and with demonstrated expertise in law, international trade, and the subject matter of the WTO Agreement and its annexes. The term of office is four years, renewable once. Terms are staggered, ensuring that not all members begin and complete their terms at the same time.

A panel decision may be appealed to the Appellate Body only by parties directly involved in a dispute. The appeal itself is limited to the legal issues contained in the panel report and the legal interpretations developed by the panel.

The proceedings of the Appellate Body are confidential, and the opinions expressed by its individual members in the report are anonymous. The Appellate Body may uphold, modify, or reverse a panel's findings and conclusions, and its report will automatically be adopted by the DSB unless the DSB decides by consensus not to do so.

Enforcement Panel and Appellate Body reports adopted by the DSB are enforced by the DSB. The DSB is responsible for monitoring compliance and, should a state fail to comply with panel or Appellate Body recommendations, the DSB may authorize either the noncomplying state to pay compensation or the injured state to retaliate.

Precedential Effect of Panel and Appellate Body Rulings The Dispute Settlement Understanding states:

> The dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system. The members of the WTO recognize that it serves to preserve the rights and obligations of members under the covered [WTO] agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law. Recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements.[35]

In other words, the concept of legal precedent does apply to the new WTO dispute settlement system,[36] but it is the flexible system of precedent that is used in international tribunals and not the rigid system of British or even American common law. That is, both the panels and the Appellate Body may rely on their own earlier legal rulings, but they are also free to deviate from those rulings as they think necessary. This is discussed in Case 3-1.

---

[35] *Id.,* para. 3.2.

[36] Under GATT 1947, the question of whether or not the rulings of a Dispute Settlement Panel were to be treated as precedents for later panels was a matter of some debate. On the one hand, panels routinely referred to earlier panel reports in support of their own rulings. Likewise, in GATT Council meetings, representatives of some contracting parties (notably the United States) argued that the panel reports constituted GATT case law. On the other hand, other representatives argued that the reports had no precedential value, and a 1982 Ministerial Decision decided that dispute settlement decisions could "not add to or diminish the rights and obligations provided in the General Agreement," implying that there could be no such thing as case law or precedent. See GATT, *Analytical Index: Guide to GATT Law and Practice*, pp. 702–706 (6th ed., 1994).

CASE 3-1 Japan—Taxes on Alcoholic Beverages

Canada v. Japan, European Communities v. Japan, United States v. Japan
World Trade Organization, Appellate Body, 1996 *Appellate Body Report AB–1996–2*[37]

MAP 3.1

Japan and the United States (1996)

Introduction

Japan and the United States appeal from certain issues of law and legal interpretations in the Panel Report *Japan—Taxes on Alcoholic Beverages* (the Panel Report). That Panel (the Panel) was established to consider complaints by the European Communities, Canada and the United States against Japan relating to the Japanese Liquor Tax Law (*Shuzeiho*), Law No. 6 of 1953 as amended (the Liquor Tax Law).

***

Issues Raised in the Appeal

The . . . United States . . . raised the following issues in this appeal:

(h) whether the Panel erred in its characterization of panel reports adopted by the GATT CONTRACTING PARTIES and the WTO Dispute Settlement Body as "subsequent practice in a specific case by virtue of the decision to adopt them."

***

Status of Adopted Panel Reports

In this case, the Panel concluded that,

> . . . panel reports adopted by the GATT CONTRACTING PARTIES and the WTO Dispute Settlement Body constitute subsequent practice in a specific case by virtue of the decision to adopt them. Article 1(b)(iv) of GATT 1994 provides institutional recognition that adopted panel reports constitute subsequent practice. Such reports are an integral part of GATT 1994, since they constitute "other decisions of the CONTRACTING PARTIES to GATT 1947."

Article 31(3)(b) of the Vienna Convention [on the Law of Treaties] states that "any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation" is to be "taken into account together with the context" in interpreting the terms of the treaty. Generally, in international law, the essence of subsequent practice in interpreting a treaty has been recognized as a "concordant, common and consistent" sequence

[37]This Appellate Body Report is posted on the Internet at www.wto.org/english/tratop_e/dispu_e/8-17.pdf.

of acts or pronouncements which is sufficient to establish a discernible pattern implying the agreement of the parties regarding its interpretation. An isolated act is generally not sufficient to establish subsequent practice; it is a sequence of acts establishing the agreement of the parties that is relevant.

Although GATT 1947[38] panel reports were adopted by decisions of the CONTRACTING PARTIES,[39] a decision to adopt a panel report did not under GATT 1947 constitute agreement by the CONTRACTING PARTIES on the legal reasoning in that panel report. The generally-accepted view under GATT 1947 was that the conclusions and recommendations in an adopted panel report bound the parties to the dispute in that particular case, but subsequent panels did not feel legally bound by the details and reasoning of a previous panel report.[40]

We do not believe that the CONTRACTING PARTIES, in deciding to adopt a panel report, intended that their decision would constitute a definitive interpretation of the relevant provisions of GATT 1947. Nor do we believe that this is contemplated under GATT 1994. There is specific cause for this conclusion in the WTO Agreement. Article IX:2 of the WTO Agreement provides: "The Ministerial Conference and the General Council shall have the exclusive authority to adopt interpretations of this Agreement and of the Multilateral Trade Agreements." Article IX:2 provides further that such decisions "shall be taken by a three-fourths majority of the Members." The fact that such an "exclusive authority" in interpreting the treaty has been established so specifically in the WTO Agreement is reason enough to conclude that such authority does not exist by implication or by inadvertence elsewhere.

Historically, the decisions to adopt panel reports under Article XXIII of the GATT 1947 were different from joint action by the CONTRACTING PARTIES under Article XXV of the GATT 1947. Today, their nature continues to differ from interpretations of the GATT 1994 and the other Multilateral Trade Agreements under the WTO Agreement by the WTO Ministerial Conference or the General Council. This is clear from a reading of Article 3:9 of the DSU, which states:

> The provisions of this Understanding are without prejudice to the rights of Members to seek authoritative interpretation of provisions of a covered agreement through decision-making under the WTO Agreement or a covered agreement which is a Plurilateral Trade Agreement.

Article XVI:1 of the WTO Agreement and paragraph 1(b)(iv) of the language of Annex 1A incorporating the GATT 1994 into the WTO Agreement bring the legal history and experience under the GATT 1947 into the new realm of the WTO in a way that ensures continuity and consistency in a smooth transition from the GATT 1947 system. This affirms the importance to the Members of the WTO of the experience acquired by the CONTRACTING PARTIES to the GATT 1947—and acknowledges the continuing relevance of that experience to the new trading system served by the WTO. Adopted panel reports are an important part of the GATT *acquis*.[41] They are often considered by subsequent panels. They create legitimate expectations among WTO Members, and, therefore, should be taken into account where they are relevant to any dispute. However, they are not binding, except with respect to resolving the particular dispute between the parties to that dispute.[42] In short, their character and their legal status have not been changed by the coming into force of the WTO Agreement.

For these reasons, we do not agree with the Panel's conclusion in paragraph 6.10 of the Panel Report that "panel reports adopted by the GATT CONTRACTING PARTIES and the WTO Dispute Settlement Body constitute subsequent practice in a specific case" as the phrase "subsequent practice" is used in Article 31 of the Vienna Convention. Further, we do not agree with the Panel's conclusion

[38]By GATT 1947, we refer throughout to the General Agreement on Tariffs and Trade, dated October 30, 1947, annexed to the Final Act Adopted at the Conclusion of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment, as subsequently rectified, amended, or modified.

[39]By CONTRACTING PARTIES, we refer throughout to the CONTRACTING PARTIES of GATT 1947.

[40]European Economic Community—Restrictions on Imports of Dessert Apples, BISD 36S/93, para. 12.1.

[41]From French: "acquired." The acquired interpretation or gloss.

[42]It is worth noting that the Statute of the International Court of Justice has an explicit provision, Article 59, to the same effect. This has not inhibited the development by that Court (and its predecessor) of a body of case law in which considerable reliance on the value of previous decisions is readily discernible.

in the same paragraph of the Panel Report that adopted panel reports in themselves constitute "other decisions of the CONTRACTING PARTIES to GATT 1947" for the purposes of paragraph 1(b) (iv) of the language of Annex 1A incorporating the GATT 1994 into the WTO Agreement.

However, we agree with the Panel's conclusion in that same paragraph of the Panel Report that unadopted panel reports "have no legal status in the GATT or WTO system since they have not been endorsed through decisions by the CONTRACTING PARTIES to GATT or WTO Members." Likewise, we agree that "a panel could nevertheless find useful guidance in the reasoning of an unadopted panel report that it considered to be relevant."

***

Conclusions and Recommendations

For the reasons set out in the preceding sections of this report, the Appellate Body has reached the following conclusions:

> the Panel erred in law in its conclusion that "panel reports adopted by the GATT CONTRACTING PARTIES and the WTO Dispute Settlement Body constitute subsequent practice in a specific case by virtue of the decision to adopt them.". . .

Casepoint

Adopted panel reports are an important part of the acquired interpretation of the GATT and should be taken into account where they are relevant to any dispute. However, they are not binding, except with respect to resolving the particular dispute between the parties to that dispute.

International Center for the Settlement of Investment Disputes

The International Center for the Settlement of Investment Disputes (ICSID) was created in 1965 at a conference in Washington, D.C., sponsored by the International Bank for Reconstruction and Development (popularly known as the World Bank). The purpose of ICSID is to encourage private investment in underdeveloped countries. Many individuals and businesses had been reluctant to make investments, fearing they would be expropriated. To calm this fear, the World Bank drafted the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the Washington Convention),[43] creating ICSID, to provide a reliable mechanism for impartially resolving disputes between an investor and the country of investment. The convention has now been ratified by 131 states.

See the ICSID home page at
www.worldbank.org/icsid.
The list of Contracting States and Other Signatories of the Convention (as of December 15, 2006) is posted at http://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=ContractingStates&ReqFrom=Main.

The ICSID Organization The ICSID, headquartered at the World Bank's office in Washington, D.C., has an Administrative Council, a Secretariat, and two panels of experts. The council is made up of representatives of the states parties to the Washington Convention and is chaired by the president of the World Bank (Article 5). It adopts the ICSID's rules regarding conciliation and arbitration and is responsible for its budget. The Secretariat, made up of a secretary-general (elected by the Council for a six-year term) and an administrative staff, serves as the ICSID's registrar (Articles 9 and 11). The council chooses the Panel of Arbitrators and the Panel of Conciliators from nominees submitted by states parties.

[43]The text of the convention is posted at http://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/main-eng.htm.

ICSID Rules The Administrative Council has enacted rules that regulate how conciliations and arbitrations are begun (called Institutional Rules) and rules for conducting conciliations (Conciliation Rules) as well as arbitral hearings (Arbitration Rules). In the materials that follow, we examine the rules relating to ICSID **arbitrations**.

arbitration (From Latin *arbitrari:* "to give a decision.") The process by which parties to a dispute submit their differences to the binding judgment of an impartial third person or group selected by mutual consent.

The litigants (i.e., the investor or *private party* and the host state or *state party*) may agree to the rules of law governing a particular arbitration. If they cannot agree, then both international law and the state party's law (including the state party's rules for deciding conflicts about the applicability of particular laws) are to apply (Article 42).

The most important basic rule established by the Washington Convention is that third-party states, including the state of the investor involved in the dispute, are not allowed to intervene. Article 27(1) of the convention provides:

> No contracting state shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another contracting state have consented to submit or shall have submitted to arbitration under this Convention, unless such other contracting party shall have failed to abide by and comply with the award rendered in such dispute.

This is a significant departure from traditional notions of international law, which required disputes between a state and the national of another state to be resolved only between the states alone.[44] In short, states that are parties to the Washington Convention are not allowed to take up disputes on behalf of their nationals unless the ICSID arbitration process fails.

Constituting an ICSID Arbitration Tribunal Before ICSID can set up a tribunal to resolve a particular dispute, two preliminary steps must be taken. First, the state wherein the investment is being made (the host state) and the state of which the investor is a national (the home state) must both be parties to the Washington Convention. Second, the investor and the host state must both consent to ICSID jurisdiction.[45]

Both steps are vital to establishing the jurisdiction of ICSID to resolve a dispute. Neither can be waived. On the other hand, whereas the convention must be properly signed and ratified, the acceptance of ICSID jurisdiction only needs to be in writing—no particular form is required.[46] As a practical matter, however, the ICSID arbitration agreement should be included in every contractual arrangement between the investor and the host state.

The *Holiday Inns v. Morocco Case*[47] involved an agreement between Morocco and two American companies: the Holiday Inns Group and Occidental Petroleum. At the request of Morocco, the companies agreed to build four hotels in that country. The "basic agreement" they signed contained an ICSID arbitration clause; however, this was not the only agreement governing the contract. To make it easier for the Moroccan government to make payments, the American companies established Moroccan subsidiaries. (This was done because Moroccan law made it difficult for the government to contract with foreign businesses.) The relationship between Morocco and the subsidiaries was described in separate agreements that did not have ICSID arbitration clauses. Thus, when Morocco failed to pay the Americans for building the hotels, both the parent American companies and their subsidiaries wanted to bring suit. However, because the agreements between Morocco and the subsidiaries had no ICSID arbitration clauses, the subsidiaries were not allowed to be parties to the

[44] See the Mavrommatis Palestine Concessions Case (*Greece v. Great Britain*) (Jurisdiction)*, Permanent Court of International Justice Reports, Series A*, No. 2, p. 12 (1924); and Administrative Decision No. V (*United States v. Germany*), Mixed Claims Commission, Opinion of Parker, Umpire, *United Nations Reports of International Arbitral Awards*, vol. 7, p. 119 (1924).

[45] Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Article 25 (1965). Article 25 is the "cornerstone" of ICSID jurisdiction according to the directors of the World Bank.

[46] The host state must notify ICSID of the particular dispute or classes of disputes that it is willing to submit to ICSID arbitration. *Id*. It may do so in a contract with a foreign investor, in a bilateral treaty with another contracting state, or in a unilateral declaration made at the time of its ratification of the ICSID Convention or at any time thereafter. Since 1965, approximately 160 countries have entered into bilateral treaties with such provisions and some 30 countries have made unilateral declarations. Antonio R. Parra, "The Role of ICSID in the Settlement of Investment Disputes," *ICSID News*, vol. 16, no. 1, pp. 5–8 (Winter 1999), posted at http://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDNewsLettersRH&actionVal=ShowDocument&DocId=DC17.

[47] *Holiday Inns/Occidental Petroleum Corp. v. Government of Morocco*, described in P. Lalive, "The First 'World Bank' Arbitration *(Holiday Inn v. Morocco)*—Some Legal Problems," *British Year Book of International Law*, vol. 51, p. 123 (1980).

arbitration proceedings. (Fortunately for the parent companies, the tribunal treated the agreements between the subsidiaries and Morocco as secondary documents that supplemented the basic agreement signed by the parents and Morocco. The parents were allowed, accordingly, to enforce those agreements.)

The Washington Convention, while speaking of *investors* and *investments*, does not define either term.

Defining Investment ICSID Convention Article 25 does not define investment. Article 25(1) provides that "jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment." Because the drafters of the ICSID convention could not agree on a definition of investment, they chose to omit it. Most commentators have said that the drafters meant for the term to be given broad scope. Indeed, because investments are generally given broad scope, the term's interpretation has never before been an issue in any case. With respect to transnational loans (international promissory notes), the first draft of the convention provided that they should be regarded as investments. The term *direct* in Article 25(1) relates to the dispute and not to the investment. So, the investment itself does not have to be direct.

Unilateral Withdrawal Is Ineffective Article 25 says that if proper consent has been given to establish an ICSID tribunal, then the tribunal can be set up even when the host state or the investor refuses to participate. Also, once consent has been given, it cannot be unilaterally withdrawn. According to Article 72, a state party cannot withdraw by filing a later reservation to the convention or even by denouncing the convention.

In *Alcoa Minerals of Jamaica, Inc. (United States) v. Jamaica*,[48] Alcoa, an American company, contracted with the Jamaican government to construct an aluminum factory in exchange for a 25-year bauxite mining concession, a promise of no increase in taxes for 25 years, and access to ICSID arbitration. Both the United States and Jamaica were parties to the Washington Convention, and Jamaica's ratification listed no reservations to the tribunal's jurisdiction. Alcoa built the plant and began mining bauxite. Then, in 1974, Jamaica decided to levy a tax on bauxite mining. Alcoa's tax bill that year was $20 million. To avoid a suit by Alcoa, Jamaica filed a reservation with ICSID excluding disputes relating to minerals or natural resources. Alcoa nevertheless went ahead and began an ICSID arbitration. Jamaica refused to participate, relying on its reservation. The tribunal decided that it had jurisdiction and that the proceedings would continue without Jamaica's participation.[49] It held that (1) consent to jurisdiction existed in writing, (2) consent existed at the time that the case was brought to ICSID, and (3) notification of the reservation did not affect any prior consent. The tribunal said that a reservation to the convention would apply only to agreements made after the reservation was filed with the ICSID.

Selecting the Arbitrators The Washington Convention offers a wide range of choices in the selection of arbitrators. The litigants may agree to any number, but if they want more than one, the number must be odd. The arbitrators may be any persons agreeable to the litigants; however, the majority must be nationals of states other than the state party to the dispute. According to Articles 38 and 40(1), should one of the litigants refuse to cooperate in making the appointments, the chairman of ICSID's Arbitration Council, at the request of either litigant and after consulting with both as far as possible, will provide the missing name or names from a list (called the Panel of Arbitrators; these names may not be nationals of the state party) maintained by ICSID.

Place of Arbitration Arbitration proceedings are normally held at ICSID's headquarters in Washington, D.C. By agreement, the litigants can elect to have the arbitration held at the offices of any institution with which ICSID has made arrangements. ICSID has entered into arrangements with the Permanent Court of Arbitration at The Hague, the Asian-African Legal Consultative Committee's Regional Offices in Kuala Lumpur and in Cairo, the Australian Center for International Commercial Arbitration in Melbourne, the Australian Commercial Disputes Center in Sydney, the Singapore International Arbitration Center, and the Gulf Cooperation Council Commercial Arbitration Center

---

[48] *Yearbook of Commercial Arbitration*, vol. 4, p. 206 (1979).

[49] The tribunal cited Articles 38 and 42 of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (1965) as authority.

in Bahrain. Also, Articles 62 and 63 specify that after consulting with ICSID's secretary-general and with the permission of the arbitration tribunal, the litigants can agree to have the proceedings held at any other location. So far, the arbitrations have been split fairly evenly between Washington and major European cities.

Exclusive Remedy Giving consent to ICSID arbitration is deemed to exclude all other remedies.[50] The case cannot be tried in a municipal or another international tribunal,[51] nor can the investor turn to the home state for diplomatic protection (Article 27).

According to Article 41, any dispute about the power of an ICSID tribunal to hear a matter is for the tribunal itself to decide (Article 41). Article 36(3) of the convention requires the secretary-general to register a request for arbitration unless the information contained in the request discloses that the dispute is "manifestly" outside the jurisdiction of the ICSID. Thus, so long as there is some showing of a basis for arbitration, a tribunal will be convened.[52]

Jurisdiction An ICSID tribunal must have jurisdiction both over the parties involved and over the subject matter of the dispute.

Personal Jurisdiction In order for a tribunal to have **personal jurisdiction**, the parties appearing before it must be a state party and a national of another contracting state. A *state party* includes the state itself, its agencies, and its subdivisions. Subdivisions include the states or provinces of a federal state, semi-autonomous dependencies, and municipalities. When a dispute arises that involves an agency or a subdivision of a state, either the agency or subdivision and the state must have consented to ICSID jurisdiction before the ICSID will set up a tribunal to hear the matter.[53]

personal jurisdiction The requirement that a tribunal must have power over the parties before it may hear a dispute.

A *national of another contracting state* can be either a natural or a juridical person. A **natural person** is a human being who has the nationality of a home state. That is, the home state must be a contracting party to the convention and not itself a party to the dispute. In addition, the natural person must have home state nationality at two critical times: (1) on the date the parties consented to arbitration and (2) on the date that a request for the arbitration is registered with ICSID.

natural person A human being.

A **juridical person** is a legal entity, other than a natural person, that has sufficient existence in the eyes of the law to function legally, sue and be sued, and make decisions through agents (e.g., a business firm). In order for a juridical person to be a party to an ICSID arbitration, it must have had the nationality of a home state on the date the parties consented to arbitration.[54] However, companies

juridical person A legal entity created by national or international law.

[50]See *Alcoa Minerals of Jamaica, Inc. (United States) v. Jamaica, Yearbook of Commercial Arbitration*, vol. 4, p. 206 (1979); and Liberian Eastern Timber Corporation v. Liberia (1987), *International Legal Materials*, vol. 26, p. 647 (1988).

[51]The host state may, however, require that all local administrative and judicial remedies be exhausted before the dispute can be taken to ICSID. Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Article 26 (1965).

[52]There is no indication in the convention about which party has the burden of proof to show that the ICSID has jurisdiction. However, in both *Alcoa Minerals of Jamaica, Inc. (United States) v. Jamaica, Yearbook of Commercial Arbitration*, vol. 4, p. 206 (1979), and the *Klockner Industrie-Anlagen GmbH (Federal Republic of Germany) v. Cameroon (Award)*, *id*., vol. 10, p. 71 (1985), the tribunals held that the burden was on the party seeking to show that the tribunal has jurisdiction.

[53]Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Article 25(3) (1965). In *Klockner Industrie-Anlagen GmbH (Federal Republic of Germany) v. Cameroon (Award)*, *Yearbook of Commercial Arbitration*, vol. 10, p. 71 (1985), a German company, Klockner, agreed to build and manage a fertilizer factory in the Cameroon for five years. The Cameroon government was to furnish the site and pay for construction by repaying the note taken out by Klockner. A joint venture, SOCAME, was set up in the Cameroon, and in due course it became a party to an agreement with Klockner. The agreement between SOCAME and Klockner had an ICSID arbitration clause, as did the principal agreement between Klockner and the Cameroon government. After a year and a half, the factory was closed and SOCAME was declared bankrupt. Klockner thereupon filed with ICSID against both SOCAME and the Cameroon government, asking for the balance due on the loan. Because SOCAME had not been designated as an agent of the Cameroon government, it would not normally have qualified as a party to an ICSID arbitration. However, the Cameroon government wanted SOCAME to be party to its counterclaim against Klockner, so, before pleadings were submitted, the Cameroon government sent a letter to the tribunal stating that (a) SOCAME was an agency of that government and (b) the government approved of SOCAME's consent to ICSID arbitration. The tribunal tersely held that "the letter resolves the problem of jurisdiction affirmatively."

[54]The convention does not expressly require a company to have home state nationality on the date that the filing is made with ICSID. This seems to indicate that a change in nationality of the company (from home to host state) would have no effect on the company's ability to begin an arbitration. However, in *Klockner Industrie-Anlagen GmbH (Federal Republic of Germany) v. Cameroon (Jurisdiction)*, *Yearbook of Commercial Arbitration*, vol. 10, p. 71 (1985), the tribunal implied that if foreign ownership ends before a case is filed with ICSID, personal jurisdiction would be lacking. (In *Klockner*, however, the jurisdiction was determined on different grounds.)

under the control of foreign nationals will also be treated as nationals of another contracting state if the contracting parties agree that they should be treated as such.[55] This is an important point because host states often require that companies be incorporated locally before they can do business, acquire land, or obtain payment from the government.

The convention does not define *foreign control*, and the decisions in various cases have not been consistent. One case found foreign control where 51 percent of the shareholders were foreigners.[56] Another held that there was foreign control when foreigners dominated the management of the firm.[57]

collusive action
(From Latin *cullosio:* "a secret understanding.") A suit in which the parties are not at odds but instead cooperate to obtain a judgment.

legal dispute
A disagreement as to the existence of a legal right or obligation, or as to the nature and extent of the compensation due for the breach of such a right or obligation.

investment
A commitment of money or capital in order to earn a financial return.

Subject Matter Jurisdiction ICSID arbitration tribunals can only decide matters that are (1) disputes that (2) arise out of an investment. The requirement that there be a dispute means that ICSID tribunals will not decide **collusive actions** (i.e., test cases) or give advisory opinions. In *AGIP Co. SpA (Italy) v. Congo*, an Italian investor, AGIP, breached its investment agreement with the Republic of the Congo. The Congo responded by nationalizing AGIP's subsidiary. AGIP then filed for arbitration, and the Congo answered by arguing that there was no dispute because it had compensated AGIP when it had nationalized the subsidiary. AGIP said that the dispute arose prior to the nationalization decree and that the compensation was inadequate. The tribunal could find no definition of a **legal dispute** in the convention, so it turned to a statement made by the executive director of the World Bank at the time the convention was opened for signature that defined a legal dispute as a conflict over rights rather than interests. Such a dispute, said the tribunal, has to relate to the existence of a legal right or a legal obligation, or to the nature and extent of compensation for the breach of such a right or obligation. Based on this definition, the tribunal concluded that there had been no dispute prior to the nationalization decree. It therefore limited its inquiry to determining if the compensation made after nationalization was adequate.

The convention also does not define **investment**. The executive director of the World Bank once described this omission as purposeful, saying that drafters of the convention thought that the primary consideration should be the intent of the parties. The intent of the parties was examined in the *Alcoa Minerals of Jamaica Case*, described earlier. The tribunal said that the agreement of the parties as to what an *investment* is, while not the deciding factor, should be given great weight. And absent some agreement by them, the word should be given its ordinary meaning—that is, putting capital into a venture with the expectation of receiving a profit. In the *Alcoa Case*, the parties seemed to use the word "investment" in its ordinary way, so the tribunal decided that the nationalization of Alcoa's aluminum plant by Jamaica was a dispute arising directly out of an investment.

The parties can also limit the subject matter of a dispute by adding restrictions in their agreement to arbitrate. Additionally, the tribunal will only consider matters raised in the claim brought by the party initiating the arbitration proceeding (Article 25) or raised in a counterclaim (Article 46).

ICSID and the North American Free Trade Agreement Chapter 11 of the North American Free Trade Agreement (NAFTA) contains provisions designed to protect cross-border investors and facilitate the settlement of investment disputes. For example, each NAFTA party must accord investors from the other NAFTA parties national (i.e., nondiscriminatory) treatment and may not expropriate investments of those investors except in accordance with international law. Chapter 11 permits an investor of one NAFTA party to seek money damages for measures of one of the other NAFTA parties that allegedly violate those and other provisions of Chapter 11. Investors may initiate an arbitration against the NAFTA party under the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL Rules) or the Arbitration (Additional Facility) Rules of the International

[55]Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Article 25(2)(b) (1965). In *Holiday Inns/Occidental Petroleum Corp. v. Government of Morocco*, described in P. Lalive, "The First 'World Bank' Arbitration (*Holiday Inns v. Morocco*)—Some Legal Problems," *British Year Book of International Law*, vol. 51, p. 123 (1980), the tribunal narrowly interpreted the convention and decided that foreign control would be implied only if no other implication would be made. However, in *AMCO Asia Corp. et al. (United States) v. Indonesia (Jurisdiction)*, *International Legal Materials*, vol. 23, p. 351 (1985), a wider interpretation of the convention was made. The tribunal looked at all the facts, assumed that the parties had acted in good faith, and concluded that foreign control would be implied because the host state knew that the company was dominated by foreigners, even though this was not expressly mentioned in the agreement containing the ICSID clause.

[56]In *Holiday Inns/Occidental Petroleum Corp. v. Government of Morocco*, described in P. Lalive, "The First 'World Bank' Arbitration (*Holiday Inns v. Morocco*)—Some Legal Problems," *British Year Book of International Law*, vol. 51, p. 123 (1980).

[57]*Liberian Eastern Timber Corporation v. Liberia* (1987), *International Legal Materials*, vol. 26, p. 647 (1988). The tribunal concluded that a local company was under French control for two independent reasons: (1) all of the shares were owned by French nationals and (2) French nationals dominated the management of the firm. A majority of directors and the manager were French.

Centre for Settlement of Investment Disputes (ICSID Additional Facility Rules). Note new rules of UNCITRAL and ILM article.

Several important Article 11 NAFTA arbitrations have taken place under ICSID rules. Case 3-2 illustrates that private investors from Canada, Mexico, or the United States may bring claims against a foreign government on issues of national treatment and expropriation, and that the judgments of municipal civil juries may create grounds for such claims.

CASE 3-2 In the Matter of the Loewen Group Inc. and Raymond L. Loewen, Claimants/Investors v. United States of America Respondent/Party

International Center for the Settlement of Investment Disputes ICSID Case No. ARB (AF)/98/3

MAP 3.2

The United States and Canada

Background

The Loewen Group (Loewen) is a Canadian-based funeral conglomerate that has acquired more than 1,100 funeral homes across Canada and the U.S. The Loewen NAFTA case arose in the context of increasing consolidation in the U.S. funeral home market, as a handful of conglomerates have acquired a number of small, independent firms. This phenomenon has drawn public attention because of subsequent consumer abuses and several high-profile investigations of anti-competitive business practices. A 1996 *Time Magazine* investigation into the funeral industry charged that "Loewen and a handful of other large death-care companies are racing to buy up as many independent funeral homes as possible—not out of any desire to share the resulting economies of scale and cut the cost of funerals—but rather to boost prices still higher."[58]

In 1994, Biloxi businessman Jeremiah O'Keefe sued Loewen in Mississippi state court, alleging that Loewen had committed unlawful, anti-competitive acts intended to drive O'Keefe's local funeral and insurance companies out of business. After a trial a Mississippi jury agreed with O'Keefe, and rendered a verdict of $260 million. According to one juror, "The Loewen group . . . clearly violated every contract it ever had with O'Keefe. . . . If there was ever an indefensible case, I believe this was it." Because the jury decided on an amount in the judgment phase of the trial and not the penalty phase, Loewen could accept the jury's verdict or go back to the same jury for the penalty phase. Loewen chose to go back to court, but this time the jury upped the damages to $500 million.

[58]"Fight to the Death: A Battle Between Rival Funeral Homes Dynasties Puts the Spotlight on a Vast But Quiet Transformation in the Way We Bury our Dead," *Time*, December 9, 1996.

Loewen decided to appeal the jury verdict to a higher court, but wanted to be exempt from posting a bond worth 125% of the damages owed. Posting a bond on appeal is fairly standard practice in U.S. state court. The purpose of this rule is to prevent defendants from using the lengthy appeals process to hide assets or otherwise evade liability. To buy a bond, a defendant will typically put forward 10% of the bond requirement in cash and pledge the rest in collateral. Loewen's request to be exempt from the rule was rejected, and Loewen appealed the issue to the Mississippi Supreme Court. In 1996 the Mississippi Supreme Court rejected Loewens' demand. Rather than post the large bond or pursue other legal avenues, Loewen decided to settle the case with O'Keefe, and on January 29, 1996, the company settled for approximately $150 million, 30% of the jury verdict.

On October 30, 1998 Loewen filed suit against the United States in ICSID under Chapter Eleven of the NAFTA. Although Loewen only paid out a fraction of the original jury award, the company demanded $725 million in compensation from the U.S. government, arguing that the verdict (including the punitive damages) and the bond requirement violated its rights as an investor under Article Eleven of NAFTA. The company claimed that the judge allowed the plaintiff's attorney to appeal to the "anti-Canadian, racial and class biases" of a Mississippi jury in violation of national treatment rules in NAFTA Article 1102. The company also claimed that the bond requirement effectively forced Loewen to settle, denying its right to appeal in violation of Article 1105 (requiring fair and equitable treatment). Finally, Loewen argued that "the excessive verdict, denial of appeal, and coerced settlement were tantamount to an uncompensated expropriation in violation of Article 1110 of NAFTA."

Loewen represented the first instance in which a jury ruling has been challenged under NAFTA. In March 1999, ICSID formed a NAFTA panel to hear the case consisting of Anthony Mason (Australia), L. Yves Fortier (Canada), and former Congressman and U.S. federal court judge Abner J. Mikva. On January 9, 2001, the panel issued an interim decision rejecting a variety of U.S. arguments, including the argument that a jury decision in private contract litigation did not constitute a governmental measure under NAFTA. Instead, the panel found NAFTA jurisdiction, and placed no limits on what types of court action or decision it considers covered by NAFTA rules. This ruling opens up the possibility that all court decisions, even those of the U.S. Supreme Court, are now open to review by NAFTA tribunals.

The Judgment of the ICSID Arbitration Panel

In its award on the merits, the tribunal concluded "that the conduct of the trial by the trial judge was so flawed that it constituted a miscarriage of justice amounting to a manifest injustice as that expression is understood in international law."[59] The tribunal faulted the trial judge for allowing several different kinds of prejudicial behavior: repeated references to Loewen's Canadian nationality,[60] suggestions that Loewen did business only with white people,[61] and appeals to class-based prejudice.[62] Article 1105(1) provides: "Each party shall accord to investments of investors of another party treatment in accordance with international law, including fair and equitable treatment and full protection and security." Although Loewen did not establish that the judge or jury was actually biased against it, the tribunal concluded that "bad faith or malicious intention" was not required. "Manifest injustice in the sense of a lack of due process leading to an outcome which offends a sense of judicial propriety is enough. . . . "[63] Applying this standard, the tribunal said that "the whole trial and its resultant verdict were clearly improper and discreditable and cannot be squared with minimum standards of international law and fair and equitable treatment."[64]

[59] *Loewen Group, Inc. v. United States*, ICSID Case No. ARB(AF)/98/3 (NAFTA Ch. 11 Arb. Trib. June 26, 2003), para. 54. Publicly released documents on all NAFTA disputes are available online at www.naftalaw.org. A pdf of this case can be found at http://www.state.gov/documents/organization/22094.pdf.

[60] *Id*. paras. 56–64.

[61] *Id*. paras. 65–67.

[62] *Id*. paras. 68–70.

[63] *Id*. para. 132.

[64] *Id*. para. 137.

Yet the tribunal rejected the Loewen's Article 1105 claim because it had failed to exhaust its domestic remedies in the U.S. judicial system. LG had failed to pursue its domestic remedies, noting that Loewen should have taken the judicial process to the highest level before resorting to a NAFTA-ICSID tribunal. If this were not true, the tribunal noted, "it would encourage resort to NAFTA tribunals rather than resort to the appellate courts and review processes of the host State, an outcome which would seem surprising, having regard to the sophisticated legal systems of the NAFTA Parties. . . . Further, it is unlikely that the Parties to NAFTA would have wished to encourage recourse to NAFTA arbitration at the expense of domestic appeal or review when, in the general run of cases, domestic appeal or review would offer more wide-ranging review, as they are not confined to breaches of international law.[65] "The central difficulty in Loewen's case," the tribunal concluded, was that "Loewen failed to present evidence disclosing its reasons for entering into the settlement agreement in preference to pursuing other options, in particular the Supreme Court option. . . . "[66]

The tribunal did offer an explanation as to why it had declined to correct what it saw as a clear miscarriage of justice. Emphasizing the limits of review in Chapter 11 cases, the tribunal stated: "As we have sought to make clear, we find nothing in NAFTA to justify the exercise by this Tribunal of an appellate function parallel to that which belongs to the courts of the host nation. In the last resort, a failure by that nation to provide adequate means of remedy may amount to an international wrong but only in the last resort. . . . Too great a readiness to step from outside into the domestic arena, attributing the shape of an international wrong to what is really a local error (however serious), will damage both the integrity of the domestic judicial system and the viability of NAFTA itself."[67]

Casepoint

Investors based in Canada, Mexico, or the United States may bring Chapter 11 investment protection claims to ICSID or UNCITRAL arbitration alleging failure of the host government to provide national treatment or failure to expropriate in accordance with international law standards. Challenges can be brought not only for legislative acts, but also for acts of judicial bodies. However, the claimant must completely exhaust domestic judicial remedies before resorting to an arbitral tribunal.

Provisional Measures and Awards An ICSID tribunal has the power to recommend provisional measures to preserve the respective rights of the parties (Article 47) and to issue binding awards (Article 53).

Awards issued by an ICSID tribunal are binding but not final. The tribunal itself can review an award either to interpret it (Article 50) or to revise it (Article 51). Appeal is also allowed to an *ad hoc* committee that has the power to annul an award.[68] An annulment proceeding was instituted in the *AMCO Asia Case* following a decision by the tribunal to award AMCO U.S. $2,472,490. The *ad hoc* committee determined that the evidence showed losses by AMCO of only $983,992, and it accordingly annulled the "award as a whole."[69]

Enforcement ICSID awards are binding on the parties to an arbitration, and the states parties to the Washington Convention agree to comply with them. The courts of the states parties (including the courts of the state that was a party to the arbitration) are forbidden to review the award (Article 53), and the states themselves are obliged to enforce the pecuniary provisions of the award as if it were

[65] *Id.*, para. 162.

[66] *Id.* para. 215.

[67] *Id.* para. 232.

[68] *Id.*, Article 52. The *ad hoc* committee consists of three persons appointed from the Panel of Arbitrators by the chairman of the Administrative Council (i.e., the president of the World Bank). Appeals to such a committee are allowed on the grounds "(a) that the Tribunal was not properly constituted; (b) that the Tribunal has manifestly exceeded its powers; (c) that there was corruption on the part of a member of the Tribunal; (d) that there has been a serious departure from a fundamental rule of procedure; or (e) that the award has failed to state the reasons on which it is based." *Id.*

[69] *AMCO Asia Corp. et al. (United States) v. Indonesia (Annulment)*, *International Legal Materials*, vol. 26, p. 467 (1987).

a final judgment of their own courts (Article 54). Should the courts of a state party to an ICSID arbitration seek to review an award, an investor can seek diplomatic remedies from its home state, and other states parties to the convention can protest as well. In Case 3-2, a principal advantage of ICSID awards can be seen: They are enforceable in any state that is a party to the Washington Convention. But note also the difficulties of collecting against sovereign assets not used for commercial purposes.

Other Arbitration Tribunals

Arbitration between private parties is not normally done on a purely *ad hoc* basis, with the parties appointing arbitrators and devising procedures and rules for the conduct of a proceeding on their own. More often, the parties agree in advance to resolve their disputes using existing guidelines set up by one of several international arbitration organizations. The most prominent of these organizations are the American Arbitration Association, the London Court of International Arbitration, the International Chamber of Commerce, and the United Nations Commission on International Trade Law (UNCITRAL).[70] Each has an established set of arbitration rules, and each maintains a panel (or list) of qualified arbitrators.[71] Despite some differences, the basic procedures used by all of them are similar and are analogous to the procedures of the World Bank's ICSID.

forum state
(Forum, from Latin: "an open square" or "market-place"; in Roman times, citizens met here to conduct business.) Forum state: the nation-state in which the court, or forum, conducts its business.

C. Settlement of Disputes in Municipal Courts

Municipal courts (also known as the "domestic" courts of various nation-states) are often called upon to settle international disputes—typically, those disputes between individuals and corporations from different nation-states, and sometimes even disputes involving sovereign states. These can include crimes and torts where the wrongful act occurred outside of the **forum state**, or in contract disputes where the contract was neither made nor performed in the forum state.

The competence or ability of a municipal court to exercise the power to try a case is known as *jurisdiction*. Under international law, the jurisdiction of municipal courts to try an international dispute is limited. Most governing rules are prohibitory—that is, they limit the court's powers. Indeed, there are few situations where international law requires a municipal court to take a case contrary to its wishes.

immunity
(From Latin *immunitas:* "freedom from public service.") Freedom or exemption from a burden or duty, such as from the obligation to appear before a court.

The ability of a defendant to escape the jurisdiction of a court is known as **immunity**. Natural and juridical persons have few (if any) immunities from the powers of a municipal court. Foreign states traditionally have had complete immunity, but this situation has changed substantially in the past 50 years. State agencies that carry out commercial activities (such as national airlines or national shipping lines) are now commonly treated as having no immunity.

Jurisdiction in Criminal Cases

Jurisdiction over criminal matters by municipal courts has some relevance for international business law, but this chapter focuses more on civil controversies. Briefly, however, criminal prosecutions are conducted in accordance with international law principles where there is some connection, or "nexus," between the regulating nation (the forum) and the crime or criminal.

territoriality nexus
Criteria that allow a court to assume criminal jurisdiction over an offense that was committed within the forum state.

Four nexuses have been invoked by courts to justify their exercise of jurisdiction (1) The **territoriality nexus** holds that the place where an offense is committed—in whole or in part—determines jurisdiction.[72] (2) The **nationality nexus** looks to the nationality or national character of the person

nationality nexus
Criteria that allow a court to assume criminal jurisdiction when the defendant is a national of the forum state.

[70]The American Arbitration Association can be found on the Internet at www.adr.org; the International Chamber of Commerce at www.iccwbo.org; and UNCITRAL at www.uncitral.org.

[71]For a comparison of these organizations from an American perspective, see Steven J. Stein and Daniel R. Wotman, "International Commercial Arbitration in the 1980s: A Comparison of the Major Arbitral Systems and Rules," *Business Lawyer*, vol. 38, p. 1685 (1983).

[72]An offense does not have to be consummated within the forum's territory for the forum to have jurisdiction. If an offense is commenced within the forum, even if it is completed or consummated abroad, the forum will have jurisdiction. Harvard Research in International Law, "Jurisdiction with Respect to Crime," *American Journal of International Law*, vol. 35, p. 435 at pp. 484–487 (1935). Logically, jurisdiction based on the place where an offense was commenced is the converse of jurisdiction based on the effects nexus, which focuses on the place where the offense is consummated. See *id.* at pp. 487–494.

committing the offense to establish jurisdiction.[73] (3) The **protective nexus** provides for jurisdiction when a national or international interest of the forum is injured by the offender.[74] (4) The **universality nexus** holds that a court has jurisdiction over certain offenses that are recognized by the community of nations as being of universal concern, including piracy, the slave trade, attacks on or the hijacking of aircraft, genocide, war crimes, and crimes against humanity.[75]

protective nexus
Criteria that allow a court to assume criminal jurisdiction in cases in which a national interest of the forum state was injured.

It is not enough that these nexuses exist; the connection between the forum and the person or activity also must be *reasonable*.[76] In determining reasonableness, courts consider one or more of the following factors, depending on the circumstances of the particular case:

- The extent to which the criminal or regulated activity takes place, or has a substantial, direct, and foreseeable effect, within the territory of the forum;
- The extent to which the defendant or the injured party has a *genuine link* (i.e., an ongoing and real relationship) with the forum;
- The character of the activity (i.e., its importance to the forum, whether other countries regulate it, and the extent to which countries generally regard it as appropriate for regulation);
- The extent to which justified expectations will be protected or harmed by the regulation;
- The extent to which another country has an interest in regulating the activity and the likelihood of a conflict with those regulations;
- The importance of the regulation to the international community; and
- The extent to which the regulation is consistent with the traditions of the international community.

universality nexus
Criteria that allow a court to assume criminal jurisdiction if the offense is one recognized by the international community as being of universal concern.

It is important to note that the four nexuses are not mutually exclusive.

Jurisdiction in Civil Cases

In civil suits, municipal courts can extend their jurisdiction over disputes between parties who appear within the territory of the forum state. Such jurisdiction is based on either *in personam*[77] or *in rem*[78] principles.

Jurisdiction over Persons

***In personam* jurisdiction** is the power of a court to decide matters relating to a natural or juridical person physically present within the forum state. Natural persons subject to *in personam* jurisdiction include nationals of the forum state, individuals physically present within the state, individuals domiciled in the state, and individuals who consent to such jurisdiction. Consent to personal jurisdiction can come about in any of the following ways: by the individual appearing in court after a suit has commenced, by a party agreeing to the personal jurisdiction of a particular court in a forum

***in personam* jurisdiction**
The power of a court or tribunal to determine the rights of a party who appears before it.

[73]Restatement (Third) of Foreign Relations Law of the United States, §404 (1987). See www.ali.org/ali/foreign.htm.

[74]*Id*. §404.

[75]*Id*. §404 states that the universal nexus may "perhaps" include "certain acts of terrorism." *Id*. Comment b asserts that "[u]niversal jurisdiction is increasingly accepted for certain acts of terrorism, such as assaults on the life or physical integrity of diplomatic personnel, kidnapping, and indiscriminate violent assaults on people at large," *Id*. §404, comment b, but it cites no cases or commentaries in support of its contention. It seems more likely, in light of the terrorist attacks on September 11, 2001, and the ensuing military action in Afghanistan, that the courts and commentators will treat terrorist acts as crimes against humanity. Crimes against humanity were originally defined in Article 6(c) of the Charter of the International Military Tribunal established after World War II (the Nuremberg Tribunal) as "murder, extermination, enslavement, deportation, and other inhumane acts committed against any civilian population." Charter of the International Military Tribunal, Nuremberg Trial Collection, The Avalon Project, Yale Law School at http://avalon.law.yale.edu/imt/imtconst.asp. Because this broad definition includes the usual definition of terrorism (which is typically described as "the sustained clandestine use of violence, including murder, kidnapping, and bombings, for a political purpose") it seems unnecessary to define terrorism separately as one of the crimes covered by the universality nexus. See Ray August, *Public International Law*, pp. 345–346 (1995).

[76]Restatement (Third) of Foreign Relations Law of the United States, §403 (1987) universality nexus: Criteria that allows a court to assume criminal jurisdiction if the offense is one recognized by the international community as being of universal concern.

[77]From Latin: "against the person."

[78]From Latin: "against the thing."

selection clause contained in a contract, or by a party appointing an agent within a state to receive service of process on his behalf.

As we mentioned earlier, juridical persons (or *persona ficta*[79]) are entities, other than natural persons, that have sufficient existence in the eyes of the law to function legally, sue and be sued, and make decisions through agents. Examples are business entities (including associations and corporations) and governmental and IGOs. Juridical persons are subject to the *in personam* jurisdiction of a municipal court in much the same way that individuals are. Thus, legal entities created within a state are nationals of that state—they are called *domestic entities*—and they may sue or be sued there. Foreign entities, however, are amenable to the jurisdiction of another state's municipal courts only if (1) they are recognized in law as juridical persons and (2) they give their consent. Governments and IGOs, accordingly, must be formally recognized, while other foreign entities (including business firms) must be created as juridical persons by recognized governments. Case 3-3 explores the requirement of recognition.

CASE 3-3 Bumper Development Corp. Ltd. v. Commissioner of Police of the Metropolis and Others (Union of India and Others, Claimants)

England, Court of Appeal, Civil Division, 1991
All England Law Reports, vol. 1991, p. 4, p. 638 (1991)

MAP 3.3

Tamil Nadu State, India (1991)

In 1976, an Indian laborer named Ramamoorthi, who lived near the site of a ruined Hindu temple at Pathur in the Indian state of Tamil Nadu, was excavating sand when his spade struck a metal object. The object was part of a series of bronze Hindu idols from the Chola period (ninth to thirteenth century A.D.); among these was a major idol (shown in Figure 3.4) known as the Siva Nataraja (or Pathur

[79]From Latin: "fictional person."

FIGURE 3.4

A Nataraja Bronze Chola from Tenth-Century Tamil Nadu (National Museum of New Delhi, India)

Source: Angelo Hornak/Alamy

Nataraja because of its place of discovery).[80] Ramamoorthi realized that he had discovered something of value, and he eventually sold the Pathur Nataraja to a dealer in religious objects. The Pathur Nataraja was in turn sold several times, with the last identified buyer being a man named Valar Prakash, who could not be traced but was last seen in Madras.

At about the time that these sales were occurring, state officials in Tamil Nadu learned of them and began criminal investigations. Statements were taken from Ramamoorthi and others about the discovery of the Pathur Nataraja and its subsequent history. As of 1982, however, the whereabouts of the idol was unknown.

Although the Pathur Nataraja was lost, several other artifacts found at the temple site in Pathur remained at that place. Among them was a stone object of religious worship known as a Sivalingam.[81] In the typical Chola-period Hindu temple, this stone would have been positioned in the sanctum and would have been the focus of religious worship. Following its discovery, the Sivalingam was reinstated as an object of worship at the site of the ruined temple in Pathur.

In June 1982, Bumper Development Corp., Ltd. (Bumper), purchased in good faith in London a Siva Nataraja (the London Nataraja) from a dealer named Sherrier, who had produced a false provenance[82] of the idol for the purpose of making the sale. Bumper then sent the idol to the British

---

[80]A Siva Nataraja is a representation of the Hindu god Siva (or Shiva), the destroyer, who is one of the three chief Hindu gods (Brahma, the creator, and Vishnu, the preserver, being the other two). As the Court of Appeal said: "The Siva Nataraja can be described in a thumb-nail sketch as the god standing with his right foot upon a dwarf and surrounded by a 'halo' which represents the flames issuing from the mouths of two crocodiles situated to the left and right of the dwarf. At the top of the halo in some Natarajas there is to be found a design either in the form of a mask or a rosette or similar adornment known as a '*Kurti Muka*.' Round the halo there are a number of 'flames' issuing radially from the halo." Depending on the period when and the area in which they were made, the Siva Natarajas vary in many respects. The one with which this appeal is concerned is circular, but many others are oval in shape. The Nataraja with which this appeal is concerned had a lotus base mounted on a square-shaped *peedam* or pedestal.

"Returning to Siva, the design again varies according to date and place. The Chola Natarajas have a number of identifying features. . . . The god has two right and two left arms and hands but only two legs, right and left. He has on each side of his head horizontally flowing hair described as *jettas*. Various objects and representations are imposed upon or incorporated in the *jettas*, including a particular one called a '*ganga*.' In one of his right hands and around the wrist there is coiled a snake—a cobra. In one of his left hands he holds another flame. . . . "

[81]The Court of Appeal described it as "a carefully fashioned stone object representing a phallus."

[82]From French *provenir*: "to come forth with" or "to originate." A *provenance* is the history of ownership of a valued object, work of art, or literature.

Museum for appraisal and conservation. While the London Nataraja was at the British Museum, it was seized by the London Metropolitan police in compliance with the British government's policy of returning stolen religious artifacts to their owners. Bumper then brought this suit against the commissioner of police of the Metropolis of London and two of his officers seeking return of the London Nataraja.

At the trial, five claimants intervened in the case. They were the Union of India (the first claimant), the state of Tamil Nadu (the second claimant), and [an individual] on his own behalf (as the third claimant) and on behalf of the temple itself (the fourth claimant). The Sivalingam, which had been reinstated as an object of worship at the temple site in Pathur after the trial had begun, was later added as an additional claimant (the fifth claimant). All of the claimants asserted that they were the rightful owners of the London Nataraja, which they claimed was one and the same as the Pathur Nataraja.

The trial court judge, Judge Ian Kennedy, held that the evidence of Ramamoorthi and others who had seen the Pathur Nataraja in 1976, as well as expert metallurgical, geological, and entomological evidence, proved that the Pathur Nataraja and the London Nataraja were one and the same. The judge also held that the temple at Pathur and the Sivalingam both had superior title to the Nataraja and that they were entitled to possession of the idol. Bumper appealed to the Court of Appeal.

The Court of Appeal first held that the evidence supported Judge Kennedy's conclusion that the London and Pathur Natarajas were the same. It then held that the law of the state of Tamil Nadu regarded the temple at Pathur as a juridical entity that possessed the right to sue and be sued and to own and possess property. The Court of Appeal then considered whether or not English law would look upon the temple as a legal entity.

Opinion by Lord Justice Purchas

Having held that the temple is a legal person under the law of Tamil Nadu acceptable in the courts of that state as a party which, with the third claimant acting as representative, could have sued for the recovery of the Nataraja, we must now decide whether, as the judge held, it is likewise acceptable in the courts of this country.

The question whether a foreigner can be a party to proceedings in the English courts is one to be determined by English law (as the *lex fori*).[83] In the case of an individual no difficulty usually arises. And the same can be said of foreign legal persons which would be recognized as such by our own law, the most obvious example being a foreign trading company. It could not be seriously suggested that such a company could not sue in the English courts to recover property of which it was the owner by the law of the country of its incorporation.

The novel question which arises is whether a foreign legal person which would not be recognized as a legal person by our own law can sue in the English courts. The particular difficulty arises out of [the] English law's restriction of legal personality to corporations or the like, that is to say, the personified groups or series of individuals. This insistence on an essentially animate content in a legal person leads to a formidable conceptual difficulty in recognizing as a party entitled to sue in our courts something which on one view is little more than a pile of stones.

There is an illuminating treatment of legal personality in *Salmond on Jurisprudence*,[84] from which we take two passages:

> Legal persons, being the arbitrary creations of the law, may be of as many kinds as the law pleases. Those which are actually recognized by our own system, however, are of comparatively few types. Corporations are undoubtedly legal persons, and the better view is that registered trade unions and friendly societies are also legal persons though not verbally regarded as corporations. . . . No other legal persons are at present recognized by English law. If, however, we take account of other systems than our own, we find that the conception of legal personality is not so

[83]From Latin: "law of the forum." The law of the state where the court hearing a case is located.

[84]Pp. 306–308 (12th ed., 1966).

> limited in its application, and that there are several distinct varieties, of which three may be selected for special mention. They are distinguished by reference to the different kinds of things which the law selects for personification. 1. The first class of legal persons consists of corporations, as already defined, namely, those which are constituted by the personification of groups or series of individuals. The individuals who thus form the *corpus*[85] of the legal person are termed its members. . . . 2. The second class is that in which the *corpus*, or object selected for personification, is not a group or series of persons, but an institution. The law may, if it pleases, regard a church or a hospital, or a university, or a library, as a person. That is to say, it may attribute personality, not to any group of persons connected with the institution, but to the institution itself. Our own law does not, indeed, so deal with the matter. The person known to the law of England as the University of London is not the institution that goes by that name, but a personified and incorporated aggregate of human beings, namely, the chancellor, vice-chancellor, fellows, and graduates. It is well to remember, however, that notwithstanding this tradition and practice of English law, legal personality is not limited by any logical necessity, or, indeed, by any obvious requirement of expediency, to the incorporation of bodies of individual persons.

Thus *Salmond on Jurisprudence* recognizes the possibilities which may not be farfetched, of (say) a foreign Roman Catholic cathedral having legal personality under the law of the country where it is situated; and, in order to make the concept more comprehensible, let it be assumed that it is given that personality by legislation specifically empowering it to sue by its proper officer for the protection and recovery of its contents. It would, we think, be a strong thing for the English court to refuse the cathedral access simply on the ground that our own law would not recognize a similarly constituted entity as a legal person. The touchstone for determining whether access should be given or refused is the comity of nations, defined by the *Shorter Oxford English Dictionary*[86] as:

> The courteous and friendly understanding by which each nation respects the laws and usages of every other, so far as may be without prejudice to its own rights and interests.

Arguing from the example of a Roman Catholic cathedral and in the belief that no distinction between institutions of the Christian church and those of other major religions would now be generally acceptable, we cannot see that in the circumstances of this case there is any offense to English public policy in allowing a Hindu religious institution to sue in our courts for the recovery of property to which it is entitled by the law of its own country. Indeed we think that public policy would be advantaged. . . .

***

We therefore hold that the temple is acceptable as a party to these proceedings and that it is as such entitled to sue for the recovery of the Nataraja.

***

For the reasons set out in this judgment we dismiss the appeal on the ground that Judge Ian Kennedy correctly decided that the temple had a title to the Nataraja superior to that enjoyed by Bumper.

Casepoint

Although in England institutions do not have separate personalities, this does not mean that other countries cannot recognize institutions as having separate legal personalities. If other countries recognize an institution (such as a church or a temple) as an entity with the right to sue or be sued, it is proper for the English courts to accept them as parties in suits brought before them.

[85] From Latin: "body."

[86] 3rd ed., 1944.

forum selection clause
A provision in a contract designating a particular court or tribunal to resolve any dispute that may arise concerning the contract.

As is the case for natural persons, a juridical person's consent to the jurisdiction of a foreign court may be given expressly or it may be implied. An example of express consent is a **forum selection clause**, that is, a clause in a contract that names the court or arbitration tribunal the parties want to have resolve any disputes relating to the contract. Consent will be implied if there are enough *contacts* between the juridical person and the foreign state. In the United States, for example, the Supreme Court has said that there must be at least certain minimum contacts that allow a court in fairness to extend its jurisdiction over a foreign corporation.[87] In determining if there are enough contacts, courts have to consider (1) whether the company has performed acts that relate to the forum state, (2) whether the suit is based on those acts, and (3) whether the company has indicated by its conduct that it intended to rely on the benefits (such as doing business) of the forum state.[88]

The enforceability of international forum selection clauses is examined in Case 3-4.

CASE 3-4 Shell v. R. W. Sturge, Ltd.

United States Sixth Circuit Court of Appeals
Federal Reporter, Third Series, vol. 55, p. 1227 (1995)[89]

MAP 3.4

London (1995)

Opinion by Judge Kennedy

Plaintiffs, investors in the Society of Lloyd's, brought this diversity action[90] against defendants R. W. Sturge, Ltd., the Society of Lloyd's, the Council of Lloyd's and the Corporation of Lloyd's seeking to rescind their investment contracts under Ohio securities law. Defendants filed a motion

[87] *International Shoe Co. v. State of Washington*, *United States Reports*, vol. 326, p. 310 (Supreme Ct., 1945).

[88] See Case 4-6, *Asahi Metal Industry Co., Ltd. v. Superior Court of California*, for an example of a juridical person's implied consent to the jurisdiction of a foreign court.

[89] The text of this opinion is posted on the FindLaw Web site at http://caselaw.findlaw.com/us-6th-circuit/1336564.html.

[90] A diversity action means a case filed in U.S. federal court based on the fact that plaintiffs and defendants are from different U.S. states, or from different nation-states. In such cases, the federal court will use federal procedural law to conduct the case, but the substantive rules of law will not be U.S. federal law, but may be state law or international law.

to dismiss for improper venue under Rule 12(b) (3) of the *Federal Rules of Civil Procedure* on the grounds that forum selection clauses in the investment contracts gave exclusive jurisdiction to the English courts. The District Court granted the motion to dismiss and plaintiffs now appeal, arguing that the forum selection clauses deprive them of their substantive rights under the Ohio securities laws and that Ohio public policy outweighs the policies served by enforcing the forum selection clauses. For the following reasons, we affirm.

I

The Society of Lloyd's, or Lloyd's of London (Lloyd's; see Figure 3.5), is not an insurance company, but rather is an insurance marketplace in which individual Underwriting Members, or Names, join together in syndicates to underwrite a particular type of business. The Corporation of Lloyd's (Corporation), which was created by an Act of Parliament, regulates the Lloyd's insurance market. The Corporation itself does not underwrite any insurance, but provides facilities and services to assist underwriters. The Corporation is managed by the Council of Lloyd's (Council) which controls the admission and discipline of Names, sets the Names' reserve requirements and establishes standards for Lloyd's policies.

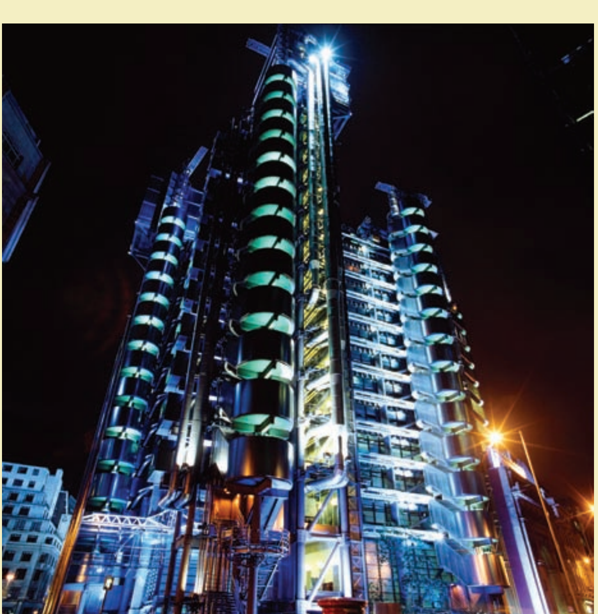


FIGURE 3.5

The Lloyd's of London Building

Source: Peter Stone/Alamy

To become a Name, one must apply and be sponsored by an existing member. Applicants must pass a means test to determine that they possess sufficient assets to satisfy claims. Those accepted as Names are required to obtain a letter of credit in favor of Lloyd's to serve as a security. The amount of the letter of credit, as well as a Name's means, determines the premium limit for each Name.

A Name cannot conduct insurance business directly, but instead enters into an Agency Agreement with a Members' Agent who acts on the Name's behalf. Names typically belong to several syndicates in order to spread their risks and the Members' Agents assist the Names in selecting the syndicates to join. Each Name is responsible for his or her proportionate share of a syndicate's losses up to his or her entire net worth.

Plaintiffs Andrew Hauck and West Shell are representatives of a class of Cincinnati-area individuals who invested in Lloyd's as Names. Each plaintiff executed a General Undertaking Agreement (General Agreement) with Lloyd's to become a Name. These General Agreements contain both a forum selection and a choice of law clause. The forum selection clause provides:

> Each party hereto irrevocably agrees that the courts of England shall have exclusive jurisdiction to settle any dispute and/or controversy of whatsoever nature arising out of or relating to the Member's membership of, and/or underwriting of insurance business at, Lloyd's. . . .

The choice of law clause states:

> The rights and obligations of the parties arising out of or relating to the Member's membership of, and/or underwriting of insurance business at, Lloyd's and any other matter referred to in this Undertaking shall be governed by and construed in accordance with the laws of England.

Each plaintiff also executed an Agency Agreement with R. W. Sturge, Ltd. ("Sturge"), appointing Sturge as his Members' Agent. The Agency Agreements contain choice of law and forum selection clauses:[91]

23. English Law:

This Agreement shall be read and construed and take effect in all respects in accordance with English Law.

24. English Jurisdiction:

Subject to Clause 22 hereof [permitting arbitration in London] the parties hereto irrevocably and unconditionally submit for all purposes of and in connection with this Agreement to the exclusive jurisdiction of the English Courts.

In most years, plaintiffs received profits, but in recent years they suffered losses. Although the outcome of their investments with Lloyd's is as yet undetermined, plaintiffs believe that their total losses will far exceed their profits.

On November 1, 1993, plaintiffs filed this action in the Court of Common Pleas in Hamilton County, Ohio, alleging that defendants Sturge, Lloyd's, the Corporation, and the Council violated Ohio securities law by selling unregistered and non-exempt securities in violation of chapter x1707 of the OHIO REVISED CODE. Under OHIO REVISED CODE §1707.43, "[e]very sale or contract for sale made in violation of Chapter x1707 of the REVISED CODE, is voidable at the election of the purchaser." Plaintiffs sought to rescind the contracts and be returned to their original positions, offering to return any benefits which they had received from their investments with Lloyd's.

Defendants removed the action to the United States District Court for the Southern District of Ohio and filed a motion to dismiss for improper venue. Defendants have stipulated for purposes of their motion to dismiss that this action involves a security under Ohio securities law. A magistrate judge, following a hearing, recommended that the motion to dismiss for improper venue be granted. The District Court adopted this recommendation on December 22, 1993. Plaintiffs now appeal.

II

The enforceability of a forum selection clause is a question of law which we review de novo. The parties do not address the issue of whether federal or state law applies in determining the enforceability of forum selection clauses in a diversity action. However, we need not decide this issue because both Ohio and federal law treat these clauses in a similar manner.

A forum selection clause in an international agreement "should control absent a strong showing that it should be set aside."[92] As the majority noted in *The Bremen v. Zapata Of-Shore Co.*, "[t]he correct approach [is] to enforce the forum clause specifically unless" plaintiffs "[can] clearly show that enforcement would be unreasonable and unjust, or that the clause was invalid for such reasons as fraud or overreaching."[93] The presumptive validity of the forum selection clause may also be set aside if plaintiffs can show that "trial in the contractual forum will be so gravely difficult and inconvenient that [they] will for all practical purposes be deprived of [their] day in court" or if "enforcement would contravene a strong public policy" of the forum state.

[91]The Agency Agreements also contain a clause permitting arbitration in London at the request of either party. Defendants contend that the District Court's dismissal of this action can be upheld on the alternate ground that this arbitration clause is enforceable. Because we find the forum selection clause to be enforceable, we need not address this issue.

[92]Interamerican Trade Corp., *Federal Reporter, Second Series*, vol. 973, p. 487 at p. 489; The Bremen v. Zapata Off-Shore Co., *United States Reports*, vol. 407, p. 1 (Supreme Ct., 1972).

[93]Bremen, *United States Reports*, vol. 407 at p. 15.

In *The Bremen v. Zapata Off-Shore Co.* the Supreme Court emphasized the importance of upholding forum selection and choice of law clauses in international contracts. *Bremen* involved a contract for towing a drilling rig from Louisiana to Italy with a provision for judicial resolution of disputes in England. The Court observed:

> The expansion of American business and industry will hardly be encouraged if, notwithstanding solemn contracts, we insist on a parochial concept that all disputes must be resolved under our laws and in our courts.

Subsequently, in *Scherk v. Alberto-Culver Co.* the Court considered the validity of clauses providing for arbitration in France under Illinois law in a contract for the sale of several German businesses. In upholding the clauses, the Court stated:

> [U]ncertainty will almost inevitably exist with respect to any contract touching two or more countries, each with its own substantive laws and conflict-of-laws rules. A contractual provision specifying in advance the forum in which disputes shall be litigated and the law to be applied is, therefore, an almost indispensable precondition to achievement of the orderliness and predictability essential to any international business transaction.

The *Scherk* Court also discussed the danger of ignoring contractual dispute resolution provisions:

> A parochial refusal by the courts of one country to enforce an international arbitration agreement would not only frustrate these purposes, but would invite unseemly and mutually destructive jockeying by the parties to secure tactical litigation advantages.

Given this background, we will now examine the enforceability of the forum selection provisions at issue in this appeal.

Plaintiffs contend that the clause is unenforceable because, together with the choice of law clause, it deprives investors of their substantive rights under Ohio securities law. Plaintiffs argue that they are entitled to a remedy based on what they classify as a "merit review" process under OHIO REVISED CODE §1707.13. Section 1707.13 permits the Ohio Division of Securities to prohibit the sale of securities which are "being disposed of or purchased on grossly unfair terms, in such manner as to deceive or defraud . . . purchasers or sellers. . . . " Plaintiffs rely on *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*,[94] an antitrust action where the Court enforced a clause providing for arbitration in Japan. The *Mitsubishi* Court did not decide whether the choice of law clause providing for Swiss law should be upheld, but noted in dicta[95] that if the forum selection and choice of law clauses "operate . . . in tandem as a prospective waiver of a party's right to pursue statutory remedies for antitrust violations," the Court would find the agreement to be against public policy.

The Second Circuit addressed this issue in *Roby v. Corporation of Lloyd's*,[96] where the plaintiff Names, whose contracts contained substantially the same clauses as those in the present action, brought a federal securities and RICO[97] action against Lloyd's' syndicates and agents. The Names argued that the contract clauses effectively waived compliance with United States securities laws despite the anti-waiver provisions of these laws. The *Roby* court noted that forum selection and choice of law clauses could not be circumvented merely because foreign law or procedure might be different or less favorable than that of the United States.[98] "Instead, the question is whether the application of the foreign law presents a danger that the . . . Names 'will be deprived of any remedy or treated unfairly.' "[99] The court rejected the plaintiffs' arguments because it found that they had

---

[94]*United States Reports*, vol. 473, p. 614 (Supreme Ct., 1985).

[95]"Dicta" are comments and thoughts from the court that are not essential to the decision or "holding" of the court.

[96]*Federal Reporter, Second Series*, vol. 996, p. 1353 (2d Circuit Ct. of Appeals), certiorari denied, *Supreme Court Reporter*, vol. 114, p. 385 (1993).

[97]Racketeer Influenced and Corrupt Organizations Act, United States Code, title 18, §1961 et seq.

[98]*Federal Reporter, Second Series*, vol. 996 at p. 1363; Mitsubishi Motors, *United States Reports*, vol. 473 at p. 629.

[99]Roby, *Federal Reporter, Second Series*, vol. 996 at p. 1363 (quoting *Piper Aircraft Co. v. Reyno*, *United States Reports*, vol. 454, p. 235 at p. 255 (1981)).

ample remedies under English law and nothing suggested that the English courts were biased or unfair. Both the Seventh and Tenth Circuits have also reached this result. In *Bonny v. Society of Lloyd's*[100] and *Riley v. Kingsley Underwriting Agencies, Ltd.*[101] some Names ignored the forum selection provisions in their contracts and brought suits in the United States alleging violations of state and federal securities law and common law fraud. The Seventh and Tenth Circuits examined English law and concluded that the Names would be able to adequately pursue their claims in England.

We agree that plaintiffs have remedies which they can pursue in England. Plaintiffs seek rescission of their contracts under OHIO REVISED CODE §1707.43. The uncontroverted affidavit of Barrister John Lewis Powell shows that "[o]ne of the remedies under English law for misrepresentation (whether innocent, negligent or fraudulent) is rescission" and that a plaintiff "may also be entitled to an indemnity against liabilities incurred." Powell's affidavit also shows that plaintiffs can bring claims against defendants based on the tort of deceit, breach of contract, negligence, and breach of fiduciary duty.

Although the Lloyd's Act of 1982 provides Lloyd's some immunity from damages, it does not preclude Names from obtaining injunctive, declaratory, rescissionary or restitutionary relief or preclude Names from damages where Lloyd's has acted in bad faith.

Furthermore, Section 47 of England's Financial Services Act of 1986 provides a cause of action for any misleading statement or practice made for the purpose of inducing involvement in an investment agreement.

Finally, England's highest appellate court recently upheld a lower court's ruling that Member's Agents can be contractually liable for negligent underwriting by the Managing Agents who run the insurance syndicates at Lloyd's.[102]

According to plaintiffs, the remedies available in England are not the equivalent of the merit review because they are grounded in misrepresentation and fraud and do not address the underlying wrong of defendants' alleged failure to subject themselves to Ohio's registration requirements. The fact that parties will have to structure their case differently than if they were litigating in federal court is not a sufficient reason to defeat a forum selection clause. We adopt the Second Circuit's reasoning [in *Roby*] in rejecting this argument:

It defies reason to suggest that a plaintiff may circumvent forum selection and arbitration clauses merely by stating claims under laws not recognized by the forum selected in the agreement. A plaintiff simply would have to allege violations of his country's tort law or his country's statutory law or his country's property law in order to render nugatory any forum selection clause that implicitly or explicitly required the application of the law of another jurisdiction. We refuse to allow a party's solemn promise to be defeated by artful pleading.

Plaintiffs next argue that it would be unreasonable to enforce the forum selection clauses in light of the strong public policy behind Ohio's registration and merit review requirements. Citing *Bronaugh v. R & E Dredging Co.*,[103] plaintiffs contend that Ohio's registration requirements are intended to "protect the public from its own stupidity, gullibility, and avariciousness."[104]

The District Court correctly held that under *Bremen*, plaintiffs must show that Ohio public policy outweighs the policies behind "supporting the integrity of international transactions."[105] In *Bonny*, the court upheld the forum selection clauses despite the federal and state policies underlying protection for investors against fraud and nondisclosure. These interests are at least equal to, if not greater than, the interest Ohio has in protecting the public from its own lack of knowledge. We agree with the court in *Bonny* that "[g]iven the international nature of the transactions involved here, and the availability of remedies under British law that do not offend the policies behind the securities laws, the parties' forum selection and choice of law provisions contained in the agreements should be given effect."[106]

. . .

[100]*Federal Reporter, Third Series*, vol. 3, p. 156 (7th Circuit Ct. of Appeals, 1993).

[101]*Federal Reporter, Second Series*, vol. 969, p. 953 (10th Circuit Ct. of Appeals, 1992).

[102]*Deeny v. Gooda Walker Ltd.*, slip op. (Queen's Bench Divisional Ct., Apr. 12, 1994), appeal dismissed, slip opinion (House of Lords, July 25, 1994).

[103]*North Eastern Reporter, Second Series*, vol. 242, p. 572 (Ohio, 1968).

[104]*Id.* at p. 576.

[105]*Federal Supplement*, vol. 850, p. 620 at p. 630 (S.D. Ohio, 1993); Bremen, *United States Reports*, vol. 407 at p. 15.

[106]*Federal Reporter, Third Series*, vol. 3 at p. 162.

III

Accordingly, the District Court's order granting defendants' motion to dismiss is AFFIRMED.

Casepoint

A forum selection clause in an international agreement should be enforced unless the plaintiffs can clearly show that (1) enforcement would be unreasonable and unjust or (2) the clause was invalid for such reasons as fraud and overreaching. Forum selection clauses are presumed to be valid because they provide for orderliness and predictability.

As in the Lloyd's case above, a forum selection clause is often accompanied by a choice of law clause. It is not always true that a forum will apply its own substantive law to a dispute. Courts often have reasons to apply the law of a different state or nation-state. Even if there is no forum selection clause, the contract may have a choice of law clause. For example, in *Shell v. Sturge*, imagine that there was no forum selection clause, but that the contract specified English law as providing the rules to decide a dispute between the parties. The Ohio court (whether state or federal) would probably choose to apply English law, unless that choice seemed entirely arbitrary or unreasonable.

Jurisdiction over Property ***In rem* jurisdiction** is the power of a court to determine the ownership rights of all persons with respect to particular property located within the territory of the forum state. For example, the ownership of real property would be determined by an *in rem* proceeding, as would the ownership of personal property physically within the state (such as a ship arrested in a port within the forum state, as was the case in *The Bremen v. Zapata Off-Shore Company* cited above in *Shell v. Sturge*).

***in rem* jurisdiction** The power of a court to determine the ownership rights of persons as to property located within the forum state.

D. Immunities of States from the Jurisdiction of Municipal Courts

Sovereign states are immune from the jurisdiction of foreign courts (1) when they engage in activities anywhere in the world that are unique to sovereigns and (2) when they act officially within their own territory. The first condition comes under the rubric of sovereign or state immunity, the second under the title of act of state.

Sovereign or State Immunity

The doctrine of **sovereign or state immunity** says that domestic courts must decline to hear cases against foreign sovereigns out of deference to their role as sovereigns.[107] "Historically the rule may be traced to a time when most states were ruled by personal sovereigns who, in a very real sense, personified the state—'*L'Etat c'est moi*.' "[108] In such a period, influenced by the survival of the principle of feudalism and the notion of "the divine right of kings," sovereigns would not permit judgments by its own courts against the public treasury. In its diplomatic relations with other sovereigns, kings would not allow their citizens to bring lawsuits against foreign sovereigns, either. Today the sovereign is not a king, but the government in all of its executive, legislative, and administrative capacities.

sovereign or state immunity Doctrine that municipal courts must decline to hear suits against foreign sovereigns.

Until the middle of the twentieth century, the rule of **absolute sovereign immunity** was generally accepted worldwide. That rule held that a state is absolutely immune and cannot be brought

absolute sovereign immunity Rule that a foreign state is immune from all types of suits.

[107] In *The Schooner Exchange v. McFadden*, *Cranch Reports*, vol. 7, p. 116 (1812), Chief Justice Marshall of the U.S. Supreme Court observed: "[A sovereign] being bound by obligations of the highest character not to degrade the dignity of his nation, by placing himself or its sovereign rights within the jurisdiction of another, can be supposed to enter a foreign territory only under an express license, or in the confidence that the [absolute] immunities belonging to his independent sovereign station, though not expressly stipulated, are reserved by implication, and will be extended to him."

[108] From French: "the state is me."

before a foreign court no matter what it does or what injuries it may cause. This made sense in the days when states were involved in little more than tax collection, law enforcement, and national defense, but it does not make sense now that so many states are engaged in extensive commercial activities. Socialist countries, and those with a socialist history, are involved in operating many kinds of state-owned businesses and sovereign wealth funds that make investments abroad. This includes China, for many years known as the People's Republic of China. Absolute sovereign immunity would mean that individuals and businesses that contracted to buy from or sell goods or services to a foreign state would be unable to sue that state if a state-owned entity in that state breached its contract. Besides being unfair, this is bad business (even for a state-run business), and state governments and municipal courts eventually came to recognize that a change was needed. Lord Denning, then the Master of the Rolls of the English Court of Appeal, once observed:

> When the government of a country enter into an ordinary trading transaction, they cannot afterwards be permitted to repudiate it and get out of their liabilities by saying that they did it out of high governmental policy or foreign policy or any other policy. They cannot come down like a god on to the stage, the *deus ex machina*,[109] as if they had nothing to do with it beforehand. They started as a trader and must end as a trader. They can be sued in the courts of law for their breaches of contract and for their wrongs just as any other trader can. They have no sovereign immunity.[110]

The preamble to the 1976 U.S. Foreign Sovereign Immunities Act[111] states: "The Congress finds that. . . [u]nder international law, states are not immune from the jurisdiction of foreign courts insofar as their commercial activities are concerned, and their commercial property may be levied upon for the satisfaction of judgments rendered against them in connection with their commercial activities."

restrictive sovereign immunity
Theory that a foreign state is not immune when the cause of action for a suit is based on conduct unrelated to the state's governmental activities.

The idea that a state should be responsible in a foreign municipal court for at least some of its conduct led to the adoption in many nation-states of the theory of **restrictive sovereign immunity**. This theory says that a state is immune from suit in cases involving injuries that are the result of its governmental actions (*jure imperii*[112]) but is not immune when the injuries result from a purely commercial or nongovernmental activity (*jure gestionis*[113]). This is now the prevalent rule in the world,[114] although China does not at this time accept the doctrine of restrictive sovereign immunity (see Reading 3-2, below).

Many states have enacted statutes adopting the restrictive sovereign immunity doctrine. Two widely emulated examples are the 1976 U.S. Foreign Sovereign Immunities Act and the 1978 U.K. State Immunity Act, which are remarkably similar in their approach and fairly representative of other acts that have been passed since. Both begin with a universal grant of immunity and then set out exceptions. The U.K. act provides: "A state is immune from the jurisdiction of the courts of the United Kingdom except as provided in the following provisions of . . . this Act."[115] The U.S. act states: "[A] . . . foreign state shall be immune from the jurisdiction of the courts of the United States and of the states [of the Union] except as provided in . . . this chapter."[116]

See the text of the 1976 U.S. Foreign Sovereign Immunities Act, posted at
http://archive.usun.state.gov/hc_docs/hc_law_94_583.html
and the 1978 U.K. State Immunity Act, posted at
www.legislation.gov.uk/ukpga/1978/33.

---

[109]From Latin: "a god out of a machine." This expression alludes to a favorite stage trick used in classical tragedies of introducing a god, usually lowered mechanically from the rafters, to solve some otherwise insolvable entanglement in the plot.

[110]I Congreso del Partido, *All England Law Reports*, vol. 1981, pt. 1, p. 1092 (Court of Appeal, 1979).

[111]United States Code, title 28, §1602 *et seq*.

[112]From Latin: "law of command."

[113]From Latin: "law of management."

[114]"At this point there can be little doubt that international law follows the restrictive theory of sovereign immunity." *Texas Trading and Milling Corp. v. Federal Republic of Nigeria*, *Federal Reporter, Second Series*, vol. 647, p. 300 (Second Circuit Ct. of Appeals, 1981).

[115]U.K. State Immunity Act, §1(1) (1978).

[116]U.S. Foreign Sovereign Immunities Act, §1604 (1976).

Both acts then describe exceptions. The principal exception is, of course, governmental participation in commercial activity, and both acts undertake to define such activity. The U.S. act defines it as "either a regular course of commercial conduct or a particular commercial transaction or act." The act then provides that "the commercial character of an activity shall be determined by reference to the nature of the course of conduct or particular transaction or act, *rather than* by reference to its *purpose*."[117] The U.K. act uses a similar approach, providing that

> "commercial transaction" means (a) any contract for the supply of goods or services; (b) any loan or other transaction for the provision of finance and any guarantee or indemnity in respect of any such transaction or of any other financial obligation; and (c) any other transaction or activity (whether of a commercial, industrial, financial, professional or other similar character) into which a state enters or in which it engages otherwise than in the exercise of sovereign authority; [but it does not include] a contract of employment between a state and an individual.

The commercial activity exception is thus broadly defined. The U.K. act says that it includes any act or transaction that a state engages in "otherwise than in the exercise of sovereign authority," and the U.S. act says that it includes conduct "not based upon the exercise of a discretionary function, or upon libel, slander, misrepresentation, or interference with contract rights."

In addition to commercial activities, both acts deny states immunity from claims for death or personal injury, for damage to or loss of tangible property, for claims relating to real property, and for actions based on intellectual property rights. The U.K. act also denies immunity for suits that are based on claims for delinquent tariffs and taxes.

However, the exceptions to immunity granted by both acts apply only if some connection exists between the activity and the forum state. In other words, the property must be located in the forum state[118] or the act or omission must take place or produce some direct effect there.[119] In the United States, this is constitutionally required by the due process clause[120]; in the United Kingdom, it is imposed by treaty obligations under the 1972 European Convention on State Immunity.[121]

Although both the U.S. and U.K. acts grant immunities to foreign states subject to exceptions, the burden of proof does not rest on the party suing the state to show that an exception exists, but rather on the state to show that it has immunity.[122] On the other hand, the remedies available to a

[117] *Id.*, §1603(d) (emphasis added). This "nature of the transaction" test had been criticized in the United States before it was adopted. "While this criterion is relatively easy to apply, it oftentimes produces rather astonishing results, such as the holdings of some European courts that purchases of bullets or shoes for the army, the erection of fortifications for defense, or the rental of a house for an embassy, are private acts. . . . Furthermore, this test merely postpones the difficulty, for particular contracts in some instances may be made only by states. (For example, any individual may be able to purchase a boat, but only a sovereign may be able to purchase a battleship. Should the purchase of a yacht be equated with the purchase of a battleship?)" *Victory Transport Inc. v. Comisaria General de Abasteciminetos y Transportes*, *Federal Reporter, Second Series*, vol. 336, p. 354 (Second Circuit Ct. of Appeals, 1964).

[118] The 1978 U.K. State Immunity Act, §5, requires that the act or omission relating to personal injury, death, or tangible property losses or damages occur in the United Kingdom; §6 requires that in claims against real estate property the property be located in the United Kingdom; and §7 requires that in actions based on intellectual property rights, those rights apply in the United Kingdom. The 1976 U.S. Foreign Sovereign Immunities Act, §1605(3), (4), and (5), imposes similar requirements.

[119] The 1976 U.S. Foreign Sovereign Immunities Act, §1605, provides: "A foreign state shall not be immune . . . in any case . . . (2) in which the action is based upon a commercial activity carried on in the United States by the foreign state; or upon an act performed in the United States in connection with a commercial activity in the foreign state elsewhere; or upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States." The 1978 U.K. State Immunity Act, §3(1), states: "A state is not immune as respects proceedings relating to—(a) a commercial transaction entered into by the state; or (b) an obligation of the state which by virtue of a contract (whether a commercial transaction or not) falls to be performed wholly or partly in the United Kingdom."

[120] See *Timberlane Lumber Co. v. Bank of America*, *Federal Reporter, Second Series*, vol. 549, p. 597 (Second Circuit Ct. of Appeals, 1976).

[121] *European Treaty Series*, no. 74; *International Legal Materials*, vol. 11, p. 470 (1972). In force since 1976.

[122] U.K. State Immunity Act, §1(1) (1978); U.S. Foreign Sovereign Immunities Act, §1604 (1976). "Once a basis for jurisdiction is alleged, the burden of proof rests on the foreign state to demonstrate that immunity should be granted." Matter of SEDCO, Inc., *Federal Supplement*, vol. 543, p. 561 (District Ct. for S. Dist. of Texas, 1982).

plaintiff in a suit against a state are limited essentially to damages—injunctions[123] and orders of specific performance are not available.

Both acts have substantially improved the ability of a party to enforce a judgment against a foreign state. Prior to their enactment, a state had to separately waive its immunity from the execution of a judgment. Now a foreign state's assets located in the forum state may be seized for the satisfaction of a judgment unless they fit within certain categories. In the United Kingdom, the property of a foreign state's central bank is immune; in the United States, the property of international institutions, central bank property, and property of a military character under the control of the foreign state's military are immune.

In addition to the several exceptions already mentioned, immunity is not available when it is waived by the state. It can be waived expressly at the time the suit is brought or in advance in a contract clause or implicitly by bringing or participating in a suit.[124] But waivers can be contentious, and agreements to arbitrate do not necessarily create the necessary waiver of sovereign immunity in the view of all states, as Reading 3-2 points out.

Reading 3-2 China and Sovereign Immunity

Will China accept restrictive sovereign immunity, as many Western nations have? Given the number and asset size of many state sponsored enterprises in China and the importance of China's sovereign wealth funds, the question has enormous practical importance. Will China be willing to participate as a defendant in distant judicial forums, or to have state funds used to satisfy default judgments from other states? The evidence clearly points in the direction of China's desire to retain immunity, even for commercial acts and investment decisions.

In a recent Hong Kong case, The Court of Final Appeal upheld that the assets of the Democratic Republic of Congo cannot be levied upon in Hong Kong by a U.S. investment fund, despite a history in Hong Kong of restrictive sovereign immunity. The Hong Kong court had referred the question of immunity to the National People's Congress Standing Committee, which reaffirmed China's insistence that Hong Kong, as part of China, would adhere to the same position: absolute sovereign immunity.

In June of 2011, Hong Kong's highest court sought a re-interpretation of governmental immunity law from National People's Congress Standing Committee [NPCSC]. This was the first time it had done so, and the question was posed following a split three-two decision over a lawsuit involving U.S.-based FG Hemisphere Associates trying to claim assets of the Democratic Republic of Congo worth more than HK$800 million. The lower courts had earlier sided with the U.S. fund on the basis that Hong Kong, like Britain, had adopted "restrictive sovereign immunity."

In the 1980s, the Democratic Republic of the Congo wanted to develop its energy infrastructure, and contracted with Yugoslavian company Energoinvest DD. This project was funded through credit that Energoinvest DD provided to the Democratic Republic of the Congo and state-owned electricity company, Société Nationale d' Electricité—both of which defaulted on repayments. The parties had agreed to arbitrate, and the dispute was referred to arbitrations, which the Democratic Republic of the Congo did not attend, and awards were made against the Democratic Republic of the Congo and Société Nationale d' Electricité. Energoinvest DD later assigned this debt to FG Hemisphere Associates LLC, a so-called "vulture fund" that buys securities in distressed investments, such as high-yield bonds in or near default, or equities that are in or near bankruptcy.

After the arbitrations, China Railway Group and several of its subsidiaries participated in a Chinese entity that entered into a joint venture agreement with a state-owned Congolese mining company. The agreement included the payment of US$221 million in mining entry fees to the Congolese government. Learning of this development, FG Hemisphere sought to levy on these fees to satisfy the outstanding arbitral award. FG Hemisphere made a successful *ex parte* application to the High Court in Hong Kong to enforce the arbitral awards against the Democratic Republic of the Congo, and obtained interim injunctions to prevent payment of entry fees by China Rail's subsidiaries to the Congolese government. This decision was later overturned after a hearing among the parties.

FG Hemisphere then appealed this decision in the Court of Appeal, where the Congolese government asserted state immunity from the proceedings. The majority held that, in line with Hong Kong common law, state immunity is restrictive, rather than absolute, and the Democratic Republic of the Congo had no immunity in commercial proceedings. Had the prevailing state immunity been absolute, the Court of Appeal majority held that it

[123]Such as the so-called *Mareva* injunction granted in the Trendtex Case to keep a state from removing its assets from the forum jurisdiction.

[124]U.K. State Immunity Act, §13(3) (1978); U.S. Foreign Sovereign Immunities Act, §1605(a)(1) (1976). The waiver must be knowingly made, however. "A foreign state does not waive its sovereign immunity merely by entering into a contract with another nation. There must be an intentional and knowing relinquishment of the legal right. . . . [While it may waive immunity by making a general appearance, it does] not waive the sovereign immunity defense by failing to timely answer." *Castro v. Saudi Arabia*, *Federal Supplement*, vol. 510, p. 309 (Dist. Ct. for W. Dist. of Texas, 1980).

had been waived by the Democratic Republic of the Congo, pursuant to its agreement to arbitrate.

The matter was then appealed to the Court of Final Appeal, and the Court of Appeal decision was overturned by the majority decision of Justices Chan PJ, Ribeiro PJ and Sir Anthony Mason NPJ, who ruled that the Democratic Republic of the Congo had not waived its immunity before the courts of Hong Kong, and found the Special Administrative Region of Hong Kong (SAR) could not have a doctrine of state immunity that was inconsistent with that of the People's Republic of China.

Justices Bokhary and Mortimer delivered dissenting judgments, finding that restrictive state immunity still applied in Hong Kong. Mortimer said that the 1997 Basic Law provided for the continuation of the common law in Hong Kong, and that as the SAR's stance on state immunity had not been modified by local or PRC legislation, Hong Kong's common law on restrictive sovereign immunity continued to apply. Both judges also deemed that had absolute immunity been the doctrine in Hong Kong, the Democratic Republic of the Congo would have waived the immunity through agreeing to the arbitration proceedings.

The orders made by the Court of Final Appeal did not amount to a final judgment. Before making a final ruling in this matter, the court was required by Article 158(3) of the Basic Law to refer questions relating to the interpretation of Articles 13 and 19 of the Basic Law—which relate to foreign affairs and the relationship between the Central Authorities and the Region—to the Standing Committee of the National People's Congress for interpretation.

The SCNPC then determined, in the summer of 2011, that the SARs, like China, must follow the doctrine of absolute sovereign immunity. In September of 2011, permanent judges Patrick Chan and Robert Ribeiro and nonpermanent judge Anthony Mason agreed the central government "has the power to determine the rules or policies on state immunity" in Hong Kong as they involve defense and foreign affairs. In its ruling, the Court said:

> China firmly adheres to the important legal doctrine of state immunity which protects the normal development of the relations among states. It means that the courts of China have no jurisdiction over, nor in practice have they ever entertained, any case in which a foreign state is sued as a defendant or any claim involving the properties of any foreign state. At the same time, China has never accepted any foreign courts having jurisdiction over cases in which the State of China is sued as a defendant, or over any cases involving the properties of the State of China. This position on state immunity adopted by China is usually referred to as "absolute immunity." China's position as regards state immunity is manifested in the formal public statements and the practice of our Government. This is a legal fact and has been widely understood by the international community. In practice of state immunity among states, some states make exceptions to state immunity and exclude commercial activities of states and their properties used for the purpose of commercial activities, etc. from the scope of state immunity. This practice is usually referred to as "restrictive immunity." In this regard, the following explanation should be made. On 14 September 2005, China signed *the United Nations Convention on Jurisdictional Immunities of States and Their Property*. The Convention confers on foreign states and their properties immunity from court jurisdiction and execution and provides, at the same time, for certain exceptions to state immunity by excluding commercial activities of states and their properties used for the purpose of commercial activities from the scope of state immunity. However, the Convention has not yet entered into force. The Standing Committee of the National People's Congress has not yet ratified the Convention. At present, China still implements the rules and policies on state immunity to which it has consistently and firmly adhered.

Until such time as the SCNPC ratifies the UN Convention on Jurisdictional Immunities of States and Their Property, China and its two SARs, Hong Kong and Macau, will adhere to the rule of absolute sovereign immunity. It remains to be seen whether non-Chinese parties dealing with state-owned enterprises or Chinese entities with substantial ties to the government will be able to secure any form of waiver of immunity that will be effective in restricting claims of absolute sovereign immunity. Insurance, performance bonds, and third-party (non-sovereign) guarantors would seem to be essential safeguards to doing business with China.

If there is a judgment against a foreign sovereign, problems of "executing on the judgment" (or collecting monies due) frequently arise. Case 3-5 examines whether or not the bank accounts of a foreign embassy are immune from judicial attachment.

CASE 3-5 Abbott v. Republic of South Africa

Spain, Constitutional Court, 1992
Revista Electronica de Derecho Informatico, vol. 1992, p. 565 (1992)
International Law Reports, vol. 113, p. 412 (1999)

The plaintiff, a foreign national, was employed as a bilingual secretary by the embassy of South Africa. It dismissed her in 1985 on the ground that she had performed her duties unsatisfactorily. She brought suit in the Labor Court of Madrid seeking reinstatement and arrears of salary. The Labor Court dismissed her suit for lacked jurisdiction, and she appealed to the Supreme Court. The Supreme Court granted her appeal, holding that South Africa did not enjoy immunity from jurisdiction in the proceedings, and remanded the case to the Labor Court for a decision on the merits.

MAP 3.5

South Africa (1992)

MAP 3.6

Spain (1992)

In 1990, the plaintiff obtained a judgment in her favor, but on appeal the High Court of Madrid held that South Africa was entitled to absolute immunity from execution. The plaintiff then brought this appeal in the Constitutional Court challenging that decision. She argued that the decision violated her right to effective judicial protection under Article 24(1) of the Spanish Constitution by not applying the doctrine of restrictive sovereign immunity.

Judgment

***

. . . [I]t remains to be decided to what extent, or alternatively, subject to what limits, a Spanish court can enforce a judgment against property of a foreign state held on Spanish territory.

In determining the question we must start from two general principles. First, international law bars execution on property of the foreign state used or intended to be used in activities of a sovereign or *de imperio* nature, permitting it only in respect of property intended for the purposes of economic activities which do not involve the exercise of a state's sovereign power. . . . Secondly, it must be particularly borne in mind that, of the various categories of property which may be held by foreign states on Spanish territory, the property of diplomatic and consular missions benefits from a special protective regime by virtue of Article 22(3) of the Vienna Convention on Diplomatic Relations, 1961[125] and Article 31(4) of the Vienna Convention on Consular Relations, 1963.[126] In other words, the relative immunity of foreign states in respect of execution is founded on the distinction between property intended for activities carried on *jure imperii* and property intended for activities carried on *jure gestionis*. However, independently of this criterion, by virtue of the Vienna Conventions of 1961 and 1963, the property of diplomatic and consular missions enjoys absolute immunity from execution.

It follows from Article 22(3) of the Vienna Convention, 1961, that property of the Republic of South Africa situated within the confines of the Embassy, including the Embassy itself, is absolutely immune from execution. However, doubt arises in the case of property of a foreign state which, while not physically present on Embassy premises nor expressly mentioned in Article 22(3), is intended by that state for the support of its diplomatic mission. In concrete terms, the problem consists in deciding whether bank accounts opened in the name of an embassy, or accounts whose assets are intended to fund embassy operations, are protected by the above rule, given that the order quashed by the decision now being challenged attached part of the funds held in a bank account opened in the name of the South African Embassy, an act which in South Africa's view involved a serious breach of relation between sovereign states.

Contemporary international practice clearly exempts bank accounts from any form of execution. . . . This is . . . the accepted approach in the most recent decisions of higher national courts.

In decision of April 12, 1984, in the case of *Alcom Ltd. v. Republic of Colombia*[127] the English House of Lords held that under English law it was not possible to attach funds held in the embassy's bank account, even though such funds, as well as being applied to cover the embassy's day-to-day operating expenses, might also be used for commercial purposes. The account must be regarded as a single whole, held for the benefit of the diplomatic mission. Similarly, the German Federal Constitutional Court, in its decision of December 13, 1977 (*Philippines Embassy* case),[128] held that accounts of diplomatic missions could not be attached, being protected by virtue of the immunities accorded to diplomatic missions by international law. The maxim *ne impediatur legatio*[129] applied, since a bank account is a necessary tool for the proper functioning of the diplomatic mission. All that was required in this regard was a declaration by the competent agency of the state in question confirming that the account was intended to ensure the continuing operation of the embassy.

Such immunity from attachment of bank accounts held by a foreign state in banks situated on the territory [of the forum state] and used for purposes of the ordinary activity of diplomatic and consular missions represents the general international practice. It follows that the immunity in relation to execution enjoyed by states and by diplomatic and consular property prevents execution from being levied . . . , as regards property held in the forum state by diplomatic and consular missions, on such accounts. And this is the case even where the funds in the accounts may also be used for the purposes of activities not involving the foreign state's sovereignty, namely those carried on *jure gestionis*, to which the rationale justifying the immunity of diplomatic and consular property cannot apply. The fact that funds held in the account to cover the

[125]Article 22(3) provides: "3. The premises of the mission, their furnishings and other property thereon and the means of transport of the mission shall be immune from search, requisition, attachment or execution."

[126]Article 31(4) provides: "4. The consular premises, their furnishings, the property of the consular post and its means of transport shall be immune from any form of requisition for purposes of national defense or public utility. If expropriation is necessary for such purposes, all possible steps shall be taken to avoid impeding the performance of consular functions, and prompt, adequate and effective compensation shall be paid to the sending State."

[127]*Appeal Cases*, vol. 1982, p. 888 (U.K. House of Lords, 1982).

[128]*Entscheidungen des Bundesverfassungsgerichts*, vol. 46, p. 342 (German Federal Constitutional Court, 1977).

[129]From Latin: "Do not impede (the workings) of an embassy."

day-to-day functioning of diplomatic and consular missions may also be used for commercial purposes does not justify the exclusion of such funds from immunity against execution, and hence from attachment. This follows both from the single and indivisible nature of the funds and from the impossibility, in the case of an account operated by a diplomatic mission, of investigating the transactions, flow of funds, and purposes to which such funds are applied. Such an investigation would involve an interference with the mission's activity, in breach of the rules of public international law.

This Court is not unaware of the problems which the immunity from attachment of such accounts may sometimes pose in cases where it is sought to levy execution against a foreign state in circumstances where the state [is not exempt from jurisdictional] immunity. However, given the reasonableness of the immunity in such cases, having regard to the sovereignty and equality of states, we are led inevitably to the conclusion that the attachment of an embassy's bank account is an act forbidden by [the rules of public international law].

***

It may be that, in addition to those assets which cannot be attached because they are intended for performance of activities of diplomatic or consular missions, the foreign state against which execution is sought (in this case the Republic of South Africa) has other property on Spanish territory. As regards such property, in so far as it exists, immunity from execution pursuant to international law . . . extends only to property intended for of acts *jure imperii*,[130] and not to property intended for activities *jure gestionis*.[131] Thus, the ordinary courts, in order to give effect to the right of enforcement of judgments, have the power to order execution to be levied on property clearly intended for a foreign state's industrial or commercial activities, where there is no involvement of its sovereign power, inasmuch as its is conducting itself in accordance with the rules governing private-law transactions. In each case it is for the court ordering execution to determine, in accordance with the rules of Spanish law, which of the property specifically held by the foreign state on Spanish territory is clearly intended for purposes of economic activities in respect of which that state, rather than exercising its sovereign power, conducts itself as if it were a private individual. Moreover, where the condition is satisfied, it is not necessary that the property in respect of which execution is sought should be intended for the selfsame activity *jure gestionis* as that which provoked the dispute. To hold otherwise would be to render illusory the right to enforcement of judgments in cases like the present one, involving the dismissal of an embassy employee. Otherwise, notwithstanding that it has been accepted that such disputes fall outside the scope of states' jurisdictional immunity, no property would be excluded from protection against execution, since the only assets linked to the activity which provoked the dispute would be those of the embassy. Can this be worded simpler?

In declaring a blanket immunity from execution in respect of all funds held in Spanish banking institutions by the State against which execution was being levied, irrespective of the purpose of such funds, and confirming closure of the [enforcement] proceedings, the judgment being challenged applied a rule of absolute immunity from execution in relation to the assets of the Republic of South Africa which is not required by [the rules of public international law], and hence amounts to a refusal to enforce a judgment without cause, contrary to the [Spanish constitutional] right to effective judicial protection. The order of the Labor Court and, to the extent it confirmed that order, the judgment being challenged, violated the respondent's right to effective judicial protection, in that it directed the proceedings to be closed without allowing any opportunity for possible enforcement of the judgment against other assets held by the Republic of South Africa on Spanish territory and intended not for the operation of its diplomatic or consular missions, but for the performance of activities in which the States was not exercising its sovereign power or authority.

***

The Constitutional Court, by the authority conferred upon it by the Constitution of the Spanish Nation, having regard to the foregoing considerations, has decided as follows:

***

[130]Governmental.

[131]Commercial.

3. To order that the proceedings be reopened before Madrid Labor Relations Court No. 11, in order that enforcement measures be pursued against any other assets of the defendant state not subject to immunity from execution in accordance with the terms . . . of this decision.

Casepoint

The Vienna Convention on Diplomatic Relations and the Vienna Convention on Consular Relations provide immunity for foreign state property used for governmental activities but not for property used for commercial activities. As a practical matter, a court may not order an embassy to disclose which of the funds in its bank accounts are maintained for commercial purposes and which are not. As a matter of public international law, embassy bank accounts are immune from judgment.

Act of State Doctrine

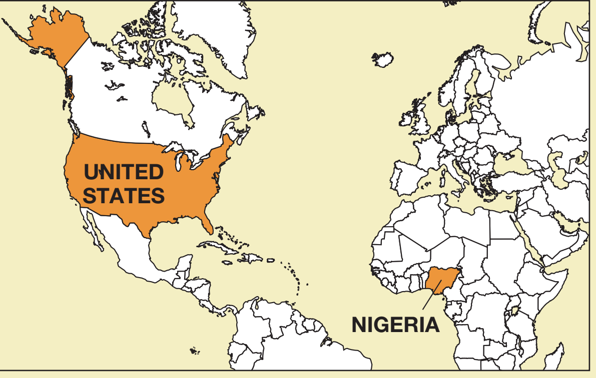
The **act of state doctrine** is a rule that restrains municipal courts in some countries from exercising jurisdiction over foreign states. This rule is most developed in the United States, where it is based on the U.S. constitutional requirement of separation of powers.[132] That is, because the U.S. Constitution assigns to the executive branch of the government responsibility for the conduct of foreign affairs, the courts (the judicial branch) must decline to hear cases that might adversely affect the executive's conduct of those affairs. In particular, a U.S. court will decline to hear cases involving an official act of a foreign sovereign performed within its own territory when the relief sought or the defense raised in the case would require the court to declare invalid the foreign sovereign's official act.

Not all actions of public officials amount to "sovereign acts" that require respect from U.S. judiciary. For example, in Case 3-6, the U.S. Supreme Court distinguished between public acts and acts of public officials in applying the act of state doctrine.

act of state doctrine Doctrine that the act of a government within the boundaries of its own territory is not subject to judicial scrutiny in a foreign municipal court. A municipal court will decline to hear a dispute based on such acts if to do so would interfere with the conduct of the forum state's foreign policy.

CASE 3-6 W.S. Kirkpatrick Co., Inc. v. Environmental Tectonics Co.

493 U.S. 400 (1990)
U.S. Supreme Court



MAP 3.7

Nigeria and the United States

[132]Countries with governmental structures similar to those of the United States, such as Mexico and Brazil, or countries whose courts are required to defer to the executive in the conduct of foreign affairs, such as the United Kingdom, also follow the act of state doctrine.

Justice Scalia delivered the Court's opinion.

In 1981, Harry Carpenter, who was then Chairman of the Board and Chief Executive Officer of petitioner W. S. Kirkpatrick & Co., Inc. (Kirkpatrick) learned that the Republic of Nigeria was interested in contracting for the construction and equipment of an aeromedical center at Kaduna Air Force Base in Nigeria. He made arrangements with Benson "Tunde" Akindele, a Nigerian citizen, whereby Akindele would endeavor to secure the contract for Kirkpatrick. It was agreed that in the event the contract was awarded to Kirkpatrick, Kirkpatrick would pay to two Panamanian entities controlled by Akindele an amount equal to 20% of the contract price, which would in turn be given as a broad two officials of the Nigerian government. In accordance with this plan, the contract was awarded to petitioner Debbie S. Kirkpatrick and company, international (Kirkpatrick international), a wholly-owned subsidiary of Kirkpatrick; Kirkpatrick paid the promised "commission" to the appointed Panamanian entities; and those funds were disbursed as bribes. All parties agree that Nigerian law prohibits both the payment and the receipt of bribes in connection with the award of a government contract.

Respondent Environmental Tectonic Corporation, International, an unsuccessful bidder for the Kaduna contract, learned of the 20% "commission" and brought the matter to the attention of the Nigerian Air Force and the United States Embassy in Lagos. Following an investigation by the Federal Bureau of Investigation, the United States Attorney for the District of New Jersey brought charges against both Kirkpatrick and Carpenter for violations of the Foreign Corrupt Practices Act of 1977 and both pleaded guilty.

Respondent then brought this civil action in the United States District Court of the District of New Jersey against Carpenter, Akindele, petitioners, and others, seeking damages under the Racketeer Influenced and Corrupt Organizations Act, the Robinson-Patman Act, and the New Jersey Anti-Racketeering Act. The defendants moved to dismiss the complaint under Rule 12(b)(6) of the Federal Rules of Civil Procedure on the ground that the action was barred by the act of state doctrine.

The District Court concluded that the act of state doctrine applies "if the inquiry presented for judicial determination includes the motivation of a sovereign act which would result in embarrassment to the sovereign or constitute interference in the conduct a foreign policy of the United States." Applying that principle to the facts at hand, the court held that respondents suit had to be dismissed because in order to prevail, respondents would have to show that "the defendants or certain other than intended to wrongfully influence the decision to award the Nigerian contract by payment of a broad, that the government of Nigeria, its officials, or other representatives knew of the offered consideration forewarning the Nigerian contract to Kirkpatrick, that the bribe was actually received or anticipated, and that, but for the payment or anticipation of the payment of the bribed, ETC would have been awarded the Nigerian contract."

The Court of Appeals for the Third Circuit reversed.

Courts' description of the jurisprudential foundation for the active state doctrine has undergone some evolution over the years. . . . Some justices have suggested possible exceptions to application of the doctrine, where one or both of the foregoing policies would seemingly not be served. An exception, for example, for active state doctrine consists of commercial transactions, since neither modern international comity of the current position of our executive branch accords sovereign immunity to such acts: Or exception for cases in which the executive branch has represented that it has no objection to denying validity to the foreign sovereign act, since then the court should be impeding no foreign-policy goals.

We find it unnecessary, however, to pursue those inquiries, since the factual predicate for application of the active state doctrine does not exist. Nothing in the present suit requires the court to declare invalid, and thus ineffective as "a rule of decision for the courts of this country," the official act of a foreign sovereign.

In every case in which we have held the active state doctrine applicable, the relief sought for the defense interposed would have required a court in the United States to declare invalid the official acts of a foreign sovereign performed within its own territory. . . . In *Sabbatino*, upholding the defendant's claim to the funds would have required a holding that Cuba's expropriation of goods located in Havana was null and void. In the present case, by contrast, neither the claim nor any asserted defense requires a determination that Nigeria's contract with Kirkpatrick International was, or was not, effective.

Petitioners point out, however, that the facts necessary to establish respondent's claim will also establish that the contract was unlawful. Specifically, they note that in order to prevail

respondent must prove that petitioner Kirkpatrick made, and Nigerian officials received, payments that violate Nigerian law, which would, they assert, support a finding that the contract is invalid under Nigerian law. Assuming that to be true, it still does not suffice. The act of state doctrine is not some vague doctrine of abstention but a "principle *of decision* binding on federal and state courts alike." As we said in *Ricaud*, "the act within its own boundaries of one sovereign State . . . becomes a rule of decision for the courts of this country." Act of state issues only arise when a court *must* decide—that is, when the outcome of the case turns upon—the effect of official action by a foreign sovereign. When that question is not in the case, neither is the act of state doctrine. This is the situation here. Regardless of what the court's factual findings may suggest as to the legality of the Nigerian contract, its legality is simply not a question to be decided in the present suit, and there is thus no occasion to apply the rule of decision that the act of state doctrine requires.

***

The short of the matter is this: Courts in the United States have the Power, and ordinarily the obligation, to decide cases and controversies properly presented to them. The act of state doctrine does not establish an exception for cases and controversies that may embarrass foreign governments, but merely requires that; in the process of deciding, the acts of foreign sovereigns taken within their own jurisdictions shall be deemed valid: That doctrine has no application to the present case because the validity of no foreign sovereign act is at issue.

The judgment of the Court for the Third Circuit is affirmed.

Casepoint

Not all acts of foreign public officials will be recognized as "public acts" for purposes of applying the act of state doctrine in U.S. courts. For the act of state doctrine to apply, the act of a public official must somehow be made public to be the official act of a sovereign on its own territory.

E. Choosing the Governing Law

When faced with civil suits involving parties, acts, or transactions from different countries, municipal courts must decide which law to apply. Should they apply the law of the forum state or the law of some other state? It would, of course, be simplest if courts applied the law of the forum state in all cases. Law writers and courts have long recognized, however, that this would be unfair. Individuals take actions in a particular place (such as signing contracts, buying property, buying equipment, making statements, hiring employees, etc.) based on the rules of law that apply in that place. To later have a court in another state apply different laws would discourage international exchanges of all kinds.

The idea that municipal courts should apply foreign laws in these kinds of cases was originally based on the idea of comity (i.e., respect for the interests of a foreign sovereign) because each state has an interest in protecting the rights of its subjects, and only by respecting the interests of foreign subjects can a state expect similar treatment for its subjects in other states.[133] This is no longer the rationale. As Chief Justice Fuller of the U.S. Supreme Court said in 1895:

> Now the rule is universal in this country that private rights acquired under the laws of foreign states will be respected and enforced in our courts unless contrary to the policy or prejudicial to the interests of the state where this is sought to be done; and although the source of this rule may have been the comity characterizing the intercourse between nations, it prevails today by its own strength and the right to the application of the law to which the particular transaction is subject is a juridical right.[134]

[133]Justice Joseph Story of the U.S. Supreme Court once wrote that American courts had an obligation to apply foreign laws out of "a sort of moral necessity to do justice, in order that justice may be done to us in return." *Commentaries on the Conflict of Laws* §35 (1834). For a discussion of the relationship of comity to the choice of law problem, see Arthur K. Kuhn, *Comparative Commentaries on Private International Law of Conflict of Laws*, pp. 28–30 (1937).

[134]*Hilton v. Guyot* (dissenting opinion), *United States Reports*, vol. 159, p. 113 (Supreme Ct., 1895).

choice of law
Rules used by municipal courts to determine which state's law they should apply in hearing a civil dispute.

Although the obligation to apply foreign law exists today as a rule of law unto itself, its existence presents states with a difficult problem: how to decide which law to apply. Courts use what are called **choice of law** rules to determine if they should apply their own law or the law of another state in settling civil disputes.

Virtually all choice of law rules follow a two-step procedure.[135] First, if the parties to a dispute have agreed to the application of the law of a particular country, the court should apply that law, unless that choice is entirely arbitrary or unreasonable. Second, if the parties have not agreed as to which law should apply (either expressly or impliedly), then the court should determine for itself which law it should apply by (1) following statutory dictates, (2) determining which state has the most significant relationship with the dispute, or (in a few states) (3) determining which state has the greatest interest in the outcome of the case.

Agreement of the Parties

choice of law clause
A provision in a contract designating the state whose law will govern disputes relating to the contract.

The agreement of the parties as to which law should apply most commonly is a factor in contract cases. By the use of a **choice of law clause**, the parties agree in advance as to what law should apply. So long as the parties made the agreement freely, even if they have no factual connection with the country whose legal system they have adopted, their choice will generally be enforced.[136]

The agreement of the parties can also be made in statements to a court. For example, in *Multi Product International v. Toa Kogyo Co., Ltd.*, a Japanese court held:

> The plaintiff brought an action in this court and expressed, in preliminary proceedings as well as in the oral proceedings, the intention that the law of Japan should be the applicable law. . . . The defendant appeared in court and also expressed the same thing. . . . Therefore, both parties are held to have had the intent that the law of Japan shall apply to the matters at issue.[137]

In contract or other cases where the parties have not agreed to the applicable law, their intention that the law of a particular country should apply can sometimes be inferred. At least, this is the theory.[138] In practice, courts seldom (if ever) infer the parties' intention.[139] Instead, they go on to their second set of choice of law rules and apply the law specified in a statutory directive, the law with the most significant relationship, or the law of the state with most interest in the outcome.

Statutory Choice of Law Provisions

In civil law countries, the law that courts will apply in a dispute when the parties themselves have not made a choice is found in statutory codes or, sometimes, in international treaties. Traditionally, these provisions

---

[135]One American commentator has observed: "Choice of law theory in most common law countries mirrors (with minor variations) U.S. approaches. Choice of law rules in non–common law countries are usually found in statutory codes or regional (or wider) international conventions. . . . Even in these codes and conventions, however, the more innovative U.S. approaches to choice of law [i.e., the most significant relationship and the governmental interests theories] find reflection, if not full acceptance." Joseph W. Dellapenna, *Suing Foreign Governments and Their Corporations*, pp. 233–234 (1988).

[136]Common law rulings to this effect include the following: *Vita Food Products Inc. v. Unus Shipping Co., Ltd.*, *Law Reports, Appeal Cases*, vol. 1939, p. 277 at p. 290 (1939); *Augustus v. Permanent Trustee Co. (Canberra)*, *Commonwealth Law Reports*, vol. 124, p. 245 at p. 252 (1971); *John Kaldor v. Mitchell Cotts Freight*, *Australian Law Reports*, vol. 90, p. 244 at pp. 256–257 (Supreme Ct. of New South Wales, 1989). An example of a civil law code provision to this effect is Japan's Law Concerning the Application of Laws in General (Law No. 10 of 1898), Article 7: "(1) The intention of the parties shall determine what country's law will govern the creation and effect of a juristic act. (2) If the intention of the parties is uncertain, the law of the place of the act shall govern."

[137]Hanreijiho, No. 863, p. 100 (1977); *Japanese Annual of International Law*, no. 23, p. 187 (1980).

[138]See *Halsbury's Laws of England*, vol. 8, para. 585 (4th ed.).

[139]In *John Kaldor v. Mitchell Cotts, Freight*, *Australian Law Reports*, vol. 90, p. 244 at p. 256 (Supreme Ct. of New South Wales, 1989), Judge Brownlie observed, "[It] has always been the case (at least so far as the submissions of counsel show, and my own research shows) that whenever a court has inferred an actual intention of the parties as what should be the proper law of the contract, that inferred intention has coincided with the view which the court would otherwise have imputed to the parties." England's Lord Denning, in particular, was a strong adherent of skipping over any consideration of the parties' inferred intent. See *Boissevain v. Weil*, *Law Reports, King's Bench*, vol. 1949, pt. 1, p. 482 at pp. 490–491 (1949); and *Armadora Occidental, S.A. v. Horace Mann Insurance Co.*, *Lloyd's Law Reports*, vol. 1977, pt. 2, p. 406 at p. 411 (1977). But see the doubt he expressed in *Augustus v. Permanent Trustee Co. (Canberra)*, *Commonwealth Law Reports*, vol. 124, p. 245 at p. 260 (1971).

are based on a concept known as the *vesting of rights*, and this approach to choosing the applicable law is, therefore, often called the **vested rights doctrine**. According to this doctrine, a court is to apply the law of the state where the rights of the parties to a suit vested (i.e., where they legally became effective).[140]

vested rights doctrine Doctrine that courts should apply the law of the state where the rights of the parties legally became effective.

To determine where particular rights vest, the codes provide fairly simple and straightforward guidelines. Usually a provision can be found that covers the general case. A good example is the Japanese general choice of law provision, which provides:

> If the intention of the parties is uncertain, the law of the place of the act shall govern.[141]

Beyond this, the courts look to the subject matter of the suit—such as **delicts** (legal offenses), contracts, or real property—and then choose the appropriate choice of law rule for that subject matter. Typical examples are these: If the suit involves a delict or tort, the governing law is the law of the place where the wrong was committed. If the suit is based on a contract, the law of the place where the contract was made governs questions of validity, and the law of the place where the contract was to be performed governs questions of performance. If the suit involves real property, the law of the place where the property is located governs.[142]

delict (From Latin *delictum:* "a fault.") In civil law countries, any private wrong or injury, or a minor public wrong or injury.

The codes also always contain a general limitation on the application of foreign law. That is, foreign law will not be followed if doing so would violate the public policy of the forum state. For example, the procedural rules of a foreign state will generally not be applied (because they would require courts to carry on their business in an unfamiliar manner);[143] a contract will not be enforced in a state that regards it as illegal (e.g., a gambling contract); foreign tax provisions will not be enforced (because they are a matter involving state sovereignty); nor will foreign penal provisions (because they are ordinarily territorial in scope).

The vested rights doctrine is the traditional device used by courts to determine the choice of law; however, it is not the only mechanism. In recent years, many civil law countries have modified their choice of law rules in response to objections that the vested rights doctrine is too rigid and fails to reflect the true interests of the states whose law may or may not be applied. The great majority of states have adopted the *most significant relationship* doctrine. Others have turned to the *governmental interests doctrine*, a doctrine that chooses the applicable law based on the "most significant relationship."

Most Significant Relationship

The **most significant relationship doctrine** has a court apply the law of the state that has the most contacts with the parties and their transaction. In essence, the courts will consider the following general factors in all cases: (1) Which state's law best promotes the needs of the international system? (2) Which state's law will be furthered the most by applying it to the case at hand? and (3) Which state's law will best promote the underlying policies of the legal subject-matter area involved?[144]

most significant relationship doctrine Doctrine that courts should apply the law of the state that has the closest and most real connection with the dispute.

[140]The vested rights doctrine used to be applied by case law in many state courts in the United States.

[141]Law Concerning the Application of Laws in General, Article 7(2) (Law No. 10 of 1898).

[142]There are many other special rules for particular kinds of cases. *The Boll Case (The Netherlands v. Switzerland)*, *International Court of Justice Reports*, vol. 1958, p. 55 (1958), involved the interpretation of a clause in a 1902 treaty governing the guardianship of minor children that provided that "the guardianship of an infant shall be governed by the national law of the infant." The case of *Kiyomu Liu v. Public Prosecutor*, *Kakyu Saibansho Minji Saibanreishu*, vol. 13, No. 10, p. 2146 (1962), *Japanese Annual of International Law*, No. 9, p. 229 (1965), involved the interpretation of the following rule for determining the applicable law for ascertaining a person's nationality: "(1) If a party has two or more nationalities and the law of the country of his nationality is to govern, the governing law shall be that of the country whose nationality he last acquired, provided Japanese law shall govern if one of the nationalities is Japanese. (2) As for a person who has no nationality, the law of the place of his domicile is deemed the law of his nationality. If his domicile is unknown, the law of the place of his residence governs. (3) Where a person's country has districts subject to different laws, the law of the district to which the person belongs shall govern."

[143]In cases dealing with title to real property, both the procedural and substantive law of the chosen state are applied.

[144]This doctrine is adopted in The Reinstatement (Second) of Laws: Conflicts, 1971, according to which the following "general" factors are considered by a court applying this doctrine: (1) The application of which state's law will best promote the needs of the international legal system for harmony in the political and commercial relations of states? (2) Will the purpose of the forum state's own law be furthered by applying it to the particular case? (3) Will the purpose of the other states' law be furthered by applying it to the particular case? (4) If a contract is involved, which state's law will best advance the legitimate expectations of the parties? (5) The application of which state's law will best promote the underlying policies of the legal subject matter (e.g., torts, contracts, etc.) involved? (6) Which state's law will best promote certainty, predictability, and uniformity of result? (7) Which state's law is easiest to determine and apply?

In addition, a court will consider *specific factors* depending on the kind of case that is before it. For tort cases, the specific factors are (1) the place of injury, (2) the place of the act, (3) the nationality, domicile, residence, or place of incorporation of the parties, and (4) the place where the relationship between the parties was centered. For personal property cases, they are (1) the location of the property and (2) the nationality, domicile, residence, or place of incorporation of the parties. For real property cases, the specific factor is the location of the property. And the specific factors in contract cases are (1) the place of contracting, (2) the place of negotiation, (3) the place of performance, (4) the location of the subject matter, and (5) the nationality, domicile, residence, or place of incorporation of the parties.

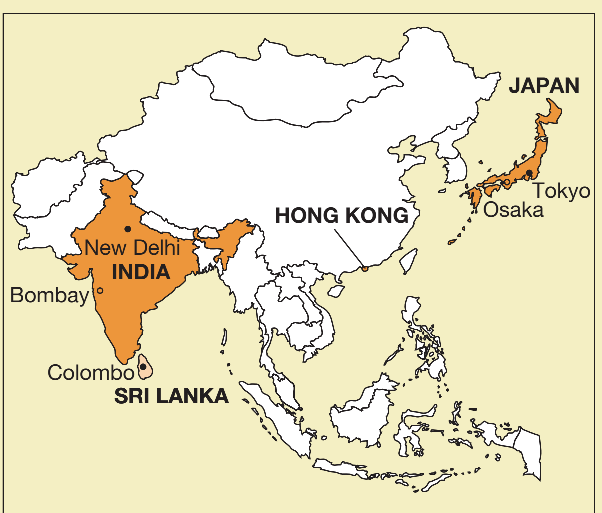
The "most significant relationship" doctrine is discussed in Case 3-7.

CASE 3-7 Bank of India v. Gobindram Naraindas Sadhwani and Others

Hong Kong, High Court, 1982
Hong Kong Law Reports, vol. 2, p. 262 (1988)

MAP 3.8

Hong Kong, Japan, and India (1982)



The Bank of India (the Bank) sued Gobindram Naraindas Sadhwani and his wife (the Gobindrams), who had acted as guarantors of a line of credit of 230,000,000 yen that the Osaka branch of the bank had provided Sadhwanis (Japan), Ltd. (SJL). The Gobindrams were residents of Hong Kong. The bank was an Indian corporation, and its head office was in Bombay. It had a regional office in Tokyo and a branch office in Osaka, Japan. SJL, which carried on business in Osaka, was managed by Mr. Gobindram's brother, Kishinchand Naraindas Sadhwani (Mr. Kishinchand), who lived with his wife near Osaka. The Kishinchands owned 60 percent of SJL, and the Gobindrams the remaining 40 percent. SJL had drawn bills of exchange that were supposed to have been paid by corporations in Sri Lanka and Nigeria that were run by other brothers of Mr. Gobindram and Mr. Kishinchand. When the bills were dishonored, the bank sought payment from Mr. Kishinchand, only to be told by Mr. Kishinchand that it should pursue the Hong Kong guarantors, the Gobindrams. The bank did not care to sue the Gobindrams because, sometime before the bills of exchange had been drawn, the bank had agreed to release the Gobindrams as guarantors. After the bank obtained a provisional attachment of Mr. Kishinchand's property in Japan from the Japanese courts, Mr. Kishinchand went to the bank's head office in Bombay and offered to bear all legal costs if the bank would pursue its claims against the Gobindrams as guarantors and the Sri Lankan and Nigerian corporations as drawees of the bills of exchange. The bank then sued the Gobindrams in Hong Kong, their place of residence. The Gobindrams in turn brought the Kishinchands into the proceeding as third parties.

At trial the Gobindrams argued that the proper law governing the guarantee contract was Japanese law and that Japanese law excused them from liability because the bank had agreed to release them as guarantors. The bank argued that either Indian or Hong Kong law should apply.

Judge Nazareth . . .

Determination of the Proper Law: The Test to Be Applied

The major issue between the parties is whether or not Japanese law is the proper law of the contract, i.e., the guarantee. The defendant contends for Japanese law in reliance upon the test of closest and most real connection. The plaintiff on the other hand contends otherwise in reliance upon the second of the three-stage or subrule test propounded thus in Dicey and Morris' *The Conflict of Laws:*

> Rule 180: The term "proper law of a contract" means the system of law by which the parties intended the contract to be governed, or, where their intention is neither expressed nor to be inferred from the circumstances, the system of law with which the transaction has its closest and most real connection.
>
> Subrule 1: When the intention of the parties to a contract, as to the law governing the contract, is expressed in words, this expressed intention, in general, determines the proper law of the contract.
>
> Subrule 2: When the intention of the parties to a contract with regard to the law governing the contract is not expressed in words, their intention is to be inferred from the terms and nature of the contract, and from the general circumstances of the case, and such inferred intention determines the proper law of the contract.
>
> Subrule 3: When the intention of the parties to a contract with regard to the law governing it is not expressed and cannot be inferred from the circumstances, the contract is governed by the system of law with which the transaction has its closest and most real connection.[145] . . .

I see no need to adumbrate the numerous authorities relied upon in the foregoing test, nor those through which counsel have conscientiously taken me and which I have carefully considered. The preponderance of authority clearly supports the three-stage criteria which in any event has been confirmed by the House of Lords in Amin Rasheed v. Kuwait Insurance Co.[146] Lord Diplock said:

> As Lord Atkin put it in Rex v. International Trustee for the Protection of *Bondholders Aktiengesellschaft:*[147]
>
> The legal principles which are to guide an English court on the question of the proper law of a contract are now well settled. It is the law which the parties intended to apply. Their intention will be ascertained by the intention expressed in the contract if any, which will be conclusive. If no intention be expressed the intention will be presumed by the court from the terms of the contract and the relevant surrounding circumstances. . . .
>
> . . . If it is apparent from the terms of the contract itself that the parties intended it to be interpreted by reference to a particular system of law, their intention will prevail and the latter question as to the system of law with which, in the view of the court, the transaction to which the contract relates would, but for such intention of the parties, have had the closest and most real connection does not arise.[148]

It is true there are cases in which the courts have proceeded directly from the first to the third stage. In those drawn to my attention, which I see no need to list, there does not seem to me to have been any conscious or considered conclusion that the second stage does not exist. Moreover, none of those cases has the authority of the House of Lords' decision in Amin

[145] Vol. 2, p. 1161 (11th ed., 1985).

[146] *Law Reports, Appeal Cases*, vol. 1984, p. 50 at p. 61 (1984).

[147] *Id.*, vol. 1937, p. 500 at p. 529 (1937).

[148] *Amin Rasheed v. Kuwait Insurance Co.*, *id.*, vol. 1984, p. 50 at p. 61 (1984).

Rasheed. . . . I conclude, therefore, that in determining the proper law, the three-stage test must be applied, notwithstanding that it is clear from the authorities that the line between the second and third stages is fine, that both those stages often merge and that the same result generally emerges from the application of either of the two latter stages.[149]

Second Stage: Inferred or Implied Choice of Law

In the absence of express intention as to the proper law, I proceed to the second stage, i.e., the implied intention to be inferred "from the terms of the contract and the relevant surrounding circumstances" in the words of Lord Atkin adopted by Lord Diplock which I quoted earlier.

As may be expected, the courts have resorted to different factors from which to infer the intentions of the parties.[150] The same factors have not always prevailed, nor have they always been accorded the same weight. The classic process of weighing the factors must be followed. In that process the plaintiff sets much more store by the common law form in which the guarantee was framed. Many of its provisions are in common form and clearly must have been drafted by reference to particular rules of the common law and decisions of the English courts. Indeed, Mr. Anthony Dicks, for the plaintiff, submits that several of those provisions are only intelligible by reference to English law.

While the latter may explain their purpose and origins, I do not accept that the former are only intelligible by reference to common law. . . .

I have no doubt that the Bank's printed form of guarantee was used as a matter of routine convenience. Had the Bank wished Indian law (the only applicable common law system contemplated by the parties) to apply, I think it would most probably, if not certainly, have provided for that in the process of devising and printing the form. In that respect, and having regard to Mr. Joshi's [the defendant's counsel's] evidence that it was good for Japanese law as well as other laws, the omission of a choice of law provision is of importance. The form in its original printed state referred to Indian currency, but this was replaced by typed references to Yen, which is indicative of Japanese law being the common choice.

The inability to enforce a contract according to one system of law has long been accepted as a relevant factor to be weighed in determining whether it is to be governed by some other law under which it is enforceable.[151] But in this case, as will be seen, the possibility of the guarantee not being enforceable wholly or partly is the result not so much of Japanese law, but of the conduct of the plaintiff (in which it need not have indulged). Moreover that conduct was subsequent to the execution of the guarantee and could hardly have been foreseen [at the time of the drafting of the contract]. In the circumstances, I do not consider that the possibility (and it was not more than that) of the contract being unenforceable in Japanese law favors common law as the proper law intended by the parties.

Mr. Dicks also submits that notwithstanding its technical façade of a Japanese corporation, SJL was part of an Indian joint family business, albeit in Japan, which resorted to the branch of an Indian bank also in Japan, to do business in an Indian way. That, again, may well be so but it does not in my view necessarily or even probably point to a choice of Indian law. Mr. Gobindram, who acted both in his own behalf and on behalf of his wife, never gave the proper law a thought, and left it all to Mr. Kishinchand in Japan. There is no evidence that Mr. Kishinchand, who likewise acted on his wife's behalf, gave it any more thought.

Having regard to the foregoing considerations, the circumstances, counsels' comprehensive submissions, and taking account of the authorities pressed upon me, and the by no means unanimous views taken in them of similar circumstances, I am satisfied that no intention as to the proper law can be inferred from the guarantee and the surrounding circumstances. . . .

[149]See Albert V. Dicey and J. H. C. Morris, *The Conflict of Laws*, vol. 2, pp. 1162–1163 (11th ed., 1985).

[150]*Halsbury's Laws of England*, vol. 8, para. 585 (4th ed.).

[151]See for example, *South African Breweries, Ltd. v. King*, *Law Reports*, *Chancery*, vol. 1899, pt. 2, p. 173 at p. 181 (1899).

Third Stage: The System with Which the Guarantee Has the Closest and Most Real Connection

In determining the legal system with which a contract is most closely connected, the courts have given great weight to the law of the place of performance.[152] That is not to say that it is not to be weighed against the other factors. Notwithstanding the possibility of the Gobindrams paying in Hong Kong, on the evidence the place of performance must be regarded as Japan.

But that is far from being the only factor pointing to Japanese law as the system with which the guarantee has its closest and most real connection. Two of the four co-guarantors resided in Japan, and one of those two, Mr. Kishinchand . . . was the only guarantor who played an active part and actually took decisions for the four. The negotiations between the parties took place in Japan. The guarantee formed part of the Sadhwani operations in Japan, and although the guarantee was legally an independent transaction and separate from the principal debtors' contract with the Bank, its connection with Japanese-based operations is inescapable.

The principal sum guaranteed was expressed in Yen and the guarantee in addition bears a 100-Yen stamp.

All the guarantors had assets in Japan, although Mr. Joshi claimed there were other ways of reaching the Gobindrams.

Some of the factors considered in the context of the second stage are also of obvious relevance. I do not propose to repeat them. It seems to me perfectly plain that it is the system of Japanese law with which the guarantee has its closest and most real connection. The only alternative is Indian law and with that the connection is comparatively tenuous. I have at the second stage explained why I do not attach much weight to the common law form of the guarantee, the English language in which it is expressed and the role of the head office in Bombay.

In my judgment, therefore, the proper law of the contract of guarantee is Japanese law, being the system of law with which it has the closest and most real connection.

The proper law of the contract was Japanese law, and Japanese law excused the Gobindrams from liability. The plaintiff's case was dismissed.

Casepoint

To determine the governing law, courts will apply a three-step test: (1) the law the parties expressly designate; (2) the law the parties impliedly designate; or, if neither (1) nor (2) is clear, then (3) the law with which the transaction has its closest and most real connection will be applied.

Governmental Interest

Courts that apply the **governmental interest doctrine** will make no choice of law unless asked to do so by the parties. If they are not asked, they will apply the law of their own state. If asked, they will then look to see which state has a legitimate interest in determining the outcome of the dispute. If only the forum state has an interest (a *false conflicts* case), they will, of course, apply the forum state's law. If both the forum state and another state or states have some legitimate interest (a *true conflicts* case), then the forum state's laws should be applied because the court obviously understands those interests better. If two states other than the forum state have legitimate interests (also a true conflicts case), then the court should dismiss the case if the state in which the court is located follows the doctrine of *forum non conveniens* (discussed later in this chapter). Otherwise, the court has the choice of applying whichever law it feels is the most appropriate or the law that is most like that of the forum state.

governmental interest doctrine
Doctrine that holds that courts should apply the law of the state that has the most interest in determining the outcome of the dispute.

[152]Albert V. Dicey and J. H. C. Morris, *The Conflict of Laws*, vol. 2, p. 1193 (11th ed., 1985).

F. Refusal To Exercise Jurisdiction

forum non conveniens (From Latin: "inconvenient forum.") Doctrine that a municipal court will decline to hear a dispute when it can be better or more conveniently heard in a foreign court.

As indicated earlier, municipal courts are seldom required to exercise jurisdiction over cases involving international disputes. The doctrine used by common law courts to refuse jurisdiction is called ***forum non conveniens***. It originated from Scottish common law and appeared in U.S. courts in the early 1900s.[153] In the Scottish case, a French plaintiff brought suit in Scotland against a French defendant, claiming damages from cargo lost en route from Scotland to France. The Scottish court, realizing that France had not only better capabilities but also an interest in the decision, dismissed the case, instructing the parties to seek a forum in France. On appeal to the House of Lords, that court found that the doctrine was not only acceptable but prudent.[154]

The U.S. Supreme Court first addressed the issue of *forum non conveniens* in the admiralty case of *Canada Malting v. Paterson Steamships, Ltd*.[155] After a collision between two vessels in American waters, the Canadian owners of cargo lost in the accident sued the Canadian owners of one of the vessels in a federal district court. They did so in large part because U.S. liability rules provided more favorable substantive law than Canadian rules. But the district court dismissed on grounds of *forum non conveniens*, and the Supreme Court affirmed that dismissal.

The opinion in *Canada Malting* by Justice Brandeis declared that courts of equity and law "also occasionally decline, in the interest of justice, to exercise jurisdiction, where the suit is between aliens or non-residents or where for kindred reasons the litigation can more appropriately be conducted in a foreign tribunal."[156]

Moreover, the court rejected the plaintiff-petitioner's contention that the U.S. courts should retain the case in order to protect the plaintiff's choice of forum and choice of law. The Canadian cargo owners had chosen an American court in large part because the relevant American liability rules were more favorable than the Canadian rules, and argued that dismissal was therefore inappropriate, but the district court's dismissal on *forum non conveniens* grounds was ultimately upheld. Thus, a change in substantive law should not affect the application of the doctrine of *forum non conveniens*.[157]

In subsequent cases, the court would apply *forum non conveniens* to nonadmiralty cases (cases in law or equity) and reaffirm the notion that plaintiffs could not resist *forum non conveniens* on the basis of unfavorable substantive law in alternative forums. The basic four-part test for the application of *forum non conveniens* is that the defendant will prevail if there is an alternative forum that is (1) available and (2) adequate, and if (3) private interest factors and (4) public interest factors point toward the alternative forum and away from the U.S. courts. There are some issues with U.S. courts dismissing cases on *forum non conveniens* grounds where the alternative judicial system is seen as corrupt or grossly inefficient.[158] As to the issue of "adequacy" generally, Case 3-8 may prove instructive.

G. Opposition to the Exercise of Jurisdiction

When a litigant brings suit in a foreign court, it sometimes happens that the litigant's home country is opposed to his doing so. The foreign court may dismiss the case using the doctrine of *forum non coveniens;* but if it does not, a court in the litigant's home country may intervene to prevent the litigant

---

[153]Paxton Blair, "The Doctrine of Forum non conveniens in Anglo-American Law," *Columbia Law Review*, vol. 29, p. 1, at pp. 2–3 (1929). Blair notes that a court may dismiss based on *forum non conveniens* "sua sponte," but not "at the close of the trial." *Id*. Charles Eric Ruhr notes that the theory of *forum non conveniens* "was first used in the admiralty courts under other names in the United States in the early part of the nineteenth century. A law journal article in 1929 by Paxton Blair extolled the virtues of *forum non conveniens* dismissals, the greatest one being the virtue of reducing congestion in certain overly used courts, such as the Southern District of New York." Charles Eric Ruhr, "COMMENT: *Forum non conveniens:* A Review of Its Application in Past and Recent Cases," *Tulsa Journal of Comparative and International Law*, vol. 6, p. 247 (Spring 1999).

[154]*Id*. at pp. 20–21, Societe du Gaz de Paris v. Societe Anonyme de Navigation "Les Armateurs Francais," [1926] Sess. Cas. (H.L.) 13.

[155]*Canada Malting v. Paterson Steamships, Ltd*., 285 U.S. 413 (1932).

[156]*Canada Malting*, 285 U.S. at pp. 422–23.

[157]This policy was reiterated in *Piper Aircraft v. Reyno*, 454 U.S. 235 (1981).

[158]*Martinez et al. v. Dow Chemical Company, et al*., 219 F. Supp. 2d 719 (2002) (finding serious due process concerns in dismissing to courts of Honduras and the Philippines based in part on Department of State conclusions about judiciaries in those states).

CASE 3-8 Jorge Luis Machuca Gonzalez et al. v. Chrysler Corporation et al.

United States Court of Appeals for the Fifth Circuit
Federal Reporter, 3rd, p. 377 (2002)

MAP 3.9

The United States and Mexico (2002)

Opinion by Judge Jolly

In this *forum non conveniens* case, we first consider whether the cap imposed by Mexican law on the recovery of tort damages renders Mexico an inadequate forum for resolving a tort suit by a Mexican citizen against an American manufacturer and an American designer of an air bag. Holding that Mexico—despite its cap on damages—represents an adequate alternative forum, we next consider whether the district court committed reversible error when it concluded that the private and public interest factors so strongly pointed to Mexico that Mexico, instead of Texas, was the appropriate forum in which to try this case. Finding no reversible error, we affirm the district court's judgment dismissing this case on the ground of *forum non conveniens*.

In 1995, while in Houston, the plaintiff, Jorge Luis Machuca Gonzalez ("Gonzalez"), saw several magazine and television advertisements for the Chrysler LHS. The advertisements sparked his interest. So, Gonzalez decided to visit a couple of Houston car dealerships. Convinced by these visits that the Chrysler LHS was a high quality and safe car, Gonzalez purchased a Chrysler LHS upon returning to Mexico. On May 21, 1996, the wife of the plaintiff was involved in a collision with another moving vehicle while driving the Chrysler LHS in Atizapan de Zaragoza, Mexico. The accident triggered the passenger-side air bag. The force of the air bag's deployment instantaneously killed Gonzalez's three-year-old son, Pablo.

Seeking redress, Gonzalez brought suit in Texas district court against (1) Chrysler, as the manufacturer of the automobile; (2) TRW, Inc., and TRW Vehicle Safety Systems, Inc., as the designers of the front sensor for the air bag; and (3) Morton International, Inc., as designer of the air bag module. Gonzalez asserted claims based on products liability, negligence, gross negligence, and breach of warranty. As noted, Gonzalez chose to file his suit in Texas. Texas, however, has a tenuous connection to the underlying dispute. Neither the car nor the air bag module was designed or manufactured in Texas. The accident took place in Mexico, involved Mexican citizens, and only Mexican citizens witnessed the accident. Moreover, Gonzalez purchased the Chrysler LHS in Mexico (although he shopped for the car in Houston, Texas). Because of these factors, the district court granted the defendants' identical motions for dismissal on the ground of *forum non conveniens*.[159] Gonzalez now appeals.

[159] In this opinion, the court refers to all defendants collectively as "Chrysler."

The primary question we address today involves the threshold inquiry in the *forum non conveniens* analysis: Whether the limitation imposed by Mexican law on the award of damages renders Mexico an inadequate alternative forum for resolving a tort suit brought by a Mexican citizen against a United States manufacturer. The *forum non conveniens* inquiry consists of four considerations. First, the district court must assess whether an alternative forum is available. An alternative forum is available if "the entire case and all parties can come within the jurisdiction of that forum." An alternative forum is adequate if "the parties will not be deprived of all remedies or treated unfairly, even though they may not enjoy the same benefits as they might receive in an American court." *In re Air Crash*, 821 F.2d at 1165.

If the district court decides that an alternative forum is both available and adequate, it next must weigh various private interest factors. If consideration of these private interest factors counsels against dismissal, the district court moves to the fourth consideration in the analysis. At this stage, the district court must weigh numerous public interest factors. If these factors weigh in the moving party's favor, the district court may dismiss the case.

The heart of this appeal is whether the alternative forum, Mexico, is adequate. [There is no real question as to the availability of Mexican courts.] The jurisprudential root of the adequacy requirement is the Supreme Court's decision in *Piper Aircraft Co. v. Reyno*, 454 U.S. 235, 70 L. Ed. 2d 419, 102 S. Ct. 252 (1981). The dispute in *Piper Aircraft* arose after several Scottish citizens were killed in a plane crash in Scotland. A representative for the decedents filed a wrongful death suit against two American aircraft manufacturers. The Court noted that the plaintiff filed suit in the United States because "[U.S.] laws regarding liability, capacity to sue, and damages are more favorable to her position than are those of Scotland." *Id*. The Court further noted that "Scottish law does not recognize strict liability in tort." *Id*. This fact, however, did not deter the Court from reversing the Third Circuit. In so doing, the Court held that "although the relatives of the decedent may not be able to rely on a strict liability theory, and although their potential damage award may be smaller, there is no danger that they will be deprived of any remedy or treated unfairly [in Scotland]." Thus, the Court held that Scotland provided an adequate alternative forum for resolving the dispute, even though its forum provided a significantly lesser remedy. In a footnote, however, Justice Marshall observed that on rare occasions this may not be true:

> At the outset of any *forum non conveniens* inquiry, the court must determine whether there exists an alternative forum. Ordinarily, this requirement will be satisfied when the defendant is "amenable to process" in the other jurisdiction. In rare circumstances, however, where the remedy offered by the other forum is clearly unsatisfactory, the other forum may not be an adequate alternative, and the initial requirement may not be satisfied. Thus, for example, dismissal would not be appropriate where the alternative forum does not permit litigation of the subject matter of the dispute.

Citing the language from this footnote, Gonzalez contends that a Mexican forum would provide a clearly unsatisfactory remedy because (1) Mexican tort law does not provide for a strict liability theory of recovery for the manufacture or design of an unreasonably dangerous product and (2) Mexican law caps the maximum award for the loss of a child's life at approximately $2,500 (730 days' worth of wages at the Mexican minimum wage rate). Thus, according to Gonzalez, Mexico provides an inadequate alternative forum for this dispute.

Gonzalez's first contention may be quickly dismissed based on the explicit principle stated in *Piper Aircraft*. As noted, there the Supreme Court held that Scotland's failure to recognize strict liability did not render Scotland an inadequate alternative forum. There is no basis to distinguish the absence of a strict products liability cause of action under Mexican law from that of Scotland. *Piper Aircraft* therefore controls. Accordingly, we hold that the failure of Mexican law to allow for strict liability on the facts of this case does not render Mexico an inadequate forum.

Gonzalez's second contention—that the damage cap renders the remedy available in a Mexican forum "clearly unsatisfactory"—is slightly more problematic. Underlying this contention are two distinct arguments: First, Gonzalez argues that if he brings suit in Mexico, the cap on damages will entitle him to a *de minimis* recovery only—a clearly unsatisfactory award for the loss of a child. Second, Gonzalez argues that because of the damage cap, the cost of litigating this case in Mexico will exceed the potential recovery. As a consequence, the lawsuit will never be brought in Mexico. Stated differently, the lawsuit is not economically viable in Mexico. It follows, therefore, that Mexico offers no forum (much less an adequate forum) through which Gonzalez can (or will) seek redress. We address each argument in turn.

In addressing Gonzalez's first argument, we start from basic principles of comity. Mexico, as a sovereign nation, has made a deliberate choice in providing a specific remedy for this tort cause of action. In making this policy choice, the Mexican government has resolved a trade-off among the competing objectives and costs of tort law, involving interests of victims, of consumers, of manufacturers, and of various other economic and cultural values. In resolving this trade-off, the Mexican people, through their duly-elected lawmakers, have decided to limit tort damages with respect to a child's death. It would be inappropriate—even patronizing—for us to denounce this legitimate policy choice by holding that Mexico provides an inadequate forum for Mexican tort victims. . . . In short, we see no warrant for us, a United States court, to replace the policy preference of the Mexican government with our own view of what is a good policy for the citizens of Mexico.

Based on the considerations mentioned above, we hold that the district court did not err when it found that the cap on damages did not render the remedy available in the Mexican forum clearly unsatisfactory.

We now turn our attention to Gonzalez's "economic viability" argument—that is, because there is no economic incentive to file suit in the alternative forum, there is effectively no alternative forum. . . . The practical and economic realities lying at the base of this dispute are clear. At oral argument, the parties agreed that this case would never be filed in Mexico. In short, a dismissal on the ground of *forum non conveniens* will determine the outcome of this litigation in Chrysler's favor.[160] We nevertheless are unwilling to hold as a legal principle that Mexico offers an inadequate forum simply because it does not make economic sense for Gonzalez to file this lawsuit in Mexico. Our reluctance arises out of two practical considerations.

First, the plaintiff's willingness to maintain suit in the alternative (foreign) forum will usually depend on, *inter alia*, (1) whether the plaintiff's particular injuries are compensable (and to what extent) in that forum; (2) not whether the forum recognizes some cause of action among those applicable to the plaintiff's case, but whether it recognizes his most provable and compensable action; (3) similarly, whether the alternative forum recognizes defenses that might bar or diminish recovery; and (4) the litigation costs (i.e., the number of experts, the amount of discovery, geographic distances, attorney's fees, etc.) associated with bringing that particular case to trial. These factors will vary from plaintiff to plaintiff, from case to case. Thus, the forum of a foreign country might be deemed inadequate in one case but not another, even though the only difference between the two cases might be the cost of litigation or the recovery for the plaintiff's particular type of injuries. In sum, we find troublesome and lacking in guiding principle the fact that the adequacy determination could hinge on constantly varying and arbitrary differences underlying the "economic viability" of a lawsuit.

Second, if we allow the economic viability of a lawsuit to decide the adequacy of an alternative forum, we are further forced to engage in a rudderless exercise of line drawing with respect to a cap on damages: At what point does a cap on damages transform a forum from adequate to inadequate? Is it, as here, $2,500? Is it $50,000? Or is it $100,000? Any recovery cap may, in a given case, make the lawsuit economically unviable. We therefore hold that the adequacy inquiry under *Piper Aircraft* does not include an evaluation of whether it makes economic sense for Gonzalez to file this lawsuit in Mexico.

[*The court then considers private and public interest factors and determines that they point more toward Mexico than the United States*.] For the foregoing reasons, the district court's dismissal of this case on the ground of *forum non conveniens* is AFFIRMED.

Casepoint

Under *forum non conveniens*, U.S. courts will not find the alternative forum inadequate even where the laws of the alternative forum would effectively prevent the plaintiff's recovery or even the filing of a lawsuit. The adequacy determination in *forum non conveniens* motions cannot hinge on differences with respect to the economic viability of the lawsuit. As long as the alternative forum's laws provide some remedy, the alternative forum will be deemed adequate.

[160] This fact is not unique to this lawsuit. A survey found that between 1945 and 1985, out of 85 transnational cases dismissed on the ground of *forum non conveniens*, only 4 percent ever reached trial in a foreign court. See *Dow Chemical Company and Shell Oil Company v. Domingo Castro Alfaro*, 786 S.W.2d 674 (1990) (Concurring Opinion, Justice Doggett).

anti-suit injunction
Court order directing a person not to proceed with litigation in a foreign court.

from proceeding with the case. The device the home country court uses is known as an **anti-suit injunction**. This injunction is directed at the litigant, ordering him or her not to proceed with the case. Two different standards are used by courts to determine whether to issue an anti-suit injunction. The first requires a court to consider comity and to grant the injunction to protect its own jurisdiction or to prevent evasion of its public policies. The second allows a court to grant the injunction if the foreign proceedings are vexatious or oppressive or if they will otherwise cause inequitable hardship.[161]

In civil law countries, the problem of multiple courts assuming jurisdiction is dealt with in treaties and statutory rules. Typical of these rules are those in the EU's Regulation on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters.[162] The regulation provides that a court has exclusive jurisdiction if the case involves (1) real property located within the forum, (2) the validity of a business organization formed or incorporated within the forum, (3) the validity of an entry in a public registry located in the forum, (4) the validity of intellectual property rights (such as trademarks, copyrights, and patents) that were granted by the forum government, and (5) the validity of judgments issued within the forum. In cases where the type of proceeding does not dictate exclusive jurisdiction, the court that first assumed jurisdiction over a matter has exclusive jurisdiction. All other courts are required to dismiss the case.

H. Proving Foreign Law

Once a municipal court has decided that it is to apply the law of a foreign state, it must determine what that law is. Courts are held to know their own state's law, and the same assumption is made for international law—the court is assumed to know the rules of international law. Courts, however, are assumed not to know the law of foreign states. In most countries, as a consequence, a party must give advance notice if it intends to raise an issue that requires a court to determine the law of another state.[163] How the law is then ascertained varies from country to country.

In France and countries deriving their law from the French Civil Code, and in the British Commonwealth countries, foreign law is regarded as a factual issue that the parties must prove in the same way they prove any fact. In Germany and countries deriving their law from the German Civil Code, and in the Scandinavian states, foreign law is regarded as law that is to be ascertained by the judge with the assistance, if necessary, of the parties or the Ministry of Justice.[164]

The federal courts and some of the state courts in the United States have recently given up the French and British practice of treating foreign law as a factual issue, and they now regard foreign law as judicially noticeable.[165] That is, judges are allowed to use any relevant source in determining the law of a foreign state, whether or not a party introduces a particular source into evidence. Unlike German judges, however, American judges are not required to consult sources on their own if the parties fail to prove what the foreign law is.

The sources that courts and parties may consult in determining the law of a foreign state include statutory materials, case decisions, commentaries, and (most commonly) expert opinion. This process is facilitated in Europe by the European Convention on Information on Foreign Law,[166] to which most

---

[161]These two standards are discussed in the following chapter in Case 4-3, *Airbus Industrie G.I.E. v. Patel*.

[162]Council Regulation (EC) No 44/2001 of December 22, 2000. *Official Journal L 012*, 16/01/2001, pp. 0001–0023. Available online from Eur-Lex at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32001R0044:EN:html. The EU Regulation is closely related to the rules in the draft Hague Convention on Jurisdiction and Foreign Judgments in Civil and Commercial Matters, a convention being drafted by the Hague Conference on Private International Law. The mission and values for the Convention are available at www.hcch.net/index_en.php?act=text.display&tid=27. Both the EU Regulation and the draft Hague Convention are based on the 1968 Brussels Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters, which was last amended in 1990. The consolidated text of the Brussels Convention in *EU Official Journal C 027*, 26/01/1998, pp. 0001–0027.

[163]The point in time when a court requires a concerned party to give notice of the applicability of a foreign law varies widely from country to country and often from court to court. See "Report of the Committee on Comparative Procedure and Practice," in American Bar Association, Section of International and Comparative Law, *Proceedings*, 1960, pp. 148–176 (1961).

[164]For example, the Polish Law on Civil Procedure, §331(1), provides: "If the necessity arises to apply foreign law, the court shall apply for an expert opinion of the Ministry of Justice, provided that the Court does not know this law or the same cannot be ascertained in the course of the proceedings." Quoted in Hans Koehler, "The Proof of Foreign Law in Poland," *id*., p. 149.

[165]Some state courts continue to follow the French and British practice. See, for example, *Doang Thi Hoang Anh v. Nelson*, *North Western Reporter, Second Series*, vol. 245, p. 511 (Iowa Supreme Court, 1976).

[166]See the text of the convention at http://conventions.coe.int/Treaty/EN/Treaties/Html/062.htm.

member states of the Council of Europe are now signatories. The convention requires signatory states to set up agencies to respond to requests from a court in another signatory state "with information on their law and procedure in civil and commercial fields as well as on their judicial organization."[167]

I. Recognition of Foreign Judgments

Judgments awarded by a municipal court are generally enforced with little difficulty in the forum state. When the court awards a judgment against a foreign defendant, however, the defendant may have few assets in the forum state; or, if the defendant is itself a foreign state, many of its assets may be immune from execution. As a consequence, a victorious plaintiff will often be forced to take the judgment abroad for enforcement.

When asked to convert a foreign judgment into an enforceable local judgment, a court will hold a hearing and, if it believes the request is justified, issue an appropriate order.[168] What it will consider in making this determination varies from state to state. The only universal consideration is that the foreign court must have had jurisdiction before handing down its judgment. Beyond this, the range of national rules runs the gamut from almost complete nonrecognition to nearly obligatory recognition of any judgment granted by a court with jurisdiction. In the Netherlands, for example, a foreign judgment will not be recognized unless the state is a party to a treaty requiring the Dutch courts to do so. On the other hand, U.S. state courts tend to go to the other extreme, especially in those states that have adopted the Uniform Foreign Money Judgment Recognition Act.

Other criteria that courts consider are (1) Is recognition of a foreign judgment contrary to the public policy of the forum state? and (2) Is there reciprocity of recognition (i.e., will the court that handed down the foreign judgment recognize the judgments of the state holding the hearing)? Obviously, as to the first of these, the public policy of particular states varies greatly. Some courts will look at the choice of law determination made by the foreign court. Others may even consider whether the original decision was meritorious. Many courts will not enforce a default judgment or an interlocutory judgment.

Arbitral awards (other than awards handed down by an International Center for the Settlement of Investment Disputes' tribunal) are treated quite differently. In states that are signatories to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards,[169] a foreign arbitral award is recognized and enforced in the same way as a domestic award.[170] In other states, foreign arbitral awards can be enforced only if they are first converted into a judicial judgment in the state where the arbitration was heard.[171]

Chapter Questions

Self-Judging Clause

1. State X has accepted the jurisdiction of the ICJ in a unilateral declaration pursuant to Article 36(2) of the ICJ's statute. The declaration, however, contains the following provision: "This declaration shall not apply to disputes with regard to matters which are essentially within the domestic jurisdiction of State X as determined by State X." (a) Is this provision valid? (b) In a suit between State X and State Y, may State Y invoke this provision as to matters it considers within its own domestic jurisdiction? Explain.

International Court of Justice: Compliance

2. State A sues State B in the ICJ. The Court hands down a judgment that is adverse to State B. State B refuses to comply with the judgment. What can State A do to get State B to comply?

[167]European Convention on Information on Foreign Law, 1968, Article 1(1). In processing a request for information, "[t]he receiving agency may, in appropriate cases for reasons of administrative organization, transmit the request to a private body or to a qualified lawyer to draw up the reply." *Id*., Article 6(2).

[168]In civil law countries, a court adds an endorsement—known as an *exequatur* (From Latin: "he may perform")—to the transcript of a foreign judgment authorizing the judgment to be executed locally.

[169]*United Nations Treaty Series*, vol. 330, p. 3, and online on the UNCITRAL Web site at www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention.html. There are presently 142 states parties to the convention. UNCITRAL, Status of Conventions and Model Laws at www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html.

[170]In addition to the enforcement of arbitral awards, the convention provides (in Article II) for the enforcement of agreements to arbitrate.

[171]In civil law countries, an *exequatur* rather than a judgment is obtained in the state where the arbitration was held. This first *exequatur* is then taken abroad, where another *exequatur* is obtained. This procedure is known as *double exequatur*. Andreas Lowenfeld, *International Litigation and Arbitration*, p. 344, n3 (1993).

ICSID Arbitration

3. State C and State D are both signatories of the Washington Convention that created the International Center for the Settlement of Investment Disputes (ICSID). Both have notified ICSID that they consider all types of investment disputes as arbitrable.

Cee Co. is a multinational firm incorporated in State C. State D asked Cee Co. to set up a subsidiary in its territory and promised Cee Co. that it would give it a tax holiday (i.e., not charge it any local taxes) for 20 years. Cee Co. agreed, but it required State D to sign an ICSID arbitration agreement.

The government of State D has changed, and the new government has cancelled all tax holidays granted to foreign firms, including Cee Co. In anticipation of Cee Co. seeking ICSID arbitration, State D has informed ICSID that it no longer considers disputes relating to taxes as being arbitrable. Cee Co. does ask ICSID to convene an arbitration tribunal. Does the tribunal have jurisdiction to proceed? Explain.

Foreign Sovereign Immunities

4. In the preceding question, assume that Cee Co. obtains an award from the ICSID tribunal. Cee Co. now seeks to enforce the award in a State C court. State D pleads that it is immune from the jurisdiction of the court. What will the court decide? Discuss.

Jurisdiction over Criminal Acts

5. State U had a long-standing relationship with N, the president of State P. President N had regularly provided information to State U's national intelligence agency on activities of the political foes of State U both in State P and in the countries that neighbor State P. At the same time, State U had long ignored N's activities in helping drug runners transport illicit drugs into State U. Now a change in the government in State U has caused State U not only to dissociate itself from the intelligence activities of President N but also to condemn his drug-related dealings. In need of a boost in the political polls, the president of State U orders his military to invade State P and apprehend President N. This is done. President N is then put on trial in a State U court for violation of State U's antidrug statutes. (a) Assuming that the court can be impartial, does it have jurisdiction to try President N? (b) Is President N immune from prosecution? Explain.

Forum Selection Clause

6. Lemon Inc. is a company registered in the U.K. which produces computers and has a call center registered in the Republic of H to address complaints associated with its computer products. The standard terms attached to the computers specify that for any deficiencies in the product, the courts of England would have exclusive jurisdiction, while the courts in the Republic of H would have exclusive jurisdiction over any complaints associated with after-sales service. Ms. Distressed buys a Lemon computer in London that has a problem after the warranty period has expired. The call center provides her with instructions that lead to the computer ceasing to function completely. She sues Lemon Inc. in a London court, arguing that the Republic of H has very low standards of consumer protection and the forum clause in the contract was "unfair." What should the court decide? Discuss.

Restrictive Sovereign Immunity

7. The London Court of Arbitration has granted an arbitral award to Gee Co. The award requires H.R.R., the state-owned railway company in State H, to pay damages to Gee Co., a company headquartered and incorporated in State G, for breach of contract for the carriage of goods. Gee Co. seeks to enforce the award in a British court. H.R.R. pleads that it is immune. What will the court decide? Discuss.

Act of State Doctrine

8. State R decides to nationalize all property within its territory belonging to nationals of the United States. The United States objects that this violates international law, but State R goes ahead anyway. Afterward, R Bank, the national bank of State R, which has assumed ownership of all of the nationalized property, sells the expropriated goods of one Mr. Ess to Tee Co., a firm in the United States. Mr. Ess brings suit in a U.S. court demanding that Tee Co. pay him for goods it received from State R. R Bank intervenes and asks the court to dismiss the suit, claiming that a decision by the court in favor of Mr. Ess would violate the act of state doctrine. The U.S. State Department has declined an invitation to say what effect a decision would have on American foreign policy vis-à-vis State R. Should the court dismiss the case? Explain.

Forum Non Conveniens

9. In relation to the situation discussed in Question 6, assume that Ms. Distressed does not succeed before the London court and decides to sue Lemon Inc's call center in the courts of the Republic of H. Lemon Inc. raises the objection that the courts in the Republic of H are *forum non conveniens* for the present dispute. Lemon Inc. argues that the call center representatives are trained in the U.K. and an assessment of the quality of the service will require evidence to be collected in the U.K. Do you think Lemon Inc. will succeed? Discuss.

CHAPTER 4

The Multinational Enterprise

Chapter Outline

A. Strategies for Doing Business Globally
Exporting and Importing
Branches and Subsidiaries
Licensing Intellectual Property and Franchising
B. The Business Form
The Importance of the Separate Legal Identity of Juridical Entities
C. The Multinational Organization
The Parent Company
The Subordinate Structure
D. International Regulation of Multinational Enterprises
Bribery and Corruption Rules
E. Home State Regulation of Multinational Enterprises
Unfair Competition Laws
Tort and Products Liability Laws
Sharp Practices
F. Host State Regulation of Multinational Enterprises
Consent to the Jurisdiction of the Host State
Common Enterprise Liability
Piercing the Company Veil
Chapter Questions

Introduction

Any business wishing to globalize has a number of choices, ranging from relatively little presence in foreign nations (licensing intellectual property, exporting, importing, franchising) to more intense involvement in legal entities formed in foreign nations (joint ventures, general partnerships, limited partnerships, corporations, and limited liability companies). Most of this chapter on the multinational enterprise (MNE) is devoted to global business strategies that involve foreign legal entities.

MNEs can take on a variety of operational structures, but common to all is the linking of two legal business entities in ways that go beyond contracting and licensing.[1] For example, a parent corporation in one "home" nation-state has subsidiaries in one or more "host" states, or a corporation in one nation-state has a wholly owned subsidiary that is a partner with a business entity in the host state. Thus, obligations between the host and home business entities are more than contractual; an ownership interest is the common bond.

[1]Licensing, particularly where intellectual property is involved, is a fairly common way for a business to operate internationally. See Chapter 9.

Just as with the establishment of business forms, the regulation of multinationals is principally a matter of municipal law (although efforts to devise international standards have recently been made). As a general rule, home states regulate the parent firms and host states regulate the subordinate firms. At times, however, home states are able to regulate foreign subordinates with extraterritorial laws, and host states may regulate the parents by piercing the fictional veil that separates the subordinates from their parents.

A. Strategies for Doing Business Globally

Exporting and Importing

One way for a business to operate internationally is to export its goods (or services) to another nation. This does not require having a subsidiary in a foreign nation, nor does it require a joint-venture or partnership with a foreign business entity. Firms may also operate internationally by importing goods or services from another country.

Exporting does raise issues of a different order from domestic sales: transportation, financing, and contracting[2] must be carefully considered, along with obtaining the proper export licenses. Constraints on exports and imports may also exist at a policy level: National laws may prohibit imports from or exports to certain countries. A current example is prohibitions on certain exports from the European Union to North Korea, or U.S. prohibitions on certain exports to Iran. Generally, Cold War–era restrictions on exports from the United States were numerous; Congress and the President passed several laws that gave the Executive Branch power to restrict exports, such as the Export Administration Act[3] and others.

A business that routinely exports may need full-time export managers who deal with foreign buyers and understand the complexities of compliance with various import and export regulations, transportation/shipping issues, and financing. Foreign sales agents are available for businesses that do not have full-time export managers. Alternatively, exports can be arranged through independent firms in the destination nation. Such a firm, acting as a "foreign distributor," may take on the risk of buying the goods, warehousing them, and servicing the imported product.

A business that exports, imports, or grants licenses to a foreign national or foreign business entity is not a "multinational enterprise" as that term is commonly used. Even where the business has a host country branch or a representative office, there may be multinational business, but not a true multinational enterprise.[4]

Branches and Subsidiaries

A branch office of a company can be set up in the United States by registering with a state agency, often a secretary of state's office. A branch is usually considered to be just an extension of the corporation, which is generally liable for any debts of the branch. In Chapter 6, we consider banks and their branches, which are a special case; most banks doing business in the United States, for example, must register not only with state authorities, but also with the Federal Reserve Bank. Establishing a branch, as China Merchants Bank did in 2008, does not create a multinational enterprise as such (see Reading 4-1).

Short of establishing a branch, a business entity may simply engage a foreign agent to serve as a representative of the business. The agent may do market analysis and product promotion or may also serve as an import representative. Host country laws will determine what the agent may or may not do. For example, the agent may be empowered to obtain leads or do limited marketing but not to enter into contracts. A business with an agent or representative office in a foreign nation is generally not considered to be doing business in the foreign country. As such, the business would not be subject to the foreign nation's regulations and would only be subject to taxes there for monies earned there.

[2]See Chapters 10–12 of this book.

[3]For a Congressional Research report on the Export Administration Act, see www.fas.org/sgp/crs/secrecy/RL31832.pdf.

[4]In Chapter 6, it is noted that banks that have branches in foreign countries may be treated in some instances as though the branch is an unrelated entity, entirely subject to the laws of the host country; in other instances, the branch is treated as mere extensions of their parents.

Reading 4-1 China Merchants Bank

In the 1980s, Japanese banks followed their corporate customers to the United States and set up branches, eventually acquiring banks like the Bank of California—now part of San Francisco's UnionBanCal Corp.

Some Chinese companies have already started to expand in the United States. But expansion was somewhat dampened after 2005, when the Chinese oil company CNOOC Ltd. abandoned a takeover bid for California's Unocal in 2005. In 2006, Chinese companies announced four U.S. acquisitions worth $25 million. More recently, the Federal Reserve has allowed more substantial Chinese banking connections, but in 2008, the China Merchants Bank branch was a major development in U.S. Chinese banking.

China Merchants Bank is partly owned by a Chinese government transportation company and is listed on the Hong Kong stock market. The bank controls one-third of China's credit card market and has many affluent customers in China. China Merchants Bank is China's sixth largest lender, and in March 2007 made application to the Federal Reserve Bank of New York to open a New York branch. The intent was to have a New York branch that would make loans and take commercial deposits. The Federal Reserve acts as a U.S. bank regulator and monetary authority.

In 1991, both the Bank of China Ltd. and the Bank of Communications opened branches in New York City. But the Foreign Bank Supervision Enhancement Act (FBSEA) was passed after U.S. regulators discovered substantial money laundering and fraud by Pakistan's Bank of Credit and Commerce International (BCCI). Regulations under the FBSEA gave oversight to new foreign bank applicants to the U.S. Federal Reserve and made foreign bank branches in the United States more difficult to establish.

On October 8, 2008, China Merchants Bank became the first Chinese bank to open a branch in the United States since the inception of the FBSEA. According to its website, the New York branch offers a wide range of cash management, corporate banking, trade finance, project finance, trading, and consulting services.

To approve China Merchants' application, the Federal Reserve had to decide that the foreign parent bank is subject to "comprehensive, consolidated supervision" by banking authorities in the home country. China Merchants Bank is supervised by the China Banking Regulatory Commission, which was established in 2004 to clean up China's bad loans and reduce the risk of bank failures.

In May of 2012, The US Federal Reserve announced its approval of China's largest bank to purchase a US bank and two other large Chinese banks to expand their business in US banking market.

The Fed approved the Industrial and Commercial bank of China Limited, China's largest bank, and two other Chinese investing firms to become bank holding companies by acquiring up to 80 percent of the voting shares of The Bank of East Asia USA, located in New York city.

The Bank of East Asia USA has total assets of approximately $780 million and operates 13 branches in New York and California, reported the Chinese news agency, Xinhua.

The Fed also approved an application of the Bank of China, the third largest bank in China, to establish a branch in Chicago and an application by the Agricultural Bank of China, the fourth largest bank in China, to set up a branch in New York City.

The applications were approved after the conclusion of the fourth round of China-US Strategic and Economic Dialogue in May of 2012. The U.S. officials were generally positive during the meetings about applications from China's major banks for mergers and new branches in the U.S.

Licensing Intellectual Property and Franchising

Licensing of intellectual property rights (including patents, trademarks, and copyrights) is an increasingly common way to create business opportunities in foreign markets. A license is a contractual grant of a legally recognized right; it becomes an international marketing tool whereby the license of a business entity in one nation is extended to a party in a different nation. Even beyond patents, trademarks, and copyrights, a business in one nation may license trade secrets, trade dress,[5] minor technological methods or processes, or protectable business plans and processes (as in franchising). Franchising from one nation to another involves substantial elements of intellectual property: trade secrets and trademarks are both integral parts of franchising.

Chapter 9 covers most legal aspects of intellectual property and licensing for international business transactions. There are various reasons for a business in one nation to consider licensing intellectual property to a foreign entity rather than undertake direct production of goods or providing of services in a host country. Perhaps the transportation of goods across great distances is cost-prohibitive, or perhaps the nature of the goods themselves makes shipping by sea inadvisable (fragile goods or goods likely to lose quality if exposed to moisture). Or perhaps the culture of the home country is so different from that of the host country that local expertise must be called on to make the franchise's brand viable. Trying to manage the brand from the host country may not be the best marketing strategy. Also, a foreign market sometimes has national laws that restrict the import of

[5]Trade dress protection in the United States is available under the Lanham Act for shape, packaging, colors, or combinations of those elements. But trade dress is protectable only if it would commonly identify the manufacturer or origin of the product. Thus, the distinctive shape of a bottle of Coke® or the round Honeywell thermostat may be protected as trade dress. However, in India, under the new Trade Marks Act of 1999, shape, packaging, and colors are protected as trademarks.

finished goods; licensing a foreign entity to produce the product allows the owner to collect royalties through contract with the foreign entity, and allows the foreign entity the chance to capitalize on the brand name and goodwill of the product's owner.

Restrictions on franchising can be found in many municipal legal systems. Some states in the United States restrict a franchisor from terminating a franchisee without cause. In the European Union, there are important guidelines that govern contractual relations and limit what franchisors and franchisees can do.[6]

B. The Business Form

States will tend to authorize or forbid different business forms based on political ideology as well as economic and social needs. In certain sectors of the economy, the business entity must be a public corporation or have some form of state-ownership. As a result, the company laws in various countries may have many unique features. Businesses attempting to go beyond branch offices to create subsidiaries or partnerships must look closely at the particular laws of a host country.

The Importance of the Separate Legal Identity of Juridical Entities

Corporations and certain other companies[7] are juridical entities that have legal identities separate from those of their owners. This separate legal identity has several important consequences. First, it means that the liability of the owners is limited to their investment in their company. Thus, a company's owners are usually not required to pay the company's obligations from their personal estates. Second, it means that rights and benefits accruing to the company belong to the company, not to its owners. In other words, only a company may lay claim to its own property. Additionally, for some companies (i.e., most kinds of corporations), the owners are neither managers nor agents nor representatives of the company; they may not, on their own, make decisions on behalf of the company, or commit the company to perform contractually, or commit crimes, torts, or delicts that would impose liability on the company.

In Case 4-1, the ICJ was asked to ignore the separate legal identity of a Canadian corporation owned principally by Belgian nationals so that Belgium could bring a claim on the owners' behalf. The court refused to do so.

C. The Multinational Organization

The Parent Company

To carry out operations internationally, large business firms have adapted their organizational structures to share risks and to take advantage of economies of scale. The simplest international operating structure is the **nonmultinational enterprise**, in which a firm organized in one country contracts with an independent foreign firm to carry out sales or purchasing abroad. Somewhat more complex is the *national multinational enterprise*, in which a parent firm established in one country establishes wholly owned branches and subsidiaries in other countries. The most complex is the *international multinational enterprise* made up of two or more parent firms from different countries that co-own operating businesses in two or more countries.

nonmultinational enterprise
A domestic firm that operates internationally through independent foreign agents.

The Nonmultinational Enterprise Many domestic firms function in the international marketplace through a foreign agent. The agent, who may be a private individual or an independent firm, acts on behalf of the domestic firm or *principal* to either sell the principal's goods or services abroad

[6]Martin Mendelsohn, *Franchising in Europe,* vol. 36, no. 2, pp. 72–73 (March 2004) and Richard Kemp, "Technology's Transfer Game (European Community Regulations on Franchising and Licensing Agreements)," *Management Today*, vol. 106, no. 1 (January 1989).

[7]All companies in France are juridical entities. In Germany, however, partnerships are not juridical entities, but other companies (including limited partnerships) are. In the common law countries, only corporations (including LLCs) are juridical entities; partnerships and limited partnerships are not.

CASE 4-1 Case Concerning Barcelona Traction, Light and Power Co. (Second Phase)

Belgium v. Spain
International Court of Justice, 1970
International Court of Justice Reports, vol. 1970, p. 3 (1970); International Law Reports, vol. 46, p. 178 (1973)

MAP 4.1

Belgium and Spain (1970)

The Barcelona Traction, Light, and Power Co. was incorporated in 1911 under Canadian law for the purpose of supplying electricity in Spain. In 1938, Spain declared the company bankrupt and took other actions detrimental to it and its shareholders. Canada would not bring a suit in the International Court of Justice, but, since an alleged 88 percent of the shareholders were Belgian, Belgium did. Spain objected that Belgium could not sponsor a complaint on behalf of Barcelona Traction's owners because only the corporation had been injured and the corporation was not Belgian.

Judgment of the Court . . .

Seen in historical perspective, the corporate personality represents a development brought about by new and expanding requirements in the economic field, an entity which in particular allows of operation in circumstances which exceed the normal capacity of individuals. As such, it has become a powerful factor in the economic life of nations. Of this, municipal law has had to take due account, whence the increasing volume of rules governing the creation and operation of corporate entities, endowed with a specific status. These entities have rights and obligations peculiar to themselves.

There is, however, no need to investigate the many different forms of legal entity provided for by the municipal laws of states, because the Court is concerned only with that exemplified by the company involved in the present case: Barcelona Traction—a limited liability company

whose capital is represented by shares. There are, indeed, other associations, whatever the name attached to them by municipal legal systems, that do not enjoy independent corporate personality. The legal difference between the two kinds of entity is that for the limited liability company it is the overriding tie of legal personality which is determinant; for the other associations, the continuing autonomy of the several members.

Municipal law determines the legal situation not only of such limited liability companies but also of those persons who hold shares in them. Separated from the company by numerous barriers, the shareholder cannot be identified with it. The concept and structure of the company are founded on and determined by a firm distinction between the separate entity of the company and that of the shareholder, each with a distinct set of rights. The separation of property rights as between company and shareholder is an important manifestation of this distinction. So long as the company is in existence, the shareholder has no right to the corporate assets.

It is a basic characteristic of the corporate structure that the company alone, through its directors or management acting in its name, can take action in respect of matters that are of a corporate character. The underlying justification for this is that, in seeking to serve its own best interests, the company will serve those of the shareholder too. Ordinarily, no individual shareholder can take legal steps, either in the name of the company or in his own name. If the shareholders disagree with the decisions taken on behalf of the company they may, in accordance with its articles or the relevant provisions of the law, change them or replace its officers, or take such action as is provided by law. Thus to protect the company against abuse by its management or the majority of shareholders, several municipal legal systems have vested in shareholders (sometimes a particular number is specified) the right to bring an action for the defense of the company, and conferred upon the minority of shareholders certain rights of the company vis-à-vis[8] its management or controlling shareholders. Nonetheless the shareholders' rights in relation to the company and its assets remain limited, this being, moreover, a corollary of the limited nature of their liability.

At this point the Court would recall that in forming a company, its promoters are guided by all the various factors involved, the advantages and disadvantages of which they take into account. So equally does a shareholder, whether he is an original subscriber of capital or a subsequent purchaser of the company's shares from another shareholder. He may be seeking safety of investment, high dividends or capital appreciation—or a combination of two or more of these. Whichever it is, it does not alter the legal status of the corporate entity or affect the rights of the shareholder. In any event he is bound to take account of the risk of reduced dividends, capital depreciation or even loss, resulting from ordinary commercial hazards or from prejudice caused to the company by illegal treatment of some kind.

Notwithstanding the separate corporate personality, a wrong done to the company frequently causes prejudice to its shareholders. But the mere fact that damage is sustained by both company and shareholder does not imply that both are entitled to claim compensation. Thus no legal conclusion can be drawn from the fact that the same event caused damage simultaneously affecting several natural or juristic persons. Creditors do not have any right to claim compensation from a person who, by wronging their debtor, causes them loss. In such cases, no doubt, the interests of the aggrieved are affected, but not their rights. Thus whenever a shareholder's interests are harmed by an act done to the company, it is to the latter that he must look to institute appropriate action; for although two separate entities may have suffered from the same wrong, it is only one entity whose rights have been infringed.

However, it has been argued in the present case that a company represents purely a means of achieving the economic purpose of its members, namely the shareholders, while they themselves constitute in fact the reality behind it. It has furthermore been repeatedly emphasized that there exists between a company and its shareholders a relationship describable as a community of destiny. The alleged acts may have been directed at the company and not the shareholders, but only in a formal sense: in reality, company and shareholders are so closely interconnected that prejudicial acts committed against the former necessarily wrong the latter; hence any acts directed against a company can be conceived as directed against its shareholders, because both can be considered in substance, i.e., from the economic viewpoint, identical. Yet even if a

[8]From French: "face to face"; in relation to each other.

company is no more than a means for its shareholders to achieve their economic purpose, so long as it is *in esse*[9] it enjoys an independent existence. Therefore, the interests of the shareholders are both separable and indeed separated from those of the company, so that the possibility of their diverging cannot be denied.

It has also been contended that the measures complained of, although taken with respect to Barcelona Traction and causing it direct damage, constituted an unlawful act vis-à-vis Belgium, because they also, though indirectly, caused damage to the Belgian shareholders in Barcelona Traction. This again is merely a different way of presenting the distinction between injury in respect of a right and injury to a simple interest. But, as the Court has indicated, evidence that damage was suffered does not *ipso facto*[10] justify a diplomatic claim. Persons suffer damage or harm in most varied circumstances. This in itself does not involve the obligation to make reparation. Not a mere interest affected, but solely a right infringed involves responsibility, so that an act directed against and infringing only the company's rights does not involve responsibility towards the shareholders, even if their interests are affected.

The situation is different if the act complained of is aimed at the direct rights of the shareholder as such. It is well known that there are rights which municipal law confers upon the latter distinct from those of the company, including the right to any declared dividend, the right to attend and vote at general meetings, the right to share in the residual assets of the company on liquidation. Whenever one of his direct rights is infringed, the shareholder has an independent right of action. On this there is no disagreement between the parties. But a distinction must be drawn between a direct infringement of the shareholder's rights, and difficulties or financial losses to which he may be exposed as the result of the situation of the company.

The Court found that the injured party was the company and not its owners. Therefore, Belgium could not bring suit against Spain on behalf of the company's Belgian owners.

The Court noted that Spain had made no objection to Canada bringing a complaint if it chose to do so. "The Canadian government's right of protection in respect of the Barcelona Traction Company," the Court concluded, "remains unaffected by the present proceedings." Canada, nevertheless, chose not to complain.

Casepoint

A company is an entity that is independent of its shareholders. Shareholders only have limited liability, so their rights in relation to the company and its assets are also limited. When a shareholder's interests are harmed by an act done to the company by a nation-state, it is the company that must seek judicial remedies and not the shareholders, unless specific shareholder rights are infringed by the state's action.

(in which case the agent is commonly called a *sales representative*) or to buy goods or procure services for the principal (the agent sometimes being called a *factor*). Neither the principal nor the agent is truly a multinational enterprise, however, because neither operates outside its home state. Their relationship is governed by an agency contract and by the agency laws of the home and host countries.

The National Multinational Enterprise A **national multinational enterprise** consists of a firm in one country—the *parent*—operating in other countries through branches and subsidiaries. A branch is a unit or a part of the parent (such as an overseas purchasing office, assembly plant, manufacturing plant, or sales office), whereas a subsidiary is a company organized as a separate legal entity that is owned by the parent.

national multinational enterprise
An enterprise organized around a parent firm established in one state that operates through branches and subsidiaries in other states.

The parents of national multinationals are most likely to be found in the United States, Europe, China, India, Brazil, and Japan. Examples are the Ford Motor Company and the Mitsubishi Group (see Figure 4.1). Incorporated in the United States in the state of Michigan in 1903, the Ford Motor Company in its early years employed sales representatives in many foreign countries. As sales increased, branch sales offices were opened, then branch assembly plants. Because of tax

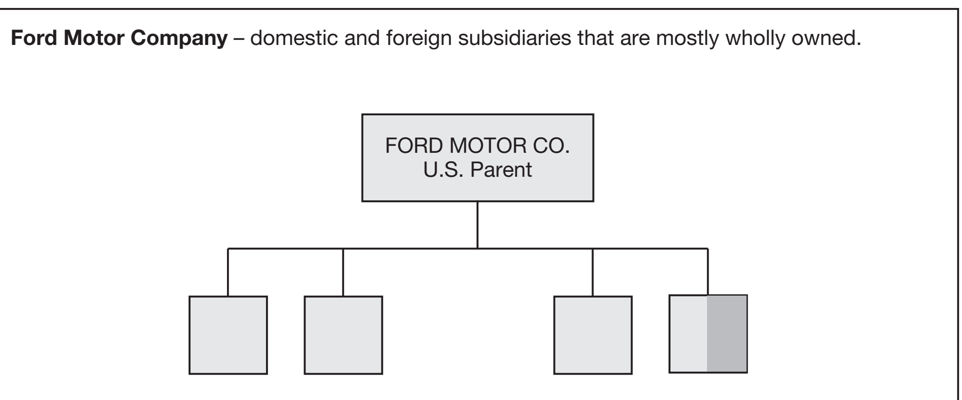
[9]From Latin: "in being"; in actual existence.

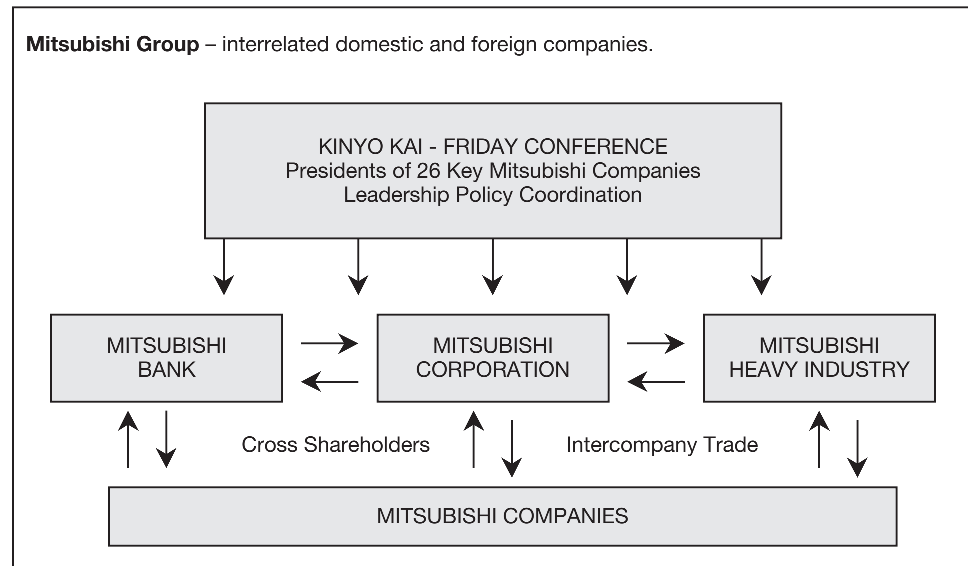
[10]From Latin: "by that very fact."

FIGURE 4.1

National Multinational Enterprises

Source: Hoover's Handbook of World Business 2002 *(Hoover's Inc., 2002) and Robert E. Tindall,* Multi-national Enterprises: Legal & Management Structures & Interrelationship with Ownership, Control, Antitrust, Labor, Taxation, & Disclosure *(Dobbs Ferry, NY: Oceana Publications, 1975).*





considerations and to insulate the parent company from local liability, the branches were converted into locally organized subsidiaries. For a brief period (from the late 1920s to the late 1940s), some of the foreign subsidiaries were jointly owned by local investors, but following World War II, Ford reacquired direct ownership of its entire overseas operation.

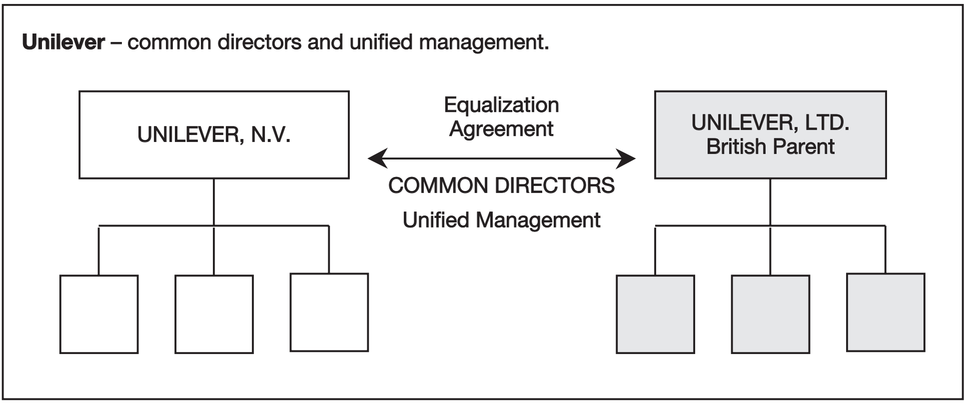
The Mitsubishi Group is a Japanese multinational made up of about 40 individual companies. Unlike Ford, however, there is no parent company. Each of the Mitsubishi companies owns substantial portions of the shares of the others. Instead of a parent company exercising control over subsidiaries, the group operates under the direction of a triumvirate of the three most important sister companies: the Mitsubishi Bank, the Mitsubishi Corporation, and Mitsubishi Heavy Industries. The senior managers of these three companies act as the co-chairmen of a coordinating board called the Kinyo-Kai, or Friday Conference. The Kinyo-Kai, which is made up of the top executives of 25 of the Mitsubishi companies, establishes common policies as a sort of senior board of directors for the entire group.

international multinational enterprise An enterprise made up of two or more parents from different states that co-own subordinate operating businesses in two or more states.

The International Multinational Enterprise The **international multinational enterprise** is like a national multinational in that it operates through subsidiaries. The difference lies in its having two or more parent companies located in different states. Most international multinationals have come about from the merger of parent firms operating in different Western European countries.

Examples of international multinationals are Unilever, the Royal Dutch/Shell Group, and Reed Elsevier (see Figure 4.2).

Unilever, a consumer goods manufacturer, is a combination of Dutch and British parent companies that together own and operate subsidiaries around the world. The two parent companies are governed by an *equalization agreement* that has been incorporated into the Articles of Association



Royal Dutch/Shell Group – jointly owned holding company with some common directors and a unified management.

ROYAL DUTCH
Dutch Parent
60%
40%
SHELL TRANSPORT
British Parent
60%
40%
Dutch
Holding Company
GROUP
MANAGING
DIRECTORS
British
Holding Company
Unified Management

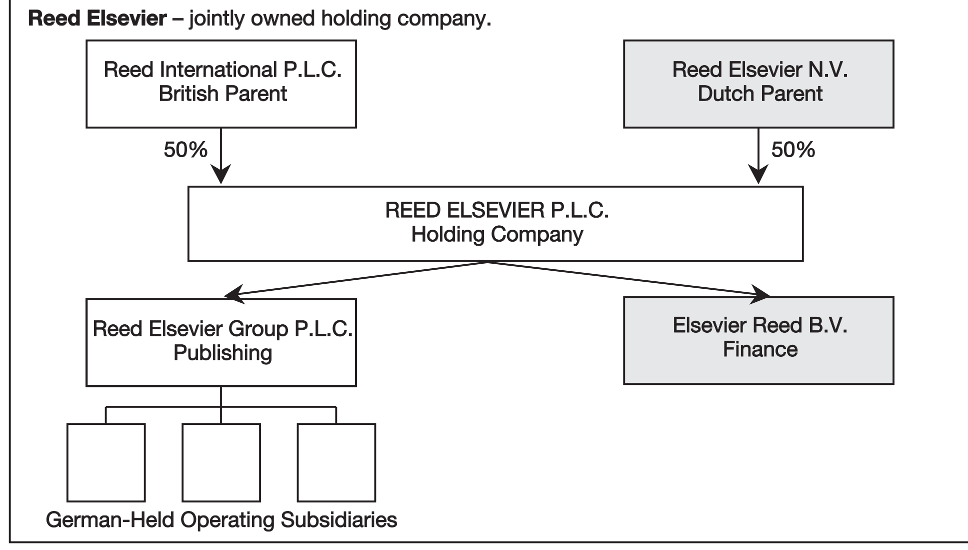


FIGURE 4.2

International Multinational Enterprises with Common Directorates

Source: Hoover's Handbook of World Business 2002 *(Hoover's Inc., 2002) and Robert E. Tindall,* Multi-national Enterprises: Legal & Management Structures & Interrelationship with Ownership, Control, Antitrust, Labor, Taxation, & Disclosure *(Dobbs Ferry, NY: Oceana Publications, 1975).*

of both. It arranges for the boards of both parents to be made up of the same individuals, and it guarantees equal treatment for both companies' shareholders.[11] To ensure that the directors are the same, both parents have set up wholly owned subsidiaries and transferred half of a special class of their

[11]The dividends paid to both companies' shareholders have to be the same, and both companies' shareholders are given the same rights should the enterprise ever be liquidated.

own shares to each of these subsidiaries. This special class of shares has the exclusive right to nominate directors; the ordinary shareholders are only allowed to elect directors who are nominated by the wholly owned subsidiaries.

The Royal Dutch/Shell Group, an oil and gas company, is another combination of Dutch and British parents. Rather than having common directors sit on the boards of the two parents, the two parents jointly own two holding companies that in turn own the operating subsidiaries. The two holding companies share some directors in common, and these serve as the managing directors of the entire group.

Reed Elsevier, a publishing and financing firm, is a third Dutch-British combination that came into being in 1993. Reed International P.L.C., incorporated in the United Kingdom, and Elsevier N.V., incorporated in the Netherlands, each own 50 percent of Reed Elsevier P.L.C., a holding company incorporated in the United Kingdom that owns the Reed Elsevier Group P.L.C., which operates publishing and information businesses, and Elsevier Reed B.V., which is a financing firm.

representative office
A contact point where interested parties can obtain information about a company. It does not conduct business for the company.

The Subordinate Structure

To do business internationally, companies must establish a foreign presence. This requires the creation of subordinate entities, such as representative offices, agencies, branches, subsidiaries, joint ventures, and holding companies (see Table 4.1). As noted earlier in the chapter, the representative offices, agencies, and branches do not create separate entities in the host country.

A **representative office** does not actually conduct business; rather, it functions as a foreign contact point where interested parties can obtain information about a particular firm.

agent
An independent person or company with authority to act on behalf of another.

An **agent** is an individual who is employed as an independent representative of a firm. Agents are subject to the supervision of the parent firm (or principal), and the authority that they can exercise is limited to what the parent delegates to them. While in the host country, they are subject to the laws of that sovereign.

branch
Unit or part of a company. It is not separately incorporated.

A **branch** is a unit of the parent company that involves not only the placement of individuals in a particular locale but also the establishment of a facility, such as an assembly plant, mining operation, or service office. As with an agency, the authority of branch personnel, including the manager and employees, is limited to what the parent has delegated.

Establishing representative offices, agencies, and branches is advantageous because these entities allow the parent to maintain direct control of the foreign operation. The practice can be disadvantageous, however, because (1) the parent has to assume all of the risk of investing abroad, (2) a foreign firm (or its agent or its branch) is often taxed at higher rates than local firms, and (3) many developing states require local participation in order for a foreign firm to either invest or expand its local investment.

subsidiary
Company owned by a parent or a parent's holding company. Unlike a branch, it is separately incorporated.

Because of these disadvantages, many multinational enterprises set up subsidiaries, joint ventures, and holding companies.

A **subsidiary** is an independently organized and incorporated company. Setting up a subsidiary can benefit a multinational firm because the subsidiary's company status insulates the parent from unlimited liability and because locally organized companies are commonly entitled to certain tax benefits that foreign branches are not.

TABLE 4.1

The parts of a multinational enterprise

Term	Definition
Parent company	Company that acts as the head office for a multinational enterprise and that owns and controls the enterprise's subordinate entities.
Branch	Unit or part of a company. It is not separately incorporated.
Agent	An independent person or company with authority to act on behalf of the enterprise.
Representative office	A contact point where interested parties can obtain information about the company. It does not conduct business for the company.
Holding company	Company owned by parent or parents to supervise and coordinate the operations of subsidiary companies.
Subsidiary	Company owned by a parent or a parent's holding company. Unlike a branch, it is separately incorporated.
Joint venture	An association of persons or companies collaborating in a business venture for more than a transitory time period. May be set up as an association or a company.

A **joint venture** is an association of persons or companies that are involved in a collaboration for more than a transitory period. It can assume any type of business form, including that of an association, a partnership, a limited partnership, a secret partnership, or an LLC. Multinational enterprises use joint ventures as a way to share risk and to facilitate entry into foreign markets. Although the joint venturers may be from the same home state or two different home states, more commonly at least one is from the host state. Indeed, many developing states insist on local participation, and a joint venture may be the only practical form for carrying on business in such a place. The venture can be for one specific project only, or a continuing business relationship such as the Sony/Ericsson joint venture. A joint venture may be a corporation, LLC, partnership or other legal structure, depending on a number of considerations such as tax and tort liability.

joint venture An association of persons or companies collaborating in a business venture for more than a transitory time period.

A **holding company** is a subsidiary company that in turn owns other subsidiaries. Holding companies are created primarily (1) to establish a consolidated management team for a group of subsidiaries or subsidiaries owned by different parents or (2) for tax advantages. Commonly, a holding company is an LLC whose shares are held by its parent or parents. For example, Berkshire Hathaway Inc. is one of the largest publicly traded holding companies.

holding company Company owned by a parent or parents to supervise and coordinate the operations of subsidiary companies.

D. International Regulation of Multinational Enterprises

Rules of ethical behavior for multinational enterprises have been promulgated by several international organizations, including the Organization for Economic Cooperation and Development (OECD), the International Labor Organization (ILO), and the World Bank.[12] Until recently, these were only suggested rules that multinationals were asked to comply with voluntarily, and most international rules continue to be voluntary. One framework for voluntary compliance on corporate social responsibility is described in Reading 4-2.

Reading 4-2 The ISO 26,000 Standard for Global Business Conduct

In a 2001 article for the *Financial Times*, Alison Maitland wrote that "there is little that is black and white about the many international agreements and principles drawn up in the past few years to promote ethical business conduct."[13] For many years, there were only broad statements exhorting multinationals to contribute to economic progress, respect human rights, and promote sustainable development. But the U.S. Ethics Officer Association, a non-profit organization representing 400 mainly U.S.-based multinationals, provided the impetus to use the International Standards Organization to create a new kind of measurement tool for global corporate responsibility. Members of the U.S. Ethics Officer Association include General Motors, Microsoft, Pfizer, Philip Morris, and Royal Dutch/Shell.

"An ISO standard is all about process, not aspirations or objectives," said Edward Petry, executive director of the EOA in 2001. "It provides specific guidance as to what any new management system must include and it hopes to achieve consistency, clarity, and measurability of internal processes."

Modeled on the ISO 9000 standard for quality management and the ISO 14000 for environmental management, ISO 26,000 sets out the internal structures, processes, and resources that organizations need to ensure that they adhere to their stated principles. It would require them to draw up a policy for business conduct, implement it, assess how well it is working, make improvements, and keep it under review.

According to Maitland, the initiative was driven by EOA members that are "under pressure from stakeholders and the financial community to provide assurance of their own ethical commitments and are concerned about the potential risk to their reputation from relations with joint venture partners and suppliers." It was hoped that an international standard might also help to fend off a series of requests to sign up to alternative codes and guidelines.

Mr. Petry noted at the time that a lack of mandatory certification would probably not satisfy some stakeholder groups. Maitland noted that some companies "may opt for external accreditation to comply with customers' or regulatory requirements or to enhance their reputation."

ISO 26,000 Project Overview

The International Standard ISO 26,000:2010, *Guidance on social responsibility*, provides harmonized, globally relevant guidance for private and public sector organizations of all types based on international consensus among

[12] See International Regulation of Multinational Corporations—selected Web-based resources at www1.umn.edu/humanrts/bibliog/businessconductlinks.html.

[13] Alison Maitland, "An Acid Test for Better Conduct in Business," *Financial Times*, August 12, 2001.

expert representatives of the main stakeholder groups, and so encourage the implementation of best practice in social responsibility worldwide.

- ISO 26,000 both adds value to existing work on social responsibility (SR) and extends the understanding and implementation of SR by:
  - Developing an international consensus on what SR means and the SR issues that organizations need to address
  - Providing guidance on translating principles into effective actions
  - Refining best practices that have already evolved and disseminating the information worldwide for the good of the international community.

What Is ISO 26,000?

ISO 26,000 is an ISO International Standard giving guidance on social responsibility (SR). It is intended for use by organizations of all types, in both public and private sectors, in developed and developing countries, as well as in economies in transition. It will assist them in their efforts to operate in the socially responsible manner that society increasingly demands.

ISO 26,000 contains voluntary guidance, not requirements, and therefore is not for use as a certification standard like ISO 9001:2008 and ISO 14001:2004.

Why Is ISO 26,000 Important?

Sustainable business for organizations means not only providing products and services that satisfy the customer, and doing so without jeopardizing the environment, but also operating in a socially responsible manner.

Pressure to do so comes from customers, consumers, governments, associations, and the public at large. At the same time, far-sighted organizational leaders recognize that lasting success must be built on credible business practices and the prevention of such activities as fraudulent accounting and labour exploitation.

On the one hand, there have been a number of high-level declarations of principle related to SR and, on the other, there are many individual SR programmes and initiatives. The challenge is how to put the principles into practice and how to implement SR effectively and efficiently when even the understanding of what "social responsibility" means may vary from one programme to another. In addition, previous initiatives have tended to focus on "corporate social responsibility", while ISO 26,000 will provide SR guidance not only for business organizations, but also for public sector organizations of all types.

ISO's expertise is in developing harmonized international agreements based on double levels of consensus—among the principal categories of stakeholder, and among countries (ISO is a network of the national standards bodies of 163 countries).

ISO 26,000 will distill a globally relevant understanding of what social responsibility is and what organizations need to do to operate in a socially responsible way.

How Will ISO 26,000 Help Organizations?

ISO 26,000 will help all types of organizations—regardless of their size, activity, or location—to operate in a socially responsible manner by providing guidance on:

- Concepts, terms and definitions related to social responsibility
- Background, trends and characteristics of social responsibility
- Principles and practices relating to social responsibility
- Core subjects and issues related to social responsibility
- Integrating, implementing and promoting socially responsible behaviour throughout the organization and, through its policies and practices, within its sphere of influence
- Identifying and engaging with stakeholders
- Communicating commitments, performance and other information related to social responsibility

What Does ISO 26,000 Contain?

The contents of ISO 26,000 are structured as follows:

- Foreword
- Introduction
- 1 Scope
- 2 Terms and definitions
- 3 Understanding social responsibility
- 4 Principles of social responsibility
- 5 Recognizing social responsibility and engaging stakeholders
- 6 Guidance on social responsibility core subjects
- 7 Guidance on integrating social responsibility throughout an organization
- Annex A—Examples of voluntary initiatives and tools for social responsibility
- Annex B—Abbreviated terms
- Bibliography

The guidance provided in these sections is intended to be clear and understandable—even to nonspecialists—as well as objective and applicable to all types of organizations, including big business and small and medium-sized enterprises, public administrations, and governmental organizations.

How Does ISO 26,000 Relate to Existing Good Work?

The guidance in ISO 26,000 draws on best practice developed by existing public and private sector SR initiatives. It is consistent with and complements relevant declarations and conventions by the United Nations and its constituents, notably the International Labour Organization (ILO), with whom ISO has established a Memorandum of Understanding (MoU) to ensure consistency with ILO labour standards. ISO has also signed MoUs with the United Nations Global Compact Office (UNGCO) and with the Organisation for Economic Co-operation and Development (OECD) to enhance their cooperation on the development of ISO 26,000.

How Did the ISO 26,000 Initiative Come About?

The need for ISO to work on an SR standard was first identified in 2001 by ISO/COPOLCO, Committee on consumer policy. In 2003, the multi-stakeholder ISO Ad Hoc Group on SR which had been set up by ISO's

Technical Management Board (TMB), completed an extensive overview of SR initiatives and issues worldwide.

In 2004, ISO held an international, multi-stakeholder conference on whether or not it should launch SR work. The positive recommendation of this conference led to the establishment in late 2004 of the ISO Working Group on Social Responsibility (ISO/WG SR) to develop the future ISO 26,000 standard.

What Will ISO 26,000 Achieve?

ISO 26,000 will integrate international expertise on social responsibility—what it means, what issues an organization needs to address in order to operate in a socially responsible manner, and what is best practice in implementing SR. ISO 26,000 will be a powerful SR tool to assist organizations to move from good intentions to good actions.

Who Developed ISO 26,000?

The membership of the ISO/WG SR was the largest and the most broadly based in terms of stakeholder representation of any single group formed to develop an ISO standard.

Six main stakeholder groups were represented: industry, government, labor, consumers, nongovernmental organizations, and participants in service and research of SR issues. In addition, geographical and gender-based balance among participants was achieved.

Under the joint leadership of the ISO members for Brazil (ABNT) and Sweden (SIS), it was made up of experts from ISO members (national standards bodies—NSBs) and from liaison organizations (associations representing business, consumers or labour, or inter-governmental or nongovernmental organizations). Membership was limited to a maximum of six experts per NSB and two experts per liaison organization.

In July 2010, the ISO/WG SR had 450 participating experts and 210 observers from 99 ISO member countries and 42 liaison organizations.

Where Can I Find More Information?

In addition to the information in this section, which is to be regularly updated, background material on ISO 26,000 and the ISO Working Group on Social Responsibility can be accessed at www.iso.org/sr_archives.

This material includes documents giving the background to ISO's SR initiative, newsletters on the progress of the work, the structure of the WG SR, a brochure in several languages on how to participate in the development of ISO 26,000, development timeframe, contacts, and other information.

Working documents of the Working Group (WG) can be accessed at: www.iso.org/wgsr.

The ISO national members bodies (NSBs) of the 83 countries shown in Table 4.2 (the acronyms of the NSBs appear in parentheses) nominated experts to participate.

TABLE 4.2

The 83 NSBs participating in WG SR

Argentina (IRAM)	Ecuador (INEN)	Libyan Arab Jamahiriya (LNCSM)	Singapore (SPRING SG)
Armenia (SARM)	Egypt (EOS)	Luxembourg (ILNAS)	South Africa (SABS)
Australia (SA)	Fiji (FTSQCO)	Malaysia (DSM)	Spain (AENOR)
Austria (ON)	Finland (SFS)	Mauritius (MSB)	Sri Lanka (SLSI)
Bahrain (BSMD)	France (AFNOR)	Mexico (DGN)	Sweden (SIS)
Bangladesh (BSTI)	Germany (DIN)	Mongolia (MASM)	Switzerland (SNV)
Barbados (BNSI)	Ghana (GSB)	Morocco (SNIMA)	Syrian Arab Republic (SASMO)
Belarus (BELST)	Greece (ELOT)	Netherlands (NEN)	Tanzania (TBS)
Belgium (NBN)	India (BIS)	Nigeria (SON)	Thailand (TISI)
Brazil (ABNT)	Indonesia (BSN)	Norway (SN)	Trinidad and Tobago (TTBS)
Bulgaria (BDS)	Iran (ISIRI)	Oman (DGSM)	Tunisia (INNORPI)
Canada (SCC)	Ireland (NSAI)	Panama (COPANIT)	Turkey (TSE)
Cameroon (CDNQ)	Israel (SII)	Peru (INDECOPI)	Ukraine (DSSU)
Chile (INN)	Italy (UNI)	Philippines (BPS)	United Arab Emirates (ESMA)
China (SAC)	Jamaica (JBS)	Poland (PKN)	United Kingdom (BSI)
Colombia (ICONTEC)	Japan (JISC)	Portugal (IPQ)	Uruguay (UNIT)
Côte d'lvoire (CODINORM)	Jordan (JISM)	Qatar (QS)	United States (ANSI)
Croatia (HZN)	Kazakhstan (KAZMEMST)	Russian Federation (GOST R)	Vietnam (TCVN)
Czech Republic (CNI)	Kenya (KEBS)	Saint Lucia (SLBS)	
Costa Rica (INTECO)	Korea, Republic of (KATS)	Saudi Arabia (SASO)	
Cuba (NC)	Kuwait (KOWSMD)	Serbia (ISS)	
Denmark (DS)	Lebanon (LIBNOR)		

Bribery and Corruption Rules

The main exception to the rule that international guidelines for ethical behavior should be voluntary is the OECD-sponsored Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, and also the implementing legislation of some 38 states that have ratified it. The convention requires states parties to outlaw the "active bribery" of foreign officials. That is, states must make it a crime for individuals and juridical persons to bribe or attempt to bribe a foreign official. They are not required, however, to outlaw the acceptance of bribes.

The United States, one of the main advocates of the OECD Convention, has outlawed the bribing of foreign officials since 1977. Indeed, it pushed for adoption of the convention in order to get its own multinational enterprises on a more level playing field with competitors from other countries, and it became one of the first countries to ratify the convention when the Senate ratified it on July 31, 1997. The U.S. Foreign Corrupt Practices Act (discussed later in this chapter) is typical of the legislation currently being enacted in other countries to implement the convention.[14]

Although the OECD Convention proves that international organizations can sponsor conventions that regulate the ethical behavior of multinational enterprises, most such regulation is a matter of municipal law. As a general rule, home states regulate the parent companies and host states regulate the subordinates. Sometimes, however, home states are able to regulate foreign subordinates with extraterritorial laws, and host states are able to regulate parent firms by piercing the fictional veil that separates the subordinates from their parents. We discuss both sorts of regulations in the materials that follow.

E. Home State Regulation of Multinational Enterprises

To the extent that a multinational enterprise operates within the domestic marketplace of its home country, the home country regulates it in the same way that national enterprises are regulated. The most important forms of national regulation include (1) the regulation of competition, (2) the regulation of injuries caused by defective products, (3) the prohibition of sharp sales practices, (4) the regulation of securities, (5) the regulation of labor and employment, (6) the establishment of accounting standards, and (7) taxation. With the growth of international trade, many of these rules have been applied to activities that take place outside the territorial boundaries of a particular state, most notably the first three: regulation of competition, regulation of injuries caused by defective products, and prohibition of fraudulent sales practices. The country most willing to apply its laws extraterritorially has been the United States, an inclination the international community has not received kindly. Indeed, most countries regard such action as an intrusion into their domestic affairs. The United States has, nevertheless, persisted; and another major player in the international commercial community, the EU, has begun to apply its internal regulations extraterritorially as well.

Sherman Antitrust Act, Section 1
Forbids combinations and conspiracies in restraint of interstate and international trade.

rule of reason
Rule applied by courts on a case-by-case basis requiring them to consider all of the circumstances in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition in violation of Sherman Act Section 1.

Unfair Competition Laws

In the United States, the principal law regulating anticompetitive activity is the **Sherman Antitrust Act** of 1890.[15] **Section 1** of the act prohibits contracts, agreements, and conspiracies that restrain interstate or international trade.[16] The American courts have interpreted this as applying only to conduct between two or more parties and only to contracts that unreasonably restrain trade. In determining whether a particular activity violates §1, the courts ordinarily do so on a case-by-case basis using a so-called **rule of reason**. That is, "the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition."[17] Over the years, however, certain agreements or joint actions involving interstate

[14]The text of the Convention is posted at www.oecd.org/document/21/0,2340,en_2649_34859_2017813_1_1_1_1,00.html. The ratification status is posted at www.oecd.org/document/58/0,3746,en_2649_201185_1889402_1_1_1_1,00.html.

[15]The text of the act is posted at www.usdoj.gov/atr/foia/divisionmanual/ch2.htm#a1.

[16]Sherman Antitrust Act of 1890, *United States Code*, Title 15, §1: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is declared to be illegal. . . ."

[17]*Business Elecs. Corp. v. Sharp Elecs. Corp.*, *United States Reports*, vol. 458, p. 717 at p. 723 (Supreme Ct., 1988).

(but not international) trade have come to be classified as automatically illegal, or *per se* violations. These include (1) horizontal price fixing (where competitors at the same level expressly or impliedly agree to charge the same price for competing products), (2) vertical price fixing (where a seller at one level sells goods to a buyer at a different level on the condition that the latter will not resell below an agreed-upon price), (3) horizontal market division (where competitors agree not to sell in each other's territories), and (4) joint refusals to deal (i.e., group boycotts). Once a particular kind of activity is classified as a *per se* violation, the courts do not apply the case-by-case rule of reason analysis but proceed directly to a consideration of the appropriate remedy in the particular case.

Sherman Antitrust Act, Section 2
Forbids monopolies and attempts to monopolize interstate and international trade.

Section 2 of the Sherman Antitrust Act forbids monopolies and attempts to monopolize commerce or trade either between the states of the United States or in international commerce affecting the United States.[18] Unlike Section 1, it applies to the conduct of a single enterprise if the enterprise is a "dominant firm," that is, a firm that "has the power to control the price" of the commodity it produces and has the ability to "exclude competitors from the market." To prove a violation, a plaintiff has to show that the defendant intended to monopolize the marketplace. This is normally done circumstantially, by showing a practice of discriminatory pricing,[19] of dumping (i.e., selling goods below their cost of production),[20] of using tying clauses (i.e., requiring purchasers of one product to buy other unrelated products), or similar conduct.

Clayton Act
Expands the enforcement provisions of the Sherman Antitrust Act. Defines exclusive dealing and tying clauses, mergers that result in monopolies, and interlocking directorates as being unfair business practices.

The **Clayton Act** of 1914 was enacted to give more teeth to the Sherman Antitrust Act, both by expanding its enforcement provisions and by defining certain specific acts that constitute unfair business competition. These include exclusive dealing and tying clauses, mergers that result in a monopoly, and interlocking directorates.[21] The **Robinson-Patman Act** of 1936[22] was added to the panoply of American anti-trust law to make price discrimination illegal.[23]

Robinson-Patman Act
Forbids price discrimination.

Enforcement Provisions of U.S. Anti-trust Laws The enforcement provisions of the American anti-trust acts are one of their two most controversial aspects. The U.S. Justice Department may bring criminal suits for egregious violations, and the U.S. Federal Trade Commission may bring civil actions (notably for injunctions) to ensure full compliance. More important, private persons are given the right to sue and recover treble damages for injuries they have suffered. This statutory treble damages provision—different from remedies offered in other nations—has attracted foreign plaintiffs to American courts. (Limiting foreign plaintiffs' use of U.S. antitrust law's extraterritorial effects is discussed in a reading later in the chapter, Reading 4-3 on page 189.) *Treble damages* is

[18]Sherman Antitrust Act of 1890, *United States Code*, Title 15, §2: "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several states, or with foreign nations, shall be deemed guilty of a felony. . . ."

[19]See Jane Black, "Tools for Discriminatory Pricing" posted at www.businessweek.com/technology/content/jul2003/tc20030731_6139_tc073.htm.

[20]Readers may wish to go to www.cid.harvard.edu/cidtrade/issues/antidumping.htm for a comprehensive summary of the trade issues surrounding anti-dumping and links to relevant papers and Web sites.

[21]The Clayton Act of 1914, *United States Code*, Title 14, §12: "(3) It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale . . . on the condition, agreement or understanding that the . . . purchaser or lessee thereof shall not use or deal in the goods . . . of a competitor of the seller." "(7) No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock . . . or . . . assets of another corporation, where in any line of commerce in any section of the country, the effect may be to substantially lessen the competition, or tend to create a monopoly." "(8) . . . [N]o person at the same time shall be a director in any two or more competing corporations, any one of which has capital, surplus, and undivided profits aggregating more than $1 million, engaged in whole or in part in commerce, other than banks, banking associations, trust companies, and common carriers."

[22]For more details, go to http://business.enotes.com/business-finance-encyclopedia/robinson-patman-act.

[23]Robinson-Patman Act of 1936, *id.*, Title 15, §13: "It shall be unlawful for any person engaged in commerce, in the course of such commerce, either directly or indirectly, to discriminate in price between different purchasers of goods of like grade and quality [where the effect of such discrimination] may be to substantially lessen competition or tend to create a monopoly in any line of commerce, or injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them. . . ." Other acts expand on these basic provisions, including the Federal Trade Commission Act, *id.*, Title 15, §45; the Hart-Scott-Rodino Improvements Act of 1976, *id.*, Title 15, §18a; the National Cooperative Research and Production Act, *id.*, Title 15, §§4301–4306; the Webb-Pomerene Act, *id.*, Title 15, §§61–65; and the Export Trading Company Act of 1982, *id.*, Title 12, §372, 635 a-4, 1841, 1843, Title 15, §§6a, 45(a)(3), 4011–4021. See U.S. Department of Justice and Federal Trade Commission, "Antitrust Enforcement Guidelines for International Operations, April 1995," reproduced in *International Legal Materials*, vol. 34, p. 1080 (1995).

a term in some statutes that permits a court to triple the amount of the actual/compensatory damages to be awarded to a prevailing plaintiff, generally in order to punish the losing party for willful conduct. The ability to award treble damages is a typical feature in legislation that recognizes the potentially willful nature of the prohibited acts. For example, such damages may be awarded by a court in the United States for willful violation of the antitrust laws, for willful infringement of a patent, for trademark counterfeiting, and under the RICO statute, 18 U.S.C. §1964 (c). The idea behind the creation of such damages, also called *exemplary damages*, is that they will encourage citizens to sue for violations that are harmful to society in general.

One famous case was filed in the early 1980s by Laker Airways, a British air carrier, which brought a multimillion-dollar action in the District Court for the District of Columbia against Pan American Airways, British Airways, British Caledonian, and other foreign airlines to take advantage of the treble damages provision that was unavailable in the home countries of the non-American defendants.[24]

The text of the various statutes enforced by the Antitrust Division is posted on the U.S. Department of Justice Web site at
www.usdoj.gov/atr/foia/divisionmanual/two.htm.

Extraterritorial Application of U.S. Antitrust Laws The other controversial feature of American antitrust law is the willingness of American courts to apply it extraterritorially. The statutory provision in the Sherman Antitrust Act declares that it applies to conduct affecting "trade or commerce among the several states, or with foreign nations," so the decisions of the courts can hardly be blamed solely on judicial largesse. Indeed, the courts have imposed several jurisdictional tests that limit the legislative rule. They require a showing that, first, an alleged defendant is subject to the personal jurisdiction of the court and, second, that the court has subject-matter jurisdiction.

Personal Jurisdiction Requirements of U.S. Antitrust Laws The American antitrust laws authorize a court to assume personal jurisdiction if a defendant has the contacts specified either by (1) Section 12 of the Clayton Act or (2) an applicable state long arm statute. Section 12 of the Clayton Act allows a court to assume personal jurisdiction over an antitrust defendant who "transacts business" in the forum jurisdiction. Generally, this is given a broad interpretation, such that a foreign corporation lacking a full-time employee, an office, a bank account, or even related business property in the United States would still be subject to the personal jurisdiction of an American court. In a few cases, personal jurisdiction was found to exist over a subsidiary incorporated in the United States that was owned and managed by a non-American parent corporation.

long arm statute
A law defining the conduct of a foreign person within a state that will subject that person to the jurisdiction of the state.

State **long arm statutes** are applicable to antitrust proceedings because of a provision in the U.S. Federal Rules of Civil Procedure that looks upon state law as an independent basis for exercising personal jurisdiction in federal cases.[25] For the most part, these state statutes give courts an even broader scope for assuming personal jurisdiction than does Section 12 of the Clayton Act.[26]

[24]*Laker Airways, Ltd. v. Pan American World Airways*, *Federal Supplement*, vol. 559, p. 1124 (District Ct. of the District of Columbia, 1983). International Antitrust Enforcement Assistance Act of 1994, U.S. Public Law No. 103–438 (November 2, 1994), authorizing U.S. government agencies to negotiate bilateral agreements with foreign governments to facilitate the exchange of documents and evidence in civil and criminal investigations. The act is reproduced in *International Legal Materials*, vol. 34, p. 494 (1995). Examples of existing cooperative accords include the 1984 Memorandum of Understanding as to Notification, Consultation, and Cooperation with Respect to Application of National Antitrust Laws between the United States and Canada, reproduced in *id*., vol. 23, p. 275 (1984), and (subject to its formal reinstatement by the EU) the 1991 Agreement between the Government of the United States of America and the Commission of European Communities Regarding the Application of Their Competition Laws, reproduced in *id*., vol. 30, p. 1487 (1991).

[25]*United States Code*, Title 28, Rule 4.

[26]Some examples of cases where courts have assumed personal jurisdiction on the basis of state long arm statutes include *Hunt v. Mobile Oil Corp*., *Federal Supplement*, vol. 410, p. 4 (District Ct. for the S. Dist. of N.Y., 1975), in which jurisdiction was based on the fact that the defendants held a small number of meetings related to an alleged conspiracy in the forum state; *Wells Fargo & Co. v. Wells Fargo Exp. Co*., *Federal Reporter, Second Series*, vol. 556, p. 406 (9th Circuit Ct. of Appeals, 1977), where jurisdiction resulted from the negotiation and consummation of a single $10,000 loan; *Cofinco Inc. v. Angola Coffee Co*., A.C., *Trade Cases*, vol. 1975–2, para. 50,456 (District Ct. for the S. Dist. of N.Y., 1975), in which a court assumed jurisdiction on the basis of telex communications to and from New York; and *King v. Hailey Chevrolet Co*., *Federal Reporter, Second Series*, vol. 462, p. 63 (6th Circuit Ct. of Appeals, 1972), in which advertising within the forum state was sufficient to establish jurisdiction.

The principal limitation of the assumption of personal jurisdiction by U.S. courts is the federal constitutional requirement of due process. This forbids the court from assuming personal jurisdiction unless a defendant has **minimum contacts** with the forum. In essence, a court has jurisdiction only if (1) the defendant purposefully did business in the forum and (2) the defendant reasonably could have anticipated that it would have to defend itself there.[27]

United States minimum contacts test
A jurisdictional test required by due process that looks to see if a person had such contacts with a state, did business within the state, and could reasonably have anticipated that it would have to defend itself there.

Subject-Matter Jurisdiction Requirement of U.S. Antitrust Laws Two tests are used to determine whether a court has subject-matter jurisdiction in an American antitrust case: (1) the effects test and (2) the jurisdiction rule of reason test. Neither can be found in the statutory provisions of the antitrust laws; both are creatures of judicial legislation. Under the **effects test**, companies carrying on business outside the United States will come within the subject-matter jurisdiction of an American court if their business activity is intended to affect U.S. commerce and is not *de minimis*.[28]

The effects test was originally set out in *United States v. Aluminum Co. of America* by Judge Learned Hand,[29] who wrote the majority opinion. The case concerned the establishment of a quota system, devised by European companies, for the export of aluminum to the United States in order to sustain a price-fixing monopoly held by an American company. Judge Hand, in determining whether the court should exercise subject-matter jurisdiction over alleged violations of the Sherman Act, focused not on Europe, where the acts were done, but where the effects of the harm were felt. In effect, the Alcoa court extended objective territoriality jurisdiction to foreign conduct when the effects of anticompetitive foreign conduct were felt within the United States. In so holding, the court stated:

United States effects test
A jurisdictional test that subjects foreign businesses to U.S. anti-trust laws if their activities were intended to affect U.S. commerce and the effect was other than minimal.

> We should not impute to Congress an intent to punish all whom its courts can catch, for conduct which has no consequences within the United States. . . . On the other hand, . . . any state may impose liabilities, even upon persons not within its allegiance, for conduct outside its borders that has consequences within its borders which the state reprehends. . . .

The Alcoa court found the contracts in question to be subject to extraterritorial jurisdiction of the U.S. antitrust laws, because although the parties did all of the illegal conduct abroad, the defendants intended to (and did, in fact) have an effect on United States imports. Note that the Alcoa test only looks to the effect of anticompetitive conduct, and does not consider comity concerns.

The Alcoa case caused a backlash in other nations, and has been criticized on several grounds. Because international business practices may affect two or more nations, some critics contend that the effects test would (if it were adopted in other countries) allow courts in several states to simultaneously apply different and conflicting antitrust rules. Other critics contend that the test interferes with a state's sovereign right to control acts within its own territory. Still others note that the test seems to have the practical effect of shifting the burden of proof to a defendant to show that his or her activities do not affect the U.S. market.

U.S. jurisdictional rule of reason test
A jurisdictional test that allows U.S. courts to assume jurisdiction over a foreign business for violation of U.S. anti-trust laws if (1) the alleged conduct was intended to affect the foreign commerce of the United States, (2) it was of such a type and magnitude as to violate the Sherman Act, and (3) as a matter of international comity and fairness, a U.S. court ought to assume extraterritorial jurisdiction over the matter.

This criticism has led several other U.S. courts of appeals to adopt a different rule. In a widely cited pair of cases, *Timberlane Lumber Co. v. Bank of America* (*Timberlane I*)[30] and *Timberlane Lumber Co. v. Bank of America* (*Timberlane II*), the Ninth Circuit Court of Appeals adopted what it called a **jurisdictional rule of reason**. This set out a three-pronged test (see Figure 4.3) to determine jurisdiction in anti-trust cases involving conduct outside the United States: (1) Was the alleged conduct intended to affect the foreign commerce of the United States? (2) Was it of such a type and magnitude to violate the Sherman Act? (3) As a matter of international comity and fairness, should a court assume extraterritorial jurisdiction over the matter? The last of these three prongs requires courts to balance the interests of the United States in assuming jurisdiction against various competing interests. Some analysts, however, believe that the third prong was effectively eliminated in the case of *Hartford Fire Insurance Co. v. California;*[31] however, many courts (such as in Case 4-2) still apply

[27] *World-Wide Volkswagen Corp. v. Woodson*, *United States Reports*, vol. 444, p. 286 (Supreme Ct., 1980).

[28] *National Bank of Canada v. Interbank Card Association*, *Federal Reporter, Second Series*, vol. 666, p. 6 (2nd Circuit Ct. of Appeals, 1981). *De minimis* is short for *de minimis non curat lex;* From Latin: "the law does not concern itself with trifles." This phrase is used by courts to justify their refusal to hear suits that would take up their time on matters of little importance.

[29] *Federal Reporter, Second Series*, vol. 148, p. 416 (2nd Circuit Ct. of Appeals, 1945). This case was originally appealed to the U.S. Supreme Court but, because six judges were not able to form a quorum to hear it due to conflicts of interest, the case was assigned to the Second Circuit.

[30] *Timberlane Lumber Co. v. Bank of America*, 549 F.2d 597 (1976).

[31] *Hartford Ins Co. v. California*, 509 U.S. 764 (1993).

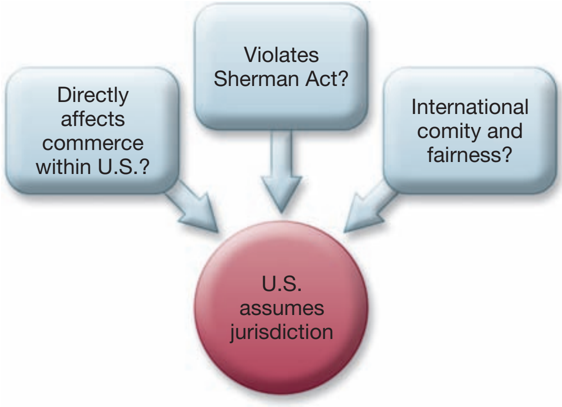


FIGURE 4.3

Jurisdiction Rule of Reason Test

the Timberlane "third-prong" factors in analyzing subject-matter jurisdiction. In *Timberlane*, the factors considered in the third prong are:

- The degree of conflict with foreign law or policy.
- The nationality or allegiance of the parties and the location or principal place of business of the companies.
- The extent to which enforcement by the involved countries might be expected to achieve compliance.
- The relative significance of the effects on the United States and other involved nations.
- Whether the explicit purpose of the alleged conduct was to harm American commerce.
- The foreseeability of the anti-competitive effects and the relative importance of the violations to commerce within the United States as compared with commerce abroad.

This approach, although not uniformly followed in all of the U.S. courts of appeals, seems nevertheless to be the prevalent test in the United States.[32]

In Case 4-2, the Ninth Circuit Court of Appeals described the subject-matter jurisdictional rule of reason and applied it in a case involving a foreign company alleged to have monopolized trade in kitchen steamers.

CASE 4-2 Metro Industries v. Sammi Corp.

United States Ninth Circuit Court of Appeals
Federal Reporter, Third Series, vol. 82, p. 839 (1996)

MAP 4.2

South Korea and the United States (1996)

KOREA
Seoul
Washington
UNITED STATES
Pacific Ocean

[32]It is consistent with the approaches set out in Restatement (Second) of Foreign Relations Law of the United States, §§23 and 42 (1965), and Restatement (Third) of Foreign Relations Law of the United States, §§402 and 403 (1984). It is also consistent with the comity considerations set out in the U.S. Department of Justice and Federal Trade Commission, "Antitrust Enforcement Guidelines for International Operations, April 1995," at p. 20, reproduced in *International Legal Materials*, vol. 34, p. 1080 (1995).

Metro Industries, Inc., imports and distributes kitchenware. Metro, based in the United States, sued Sammi Corp. (a South Korean exporting company) and two of its American subsidiaries under U.S. antitrust laws. Metro alleged an improper "market division" stemming from the Korean government's design registration system. The registration system gives Korean holloware[33] producers the exclusive right to export a particular holloware design for three years. Under Section 1 of the Sherman Act, market divisions have sometimes been considered a per se violation. Metro alleged that Sammi used this registration system in 1983 to prevent Metro and other kitchenware importers from acquiring Korean-made stainless steal steamers from any of Sammi's competitors in Korea.

Metro is appealing the district court's grant of Sammi's motion for summary judgment on the Sherman Act Section 1 claim.

Facts and Procedural History

Metro started a stainless steel kitchenware business in about 1977, importing mixing bowls from a Korean supplier called Haidong. In 1978 it began to purchase bowls from Sammi, and over the next few years, expanded its business to include other kitchenware. By 1981, importing and selling stainless steel kitchenware constituted Metro's principal business activity.

Sammi is a large Korean trading company that purchases a wide variety of finished products, including stainless steel steamers, for export to the United States and other countries. Sammi is a member of the Korea Holloware Association. This association, through a thirteen member design registration committee, grants pattern and design registration rights for particular products based on the shape, appearance, and color of the products. The registration committee consists of members from manufacturing companies, trading companies, the Korea Association of patent attorneys, and three members of Korean government organizations. A trading company, such as Sammi, can only hold a pattern design right jointly with a manufacturer. Registration gives the design holder the exclusive right to export a particular design for three years, and the rights can be extended for three additional years.

According to Metro, in late 1981, it raised the idea of a line of stainless steel steamers with Sammi, provided Sammi with models, and asked Sammi to develop samples and to prepare to supply the steamers. Sammi registered the steamer design and began to supply Metro with steamers. Metro experienced a disruption of steamer deliveries from Sammi at some time during 1983. Metro alleges that its attempts to order the steamers from another company were blocked by Sammi. Eventually, in late 1983, Metro was able to secure a source of steamers from a Korean company called Sambo and apparently had no further disruptions in its steamer shipments.

In December 1983, Metro filed a complaint in the United States District Court for the Central District of California against Sammi and two of its American subsidiaries alleging violations of §§1 and 2 of the Sherman Act. . . .

> [In June 1984, Metro's case against Sammi was dismissed. In the meantime, the trial court began hearing another case, *Vollrath Co. v. Sammi Corp.*, based on similar facts and a similar claim, violation of Sections 1 and 2 of the Sherman Act. The jury found in favor of Vollrath but the trial judge overruled the finding and granted a judgment notwithstanding the verdict. While the Vollrath case was on appeal, Metro filed for leave to reinstitute its claim and it was allowed to do so. The trial judge ordered Metro's case to remain off the calendar until the *Vollrath* appeal was decided. In December 1993, the Court of Appeals affirmed the trial judge's judgment.]

. . . Subsequent to the district court's decision in the Vollrath case, Metro began arguing a new theory—that the Korean design registration system under which Sammi had the exclusive rights to manufacture a particular steamer design constituted a market division that was illegal per se under §1 of the Sherman Act. In May 1994, Sammi filed a motion to dismiss all claims

[33]*Holloware* is any tableware (often metal) that serves as a container or receptacle (as distinguished from silverware).

against Sammi and its subsidiaries. . . . The district court granted Sammi's motion . . . finding that Metro had failed to present sufficient evidence to carry its burden on any of its claims.

Discussion

Metro appeals only the district court's grant of summary judgment in favor of Sammi on Metro's Sherman Act §1 market division claim.

Section 1 of the Sherman Antitrust Act, as amended in 1990, reads, in relevant part:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is hereby declared to be illegal.[34]

Metro alleges that the Korean Holloware Association registration system constitutes a "naked" market division agreement, which is per se illegal under the Sherman Act. Thus, Metro argues, an examination of the impact of the registration system on competition in the United States is not necessary to find a violation of §1.

Because conduct occurring outside the United States is only a violation of the Sherman Act if it has a sufficient negative impact on commerce in the United States, per se analysis is not appropriate. Indeed, when the alleged illegal conduct occurred in a foreign country, we must examine the impact on commerce in the United States before we can determine that we have subject matter jurisdiction over a claim. . . .

I. Per se Treatment Is Inappropriate in This Case

> "Ordinarily, whether particular concerted activity violates §1 of the Sherman Act is determined through case-by-case application of the so-called rule of reason—that is, 'the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition."'[35] "Certain categories of agreements, however, have been held to be *per se* illegal, dispensing with the need for case-by-case evaluation."[36] "Such agreements are those that always or almost always tend to restrict competition and decrease output." In general, "[a] market allocation agreement between competitors at the same market level is a classic *per se* antitrust violation."[37]

A. The Korean Registration System Is Not Illegal *Per se* Where the conduct at issue is not a garden-variety horizontal division of a market, we have eschewed a *per se* rule and instead have utilized rule of reason analysis. In deciding whether to extend the *per se* rule to a previously unexamined business practice, we are to examine whether "the practice facially appears to be one that would always or almost always tend to restrict competition and decrease output, . . . or instead one designed to 'increase economic efficiency and render markets more, rather than less, competitive."'[38]

The Korean registration system is not a classic horizontal market division agreement in which competitors at the same level agree to divide up the market for a given product. Metro does not point to, and we have not found, a single instance in which an arrangement similar to the Korean manufacturer-exporter design registration system has undergone judicial scrutiny in the Sherman Act context. The novelty of this arrangement "strongly supports application of rule-of-reason analysis."[39]

Further, as discussed below, there is no evidence of a negative effect on competition, which also militates against extension of the *per se* rule. The record reveals that

---

[34] 15 U.S.C. §1 (1994).

[35] *Business Elecs. Corp. v. Sharp Elecs. Corp.*, 485 U.S. 717, 723, 108 S. Ct. 1515, 1519, 99 L. Ed. 2d 808 (1988)

[36] *United States v. Brown*, 936 F.2d 1042, 1045 (9th Cir. 1991)

[37] Id.

[38] *Broadcast Music, Inc. v. Columbia Broadcasting Sys.*, 441 U.S. 1, 19–20, 99 S. Ct. 1551, 1562, 60 L. Ed. 2d 1 (1979)

[39] *Northrop Corp. v. McDonnell Douglas Corp.*, 705 F.2d 1030, 1050 (9th Cir.)

the registration protection was limited to particular designs of a product "based on shape, appearance, and color of the products." The protection extends for only three years, renewable for three additional years. Contrary to Metro's assertions, the record does reveal the output increasing potential of the registration system. Sammi's general manager of housewares indicated that tooling and production of a new product takes several years. Thus, the limited protection could encourage manufacturers to develop and produce new products, knowing that they would have the exclusive right to export a particular design for a limited period of time.

Finally, there is no evidence that the purpose of the design registration system was to restrain trade, which also counsels in favor of rule of reason analysis. The Korean association was apparently a quasigovernmental group (in that it was sanctioned by the Korean government and three of its thirteen members were representatives of the Korean government) that was formed to ensure product and design quality and to protect from copying. Sammi's general manager of housewares indicated that the system was designed "to promote the manufacturer to develop better quality product, a better quality design, and protect them from copy[ing] by other manufacturers."

Accordingly, rule of reason analysis is appropriate in this case.

B. Foreign Conduct Cannot Be Examined Under the *Per se* Rule Even if Metro could prove that the registration system constituted a "market division" that would require application of the *per se* rule if the division occurred in a domestic context, application of the *per se* rule is not appropriate where the conduct in question occurred in another country. Determining whether the registration system was a violation of the antitrust laws would still require an examination of the impact of the system on commerce in the United States. "The Sherman Act does reach conduct outside our borders, but only when the conduct has an effect on American commerce." According to a leading treatise:

> [T]he conventional assumptions that courts make in appraising restraints in domestic markets are not necessarily applicable in foreign markets. A foreign joint venture among competitors, for example, might be more "reasonable" than a comparable domestic transaction in several respects: the actual or potential harms touching American commerce may be more remote; the parties' necessities may be greater in view of foreign market circumstances; and the alternatives may be fewer, more burdensome, or less helpful.
>
> The fact that foreign conduct would be a *per se* offense—one that is condemned without proof of particular effects and with little regard for possible justifications in the particular case—when entirely domestic does not call for a fundamentally different analysis. Domestic antitrust policy uses *per se* rules for conduct that, in most of its manifestations, is potentially very dangerous with little or no redeeming virtue. That rationale would be inapplicable to foreign restraints that, in many instances, either pose very little danger to American commerce or have more persuasive justifications than are likely in similar restraints at home. For example, price fixing in a foreign country might have some but very little impact on United States commerce.[40]

Thus, the potential illegality of actions occurring outside the United States requires an inquiry into the impact on commerce in the United States, regardless of the inherently suspect appearance of the foreign activities. Consequently, where a Sherman Act claim is based on conduct outside the United States, we apply rule of reason analysis to determine whether there is a Sherman Act violation.

II. Jurisdictional Inquiries Are Required When a Sherman Act Claim Is Based on Foreign Conduct

[40] Phillip Areeda & Donald F. Turner, *Antitrust Law* Par. 237 (1978).

When we examine foreign conduct to determine if there is an antitrust violation, our jurisdiction is not a foregone conclusion. "When foreign conduct is involved, the courts customarily appraise its substantive antitrust significance only after deciding whether the Sherman Act asserts jurisdiction over it. . . . "[J]urisdictional" and "substantive" inquiries are not wholly independent." We examined the jurisdictional considerations in applying the Sherman Act to foreign conduct in *Timberlane Lumber Co. v. Bank of America* (*Timberlane I*), and *Timberlane Lumber Co. v. Bank of America* (*Timberlane II*). Both cases concerned an American lumber producer's Sherman Act claims based on its allegations that Bank of America and several co-conspirators had conspired and acted to preclude a subsidiary of Timberlane from competing in the Honduran lumber market and exporting lumber into the United States.

In *Timberlane I*, we articulated a "jurisdictional rule of reason," to be applied to Sherman Act claims arising out of foreign conduct. The inquiry requires the weighing of the answers to three questions:

> Does the alleged restraint affect, or was it intended to affect, the foreign commerce of the United States? Is it of such a type and magnitude so as to be cognizable as a violation of the Sherman Act? As a matter of international comity and fairness, should the extraterritorial jurisdiction of the United States be asserted to cover it?

The comity question alone requires the consideration of several elements, including

> the degree of conflict with foreign law or policy, the nationality or allegiance of the parties and the locations or principal places of business of corporations, the extent to which enforcement by either state can be expected to achieve compliance, the relative significance of effects on the United States as compared with those elsewhere, the extent to which there is explicit purpose to harm or affect American commerce, the foreseeability of such effect, and the relative importance to the violations charged of conduct within the United States as compared with conduct abroad.

***

[In *Timberlane II*] . . . we found that Timberlane adequately pleaded that there was an actual or intended effect on American foreign commerce and that Timberlane had made the minimal injury allegations necessary to support an a Sherman Act claim, thus satisfying the first two prongs of the *Timberlane I* test. As for the comity prong, we found that the conduct in Honduras at issue was allowed or even encouraged by Honduran law; thus the factor considering "the degree of conflict with foreign law or policy," weighed strongly against Sherman Act jurisdiction.

Other factors, including the relative insignificance of the actions to the U.S. lumber market compared with the significant impact on the Honduran lumber market, the lack of evidence of intent to affect the U.S. market, and the lack of foreseeability of an effect on the U.S. market, also counseled against jurisdiction. We concluded that the exercise of federal jurisdiction would not be proper.

Metro has made sufficient allegations to state a claim under the Sherman Act. Comity considerations are less compelling here than they were in *Timberlane*. . . . [T]here is no conflict with foreign law or policy because the Korean holloware registration system was not compelled by the Korean government, even though three government representatives serve on the design and pattern registration committee. Though Sammi is a foreign corporation, it apparently does a great deal of business in the United States, so it has assets which could be used to secure any judgment against it. The impact of the registration is felt more in the United States than in Korea because the registration system only limits the export of particular designs, and it was certainly foreseeable that these export restrictions could affect the United States. Considering all the factors, principles of comity and fairness do not deprive this court of jurisdiction.

As *Timberlane II* makes clear, the other two prongs of the "jurisdictional rule of reason" test are substantially intertwined with the merits of Metro's Sherman Act claim. Thus, while we could ultimately determine that we lack subject matter jurisdiction over Metro's Sherman Act claim because of a lack of impact in the United States, such a conclusion would only come after the factual inquiry into markets, market power, and other factors necessary to find a substantive violation of the Sherman Act. By alleging in its complaint that because of Sammi's manipulation of the registration system "existing and potential competition in the relevant markets has been unreasonably restrained and substantially lessened, independent United States importer-distributors have been severely damaged or eliminated from the markets, concentration has been increased in those markets, and a tendency towards monopoly has been created," Metro has made the minimal allegations about the impact on competition in the United States necessary to state a claim for a Sherman Act violation. We have jurisdiction to review Metro's claims, and examine Sammi's alleged conduct under the rule of reason.

III. Metro Cannot Show a Substantial Anticompetitive Effect in the United States or Antitrust Injury

Under the rule of reason, a plaintiff must establish "antitrust injury," that is, that the conduct at issue actually caused "injury to competition, beyond the impact on the claimant, within a field of commerce in which the claimant is engaged." Because Metro relies almost entirely on a *per se* argument, it points to little evidence of the impact of the Korean registration system on competition in the United States. It merely suggests that it could present evidence of "the harm and consequent damage to Metro and its customers." . . . We conclude that . . . a rational trier of fact could not find in favor of Metro on its Sherman Act claim.

To show an injury to competition, the plaintiff ordinarily "must delineate a relevant market and show that the defendant plays enough of a role in that market to impair competition significantly." . . .

Metro has produced no evidence of actual injury to competition in the United States. Rather, based on its own conclusion that the relevant market consists only of stainless steel steamers, it asserts that Sammi has a monopoly in that market and that output would only be reduced in the United States if Sammi chose to do so. . . . [But] Metro has produced no evidence of reduced output or increased prices. These assertions are insufficient to satisfy [the] requirement that Metro come forward with specific facts supporting its claims of injury to competition when responding to a motion for summary judgment.

***

Conclusion

For the reasons stated above, we AFFIRM the district court's grant of summary judgment in favor of Sammi. . . .

Casepoint

(1) Conduct occurring outside the United States will violate the Sherman Act only if it has a sufficiently negative impact on commerce in the United States. (2) While market allocation agreements between competitors at the same market level is a classic *per se* anti-trust violation, the Korean Registration system is not illegal *per se*, as it is not a "classic horizontal market division arrangement." (3) Even if it were, it takes place primarily in another country, and illegality requires an examination of the impact of this arrangement on U.S. commerce, so a rule-of-reason analysis is required. (4) Using *Timberlane* factors (including comity and fairness) does not preclude plaintiff's action here, but the plaintiff has failed to show a substantial anti-competitive effect in the U.S. from the alleged anti-competitive acts.

European Community Treaty, Article 81
Forbids competitors to enter into agreements to prevent, restrain, or distort trade.

Regulation of Anticompetitive Behavior in the EU The European Community Treaty contains two articles—Articles 81 and 82—that regulate business competition.[41] **Article 81** (which is analogous to Section 1 of the U.S. Sherman Antitrust Act) prohibits normal arm's-length competitors from entering into agreements or carrying on concerted practices that either prevent, restrain, or distort trade. The following activities are expressly prohibited: (1) fixing any trading condition, including price fixing; (2) limiting or controlling production, markets, technical development, or investment; (3) allocating markets or sources of supply; (4) applying unequal terms to parties furnishing equivalent consideration; and (5) using unrelated tying clauses.[42] Paragraph 3 of Article 81 also sets out an exception, providing that agreements or practices that both (1) contribute to improved production, improved distribution of goods, or improved technical processes and (2) do not prevent competition in a substantial part of the market in question are exempted from the application of the basic rule.[43]

Because of the exception in Article 81 paragraph 3, the EC courts have held that the rule of reason that applies to Section 1 of the Sherman Act cannot similarly apply to the European provision.

European Community Treaty, Article 82
Forbids dominant businesses from taking advantage of their position to the detriment of consumers.

Article 82 (which is analogous to Section 2 of the Sherman Antitrust Act) forbids businesses with a dominant position[44] in their marketplace[45] to take improper advantage[46] of their position to the detriment of consumers. As with Article 81, specific prohibitions are listed. They are (1) directly or indirectly imposing unfair prices or trading conditions; (2) limiting production, markets, or technical developments to the prejudice of consumers; (3) applying unequal conditions to equivalent transactions with different trading partners; and (4) imposing unrelated tying clauses. Unlike Article 81, there is no exception clause.

Determining compliance with Articles 81 and 82 is left solely to the European Commission, which can impose substantial fines in its own right.[47] For non-EU firms, the most significant aspect of the EU's business competition rules is their extraterritorial impact. The European Commission and the European Court of Justice have applied the rules to foreign firms to the extent that the firms' activities have an effect on trade or commerce within the EU. (In essence, the commission and the court are using the American effects test.) Thus, a foreign firm that conspires with EU firms to monopolize trade within the EU would be in breach of the EC Treaty. Similarly, a parent firm would be responsible for the acts of its subsidiaries to the extent that it controls those acts. Also, a foreign firm seeking to acquire a competitor within the EU must convince the EU that the resulting merger will not improperly monopolize the marketplace.

---

[41]The Treaty of Amsterdam, adopted in 1997 and effective May 1, 1999, renumbered the articles of the principal EU treaties, including the Treaty Establishing the European Community. Articles 81 and 82 were previously numbered as Articles 85 and 86.

[42]Treaty Establishing the European Community, Article 81(1): "The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between member states and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which: (a) directly or indirectly fix purchase or selling prices or any other trading condition; (b) limit or control production, markets, technical development, or investment; (c) share markets or sources or supply; (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts."

[43]*Id*., Article 81(3): "The provisions of paragraph 1 may, however, be declared inapplicable in the case of: any agreement or category of agreements between undertakings; any decision or category of decisions by associations of undertakings; any concerted practice or category of concerted practices; which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not: (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives; (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question."

[44]A firm in a dominant position is one having the power to behave independently without taking into account, to any substantial extent, competitors, purchasers, or suppliers.

[45]A market is the merchandising of products regarded as similar by customers. It is a "substantial" market, and thus one covered by Article 82, if it is appreciably large, even if it is entirely within the territory of a single member state.

[46]An improper advantage is any action reducing supplies to purchasers. Note that there need not be a causal connection between dominance and improper advantage for Article 82 to apply.

[47]The fines for noncompliance are up to 5,000 euros for each day of noncompliance. For supplying false or misleading information for an Articles 81/82 investigation, the fines are 5,000 euros. For violating Articles 81/82, the fines can be up to 1 million euros.

Opposition to the Extraterritorial Application of Unfair Competition Laws At the beginning of the nineteenth century, an English judge once asked:

> Can the island of Tobago pass a law to bind the rights of the whole world? Would the world submit to such an assumed jurisdiction?[48]

The willingness of American and EU courts to apply antitrust laws extraterritorially has been roundly criticized by many countries, especially Third World states. The most prominent developed state to object to this practice has been the United Kingdom, especially before it joined the EU.[49] Even afterward, however, it took a dim view of the practice, especially in regard to U.S. decisions. In 1978, in the case of *Rio Tinto Zinc Corporation v. Westinghouse Electric Corporation*, the English House of Lords observed that it may be the policy of one country to defend what is the policy of another to attack. In that case, Viscount Dilhorne said the following about American policy:

> For many years now the United States has sought to exercise jurisdiction over foreigners in respect of acts done outside the jurisdiction of that country. This is not in accordance with international law and has led to legislation on the part of other states, including the United Kingdom, designed to protect their nationals from criminal proceedings in foreign courts where the claims to jurisdiction by those courts are excessive and constitute an invasion of sovereignty.[50]

The British objections to the American antitrust laws have been twofold. One, they dislike the fact that suits for punitive treble damages can be brought by private plaintiffs. The British public, business community, and government often characterize these plaintiffs as menaces. Two, they dislike the discriminatory application of U.S. antitrust laws. Although the United States' Sherman Antitrust Act requires foreign exporters to act competitively in the international marketplace, its Webb Pomerene Act[51] exempts U.S. export associations from compliance with the Sherman Act.[52] Thus, there is a curious double standard.

These two negative features of the U.S. antitrust laws have led to diplomatic protests and to the enactment of blocking statutes, not only by Britain but also by many other states. Indeed, one commentator has noted that "there have been five diplomatic protests of U.S. antitrust cases for every instance of express diplomatic support, and three blocking statutes for every cooperation agreement."[53]

blocking statute
Law enacted in some states to obstruct the extraterritorial application of U.S. antitrust laws by limiting a plaintiff's right to obtain evidence or to enforce a judgment, and that allows a defendant to bring suit locally to recover punitive damages paid in the United States.

Blocking Statutes **Blocking statutes** are possibly the most forceful responses that states have made to the extraterritorial application of American anti-trust laws.

These statutes typically have three features: (1) they limit the extent to which a U.S. plaintiff can obtain evidence or seek production of commercial documents outside of the United States for use in investigations or proceedings in the United States; (2) they make it difficult for a successful plaintiff to enforce a U.S. judgment outside the United States; and (3) by virtue of a *clawback* provision, they allow defendants to bring suit in their home country to recover the punitive damages they paid in the United States.

Blocking statutes began soon after the Alcoa decision. The message to the American courts was clear—foreign nations with blocking statutes would not allow "perceived abuses in the application of

---

[48] *Buchanan v. Rucker*, *English Reports*, vol. 108, p. 546 (1808).

[49] In 1953, the English Court of Appeal enjoined one of the parties involved in litigation based on the Sherman Antitrust Act from obeying an order of a U.S. court. *United States v. Imperial Chemical Industries, Ltd.*, *Federal Supplement*, vol. 100, p. 504 (District Ct. for the S. Dist. of N.Y., 1951), *Federal Supplement*, vol. 105, p. 215 (District Ct. for the S. Dist. of N.Y., 1952); *British Nylon Spinners, Ltd. v. Imperial Chemical Industries, Ltd.*, *Law Reports, Chancery*, vol. 1953, p. 19 (1953), *Law Reports*, *Chancery*, vol. 1955, p. 37 (1955).

[50] *Id.*, p. 631.

[51] The Webb-Pomerene Act provides a limited antitrust exemption for the formation and operation of associations of otherwise competing businesses to engage in collective export sales. The exemption applies only to the export of "goods, wares, or merchandise." It does not apply to conduct that has an anticompetitive effect in the United States or that injures domestic competitors of the members of an export association. Nor does it provide any immunity from prosecution under foreign antitrust laws.

[52] The Webb-Pomerene Act is not unique in exempting export associations from the application of anticompetition laws. Statutes in the United Kingdom, Canada, Germany, Japan, and Australia grant similar exemptions.

[53] P. C. F. Pettit and C. J. D. Styles, "The International Response to the Extraterritorial Application of United States Antitrust Laws," *The Business Lawyer*, vol. 37, p. 697 (1982).

United States anti-trust laws." Foreign countries with blocking statutes, whose leaders felt the United States courts were overextending their jurisdiction and disregarding comity concerns, attempted to use the blocking statues to make it very difficult for plaintiffs in the United States to obtain discovery or to enforce any judgments. Without adequate discovery, it was difficult for any case that required foreign discovery to proceed beyond the pleadings stage. Additionally, without being able to enforce a judgment, plaintiffs had little incentive to bring suit.

To the disappointment of foreign nations, blocking statutes remained largely ineffective. In the face of these foreign blocking statutes, American courts continued to subject foreign entities to court-ordered discovery, even where the defendants were also subject to civil or criminal sanctions in their home countries. While foreign states adopted elements of their foreign blocking statutes, such as barriers to judgment enforcement, which may have been initially effective in making foreign companies judgment proof, many defendants found to be in violation of antitrust laws have had assets in the United States, which plaintiffs may seek to attach in satisfaction of judgments—effectively avoiding the barriers presented in the foreign blocking statutes.

Anti-Suit Injunctions In addition to foreign legislators' attempts to curtail the extraterritorial application of American anti-trust legislation, foreign courts have sometimes been willing to hand down injunctions forbidding one of their nationals from initiating an antitrust suit in the United States against another of their nationals. Here is a summary of a case involving the EU's Airbus consortium.

In Brief: CASE 4-3 Airbus Industrie G.I.E. v. Patel

United Kingdom, House of Lords, 1998

MAP 4.3

India (1998)

Facts

Four citizens of the United Kingdom were killed and four were injured when an Airbus A-320 plane crashed in India. They, or their representatives, joined a suit in a Texas court against Airbus Industrie brought by the representatives of three Americans killed in the crash. Airbus Industrie then obtained a judgment from an Indian court forbidding any injured parties from bringing suit in any court except in India. Airbus Industrie then obtained an anti-suit injunction from the English High Court forbidding the U.K. citizens or their representatives from proceeding with the suit in Texas. The U.K. citizens' representatives appealed.

Issue

Should an anti-suit injunction be granted by the United Kingdom against U.K. citizens proceeding in a U.S. court where an Indian court has issued an anti-suit injunction?

Decision

No.

Reasoning

Comity requires sovereign states to exercise caution in granting anti-suit injunctions. They are most often necessary to (1) protect the jurisdiction of the enjoining court or to (2) to prevent the litigant's evasion of important public policies of the forum. This is the stricter of two standards used by U.S. courts. The more lenient standard allows courts to grant an injunction if the foreign proceedings are vexatious, oppressive, or will otherwise cause inequitable hardship. Here India is the natural forum for the dispute, as the accident took place there. But India is powerless to restrain the U.K. citizens from using U.S. courts to file against Airbus Industrie. But in a world of independent jurisdictions, interference (even indirect) by the courts of one jurisdiction with the jurisdiction of a foreign court cannot be justified by the fact that a third jurisdiction is affected but is powerless to intervene. The remedy of *forum non conveniens*, recognized in most common law countries, may resolve this matter, as Texas has now adopted this principle, which may become accepted in civil law countries as well.

Order

The anti-suit injunction is dismissed.

The U.S. Supreme Court has recently sought to limit the extraterritorial effect of U.S. antitrust laws. In Reading 4-3, the case of *Hoffman-LaRoche LTD. v. Empagran* is discussed.

Reading 4-3 F. Hoffman-La Roche Ltd. v. Empagran

In June 2005, a unanimous U.S. Supreme Court limited the reach of U.S.-issued U.S. antitrust laws in *F. Hoffmann-La Roche Ltd. v. Empagran, S.A.* The Court held that purchasers outside the United States who claim injury from price-fixing cannot sue in U.S. courts if their case depends solely on allegations that they were harmed by the same conduct that also injured customers in the United States.

Empagran was a class action lawsuit brought by both domestic and foreign vitamin buyers. They claimed that defendant vitamin manufacturers and distributors (domiciled both within and outside the United States) had engaged in a conspiracy to fix prices. Defendants moved to dismiss all suits of plaintiff purchasers that had bought vitamins outside the United States on the basis of (1) comity and (2) that the Foreign Trade Antitrust Improvements Act

of 1982 (FTAIA)[54] disallowed anti-trust suits for transactions in foreign commerce—that is, commerce taking place entirely outside the United States—unless the plaintiff can show that (1) the alleged harmful conduct had a "direct, substantial, and reasonably foreseeable effect" on U.S. commerce and (2) the effect on U.S. commerce gave rise to a claim under the Sherman Act.

The federal circuit courts had split on the meaning of the FTAIA's language. The Fifth Circuit had ruled in *Den Norske Stats Oljeselskap As v. HeereMac VOF*, 241 F.3d 420 (5th Cir., 2001) that a plaintiff could pursue an antitrust claim in U.S. courts only if the plaintiff's "own injury" was directly caused by the defendant's wrongdoing and that the same wrongdoing also had an effect on U.S. commerce. Yet the Second Circuit had ruled in *Kruman v. Christie's Int'l PLC*, 284 F.3d 384 (2d Cir., 2002), that a plaintiff could maintain an action in U.S. courts as long as anyone (not necessarily a plaintiff) had a claim based on the wrongdoing and its effect on U.S. commerce. In *Empagran*, the D.C. Circuit had decided that plaintiffs purchasing overseas could bring suit, relying on *Kruman*.

The Supreme Court reversed. It determined that all antitrust suits claiming an injury based on conduct in foreign commerce must satisfy the FTAIA's two-part test. Then it held that the FTAIA does not grant jurisdiction to U.S. courts to hear claims of injury in foreign markets where those injuries are independent of harms to consumers in the United States. Thus, any claims based on *foreign effects* that are independent of U.S. effects are beyond the scope of the U.S. antitrust laws.

In so doing, the Court applied a rule of statutory construction that presumes that Congress did not intend to interfere with the sovereignty of foreign nations. This rule of construction "helps the potentially conflicting laws of different nations work together in harmony—a harmony particularly needed in today's highly interdependent commercial world." Allowing antitrust lawsuits to proceed where the injuries in foreign markets are not linked to harm to U.S. consumers would create a "a serious risk of interference with a foreign nation's ability independently to regulate its own commercial affairs."

The Court acknowledged that Congress could have an interest in legislating foreign conduct where it harms U.S. commercial interests, but determined that Congress has no basis to impose U.S. law for injuries suffered in foreign commerce. Even if other sovereigns agree with the United States that price-fixing is illegal, U.S. antitrust remedies differ significantly from remedies in other nations. As the Court noted:

> The application, for example, of American private treble-damages remedies to anticompetitive conduct taking place abroad has generated considerable controversy. . . . And several foreign nations have filed briefs here arguing that to apply our remedies would unjustifiably permit their citizens to bypass their own less generous remedial schemes, thereby upsetting a balance of competing considerations that their own domestic antitrust laws embody. . . .
>
> Why should American law supplant, for example, Canada's or Great Britain's or Japan's own determination about how best to protect Canadian or British or Japanese customers from anticompetitive conduct engaged in significant part by Canadian or British or Japanese or other foreign companies?

The Court may still allow U.S. antitrust laws to apply where plaintiffs who purchase outside the United States can allege and prove that their injuries were linked to effects on U.S. markets. It made it clear that its holding was limited to situations where the adverse effect on foreign commerce was "independent" of any domestic effect.

Seen in this light, the overall effect on Empagran is to largely keep "direct effects" jurisdiction intact. Moreover, non-U.S. companies who want to avoid the reach of U.S. and E.U. laws on anti-trust or bribery may have little room left to maneuver. International cooperation has vastly improved since the International Antitrust Enforcement Assistance Act[55] was passed in 1994, and there has been a growing international consensus that cartels are harmful and victimize both consumers and businesses. Moreover, the International Competition Network (ICN) was created by anti-trust officials from fourteen nations in October of 2001, and has helped to create cooperation and convergence on the values of a competitive global market. ICN membership includes 107 competition agencies from over ninety-six nations. Even divergent values and perspectives over bribery of public and private officials has started to converge, as Reading 4-3 makes clear.

Tort and Products Liability Laws

By operating globally, MNEs will invariably face laws from different jurisdictions. Whether plaintiffs make claims based on intentional tort or negligence, the actions (or inactions) of an MNE in one nation can cause harms to individuals or business entities in another nation. In this section, we see how Dow Jones Company may be held accountable for an intentional tort in Victoria (Australia) for acts done in New Jersey (United States) (Case 4-4, *Dow Jones & Co. v. Gutnick*). We also see how a German automaker can be held accountable in U.S. courts for negligence and products liability (Case 4-5, *World-Wide Volkswagen v. Woodson*). Finally, we see how a Taiwanese company was relieved of accountability in U.S. courts for its manufacture of a potentially defective motorcycle tire valve (Case 4-6, *Asahi v. Superior Court of California*).

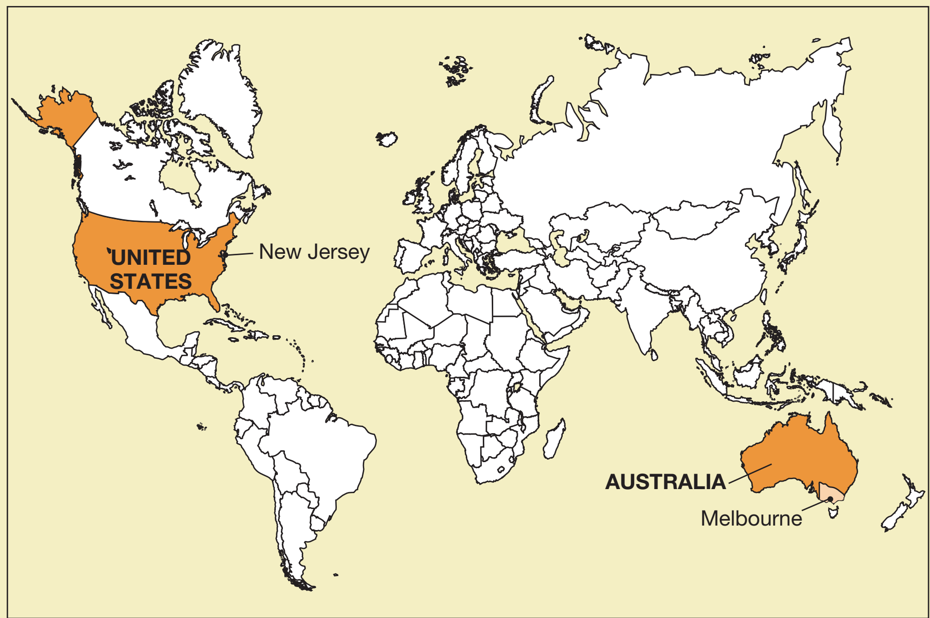
Intentional Tort Liability Certain torts are deemed *intentional*. That is, a court may find that the defendant did not harm someone out of neglect or carelessness, but probably acted with an intent to do harm. Cases of assault, defamation, intentional infliction of emotional distress, interference with

[54] 15 U.S.C. §6a.

[55] 15 U.S.C. §§6201-12.

CASE 4-4 Dow Jones & Co. Inc. v. Gutnick

High Court of Australia.
December 2002.



MAP 4.4

United States and Australia (2002)

The October 28, 2000 edition of *Barron's Online*, published by Dow Jones, contained an article entitled "Unholy Gains" in which several allegedly defamatory statements were made regarding Mr. Joe Gutnick, a resident of Melbourne, Australia. While only five copies of the print edition were sent from New Jersey (U.S.) for circulation in Australia, the internet version of *Barron's* had over half a million subscribers, with some 1700 online subscribers in Australia. The issue for the Court was whether the article was "published" in the United States in a way that did not provide Australian courts with personal jurisdiction over Dow Jones.

The trial and appellate courts had found that Australian courts had personal jurisdiction over Dow Jones, which appealed to the High Court of Australia. All seven High Court justices determined that Gutnick could bring suit in Victoria, the place where damage to his reputation occurred. Defamation did not occur at the time of publishing, but rather when some third party read the publication and thereby thought less of Gutnick.

The respondent is a businessman. He is involved in philanthropic, political, sporting and religious affairs. His business activities have extended beyond Australia. He lives in Victoria and has many friends and associates there. He is the chairman of a corporation, shares in which are traded in the United States. He has sought investment in that corporation from investors in the United States.

It is unnecessary to set out the whole of the article. The first three paragraphs sketch some of the interests of the respondent. The fourth states that some of his business dealings with religious charities raise "uncomfortable questions." The author then uses some language that the media have appropriated from the law courts, implying that a balanced trial with equal opportunity to participate by all concerned has taken place: that a "*Barron's* investigation *found* that several charities traded heavily in stocks promoted by Gutnick" (emphasis added). The article associates the respondent with Mr. Nachum Goldberg who is apparently a convicted tax evader and another person awaiting trial for stock manipulation in New York. . . .

The respondent brought proceedings against the appellant in defamation in the Supreme Court of Victoria. After an amendment of his statement of claim he alleged publication both online and by hard copies sold in Australia. He pleaded that the article meant, and was understood to mean that he:

a. was a customer of Nachum Goldberg who had recently been imprisoned for tax evasion and money laundering; and
b. was Nachum Goldberg's biggest customer; and
c. was masquerading as a reputable citizen when he was, in fact, a tax evader who had laundered large amounts of money through Nachum Goldberg; and
d. had bought Nachum Goldberg's silence so as to conceal his identity as one of Goldberg's customers.

On service of the writ and statement of claim in the United States, the appellant entered a conditional appearance and applied to have service of the writ and statement of claim set aside, or alternatively, to have the respondent's action permanently stayed. The appellant undertook, in the event of a stay of the Victorian action, to raise no limitations or jurisdictional objections there if the respondent were to sue in the United States. . . . The primary judge summarized the appellant's arguments: that publication was effected in New Jersey and not Victoria; that no act was committed in Victoria to ground service of Victorian proceedings out of Victoria without an order of the Court pursuant to O7 of the Rules of Court of that State; and, thirdly that Victoria was not a convenient forum for the trial of the respondent's action.

***

In this Court, the appellant repeated the arguments rehearsed in the courts below. The Internet, which is no more than a means of communication by a set of interconnected computers, was described, not very convincingly, as a communications system entirely different from pre-existing technology. The nature and operation of the Internet and the World Wide Web were explained by two highly qualified experts, Mr Barry Hammond BSc, Internet consultant to leading Australian companies, and Dr Roger Clarke, Visiting Fellow (formerly Reader in Information Systems) in the Computer Science Department, Australian National University. They described the Internet as a set of interconnexions among computers all over the world to facilitate an exchange of messages. Using their computers, people can communicate with one another, and gain access to information. They claimed that it was a unique telecommunications system defying analogy with pre-existing technology. The description, however, by the appellant of the server as passive is inaccurate.

***

A publisher, particularly one carrying on the business of publishing, does not act to put matter on the Internet in order for it to reach a small target. It is its ubiquity, which is one of the main attractions to users of it. And any person who gains access to the Internet does so by taking an initiative to gain access to it in a manner analogous to the purchase or other acquisition of a newspaper, in order to read it.

***

The most important event so far as defamation is concerned is the infliction of the damage, and that occurs at the place (or the places) where the defamation is comprehended. Statements made on the Internet are neither more nor less "localized" than statements made in any other media or by other processes. Newspapers have always been circulated in many places. The reach of radio and television is limited only by the capacity of the technology to transmit and hear or view them, which already, and for many years, has extended beyond any one country.

***

There is nothing unique about multinational business, and it is in that that this appellant chooses to be engaged. If people wish to do business in, or indeed travel to, or live in, or utilise the infrastructure of different countries, they can hardly expect to be absolved from compliance with the laws of those countries. The fact that publication might occur everywhere does not mean that it occurs nowhere. Multiple publication in different jurisdictions is certainly no novelty in a federation such as Australia.

***

If a publisher publishes in a multiplicity of jurisdictions it should understand, and must accept, that it runs the risk of liability in those jurisdictions in which the publication is not lawful and it inflicts damage.

***

The appellant's submission that publication occurs, or should henceforth be held to occur relevantly at one place, the place where the matter is provided, or first published, cannot withstand any reasonable test of certainty and fairness. If it were accepted, publishers would be free to manipulate the uploading and location of data so as to insulate themselves from liability in Australia, or elsewhere: for example, by using a web server in a "defamation free jurisdiction" or, one in which the defamation laws are tilted decidedly towards defendants. Why would publishers, owing duties to their shareholders, to maximise profits, do otherwise? The place of "uploading" to a web server may have little or no relationship with the place where the matter is investigated, compiled or edited. Here, the State where the matter was uploaded was different from the State in which the article was edited. Matter may be stored on more than one web server, and with different web servers at different times. Different parts of a single web page may be stored on different web servers in different jurisdictions. Many publications in this country, whether by television, radio, newspaper or magazine, originate in New South Wales. The result of the adoption of a rule of a single point of publication as submitted by the appellant, is that many publications in Victoria, South Australia, Tasmania, Western Australia and Queensland would be governed by the Defamation Act 1974 (NSW) which provides, in its present form, for a regime by no means commanding general acceptance throughout this country. Choice of law in defamation proceedings in this country raises a relatively simple question of identifying the place of publication as the place of comprehension: a readily ascertainable fact.

I agree with the respondent's submission that what the appellant seeks to do, is to impose upon Australian residents for the purposes of this and many other cases, an American legal hegemony in relation to Internet publications. The consequence, if the appellant's submission were to be accepted would be to confer upon one country, and one notably more benevolent to the commercial and other media than this one, an effective domain over the law of defamation, to the financial advantage of publishers in the United States, and the serious disadvantage of those unfortunate enough to be reputationally damaged outside the United States. A further consequence might be to place commercial publishers in this country at a disadvantage to commercial publishers in the United States. . . .

The appeal should be dismissed with costs.

Casepoint

A U.S. company that publishes on the World Wide Web using a server in one state may well be held liable in Australian courts for a defamatory story about a resident of Australia. The Australian court is likely to find personal jurisdiction even though the defendant is not physically present in Australia and has no offices or agents in Australia, as long as the defamatory story would forseeably cause damage to the reputation of a person in Australia.

contract, trespass, nuisance, and other causes of action are not torts of negligence but are torts of intent. The plaintiff does not need to show that the defendant had a malicious state of mind; courts will infer intent from the defendant's acts. In Case 4-4, *Dow Jones & Co. Inc v. Gutnick*, the alleged intentional tort of defamation originated in New Jersey (United States) on an Internet Web server while the damage to reputation was done in Australia. Dow Jones tried to argue that Australia should not regulate Internet postings originating on a server in the United States.

Products Liability Theories **Products liability** laws attempt to discourage manufacturers from putting defective products into the marketplace by requiring them to assume liability for the injuries their products cause. Three theories are commonly relied upon to do this: (1) breach of contract, (2) negligence, and (3) strict liability. Most states (including Japan and most states in the developing world) use only the first two of these. The common law countries (i.e., the United States and the British Commonwealth countries) use all three. The EU now relies principally on the last.

products liability Liability of a manufacturer for the injuries caused by its defective products.

TABLE 4.3

Bases for imposing products liability in Japan

	Breach of Contract	Negligence
Products covered	All products	All products
Basic test	Was the product unfit for the purpose for which it was sold?	Considering all of the circumstances, was reasonable care exercised?
Elements	1. Contractual duty not to deliver defective product 2. Breach of express or implied contractual duty 3. Breach caused injury or damage	1. Duty of care 2. Breach of duty 3. Breach caused injury or damage
Defenses	1. Claimant was not in privity with defendant 2. Defendant had disclaimed liability 3. Intervening or superceding event caused defect 4. Defendant exercised reasonable care in attempting to prevent defect 5. If claim is for reach of implied duty, claimant cannot have been aware of the defect at the time of the purchase	1. Exercise of reasonable care 2. Intervening or superceding event caused injury or damage 3. Claimant unreasonably assumed risk 4. Claimant was negligent 5. Defect could not have been discovered using the scientific or technical means available at the time the product was put in circulation
Damages available	1. Personal injury 2. Property loss 3. Economic loss	1. Personal injury 2. Property loss 3. Economic loss

Japanese Products Liability Laws The Japanese Civil Code provides two ways to impose liability for defective products: breach of contract and negligence. See Table 4.3.

The remedies provided by contract law are quite restricted. In essence, they are based on (1) a seller's failure to perform and (2) a seller's breach of an implied warranty not to deliver a defective product.

A seller's obligation with respect to every sales contract is to deliver a product that is fit for the purpose for which it was sold.[56] Failure to perform by delivering a defective product is a breach of both the seller's obligation and the contract. The seller is then responsible for damages for personal and property losses and (unlike the common law and that of EU states) for economic losses as well.

privity
A legal relationship sufficiently close and direct to support a legal claim on behalf of or against another with whom the relationship exists.

This remedy is limited, however, by two familiar rules: privity and burden of proof. **Privity** only allows the immediate purchaser to sue (although a few Japanese courts have recently extended liability to foreseeable users as well as purchasers). Because contracts are part of the Japanese law of obligations, the **burden of proof** is on the plaintiff to show that the seller was at fault. Moreover, even when this can be done, the seller can avoid liability by showing that the defect was due to some factor beyond the seller's control or that the seller took reasonable steps to prevent the defect.

burden of proof:
The responsibility of proving a disputed charge or allegation.

Liability for breach of the implied warranty not to deliver a latent defect is also a very limited remedy. First, privity restricts recovery to the immediate purchaser. Second, the buyer cannot be aware of the defect at the time the product was purchased. Third, the seller's liability is limited to repairing or replacing the product.

With respect to both breach of contract and breach of warranty actions, the seller is allowed to limit liability by issuing disclaimers. Although the disclaimers cannot violate public policy and must meet certain content requirements, they do effectively allow sellers to avoid all liability. For all of these reasons, the usefulness of contract law to impose liability on a seller for a defective product is minimal.

negligence
The neglect or omission of reasonable precaution or care.

Negligence is a more likely basis for imposing liability. Even so, the proof requirements are relatively demanding. A claimant must prove (1) the existence of a defect, (2) that the defect was the result of the defendant's conduct, (3) that the plaintiff suffered an injury, (4) that the injury was caused by the defect, and (5) that the defendant breached a duty of care to the plaintiff.

[56]Japanese Civil Code, Article 415: Compensation for damages is not due in case the performance becomes impossible for any cause for which the obligor is not responsible.

TABLE 4.4

Bases for imposing products liability in common law states

	Negligence	Strict Liability
Products covered	All products	Product dangerously defective in design or manufacture
Basic test	Considering all of the circumstances, was reasonable care exercised?	Was there a defect making the product unreasonably dangerous?
Elements	1. Duty of care 2. Breach of duty 3. Breach caused injury or damage	1. Unreasonably dangerous defect 2. Defect caused injury or damage
Defenses	1. Exercise of reasonable care 2. Intervening or superceding event caused injury or damage 3. Claimant unreasonably assumed risk 4. Claimant was negligent 5. Defect could not have been discovered using the scientific or technical means available at the time the product was put in circulation	1. Defect did not exist when product left defendant's control 2. Claimant misused the product in an unforeseeable manner 3. Claimant unreasonably assumed risk 4. Claimant was negligent 5. Defect could not have been discovered using the scientific or technical means available at the time the product was put in circulation
Damages available	1. Personal injury 2. Property loss	1. Personal injury 2. Property loss

Some Japanese trial courts have recently begun to relax some of these proof requirements. In particular, these courts will not require the plaintiff to show that certain products—especially foodstuffs and pharmaceuticals—are defective. Also, causation may be shown inferentially through the use of statistical data.

The remedies available upon proof of the defendant's negligence are the same as those for breach of a seller's contractual duty to perform: that is, damages for personal, property, and economic losses.

Common Law Products Liability Rules Liability for defective products may be shown in the common law countries through breach of contract, negligence, or strict liability. See Table 4.4. Because of the limitations of privity, breach of contract is seldom used.[57] Instead, claimants in these countries most often rely on the theories of negligence and (if a product is unreasonably dangerous) strict liability.

The common law negligence theory (as it relates to products liability) is essentially the same as the theory used in Japan; however, two doctrines make it somewhat easier for a common law claimant to meet the proof requirements. One is the doctrine of *res ipsa loquitur* (a Latin phrase meaning "the thing speaks for itself"). This excuses an injured claimant who can show that a product was defective when it left the hands of the defendant from having to prove that the defendant caused the defect. The other doctrine is **negligence *per se***.[58] This excuses a claimant from showing that the defendant breached a duty of care in those cases where the defendant violated a statutory manufacturing or disclosure requirement. For example, a manufacturer who sells a stove that does not meet statutory safety requirements could be sued on the grounds that failure to observe the requirements is in and of itself an automatic breach of the manufacturer's duty of reasonable care.

negligence *per se*
Conduct defined by statute as automatically constituting negligence.

Under the common law theory of **strict liability**, defendants can be held liable for acts that are unreasonably dangerous no matter what their intentions may have been or whether or not they exercised reasonable care. The theory is succinctly set out in the Restatement of Torts as follows:

strict liability
Imposing liability on an actor regardless of fault.

1. One who sells any product in a defective condition unreasonably dangerous to the user or consumer or to his property is subject to liability for physical harm thereby caused to the ultimate user or consumer or to his property, if

[57]The proof requirements to show a common law breach of contract are the same as those set out in the Japanese Civil Code.

[58]From Latin *per se:* "by or in itself"; intrinsically.

TABLE 4.5

Basis for imposing products liability in the EU

	Strict Liability
Products covered	Products other than primary agricultural products and game
Basic test	Considering all of the circumstances, was the product unsafe?
Elements	1. Unsafe defect
	2. Defect caused injury or damage
Defenses	1. Defendant did not put product into circulation
	2. Defect did not exist when product left defendant's control
	3. Defendant did not make the product for sale or distribution and did not himself sell or distribute it
	4. Defect results from compliance with a mandatory regulation issued by a public authority
	5. Defect could not have been discovered using the scientific or technical means available at the time the product was put in circulation
	6. If defendant is the manufacturer of a component, the defect relates to the design of the product to which the component is a part or the instructions provided by the manufacturer of the product
Damages available	1. Personal injury
	2. Property loss

a. the seller is engaged in the business of selling such a product, and
b. it is expected to and does reach the user or consumer without substantial change in condition in which it is sold.

2. The rule stated in Subsection (1) applies although

a. the seller has exercised all possible care in the preparation and sale of his product, and
b. the user or consumer has not bought the product from or entered into any contractual relation with the seller.[59]

The major advantage of strict liability from the claimant's perspective is that it does not require the showing of negligence. There is, however, a significant limitation: The defective product must be "unreasonably dangerous." This means that the claimant has to show either (1) that the product was dangerous beyond the expectations of the ordinary consumer or (2) that a less dangerous alternative was economically feasible for the manufacturer to produce and the manufacturer failed to produce it.

EU Products Liability Rules An EU directive establishes a common minimum products liabilities standard for all EU member states.[60] See Table 4.5. This standard is similar to the strict liability theory used in the common law countries. However, it does not require the claimant to show that a defect is unreasonably dangerous. The directive provides:

1. A product is defective when it does not provide the safety which a person is entitled to expect, taking all circumstances into account, including:
   a. the presentation of the product;
   b. the use to which it could reasonably be expected that the product would be put;
   c. the time when it was put into circulation.
2. A product does not have a defect for the sole reason that a better product is subsequently put into circulation.

---

[59]Section 402A of the Restatement (Second) Torts specifically applies to "any person engaged in the business of selling products for use or consumption." The section permits a person injured by an allegedly defective product to sue any seller of that product if that seller is engaged in the business of selling such a product. Some courts have applied the Restatement Section 402A to sellers of used goods, including any manufacturer of such a product, and to any wholesale or retail dealer or distributor.

[60]European Community (now European Union) Directive No. 85/374 on the Approximation of the Laws, Regulations, and Administrative Provisions of the Member States Concerning Liability for Defective Products, *Official Journal*, No. L 210/29 (August 7, 1985). See http://ts.nist.gov/Standards/Global/upload/product-liability-guide-824.pdf for the text and guidelines for the directive.

The EU directive is similar to the common law strict liability rule as it is applied in the British Commonwealth countries (but not in the United States) in that it allows EU member states to set a total maximum liability limit that a product producer may have to pay. It states that "any member state may provide that a producer's total liability for damage resulting from a death or personal injury and caused by identical items with the same defect shall be limited to an amount which may not be less than 70 million euros."[61]

Extraterritorial Application of Products Liability Laws As is the case with unfair competition laws, the U.S. courts have been the most willing to apply their domestic products liability laws extraterritorially. U.S. courts consider two issues when deciding whether they can exercise jurisdiction in a product liability case: personal jurisdiction and *forum non conveniens*.

Personal Jurisdiction Requirements of U.S. Products Liability Laws Products liability is a creature of the laws of the individual states of the United States rather than federal law. As a consequence, personal jurisdiction must be found in the individual states' long arm statutes. These are the same statutes that apply in anti-trust cases. Most are quite broad, and virtually any business activity in the local forum will be enough to establish long arm jurisdiction.

As with the antitrust cases, however, establishing long arm jurisdiction is not enough by itself. A claimant must also satisfy the federal constitutional requirement of due process by showing that the defendant had *minimum contacts* with the forum. In short, the minimum contacts test allows a court to assume jurisdiction only if (1) the defendant purposefully availed itself of doing business in the forum and (2) the defendant reasonably could have anticipated that it would have to defend itself there. The minimum contacts test is discussed in Case 4-5.

In Brief: CASE 4-5 World-Wide Volkswagen v. Woodson

U.S. Supreme Court.
444 U.S. 286 (1980).

MAP 4.5

United States and Oklahoma (1980)

Facts

In 1976, Harry and Kay Robinson bought a new car from Seaway Volkswagen in Massena, New York. "The following year the Robinson family, who resided in New York, left that State for a new home in Arizona. As they passed through the State of Oklahoma, another car struck

[61]*Id.*, Article 16(1). As of July 2002, 70 million euros was approximately U.S. $69 million.

their Audi in the rear, causing a fire which severely burned Kay Robinson and her two children."[62]

The Robinsons sued in tort in Oklahoma, using various theories of products liability. The defendants included the automobile retailer (Seaway) and its wholesaler (World-Wide Volkswagen), New York corporations that did no business in Oklahoma.

Issue

Petitioners entered special appearances, claiming that Oklahoma's exercise of jurisdiction over them would offend limitations on the State's jurisdiction imposed by the Due Process Clause of the Fourteenth Amendment. The trial court rejected Seaway and World-Wide's claims. Petitioners sought a restraining order from the Oklahoma Supreme Court to restrain the respondent trial judge (Woodson) from exercising *in personam* jurisdiction over them.

They argued that Oklahoma did not have personal jurisdiction under the Due Process Clause of the Fourteenth Amendment, because they were not "doing business" in Oklahoma, and the only connection between New York and Oklahoma was that the allegedly defective car sold in New York was in an accident in Oklahoma.

Decision

Okahoma does not have personal jurisdiction over the New York retailer (Seaway) or distributor (World-Wide).

Rationale

Reviewing its personal jurisdiction, Fourteenth Amendment cases, the court noted that for a state court to exercise *in personam* jurisdiction over a defendant, there must exist *minimum contacts* between the defendant, the forum, and the claim being made by plaintiffs. In its "syllabus" of the case, the court noted that the Petitioners carried on no activities in Oklahoma, made no sales and performed no services there, and had not solicited business there, either through advertising or sales representatives. The record did not reflect ongoing sales to Oklahoma residents or any indication that the dealer or the regional distributor sought to serve the Oklahoma market. The court noted that it was "foreseeable" that some automobiles sold by Seaway and World-Wide would travel through Oklahoma or even be taken there for regular use by purchasers who moved from the New York area to Oklahoma. But it determined that this would not be an adequate basis for Oklahoma to assert jurisdiction over Seaway or World-Wide. For due process, it would not be fair to assert jurisdiction over a seller that could merely "foresee" that its product would end up in Oklahoma; more critical is the seller's conduct and connection with the forum, conduct and connection that make it such "that he should reasonably anticipate being haled into court there."[63]

Thus, the court rules that the New York retailer (Seaway) and distributor (WW VW) have no contacts with Oklahoma and thus it reverses the judgment of the Supreme Court of Oklahoma. The case cannot proceed against either the retailer or distributor in Oklahoma. But the case could proceed against the North American distributor and the German manufacturer.

The reasoning in *World-Wide Volkswagen* has been used repeatedly by the U.S. Supreme Court, as seen in the *Asahi Case* (4-6). In each case, whether the issue is a U.S. state's power to assert jurisdiction over a company from another U.S. state or the power of the United States to assert personal jurisdiction over a company based elsewhere, the Court resists extending any state's power too far over any other state. Looking at the *Asahi Case*, you might wonder why the Court seems to extend due process rights to foreign entities. It does not do so expressly, but the outcome is the same: Companies that do not "avail themselves" of doing business in one country should not be held accountable in the courts of that country.

[62]*Id*. at p. 288.

[63]*Id*. at p. 297.

CASE 4-6 Asahi Metal Industry Co., Ltd. v. Superior Court of California, Solano County United States Supreme Court

United States Supreme Court Reports, vol. 480, p. 102 (1987)

MAP 4.6

California (1987)

Opinion by Justice O'Connor

This case presents the question whether the mere awareness on the part of a foreign defendant that the components it manufactured, sold, and delivered outside the United States would reach the forum State in the stream of commerce constitutes "minimum contacts" between the defendant and the forum state such that the exercise of jurisdiction "does not offend traditional notions of fair play and substantial justice."

On September 23, 1978, on Interstate Highway 80 in Solano County, California, Gary Zurcher lost control of his Honda motorcycle and collided with a tractor. Zurcher was severely injured, and his passenger and wife, Ruth Ann Moreno, was killed. In September 1979, Zurcher filed a product liability action in the Superior Court of the state of California in and for the County of Solano. Zurcher alleged that the 1978 accident was caused by a sudden loss of air and an explosion in the rear tire of the motorcycle, and alleged that the motorcycle tire, tube, and sealant were defective.

Zurcher's complaint named, *inter alia*, Cheng Shin Rubber Industrial Co., Ltd. (Cheng Shin), the Taiwanese manufacturer of the tube. Cheng Shin in turn filed a cross-complaint seeking indemnification from its codefendants and from petitioner, Asahi Metal Industry Co., Ltd. (Asahi), the manufacturer of the tube's valve assembly. Zurcher's claims against Cheng Shin and the other defendants were eventually settled and dismissed, leaving only Cheng Shin's indemnity action against Asahi.

California's long-arm statute authorizes the exercise of jurisdiction "on any basis not inconsistent with the Constitution of this state or of the United States." Asahi moved to quash Cheng Shin's service of summons, arguing the state could not exert jurisdiction over it consistent with the Due Process Clause of the Fourteenth Amendment.

In relation to the motion, the following information was submitted by Asahi and Cheng Shin. Asahi is a Japanese corporation. It manufactures tire valve assemblies in Japan and sells the assemblies to Cheng Shin, and to several other tire manufacturers, for use as components in

finished tire tubes. Asahi's sales to Cheng Shin took place in Taiwan. The shipments from Asahi to Cheng Shin were sent from Japan to Taiwan. Cheng Shin bought and incorporated into its tire tubes 150,000 Asahi valve assemblies in 1978; 500,000 in 1979; 500,000 in 1980; 100,000 in 1981; and 100,000 in 1982. Sales to Cheng Shin accounted for 1.24 percent of Asahi's income in 1981 and 0.44 percent in 1982. Cheng Shin alleged that approximately 20 percent of its sales in the United States are in California. Cheng Shin purchases valve assemblies from other suppliers as well, and sells finished tubes throughout the world.

In 1983, an attorney for Cheng Shin conducted an informal examination of the valve stems of the tire tubes sold in one cycle store in Solano County. The attorney declared that of the approximately 115 tire tubes in the store, 97 were purportedly manufactured in Japan or Taiwan, and of those 97, 21 valve stems were marked with the circled letter "A," apparently Asahi's trademark. Of the 21 Asahi valve stems, 12 were incorporated into Cheng Shin tire tubes. The store contained 41 other Cheng Shin tubes that incorporated the valve assemblies of other manufacturers. An affidavit of a manager of Cheng Shin whose duties included the purchasing of component parts stated: "In discussions with Asahi regarding the purchase of valve stem assemblies, the fact that my Company sells tubes throughout the world and specifically the United States has been discussed. I am informed and believe that Asahi was fully aware that valve stem assemblies sold to my Company and to others would end up throughout the United States and in California." An affidavit of the president of Asahi, on the other hand, declared that Asahi "has never contemplated that its limited sales of tire valves to Cheng Shin in Taiwan would subject it to lawsuits in California." The record does not include any contract between Cheng Shin and Asahi.

Primarily on the basis of the above information, the Superior Court denied the motion to quash summons, stating: "Asahi obviously does business on an international scale. It is not unreasonable that they defend claims of defect in their product on an international scale."[64]

The Court of Appeal of the state of California issued a peremptory writ of mandate[65] commanding the Superior Court to quash service of summons. The court concluded that "it would be unreasonable to require Asahi to respond in California solely on the basis of ultimately realized foreseeability that the product into which its component was embodied would be sold all over the world including California."

The Supreme Court of the state of California reversed and discharged the writ issued by the Court of Appeal. The court observed: "Asahi has no offices, property or agents in California. It solicits no business in California and has made no direct sales [in California]." Moreover, "Asahi did not design or control the system of distribution that carried its valve assemblies into California." Nevertheless, the court found the exercise of jurisdiction over Asahi to be consistent with the Due Process Clause. It concluded that Asahi knew that some of the valve assemblies sold to Cheng Shin would be incorporated into tire tubes sold in California, and that Asahi benefited indirectly from the sale in California of products incorporating its components.

The court considered Asahi's intentional act of placing its components into the stream of commerce—that is, by delivering the components to Cheng Shin in Taiwan—coupled with Asahi's awareness that some of the components would eventually find their way into California, sufficient to form the basis for state court jurisdiction under the Due Process Clause.

We granted certiorari and now reverse.

II

A

The Due Process Clause of the Fourteenth Amendment limits the power of a state court to exert personal jurisdiction over a nonresident defendant. "[T]he constitutional touchstone" of the determination whether an exercise of personal jurisdiction comports with due process "remains

[64]Order Denying Motion to Quash Summons, *Zurcher v. Dunlop Tire & Rubber Co*., No. 76180 (Super. Ct., Solano County, California, April 20, 1983).

[65]A final order of a court to any governmental body, government official, or a lower court to perform an act the court finds is an official duty required by law. This is distinguished from an alternative writ of mandate (*mandamus*), which orders the governmental agency, court, or officials to obey the order or show cause at a hearing why it should not.

whether the defendant purposefully established 'minimum contacts' in the forum state."[66] Most recently we have reaffirmed the oft-quoted reasoning of [our decision in] *Hanson v. Denckla*[67] that minimum contacts must have a basis in "some act by which the defendant purposefully avails itself of the privilege of conducting activities within the forum state, thus invoking the benefits and protections of its laws." [In] *Burger King* [we said:] "Jurisdiction is proper . . . where the contacts proximately result from actions by the defendant himself that create a 'substantial connection' with the forum state."

Applying the principle that minimum contacts must be based on an act of the defendant, the Court in *World-Wide Volkswagen Corp. v. Woodson*[68] rejected the assertion that a consumer's unilateral act of bringing the defendant's product into the forum state was a sufficient constitutional basis for personal jurisdiction over the defendant. It had been argued in *World-Wide Volkswagen* that because an automobile retailer and its wholesale distributor sold a product mobile by design and purpose, they could foresee being haled into court in the distant states into which their customers might drive. The Court rejected this concept of foreseeability as an insufficient basis for jurisdiction under the Due Process Clause. The Court disclaimed, however, the idea that "foreseeability is wholly irrelevant" to personal jurisdiction, concluding that "[t]he forum state does not exceed its powers under the Due Process Clause if it asserts personal jurisdiction over a corporation that delivers its products into the stream of commerce with the expectation that they will be purchased by consumers in the forum state."[69] The Court reasoned:

> When a corporation 'purposefully avails itself of the privilege of conducting activities within the forum state,'[70] it has clear notice that it is subject to suit there, and can act to alleviate the risk of burdensome litigation by procuring insurance, passing the expected costs on to customers, or, if the risks are too great, severing its connection with the state. Hence if the sale of a product of a manufacturer or distributor . . . is not simply an isolated occurrence, but arises from the efforts of the manufacturer or distributor to serve, directly or indirectly, the market for its product in other states, it is not unreasonable to subject it to suit in one of those states if its allegedly defective merchandise has there been the source of injury to its owners or to others.[71]

In *World-Wide Volkswagen* itself, the state court sought to base jurisdiction not on any act of the defendant, but on the foreseeable unilateral actions of the consumer. Since *World-Wide Volkswagen*, lower courts have been confronted with cases in which the defendant acted by placing a product in the stream of commerce, and the stream eventually swept the defendant's product into the forum state, but the defendant did nothing else to purposefully avail itself of the market in the forum state. Some courts have understood the Due Process Clause, as interpreted in *World-Wide Volkswagen*, to allow an exercise of personal jurisdiction to be based on no more than the defendant's act of placing the product in the stream of commerce. Other courts have understood the Due Process Clause and the above-quoted language in *World-Wide Volkswagen* to require the action of the defendant to be more purposefully directed at the forum state than the mere act of placing a product in the stream of commerce.

The reasoning of the Supreme Court of California in the present case illustrates the former interpretation of *World-Wide Volkswagen*. The Supreme Court of California held that, because the stream of commerce eventually brought some valves Asahi sold Cheng Shin into California, Asahi's awareness that its valves would be sold in California was sufficient to permit California to exercise jurisdiction over Asahi consistent with the requirements of the Due Process Clause. The Supreme Court of California's position was consistent with those courts that have held that mere foreseeability or awareness was a constitutionally sufficient basis for personal jurisdiction

---

[66]*Burger King Corp. v. Rudzewicz*, *United States Reports*, vol. 471, p. 462 at p. 474 (Supreme Ct., 1985), quoting *International Shoe Co. v. Washington*, *id*., vol. 326 at p. 316.

[67]*Id*., vol. 357, p. 235 at p. 253 (1958).

[68]*United States Reports*, vol. 444, p. 286 (1980).

[69]*Id*., at pp. 297–298.

[70]*Hanson v. Denckla*, *United States Reports*, vol. 357 at p. 235 (Supreme Ct., 1958).

[71]World-Wide Volkswagen, *United States Reports*, vol. 444, at p. 297.

if the defendant's product made its way into the forum state while still in the stream of commerce.[72]

Other courts, however, have understood the Due Process Clause to require something more than that the defendant was aware of its product's entry into the forum state through the stream of commerce in order for the state to exert jurisdiction over the defendant. In the present case, for example, the state Court of Appeal did not read the Due Process Clause, as interpreted by *World-Wide Volkswagen*, to allow "mere foreseeability that the product will enter the forum state [to] be enough by itself to establish jurisdiction over the distributor and retailer." In *Humble v. Toyota Motor Co.*[73] an injured car passenger brought suit against Arakawa Auto Body Company, a Japanese corporation that manufactured car seats for Toyota. Arakawa did no business in the United States; it had no office, affiliate, subsidiary, or agent in the United States; it manufactured its component parts outside the United States and delivered them to Toyota Motor Company in Japan. The Court of Appeals, adopting the reasoning of the District Court in that case, noted that although it "does not doubt that Arakawa could have foreseen that its product would find its way into the United States," it would be "manifestly unjust" to require Arakawa to defend itself in the United States.

We now find this latter position to be consonant with the requirements of due process. The "substantial connection" between the defendant and the forum state necessary for a finding of minimum contacts must come about by an action of the defendant purposefully directed toward the forum state. The placement of a product into the stream of commerce, without more, is not an act of the defendant purposefully directed toward the forum state.

Additional conduct of the defendant may indicate an intent or purpose to serve the market in the forum state, for example, designing the product for the market in the forum state, advertising in the forum state, establishing channels for providing regular advice to customers in the forum state, or marketing the product through a distributor who has agreed to serve as the sales agent in the forum state. But a defendant's awareness that the stream of commerce may or will sweep the product into the forum state does not convert the mere act of placing the product into the stream into an act purposefully directed toward the forum state.

Assuming, *arguendo*,[74] that respondents have established Asahi's awareness that some of the valves sold to Cheng Shin would be incorporated into tire tubes sold in California, respondents have not demonstrated any action by Asahi to purposefully avail itself of the California market. Asahi does not do business in California. It has no office, agents, employees, or property in California. It does not advertise or otherwise solicit business in California. It did not create, control, or employ the distribution system that brought its valves to California. There is no evidence that Asahi designed its product in anticipation of sales in California. On the basis of these facts, the exertion of personal jurisdiction over Asahi by the Superior Court of California exceeds the limits of due process.

B

The strictures of the Due Process Clause forbid a state court to exercise personal jurisdiction over Asahi under circumstances that would offend "traditional notions of fair play and substantial justice."[75]

We have previously explained that the determination of the reasonableness of the exercise of jurisdiction in each case will depend on an evaluation of several factors. A court must consider the burden on the defendant, the interests of the forum state, and the plaintiff's interest in obtaining relief. It must also weigh in its determination "the interstate judicial system's interest in obtaining the most efficient resolution of controversies; and the shared interest of the several states in furthering fundamental substantive social policies."[76]

[72]See *Bean Dredging Corp. v. Dredge Technology Corp.*, *Federal Reports, Second Series*, vol. 744, p. 1081 (5th Circuit Ct. of Appeals, 1984); *Hedrick v. Daiko Shoji Co.*, *id.*, vol. 715, p. 1355 (9th Circuit Ct. of Appeals, 1983).

[73]*Id.*, vol. 727, p. 709 (8th Circuit Ct. of Appeals, 1984).

[74]From Latin: "for the sake of the argument."

[75]*International Shoe Co. v. Washington*, *United States Reports*, vol. 326, p. 310 at p. 316 (Supreme Ct., 1945), quoting *Milliken v. Meyer*, *id.*, vol. 311, p. 457 at p. 463 (Supreme Ct., 1940).

[76]World-Wide Volkswagen, *id.*, vol. 444 at p. 292.

A consideration of these factors in the present case clearly reveals the unreasonableness of the assertion of jurisdiction over Asahi, even apart from the question of the placement of goods in the stream of commerce.

Certainly the burden on the defendant in this case is severe. Asahi has been commanded by the Supreme Court of California not only to traverse the distance between Asahi's headquarters in Japan and the Superior Court of California in and for the County of Solano, but also to submit its dispute with Cheng Shin to a foreign nation's judicial system. The unique burdens placed upon one who must defend oneself in a foreign legal system should have significant weight in assessing the reasonableness of stretching the long arm of personal jurisdiction over national borders.

When minimum contacts have been established, often the interests of the plaintiff and the forum in the exercise of jurisdiction will justify even the serious burdens placed on the alien defendant. In the present case, however, the interests of the plaintiff and the forum in California's assertion of jurisdiction over Asahi are slight. All that remains is a claim for indemnification asserted by Cheng Shin, a Taiwanese corporation, against Asahi. The transaction on which the indemnification claim is based took place in Taiwan; Asahi's components were shipped from Japan to Taiwan. Cheng Shin has not demonstrated that it is more convenient for it to litigate its indemnification claim against Asahi in California rather than in Taiwan or Japan.

Because the plaintiff is not a California resident, California's legitimate interests in the dispute have considerably diminished. The Supreme Court of California argued that the state had an interest in "protecting its consumers by ensuring that foreign manufacturers comply with the state's safety standards." The state Supreme Court's definition of California's interest, however, was overly broad. The dispute between Cheng Shin and Asahi is primarily about indemnification rather than safety standards. Moreover, it is not at all clear at this point that California law should govern the question whether a Japanese corporation should indemnify a Taiwanese corporation on the basis of a sale made in Taiwan and a shipment of goods from Japan to Taiwan. The possibility of being haled into a California court as a result of an accident involving Asahi's components undoubtedly creates an additional deterrent to the manufacture of unsafe components; however, similar pressures will be placed on Asahi by the purchasers of its components as long as those who use Asahi components in their final products, and sell those products in California, are subject to the application of California tort law.

World-Wide Volkswagen also admonished courts to take into consideration the interests of the "several states," in addition to the forum state, in the efficient judicial resolution of the dispute and the advancement of substantive policies. In the present case, this advice calls for a court to consider the procedural and substantive policies of other nations whose interests are affected by the assertion of jurisdiction by the California court. The procedural and substantive interests of other nations in a state court's assertion of jurisdiction over an alien defendant will differ from case to case. In every case, however, those interests, as well as the Federal Government's interest in its foreign relations policies, will be best served by a careful inquiry into the reasonableness of the assertion of jurisdiction in the particular case, and an unwillingness to find the serious burdens on an alien defendant outweighed by minimal interests on the part of the plaintiff or the forum state. "Great care and reserve should be exercised when extending our notions of personal jurisdiction into the international field."[77]

Considering the international context, the heavy burden on the alien defendant, and the slight interests of the plaintiff and the forum state, the exercise of personal jurisdiction by a California court over Asahi in this instance would be unreasonable and unfair.

III

Because the facts of this case do not establish minimum contacts such that the exercise of personal jurisdiction is consistent with fair play and substantial justice, the judgment of the Supreme Court of California is reversed, and the case is remanded for further proceedings not inconsistent with this opinion.

It is so ordered.

[77] *United States v. First National City Bank*, *United States Reports*, vol. 379, p. 378 at p. 404 (1965) (Justice Harlan, dissenting).

Casepoint

The Due Process Clause of the Fourteenth Amendment allows a state court to exercise personal jurisdiction over a foreign defendant only where the "defendant purposefully established 'minimum contacts' in the forum state." Foreseeability that a product will enter a state in the stream of commerce is not a sufficient basis for the state to assert jurisdiction *(World-Wide Volkswagen v. Woodson)*. It would be "manifestly unjust" to require a foreign defendant to appear when the only connection with the forum state is that the defendant could have foreseen that a product put in the stream of commerce would eventually find its way into that state (*Humble v. Toyota Motor Co.*).

forum non conveniens (From Latin: "inconvenient forum.") Doctrine that a municipal court will decline to hear a dispute when it can be better or more conveniently settled in a foreign forum.

sharp practices Business dealings meant to obtain a benefit for a person or firm regardless of the means used.

Forum Non Conveniens Unlike their approach to antitrust cases, American courts do not apply a separate test for subject-matter jurisdiction in products liability cases. Nevertheless, the considerations the courts look at in anti-trust cases are sometimes explored in products liability cases through the device of ***forum non conveniens***. This allows courts applying this device to determine if the forum state has enough interest in the outcome of the dispute to take jurisdiction. The factors considered are (1) the private interests of the parties (i.e., the ease and cost of access to documents and witnesses) and (2) the public interest factors (i.e., the interest of the forum state, the burden on the courts, and notions of judicial comity).

Sharp Practices

Sharp practices are dishonest business dealings meant to obtain a benefit for an individual or firm regardless of the means used. They include such conduct as misrepresentation and bribery. Generally, in the past, only host states regulated the sharp practices of investors and MNEs. However, with the adoption of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions—discussed earlier—sharp practices are now to be regulated by home states as well. Because the OECD's member states are the wealthiest countries—including Japan, Germany, France, Italy, the United Kingdom, and the United States—nearly all of the world's major MNEs will soon be subject to these regulations.

The one exception to the old rule that sharp practices were regulated only by host states was the United States. In 1977, in response to several scandals involving American companies bribing foreign government officials to obtain lucrative contracts (especially Lockheed Aircraft's bribing of the prime minister of Japan to secure sales of jet fighter planes), the United States enacted the Foreign Corrupt Practices Act (FCPA).[78]

The FCPA, as currently written,[79] attacks sharp practices in two ways. First, it imposes accounting obligations on companies as a means of indirectly deterring bribery. These require MNEs (1) to account with "reasonable detail" for all company transactions (especially the transfer of assets) and (2) to maintain a system of internal accounting controls that provide "reasonable assurances" that all transactions are properly authorized by the company.[80]

[78]The text of the FCPA is posted at www.usdoj.gov/criminal/fraud/fcpa.html.

[79]As it was originally enacted, the FCPA proved difficult to interpret and apply. Its attempts to distinguish between prohibited *bribery* payments and permissible *facilitating* payments were confusing. Terms and phrases such as *essentially ministerial or clerical*, *obtaining or retaining business*, *reason to know*, *such thing of value*, and *corruptly* were not defined. As a consequence, many American exporters, uncertain about the applicability of the act and their potential liability, retreated from the global marketplace. In response to the chilling effect that some of the provisions in the act were having on American competitiveness abroad, Congress amended the FCPA as part of the Omnibus Trade and Competitiveness Act of 1988.

[80]*Reasonable detail* and *reasonable assurances* are defined as "such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs." Criminal liability will attach, but only if persons "knowingly circumvent or knowingly fail" to maintain the system of accounting controls required by the act. The accounting provisions, however, are not meant to impose liability on a company for inadvertent or technical errors in maintaining books and records. In 196 *United States Code*, Title 15, §§78dd-2(b)(1)(B)(3), 78ff(c)(3) (1976). In *United States v. McLean*, *Federal Reporter, Second Series*, vol. 738, p. 644 (1984), the court held that a company's officers, agents, and employees could only be prosecuted after their company was first convicted. This requirement, it said, was necessary to keep the company from using its officers, agents, and employees as scapegoats.

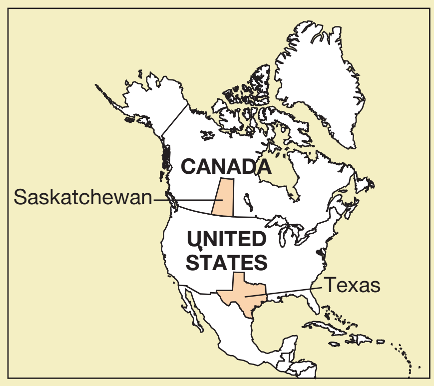
Second, the FCPA makes it illegal for American companies, foreign companies registered with the U.S. Securities and Exchange Commission, or their officers, agents, or employees to knowingly bribe a foreign government official, a foreign political party official, or a candidate for foreign political office. That is, firms and individuals will be criminally liable if they make a payment "knowing" or in "conscious disregard" that it will be used as a bribe—a bribe being the giving of, or the promise to give, anything of value to influence a foreign official to let the firm or individual making the payment to engage in a new business or to allow that firm or individual to continue its existing business.

The FCPA's antibribery provisions do not apply to so-called routine governmental actions. That is, a person is not engaging in bribery by paying a foreign official to obtain permits, licenses, or documents that allow the person to do business in the official's country. Nor is it a bribe to pay an official to process papers, such as visas; to obtain work orders, police protection, or mail, phone, power, or water services; to schedule inspections; or to do any other acts of a "similar nature." In addition, a person charged with violating the FCPA may defend him- or herself by showing that the payment was lawful under the written laws of the foreign country or by showing that the payment was a "reasonable and bona fide expenditure" related to carrying out or executing a contract.

Not all of the participants in a bribery scheme are subject to prosecution under the FCPA. Case 4-7 points out that one group was not the intended target of this legislation.

CASE 4-7 United States v. Blondek, Tull, Castle, and Lowry

United States District Court for the Northern District of Texas, 1990.
Federal Supplement, vol. 741, p. 116 (1990).



MAP 4.7

United States and Canada (1990)

Opinion by Judge Sanders

All four defendants in this case are charged in a one-count indictment with conspiring to violate the Foreign Corrupt Practices Act of 1977 (FCPA). Defendants Castle and Lowry have moved to dismiss the indictment against them on the grounds that as Canadian officials, they cannot be convicted of the offense charged against them. The two other defendants, Blondek and Tull, are U.S. private citizens, and they do not challenge their indictment on this ground. The Court has considered supplemental briefing and oral argument on the motions.

The indictment charges all four defendants with conspiring to bribe foreign officials in violation of the FCPA. Blondek and Tull were employees of Eagle Bus Company, a U.S. concern as defined in the FCPA. According to the indictment, they paid a $50,000 bribe to defendants Castle and Lowry to ensure that their bid to provide buses to the Saskatchewan provincial government would be accepted.

There is no question that the payment of the bribe by defendants Blondek and Tull is illegal under the FCPA, and that they may be prosecuted for conspiring to violate the Act. Nor is it disputed that defendants Castle and Lowry could not be charged with violating the FCPA itself, since the Act does not criminalize the receipt of a bribe by a foreign official. The issue here is

whether the government may prosecute Castle and Lowry under the general conspiracy statute[81] for conspiring to violate the FCPA. Put more simply, the question is whether foreign officials, whom the government concedes it cannot prosecute under the FCPA itself, may be prosecuted under the general conspiracy statute for conspiring to violate the Act.

In *Gebardi v. United States*,[82] the Supreme Court confronted a similar issue: whether a woman who agreed to be transported by her lover across state lines to engage in sexual intercourse could be convicted of a conspiracy to violate the Mann Act. The Mann Act prohibited the transportation of women across state boundaries for immoral purposes, but did not criminalize the conduct of the women being transported. Acknowledging that it could not prosecute the woman for violating the Mann Act itself, the government prosecuted her instead for conspiring to violate the Mann Act. The woman objected to her conviction on the grounds that the Mann Act exempted her from prosecution for her participation.

The Court noted first that the incapacity of a person to commit the substantive offense does not necessarily imply that he may conspire with others to commit the offense with impunity, since the state may criminalize the collective planning of the criminal conduct.[83] For example, it is a crime for a bankrupt to conceal property from his trustee, and thus only bankrupts may be convicted of the substantive offense of concealing property. But convictions of others for conspiring with the bankrupt to conceal property have been upheld.[84]

The Court distinguished the case before it on the grounds that a violation of the Mann Act necessarily required the agreement of the woman to the criminal act—her transportation across a state line. Yet the Act did not make the woman's consent a crime. The Court concluded that by excluding the transported woman from prosecution under the Mann Act, Congress evinced an affirmative legislative policy "to leave her acquiescence unpunished."[85] A necessary implication of that policy was that the woman's agreement to participate was immune from any kind of prosecution, including prosecution for conspiring to violate the Mann Act. To do otherwise, the Court reasoned, would allow the executive branch to extend the reach of the Act beyond the scope of Congress' intention. . . .[86] On this basis, the Court reversed the conviction of the woman for conspiring to violate the Mann Act.

The principle enunciated by the Supreme Court in Gebardi squarely applies to the case before this Court. Congress intended in both the FCPA and the Mann Act to deter and punish certain activities which necessarily involved the agreement of at least two people,[87] but Congress chose in both statutes to punish only one party to the agreement.

In *Gebardi*, the Supreme Court refused to disregard Congress' intention to exempt one party by allowing the executive to prosecute that party under the general conspiracy statute for precisely the same conduct. Congress made the same choice in drafting the FCPA, and by the same analysis, this Court may not allow the executive to override the congressional intent not to prosecute foreign officials for their participation in the prohibited acts.

In drafting the Mann Act, Congress was probably motivated by a protective instinct toward women based on a belief that most women would not participate in the activity without coercion or duress by the man involved. The government tries to distinguish *Gebardi* on this ground, asserting that "the exception" provided in *Gebardi* to prosecution for conspiracy only applies to individuals belonging to the class of persons the criminal statute was designed to protect.

Nothing in Gebardi indicates that only "protected" persons are exempted from conspiracy charges; rather, the Court explicitly built its analysis on Congress' clear intention, evinced by the plain language of the statute, to exempt the transported women from all prosecutions for their involvement in the prohibited activities. A similar intent is apparent from the language of the FCPA, especially when compared to other bribery statutes which criminalize both the payment and receipt of bribes. . . .

---

[81] *Id.*, Title 18, §371. The text of the statute is posted at www.usdoj.gov/usao/eousa/foia_reading_room/usam/title9/crm00923.htm.

[82] *United States Reports*, vol. 287, p. 112 (Supreme Ct., 1932).

[83] *Id.*, at pp. 120–121.

[84] See *id.* at p. 120 n. 5 and the cases cited therein.

[85] *Id.*, at p. 123.

[86] *Id.*

[87] In the Mann Act, the two necessary parties were the transporter and the transported woman, and in the FCPA the necessary parties were the U.S. company paying the bribe and the foreign official accepting it.

Even accepting the general idea that Congress must have some reason for exempting from prosecution a class of persons necessarily involved in the prohibited conduct, Congress was quite explicit about its reasons, but none of these reasons have anything to do with foreign officials. Instead, the exclusive focus was on the U.S. companies and the effects of their conduct within and on the United States.

First, Congress was concerned about the domestic effects of such payments. In the early 1970s, the Watergate affair and resulting investigations revealed that the payment of bribes to foreign officials was a widespread practice among U.S. companies. In the House Report accompanying an earlier version of the Act, it was noted that more than 400 companies had admitted making such payments, distributing well over 300 million dollars in corporate funds to foreign officials.[88] Such massive payments had many negative domestic effects, not the least of which was the distortion of, and resulting lack of confidence in, the free market system within the United States.

The payment of bribes to influence the acts or decision[s] of foreign officials . . . is unethical. It is counter to the moral expectations and values of the American public. But not only is it unethical, it is bad business as well. It erodes public confidence in the integrity of the free market system. . . . In short, it rewards corruption instead of efficiency and puts pressure on ethical enterprises to lower their standards or risk losing business.[89]

The House Committee further noted that many of the payments were made not to compete with foreign companies, but rather to gain an edge over a competitor in the United States.[90]

Congress' second motivation was the effect of such payments by U.S. companies on the United States' foreign relations. The legislative history repeatedly cited the negative effects the revelations of such bribes had wrought upon friendly foreign governments and officials.[91] Yet the drafters acknowledged, and the final law reflects this, that some payments that would be unethical or even illegal within the United States might not be perceived similarly in foreign countries, and those payments should not be criminalized. For example, grease payments, those payments made "to assure or to speed the proper performance of a foreign official's duties," are not illegal under the Act since they were often a part of the custom of doing business in foreign countries.[92] Additionally, the Act was later amended to permit an affirmative defense on the grounds that the payment was legal in the country in which it was made.[93] These exclusions reinforce the proposition that Congress had absolutely no intention of prosecuting the foreign officials involved, but was concerned solely with regulating the conduct of U.S. entities and citizens.[94]

The government argues that the following statement in the House Report evinces a clear intent by Congress to allow conspiracy prosecutions of foreign officials: "The concepts of aiding and abetting and joint participation would apply to a violation under this bill in the same manner in which those concepts have always applied in both SEC[95] civil actions and implied private actions brought under the securities laws generally."[96] The government's reliance is misplaced. Congress included this statement to clarify the rights of civil litigants in pursuing a private right of action under the Act, an area entirely different from criminal prosecutions.

---

[88] House of Representatives Report No. 640, p. 4 (95th Congress, 1st Session, 1977).

[89] *Id*., at pp. 4–5. See also Senate Report No. 114, p. 4 (95th Congress, 1st Session, 1977).

[90] House of Representatives Report No. 640, at p. 5 (95th Congress, 1st Session, 1977).

[91] *Id*. See also Senate Report No. 114, p. 4 (95th Congress, 1st Session, 1977).

[92] House of Representatives Report no. 640, p. 8 (95th Congress, 1st Session, 1977); see also *United States Code*, Title 15, §78dd-2(b).

[93] *United States Code*, Title 15, §78dd-2(c) (1).

[94] Congress considered, and rejected, the idea that a demand for a payment by a foreign official would be a valid defense to a criminal prosecution under the Act, because "at some point the U.S. company would make a conscious decision whether or not to pay a bribe. That the payment may have been first proposed by the recipient rather than the U.S. company does not alter the corrupt purpose on the part of the person paying the bribe." Senate Report no. 114 at pp. 10–11, *United States Code, Congressional & Administrative News*, p. 4108 (1977). The very fact that Congress considered this issue underscores Congress' exclusive focus on the U.S. companies in making the payment. If the drafters were concerned that a demand by a foreign official might be considered a defense to a prosecution, they clearly were expecting that only the payors of the bribes, and not the foreign officials demanding and/or receiving the bribes, would be prosecuted.

[95] Securities and Exchange Commission. A U.S. government agency created by the Securities Exchange Act of 1934 that is responsible for protecting the interests of investors and the public in connection with the public issuance and sale of corporate securities.

[96] House of Representatives Report no. 640, p. 8 (95th Congress, 1st Session, 1977).

This language does not refute the overwhelming evidence of a congressional intent to exempt foreign officials from prosecution for receiving bribes, especially since Congress knew it had the power to reach foreign officials in many cases, and yet declined to exercise that power.[97] Congress' awareness of the extent of its own power reveals the fallacy in the government's position that only those classes of persons deemed by Congress to need protection are exempted from prosecution under the conspiracy statute. The question is not whether Congress could have included foreign officials within the Act's proscriptions, but rather whether Congress intended to do so, or more specifically, whether Congress intended the general conspiracy statute, passed many years before the FCPA, to reach foreign officials.

The drafters of the statute knew that they could, consistently with international law, reach foreign officials in certain circumstances. But they were equally well aware of, and actively considered, the "inherent jurisdictional, enforcement, and diplomatic difficulties" raised by the application of the bill to noncitizens of the United States.[98] In the conference report, the conferees indicated that the bill would reach as far as possible, and listed all the persons or entities who could be prosecuted. The list includes virtually every person or entity involved, including foreign nationals who participated in the payment of the bribe when the U.S. courts had jurisdiction over them.[99] But foreign officials were not included.

It is important to remember that Congress intended that these persons would be covered by the Act itself, without resort to the conspiracy statute. Yet, the very individuals whose participation was required in every case—the foreign officials accepting the bribe—were excluded from prosecution for the substantive offense. Given that Congress included virtually every possible person connected to the payments except foreign officials, it is only logical to conclude that Congress affirmatively chose to exempt this small class of persons from prosecution.

Most likely, Congress made this choice because U.S. businesses were perceived to be the aggressors, and the efforts expended in resolving the diplomatic, jurisdictional, and enforcement difficulties that would arise upon the prosecution of foreign officials was not worth the minimal deterrent value of such prosecutions. Further minimizing the deterrent value of a U.S. prosecution was the fact that many foreign nations already prohibited the receipt of a bribe by an official.[100] In fact, whenever a nation permitted such payments, Congress allowed them as well.[101]

Based upon the language of the statute and the legislative history, this Court finds in the FCPA what the Supreme Court in *Gebardi* found in the Mann Act: an affirmative legislative policy to leave unpunished a well-defined group of persons who were necessary parties to the acts constituting a violation of the substantive law. The government has presented no reason why the prosecution of defendants Castle and Lowry should go forward in the face of the congressional intent not to prosecute foreign officials. If anything, the facts of this case support Congress' decision to forego such prosecutions since foreign nations could and should prosecute their own officials for accepting bribes. Under the revised statutes of Canada the receipt of bribes by officials is a crime, with a prison term not to exceed five years,[102] and the Royal Canadian Mounted Police have been actively investigating the case, apparently even before any arrests by U.S. officials.[103] In fact, the Canadian police have informed defendant Castle's counsel that charges will likely be brought against defendants Castle and Lowry in Canada.[104] Thus, prosecution and punishment will be accomplished by the government which most directly suffered the abuses allegedly perpetrated by its own officials, and there is no need to contravene Congress' desire to avoid such prosecutions by the United States.

---

[97]See House of Representatives Report no. 640, p. 12, n. 3 (95th Congress, 1st Session, 1977) (United States has power to reach conduct of noncitizens under international law).

[98]See House of Representatives Conference Report no. 831, p. 14 (95th Congress, 1st Session, 1977).

[99]*Id*.

[100]See Senate Report no. 114, p. 4 (95th Congress, 1st Session, 1977) (testimony of Secretary Blumenthal that in many nations such payments are illegal).

[101]See *United States Code*, Title 15, §78dd-2(c)(1).

[102]See *Criminal Code, Revised Statutes of Canada*, chap. C-46, §121 (pp. 81–84) (1985).

[103]Defendant Castle's and Lowry's Supplemental Memorandum in Support of Motion to Dismiss, filed May 14, 1990, p. 10.

[104]*Id*. p. 10 and nn. 3, 4.

As in *Gebardi*, it would be absurd to take away with the earlier and more general conspiracy statute the exemption from prosecution granted to foreign officials by the later and more specific FCPA. Following the Supreme Court's admonition in an analogous criminal case that "[a]ll laws are to be given a sensible construction; and a literal application of a statute, which would lead to absurd consequences, should be avoided whenever a reasonable application can be given to it, consistent with the legislative purpose,"[105] the Court declines to extend the reach of the FCPA through the application of the conspiracy statute.

Accordingly, defendants Castle and Lowry may not be prosecuted for conspiring to violate the Foreign Corrupt Practices Act, and the indictment against them is dismissed.

Casepoint

(1) Nationality jurisdiction provides the basis for extraterritorial application of U.S. law. (2) In the FCPA, Congress intended to criminalize the act of paying of bribes by Americans because it thought bribery to be an unethical business practice. It did not want to criminalize the taking of bribes by foreign officials because this could have a negative impact on foreign relations (such as embarrassing friendly foreign officials).

In recent years, the U.S. Department of Justice and the U.S. Securities Exchange Commission have been aggressive in prosecuting corporations (and individuals) under the FCPA. To an increasing extent, prosecutions of foreign corporations are taking place, and jurisdiction is premised on the territorial effects of foreign activities. How this will be ultimately judged by the U.S. Supreme Court following *Empagran* (Reading 4-3) remains to be seen. Meanwhile, as Reading 4-4 demonstrates, the United Kingdom passed a very strict anti-bribery law in 2010, which claims not only nationality jurisdiction over U.K. citizens and companies, but objective territoriality jurisdiction as well.

Reading 4-4 Current Events in International Law: The New Global Reach of Anti-Corruption Laws

The year 2010 led all years for the record number of fines imposed under the Foreign Corrupt Practices Act (FCPA): 1.8 billion dollars in fines were levied on global companies for violations. That total included eight of the ten highest fines ever imposed under the FCPA. About half of the companies fined were not U.S. companies, but were indicted for activities that had a direct effect on the U.S. market, or involved incorporated subsidiaries of U.S. companies. Corporate defense attorneys noted an interesting trend, as well: aggressive enforcement of the FCPA by U.S. authorities involved (1) novel jurisdictional theories, (2) use of money laundering laws to indict agents of corruption, and (3) increased cooperation between the U.S. government and other enforcement agencies in Europe and beyond. Assistant Attorney General Lanny Breuer spoke to a gathering late in 2010 and said, "FCPA enforcement is stronger than it's ever been—and getting stronger."

Enforcement goes well beyond the borders of the U.S. Of the record-number 21 corporations indicted in 2010, 10 of them were not based in the U.S., and the biggest fines were paid by foreign companies. U.S. authorities claim jurisdiction over foreign companies based on the "objective territoriality" of their actions—the *effect* of the action on the U.S. market. This is in distinction to the "nationality" basis of jurisdiction (the actor is a citizen of the state whose laws are being applied), or the most traditional basis of "territoriality," where the criminal act is actually done within U.S. boundaries. The Department of Justice will consider any money passing through the United States as a "territorial effect," and an adequate basis for providing jurisdiction.

At one time, the U.S. was virtually alone in pursuing bribery in the global marketplace. The 1976 FCPA was widely criticized by U.S. businesses as imposing a kind of parochial morality on world where cultural and moral standards differed. An oft-repeated criticism of the law was that the U.S. was "shooting itself in the foot" or crippling U.S. businesses in their efforts to gain a share of global business. Later changes in the FCPA allowed for a company's agents to make facilitation payments to expedite routine handling of customs or port of entry barriers and other small discretionary acts by low-level public officials.

The OECD Anti-Bribery Convention

Over 20 years later, the FCPA's targeting of global bribery of public officials was bolstered by the Organization for Economic Cooperation and Development (the OECD), which created a multilateral treaty (convention) that

[105] *United States v. Katz*, *United States Reports*, vol. 271, pp. 354, 357 (Supreme Ct., 1926).

encouraged signatory states to pass criminal laws that would sanction the bribery of public officials. The *OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions* was signed in December of 1997 and entered into force in 1999. There are currently 38 signatory nations with implementing legislation. China, Russia, and India are not among the nations that have signed and implemented the convention.

The OECD has no authority to implement the convention, but instead monitors implementation by participating countries. Countries are responsible for implementing laws and regulations that conform to the convention and therefore provide for enforcement. The OECD performs its monitoring function in a two-phased examination process. Phase I consists of a review of legislation implementing the conventions in the member country with the goal of evaluating the adequacy of the laws. Phase 2 assesses the effectiveness with which the legislation is applied.

As for U.S. anti-bribery enforcement, many defense attorneys now believe that the DOJ and the Securities Exchange Commission (SEC) enforcement actions of corruption have (1) become a source of income for the government, and that enforcement trends are not only sharply up, but will continue to be, and (2) that other nations will also embark on more aggressive anti-corruption enforcement.

The year 2010 was also the year that 56 mutual legal assistance treaties (MLATs) between EU member states and the United States entered into force. These treaties enable cooperation among different nations' judicial systems by facilitating the identification of financial information in criminal investigations, allowing evidence (including testimony) to be taken via video conferencing, and generally speeding the authorization of joint investigations by different national authorities. U.S. cooperation with E.U. authorities is evident in ongoing investigations with Germany into Allianz and Hewlett Packard Co.

The Global Trend Toward Anti-Corruption Enforcement

The growing global trend toward anti-corruption enforcement can also be seen in the United Kingdom, which now has an anti-bribery act that has extra-territorial effect even more extensive than the FCPA's reach.

The Bribery Act 2010 came into force on July 1, 2011. It had strong cross-party support in Parliament and received Royal Assent on April 8, 2010. On its Web site, the Foreign Ministry notes that:

> "Bribery has no place in British business, at home or abroad. This new robust law reflects the U.K.'s role in the fight against bribery and paves the way for competitive but fair practice. Over time it will have a positive impact on the prospects of U.K. businesses through enhanced reputation for ethical standards, reduced costs and an international level-playing field."

The Bribery Act creates the following offenses:

1. Active bribery: promising or giving a financial or other advantage.
2. Passive bribery: agreeing to receive or accepting a financial or other advantage.
3. Bribery of foreign public officials.
4. The failure of commercial organizations to prevent bribery by an associated person (corporate offense).

Under the current law, imprisonment for up to seven years with unlimited fines will increase under the Bribery Act to a maximum of 10 years imprisonment.

The Bribery Act applies to U.K. citizens, residents, and companies established under U.K. law. In addition, non-U.K. companies can be held liable for a failure to prevent bribery if they do business in the U.K.

Companies can be liable for bribery committed for their benefit by their employees or other associated persons.

A company or corporate entity is culpable for board-level complicity in bribery, including bribery through intermediaries. There is also personal liability for senior company officers that turn a blind eye to such board-level bribery.

In addition, a company or corporate entity is culpable for bribes given to a third party with the intention of obtaining or retaining business for the organization or obtaining or retaining an advantage useful to the conduct of the business by their employees and associated persons, even if they had no knowledge of those actions. The company can invoke in its defense that it "had in place adequate procedures designed to prevent persons associated [with the company] from undertaking such conduct."

Liability under the Act can happen no matter where the offense is committed, as long as the act is done by a British resident, a corporation incorporated there, or one that carries on any part of its business there. "Carries on business" is a broad standard, and could be interpreted as generously as the DOJ has interpreted the FCPA: even if a company uses the conduits or channels of commerce in the U.K., such as having a bank transfer all or part of the funds as part of the transaction, the U.K. law could apply.

It is also significant that the U.K. legislation extends to the bribery of public citizens, while the U.S. act does not. Even more significant, section 7 creates criminal liability for failing to prevent bribery; not only is it not necessary to have explicit knowledge of the illegal payment, but "plausible deniability" is no longer an excuse—failing to take active measures to prevent bribery is also an offense. This presumably includes subsidiaries and joint venturers as well as employees in the parent company.

Another very broad phrase, "favorable treatment," is likely to be heavily litigated as the Act is enforced. The Act proposes not only to punish bribes for contracts gained, but also bribes to secure any "favorable treatment" from the bribee or his company or government. Also, unlike the FCPA, the U.K. Bribery Act does not make exceptions for "facilitating payments."

Adapting to New Trends in Anti-Bribery Enforcement

With the advent of the U.K. bribery law, policies and practices of non-U.K. companies now geared toward FCPA compliance must be re-aligned to take the new law into account. "Adequate procedures" in place and uniformly administered may provide a defense to the strict liability charge of "failing to prevent" bribery. This will, however, require top-level commitment to anti-corruption efforts, and maintaining tough policies with regard to payments and gifts, and considerable diligence in monitoring agents and consultants, subsidiaries and joint venturers. "Ask me no questions, tell me no lies" will not suffice. The burden will fall on companies to show that they have been duly diligent in making and maintaining "adequate procedures."

For guidance, many companies may turn to the Organisation for Economic Co-operation and Development's good practice guidance on

internal controls, ethics, and compliance and the anti-bribery strategies. These are published by Transparency International and the Global Infrastructure Anti-Corruption Centre. Also, the GC100, a group of general counsel from prominent U.K. companies, has already published a draft guidance that sets out its view of the key components of adequate procedures.

These materials reveal that adequate procedures will likely include the right "tone at the top," embodied in a statement of values, a code of conduct with respect to gifts, hospitality, bribery, expediting payments, charitable and political donations, facilitating payments, thorough vetting of agents and sales representatives, having a compliance officer (or officers), training procedures, disciplinary processes, risk management monitoring and re-assessment, re-vamped accounting and financial procedures, and even the encouragement of whistle blowing.

To some extent, the existing procedures that U.S. companies have adopted to take advantage of the Federal Sentencing Guidelines will speak to "adequate procedures" under the U.K. law, but should be re-examined and re-assessed in light of the U.K. law.

A copy of the law can be accessed at
www.legislation.gov.uk/ukpga/2010/23/contents.

F. Host State Regulation of Multinational Enterprises

Host states regulate multinational enterprises in much the same way that home states do. Thus, host states will apply their own unfair competition, products liability, and sharp practices rules to foreign multinationals operating within their territory. The focus of host state regulation, however, is not on making the local parent company responsible for the conduct of a foreign subsidiary, but on making the foreign parent responsible for the conduct of the local subsidiary. This generally leads host state courts to make three types of investigations (see Figure 4.4): (1) whether a foreign company has consented to the jurisdiction of the host state; (2) whether a local firm is part of a common enterprise with a foreign firm, making both liable for activities of the local firm; or (3) whether the independent corporate status of a subsidiary can be ignored so that liability can be imposed on its parent.

Foreign company consented to jurisdiction

OR

Independent status can be ignored

OR

Local firm part of common enterprise

FIGURE 4.4
Tests for U.S. Jurisdiction

Consent to the Jurisdiction of the Host State

As we have seen earlier, a person or company must give its consent (either expressly or impliedly) before either will be subject to the jurisdiction of a local state. A company that incorporates or has its main office in a state is said to have expressly consented to the jurisdiction of that state. Similarly, a foreign company that applies to obtain a certificate to do business in a host state must expressly consent to the state's jurisdiction as a condition of obtaining the certificate. One must distinguish between applying for a certificate to do business and setting up a subsidiary. Whereas the subsidiary is a local firm and therefore subject to the jurisdiction of the local state, the parent is merely a foreign shareholder that has not consented to the state's jurisdiction.

Implied consent to the jurisdiction of a state can be found from a foreign firm doing business within the state. As we have already discussed, courts will look to local long arm statutes that define *doing business* and to basic concepts of fairness before they will exercise jurisdiction over a foreign company. Commonly, jurisdiction will be found if a company is—either directly or through an agent—carrying on a business, soliciting business, or engaging in any other persistent conduct related to the making of a profit.

Common Enterprise Liability

When individuals or companies (including related subsidiary companies of a multinational firm) function as part of a common enterprise, courts will treat them as if they were members of a joint venture or partnership, with each of them having joint[106] or joint and several[107] liability for the obligations of the entire enterprise. In determining whether persons or firms are members of a common enterprise, courts look at the intent of the parties. If the parties have not entered into a

[106] *Joint liability* means that all of the members in a venture must be sued together.

[107] *Joint and several liability* means that any one of the members in a venture may be sued separately whether or not the other members are sued.

formal agreement creating a partnership or joint venture, the courts will consider several factors in determining intent, including (1) sharing of profits or losses, (2) sharing in the management, and (3) joint ownership of the business.

common enterprise liability
Each member of a common enterprise will have liability for the conduct of the entire enterprise.

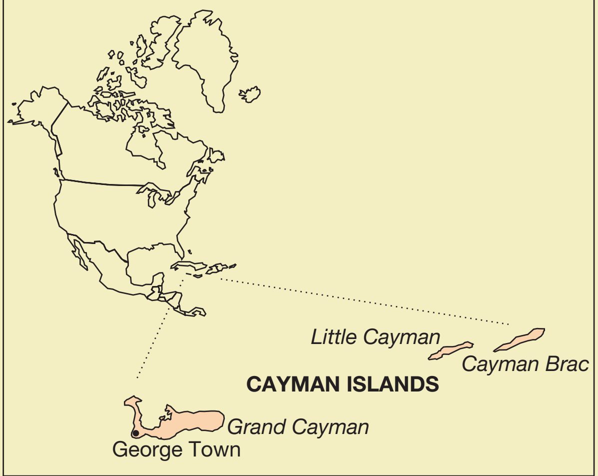
The significance of **common enterprise liability** is illustrated by Case 4-8.

CASE 4-8 Touche Ross & Co. v. Bank Intercontinental, Limited

The Cayman Islands Law Reports, vol. 1986–87, p. 156 (1988)

MAP 4.8

The Cayman Islands (1988)



Touche Ross & Co., a firm of accountants practicing in the Cayman Islands, carried out audit work in the Cayman Islands for the Bank Intercontinental, Limited, a company incorporated under Cayman law. The bank brought suit in Florida alleging professional negligence against a firm named as Touche Ross & Co., maintaining that it was a multinational patrtnership of accountants with offices in Florida, New York, the Cayman Islands, and worldwide. Individuals alleged to be partners in this multinational firm, who were resident in Florida and various other parts of the world, were joined as defendants in the suit.

Touche Ross & Co., a firm of accountants constituted under the laws of New York, then initiated suit in the Cayman Islands seeking to restrain the bank from continuing to prosecute the Florida suit. The New York firm (the plaintiff in this case and the defendant in Florida) argued that the audit work had been carried out exclusively by the Cayman firm of the same name according to the terms of a contract between that firm and the defendant that was governed by Cayman law. It urged the court to hold that the proper forum for the trial of the bank's suit was the Cayman Islands, because the suit had no real connection with Florida and the bank only alleged that Touche Ross & Co. was a single worldwide partnership (with partners resident in Florida) so that it could bring the suit there.

This court initially granted an ex parte[108] injunction based on the plaintiff's allegations that the Florida proceedings appeared to be an attempt to cloak Touche Ross & Co. in a multinational mantle with connections to Florida as a pretext for suing there. This court gave the bank (the defendant in this case and the plaintiff in Florida) leave to apply to discharge the injunction and the bank did so. Its decision on the bank's application follows.

[108]From Latin: "from one party or side." An *ex parte* injunction is one that is granted upon the request and for the benefit of one party only, and without notice to the party or parties adversely interested and without the latter being present or having the opportunity to contest the granting of the injunction.

Opinion by Judge Hull

In the *ex parte* application, Mr. Foster [counsel] for the plaintiff in Cayman relied on affidavits sworn by Mark Edward Davidson, a New York attorney-at-law, Richard Surgeson, a chartered accountant in the Cayman Islands, and Mr. Foster himself.

Mr. Foster submitted that the evidence supporting his application showed that the Bank was a Cayman company and that the Florida action related to audit work performed by chartered accountants in the Cayman Islands and in substance alleged professional negligence. He said that the work had been performed by "Touche Ross & Co.," a Cayman firm of chartered accountants, pursuant to a contract between that firm and the Bank. The evidence showed that the contract was to be interpreted in accordance with the law of the Cayman Islands, and that the plaintiff in Cayman (i.e. "Touche Ross & Co. of New York") was a separate entity from the Cayman firm and had in no way been connected with the contract or with any audit work undertaken by the Cayman firm for the Bank. The Cayman Islands were the proper forum for the action. The matter had no real connection with Florida. The Bank had alleged that the defendant in the Florida action was one worldwide firm in order to bring the action there. Mr. Foster said that he had to satisfy me that it was acting in bad faith; he submitted that the evidence showed that the allegation was specious.

. . . In his affidavit, Mr. Surgeson stated that Touche Ross & Co. in the Cayman Islands was an entirely separate and different legal entity from the partnership known as "Touche Ross & Co. of New York." He deposed that the firms had separate partners, that neither had any proprietary or other interest in the other, that they determined independently the conduct of their respective businesses, and that the Cayman firm had no offices or records in the United States. He also deposed that to the best of his knowledge and belief the New York firm did not have offices or operate here, nor were any of its partners or employees authorized to practice as accountants here, and that none of the partners or employees in the Cayman firm were authorized to practice public accounting within the United States.

Mr. Surgeson said that the only relationship between the two firms was that they were both affiliated to a Swiss *verein*[109] known as "Touche Ross International," which was an association made up of various firms throughout the world to enhance professional cooperation and cooperation between its affiliates. These firms however remained separate entities and none was subject to control by any of the others. They determined separately which clients they would serve and were individually responsible for their own obligations to their clients' affiliates. The *verein* did however undertake so far as possible to assist other affiliates by providing services on request within its own jurisdiction. The bank, Mr. Surgeson said, had been a client of the Cayman firm which had audited its accounts for the years 1980, 1981, and 1982. This work was done at the request of the bank. The New York firm had not been involved in any way in that work, nor to the best of his knowledge or belief had the bank ever been its client or had professional services provided by it.

Mr. Davidson deposed that he was the New York attorney for the New York firm. . . .

Mr. Davidson's evidence was . . . that the New York firm was legally a separate entity from the Cayman firm. They were not authorized in law to practice in each other's jurisdiction. The Cayman firm had no officers in the United States, the bank was a Cayman company, the firm which had done the work in issue was Caymanian, and the papers and the witnesses were located here. The alleged injury occurred here and involved issues of Cayman law. . . .

. . . In support of its application to discharge the injunction, the Bank filed two affidavits.

One was by Mr. George Cassidy, stating that he was the Chairman of the Board of the Bank and that he was authorized to make the affidavit. The other was sworn by Mr. Stephen Martin Zukoff, who deposed that he was an attorney-at-law licensed to practice in the States of New York and Florida and the District of Columbia, and that he was one of the attorneys representing the Bank in the action in Florida. Each affidavit contains argument and even invective. Leaving that aside, they assert the following matters of fact.

[109]A Swiss *verein* (*verein* is German for "association" or "union") is a business organization consisting of a number of independent offices, each of which has limited liability vis-à-vis the others. It is similar to the Anglo-American voluntary association. The form is often used by multinational professional firms. One advantage to the *verein* structure is that because control of the firm is decentralized, offices are only bound by regulators in their country. For instance, overseas offices of accounting firms in a *verein* structure are not bound by Securities and Exchange Commission subpoenae from the United States.

Mr. Zukoff said that there had been over 120 pleadings and extensive hearings in the Florida action. All the matters which Mr. Davidson raised in this court had been heard and determined in Florida. . . .

Mr. Cassidy's affidavit contains various statements relating to the state of the action in Florida. . . .

. . . Mr. Cassidy also exhibited various documents which, the Bank contends, indicate that the defendant in Florida held itself out as a worldwide multinational firm, ready to perform international services and to handle work anywhere in the world, and that it allowed all of its offices to be listed as one firm. He also deposed that the Bank was ready, on advice, to have the Florida action tried without "the work papers," and that all current officers and directors of the Bank resided in the United States.

. . . As I now see the matter, it is essential for the determination of this case to have a clear understanding of the Bank's allegations as to the nature and extent of the entity that is suing in Florida and to distinguish those allegations from the ones put forward by the present plaintiff here as to the nature and extent of its own identity. Although it may seem a little pedantic at times, it is for those reasons that I have used the expressions "the plaintiff in Cayman" and "the defendant in Florida" in contra-distinction.

The Bank in the Florida action is averring that the defendant there, which is admittedly a firm practicing accountancy in the United States, is in fact a multinational firm that also practices in these Islands and elsewhere. A central issue in the present application is whether or not this is a specious assertion, made in bad faith. . . .

. . . Having seen the Bank's affidavits and those for the plaintiff in Cayman in reply, it was clear to me that in the unsuccessful motion for dismissal by the defendant in Florida, the question whether or not it was one worldwide partnership was in issue. . . . [A]fter considering all the affidavits in the inter partes hearing, I attached weight (which I had not previously done) to the fact that the defendant in Florida had failed to persuade the court there, summarily as it were, that the allegation of a worldwide partnership was specious. . . .

Mr. Davidson in his . . . affidavit . . . disclosed that the Bank was relying on certain public relations materials. He said that none of these described Touche Ross & Co. as a "worldwide partnership" as alleged in the complaint and went on to say:

> Indeed, as stated in a publication frequently cited by [Bank Intercontinental, Limited]—"A World of Professional Services" . . . Touche Ross International today has unified 54 national firms into one worldwide organization. Led by respected national businessmen and professionals, the practice in each country is locally owned and managed.

Mr. Cassidy's affidavit exhibited material of this nature. One exhibit is headed, prominently, "LOCAL ATTENTION FROM A WORLD CLASS ORGANIZATION." It then continues—

> Touche Ross is one of the largest multinational accounting, tax and management consulting firms operating in 87 countries with a staff of 20,000 including 8,000 in the United States. Our professionals include CPAs, lawyers, MBAs . . . and other highly skilled individuals. There are seven offices located in Florida. . . .

Then follows profiles of the Florida partners. Another exhibit is a brochure. It refers to "Touche Ross International." It is headed "A FIRM WITH A DIFFERENCE" and it begins:

> Having pioneered in structuring the first truly multinational professional services firm, Touche Ross International today has unified 54 national firms into one worldwide organization. Led by respected national businessmen and professionals, the practice in each country is locally owned and managed. The parties in each country are joined together through membership in Touche Ross International, a legal entity formed under Swiss law. Our national firms, the experience of our professionals, and our common standards of professional performance are assets to international clients. Universal quality control and financial responsibility apply to all work done in the Touche Ross name.

That paragraph includes the sentence referred to by Mr. Davidson: "Led by . . . locally owned and managed." Moreover, I have not quoted the whole of the exhibit. And it is talking about "Touche Ross International." Later it refers to "the member firms of Touche Ross International" (under a subheading "Our Firm Worldwide," however). Also, of course, this public relations material has to be considered in conjunction with the affidavits on the *ex parte* application describing the organization of individuals using the style "Touche Ross."

Nevertheless, I think it has to be said (whatever the "Touche Ross" label may eventually be held to mean in law in any given situation) that these materials undoubtedly convey and must be intended to convey, at first sight, the impression not only that there is a multinational entity called "Touche Ross" but also that it is one which at least has a professional relationship with its constituent elements, and more than that (because one exhibit says so in its terms) one which controls in terms of quality and financial responsibility the work done in the Touche Ross name.

The legal nature of the Swiss entity is not explained in the public relations material so exhibited. The plaintiff in Cayman has not sought to dissociate itself from this public relations material. It is very difficult to avoid the inference that those who are associated with it are holding themselves out as members of a single worldwide entity with collective professional responsibility, or at the least that anyone who alleges this cannot be dismissed as raising a patently specious argument. The impression given by the publicity material certainly stands in marked contrast to the subsequent, detailed explanations of the precise relationship of "Touche Ross" associates given in the affidavits of . . . Surgeson. . . .

***

Although, as I see it, the present application does not turn solely on those exhibits, they are in my view very material. They go directly to the question whether the bank, by alleging one worldwide firm, was contriving a pretext for the Florida action. I granted the injunction *ex parte* on the strength of the affidavits of the plaintiff in Cayman as they then stood. If I had been aware of these exhibits and had had (at least as I now see it) a sharper appreciation of the failure of the defendant in Florida to have the action there dismissed on an interlocutory application, I would at least have been very much more circumspect about doing so. In any case, I have changed my initial view. . . .

The view I therefore came to, after hearing both sides, was that the submission that the allegation in Florida of a worldwide firm was patently a pretext could not be sustained.

***

. . . The action has already continued for some time in the United States. The court in Florida has not thrown it out. It has ordered pretrial discovery, on the evidence for the plaintiff in Cayman, to enable the Bank to explore the evidence supporting its allegation of one worldwide firm. I am not familiar enough with American pretrial discovery to comment on that adversely; in any case I suspect that it may be parochial to do so. The weight of the evidence and submissions in the case in my view point clearly to the fact that a court of superior jurisdiction in the United States is seized of the matters in issue. It has not seen fit to dismiss the action. . . . The reality, I think, is that by suing here, the present plaintiff is in effect trying to prevent the determination in Florida of an issue which can and ought properly to be left to be decided there. I am not satisfied that the injunction should be continued.

For these reasons, I discharged it.

On appeal, the Cayman Islands Court of Appeal reversed the decision of Judge Hill and reinstated the injunction. It did so because it believed that the issue of whether or not Touche Ross & Co. was a multinational enterprise with responsibility for the Cayman Island firm was an issue that could be tried in either Florida or the Cayman Islands and that the genuine[ness] or otherwise of the assertion of the firm's multinational character was not sufficient by itself to determine the question of whether the Florida proceedings should be stayed. Rather than focusing on this issue, Judge Hill should have been looking at whether or not the granting of the injunction preventing the Bank from bringing the case in Florida would have had the effect of depriving the Bank of a legitimate personal or judicial advantage. Because the Bank had been unable to show that it had been deprived of an advantage, and because the cause of action itself arose in the Cayman Islands, Judge Hill should not have discharged the injunction. The Court of Appeal, accordingly, reinstated it.

Casepoint

When a firm is deemed to be part of a common enterprise, all firms in the enterprise have joint liability for the obligations of each other. But any particular court may not have personal jurisdiction over many of the foreign firms that form the common enterprise. Thus, plaintiffs would be well served to bring suit in a state where at least one firm has plentiful assets.

Piercing the Company Veil

In some unusual situations, a company is used by its owners to perpetrate a fraud, to circumvent the law, or in some other way to carry out illegal activities. In such cases, a court will ignore the corporate structure of a company and **pierce the company veil**, exposing the shareholders to personal liability.

pierce the company veil
An expression indicating that the legal fiction that a company is a separate legal entity will be set aside and the shareholders of the company will be held liable for its conduct as if they were partners in a partnership.

There are four circumstances under which courts will pierce the corporate veil: (1) the controlled company, (2) the alter ego company, (3) undercapitalization, and (4) personal assumption of liability.

The Controlled Company The corporate status of a controlled company will be ignored if (1) its financing and management are so closely connected to its parent that it does not have any independent decision-making authority and (2) it is induced to enter into a transaction beneficial to the parent but detrimental to it and to third parties.

The Alter Ego Company The company veil will be pierced if the company is not treated by its shareholders as a separate juridical entity—that is, if it is treated as the alter ego of the shareholders. Examples of such conduct include the commingling of corporate and personal assets, the use of company assets by shareholders for their personal benefit, and the failure to hold and record minutes of board of directors' meetings.

Undercapitalization When a company has insufficient capital at the time it is formed to meet its prospective debts or potential liabilities, the courts will sometimes set aside the corporate veil. This is especially so if the corporation later fails to obtain the amount of insurance that any reasonable business would be expected to have as a matter of public responsibility.

Personal Assumption of Liability Shareholders can, of course, personally assume liability for the obligations of a company. This is especially common if a company is new, small, or marginally successful. Creditors will seldom lend money to such a company unless the shareholders personally guarantee the performance of the company.

The cases of common enterprise liability establish another route for piercing the corporate veil. Overall, the U.S. judiciary's presumption against piercing the corporate veil may not be held as strongly in other countries.[110]

Chapter Questions

Blocking Statutes

1. Regal Shipping, Ltd., is a publicly traded company incorporated in the United Kingdom. It carries freight between Europe and the United States. Two years ago it lowered its fares to half those of its competitors. The competitors (i.e., Plebeian Shipping Lines, Ltd., a U.K. company, and seven other shipping companies incorporated in the United States, Canada, France, Germany, Italy, and Japan) were enraged by Regal's action, and they secretly agreed to lower their own prices until they could run Regal out of business. Regal suffered huge losses and is on the brink of bankruptcy. It hopes to recoup its losses and stay in business by bringing an anti-trust suit in the United States against its competitors.
   a. In connection with its suit in the United States, Regal asks an English court to compel Plebeian to turn over corporate documents showing the extent of the conspiracy between Plebeian and the other seven of Regal's competitors. Will Regal succeed? Discuss.
   b. Plebeian brings an appropriate action in an English court asking the court to issue an injunction to bar Regal from suing Plebeian in the United States. Will Plebeian succeed? Discuss.
   c. The other competitors bring a separate action in England asking the English court to enjoin Regal from continuing with its suit in the United States. Will they succeed? Discuss.
   d. Assume that Regal was successful in its suit in the United States and that the U.S. court awarded it treble damages. Is there anything Plebeian can do to minimize the amount of the judgment it is supposed to pay Regal? Discuss.

Competition Law and Jurisdictional Rule of Reason

2. Goliath, Inc., a U.S. producer of gem-quality sapphires, set up a subsidiary holding company in the Cayman Islands (Junior, Ltd.) to control all of Goliath's non-U.S. subsidiaries. Junior then entered into a cartel agreement with producers of sapphires in those countries (other than the United States) where sapphires are found. The cartel agreement allocated markets and set prices for all sapphires sold outside of the United States. The U.S. government has now brought suit against both Goliath and Junior for violating the U.S. Sherman Antitrust Act. Goliath answers that it was not a party to the cartel agreement and that the agreement does not affect the

[110] *Finnish Fur Sales Co. Ltd. v. Juliette Shulof Furs, Inc, George Shulof and Juliette Shulof*, *Federal Supplement*, vol. 777, p. 139 (Federal Dist. Ct., Southern District of New York, 1991).

U.S. market for sapphires. Junior answers that it is not subject to the jurisdiction of the U.S. courts. Are Goliath and Junior correct?

3. The Nicaraguan Rum Association, which has a representative in the United States, convened a meeting to address concerns regarding the gradual depletion of international Nicaraguan rum sales. The depletion is primarily due to several companies selling imitation lower quality rum. Further, Nicaragua is trying to recover from a financial crisis and the rum producers constitute a substantial taxpayer base. There are still some distributors, primarily in the United States, who cater to loyal customers—customers who can tell the difference between Nicaraguan and other rum—but the market is not expanding.

The solution advocated is a revision of the rum prices in order to ensure that the industry continues to exist. Per the new price list circulated, the average increase in the price of Nicaraguan rum sold internationally is around 10% of the original price. The justice department in the U.S. brings a motion against the Nicaraguan rum producers, alleging a breach of the Sherman Act. The defendants file a motion to dismiss the indictment, arguing that the United States lacks the jurisdiction to prescribe over the activities of the Nicaraguan Rum Association and its members, which all took place outside of the United States. Is this true? Discuss.

4. I Company is a large American manufacturer of computers. It controls approximately 65 percent of the market in the European Community. It refuses to share the patents and copyrights it owns for the operating system software that controls its computers, thus not allowing other manufacturers to make computers that are compatible with I's computers (i.e., other manufacturers cannot make and sell computers that will run the same programs as I Company's computers). Is this a violation of Article 81 or 82 of the European Community Treaty? Discuss.

5. Could I Company, in the previous question, be charged with violating American anti-trust laws? Discuss.

6. The Mighty Motor Car Co. and the Novel Automobile Corp. manufacture cars and trucks in Country J. They recently entered into a noncompetition agreement with the approval of the Country J Ministry of Trade. The agreement provides (a) that Mighty will sell its vehicles in the United States and that Novel will not and (b) that Novel will sell its vehicles in the EU and that Mighty will not.

Since the signing of this agreement, the Foreign Car and Truck Import Co., a U.S. importer of Novel cars and light trucks, is unable to obtain vehicles to import to the United States. As a consequence, it has brought suit against Novel in a U.S. court alleging that the agreement between Mighty and Novel violated the U.S. Sherman Antitrust Act. Novel has asked the court to dismiss the case for lack of subject-matter jurisdiction. Should it do so? Discuss.

7. Assume the same facts as in the preceding question. Does the arrangement between Mighty and Novel violate either Article 81 or 82 of the European Community Treaty? Can the EU Commission take action against either Mighty or Novel? If it can, what action can it take? Discuss.

Products Liability—Jurisdiction

8. Brand X Inc. is a corporation based in the United States. They do business in India through various channels, especially in controversial sectors. Two of these channels are a branch office of Unheedlock and Brand X Defiance Ltd. (a subsidiary registered with the Bombay Stock Exchange). An investigative journalist has on separate occasions found both Brand X and Brand X Defiance Ltd. offering bribes to Mr. Y—a Member of Parliament in India—to speed up a project that would take longer in the normal course of things. The United States is looking to prosecute Brand X and Brand X Defiance Ltd. under the Foreign Corrupt Practices Act (FCPA), and Mr. Y under the general conspiracy statute for conspiring to violate the FCPA. The 1988 Prevention of Corruption Act in India aims to prevent corrupt practices by prosecuting the public officials who receive bribes. However, there is currently no Indian law that makes private parties liable for offering bribes to such officials. You have been retained as defense council for Brand X, Brand X Defiance Ltd., and Mr. Y. Discuss some of the main issues you would be considering while preparing your case.

Corrupt Practices

9. In relation to the situation described in the previous question, assume that Brand X is a corporation registered in the U.K. and the relevant legislation is the Bribery Act 2010, instead of the FCPA. Would this change the possible liability of the parties accused? Discuss.

Common Enterprise

10. Good, Better & Best (GBB) is the name used by several firms of business consultants located in many different countries, including countries in Western Europe, North America, South America, and the Orient. Depending on local laws, the firms are organized either as partnerships or as limited liability stock companies. The senior partners or presidents of the several firms meet on a regular basis to coordinate worldwide advertising and standardize the policies and practices of the several firms. The firms exchange information, and they share employees as the need may arise. Multinational clients are assured that they will be served by the local GBB firm in any country where the client does business.

One of the GBB firms in Country X (GBB-X) provided marketing information to Local Company. The information had been negligently prepared by GBB-X, and it contained gross errors. Relying on that information, Local made several disastrous investments, and it lost most of its net worth. Local wants to sue GBB-X, but it knows that GBB-X has few assets. Will Local be successful if it asks the court in which it is suing the GBB-X firm to join others of the GBB firms as codefendants? Would the choice of the court in which GBB brings its suit be important in deciding this? Discuss.

11. Big Shipping Lines is a transoceanic freight company incorporated in Country Z. To avoid potential liability from shipping crude oil from the Persian Gulf to Europe in the antiquated single-hull ships that it owns, it set up 14 different companies (including the Small Shipping Co.) and transferred ownership of one ship to each of them. Each company then purchased insurance to cover the losses of the ship and the ship's cargo, but nothing else.

The SS *Small*, which belonged to the Small Shipping Co., negligently ran aground on a shoal in the eastern Mediterranean Sea, spilling its entire load of some 5 million barrels of crude oil. The oil has washed ashore in Greece, Turkey, Cyprus, Syria, Lebanon, Israel, Egypt, and Libya. Each of these countries has brought suit in Country Z against the Small Shipping Co., its sister companies, and Big Shipping Lines. The sister companies and Big Shipping Lines have asked the court to dismiss the complaints against them. They contend that the Small Shipping Co. is a separate company and is solely liable for its own torts. How should the court rule? Discuss.

CHAPTER

5 Foreign Investment

Chapter Outline

A. Foreign Investment Laws and Codes
National Foreign Investment Policies
Regional Investment Policies
Screening Foreign Investment Applications
Formal and Informal Application Processes
Approval of Foreign Investment Applications
Business Forms
Limitations on Foreign Equity
Sectoral Limitations
Geographic Limitations
Free Zones
Foreign Investment Guarantees
B. Supervision of Foreign Investment
Start-Up Standards
Operational Reviews
Modification of Foreign Investment Agreements
Protection of Subsidiaries
Penalties for Noncompliance
C. Securities Regulations
Securities
Trading in Securities
Securities Exchanges
Issuance of Securities
Clearance and Settlement Procedures
Insider Trading Regulations
Takeover Regulations
D. Enforcement of Securities Regulations Internationally
International Enforcement Cooperation
The Convention on Insider Trading
Extraterritorial Application of U.S. Securities Laws
Chapter Questions

A. Foreign Investment Laws and Codes

Foreign investment involves ownership by one "person" (whether it be an individual, a partnership, business organization, or government entity) of 10 percent or more of the controlling interest in an enterprise not located in the person's home country. The regulations governing foreign investments are commonly set out in *investment laws*. In socialist-oriented countries that allow foreign investment in joint venture form only, the regulations are usually called *joint venture laws*. Until 1987, for example, Vietnam allowed only joint ventures.[1] But foreign investment is one of the most sought-after resources that states could ask for, and most states will set up investment codes to encourage foreign capital investment in a legal framework that will benefit the state, not just the investor.[2]

A few states do not have general investment laws but instead put restrictions on investment in specific sectors of the economy, such as agriculture, technology, media (television and movies), and tourism. The United States restricts some foreign companies from investing in security or defense industries that are considered "strategic." Many other economies have a complex system of laws controlling investment, providing incentives, governing technology transfers, and limiting foreign exchange such that the combination of these laws functions as a kind of investment code. Often these laws are incorporated into bilateral investment treaties (BITs).[3] A typical BIT goes well beyond the traditional treaty of friendship, navigation, and commerce (FNC treaty).

BITs usually define foreign investment and the conditions under which investors from one state can invest in the other state. Most BITs grant certain guarantees for investments made by an investor of one Contracting State in the territory of the other; the United Nations Conference on Trade and Development (UNCTAD) reports that BITs constitute "the most important protection of international foreign investment" to date. BITs usually include guarantees of fair and equitable treatment, protection from expropriation, and arrangements for repatriation of profits to the home country. They will also usually guarantee fund transfers and the recouping of capital gains, as well as providing for dispute settlement procedures. Most BITs allow for alternative dispute resolution, often through the ICSID (International Center for the Settlement of Investment Disputes) (see Chapter 3), rather than suing the host state in its own courts.

The world's first BIT was signed on November 25, 1959, between Pakistan and Germany. There are currently more than 2,600 BITs in force, involving most countries in the world.

The number of BITs increased from 385 at the end of the 1980s to 2,265 by 2003, involving 176 countries; at that time, 1,013 (55 percent) were between Western countries and developing nations or Central or Eastern European nations. But the developed nations have concluded most of the world's BITs, and some critics believe that the arbitration and dispute resolution processes in most BITs favor developed nations' interests.

Many of the BITS designate the World Bank's International Center for the Settlement of Investment Disputes (ICSID) as the arbitral body. In the vast majority of ICSID arbitration cases, complaints were filed against developing or Central and Eastern European nations, and only a handful

---

[1]In 1987, Vietnamese law changed to use low taxes to encourage joint ventures and to permit wholly owned foreign enterprises in Vietnam. The code, which was designed to emphasize the development of export industries and services, also granted full repatriation of profits after taxes and guaranteed foreign enterprises against government expropriation. The new law also encouraged oil exploration and production contracts. The Foreign Investment Law (FIL) has since been amended. The Law on Foreign Investment in Vietnam was originally adopted on December 29, 1987, by the National Assembly, Legislature VIII, during its Second Session (the "1987 FIL"). The 1987 FIL was revised twice, on June 30, 1990, and December 23, 1992, respectively. On November 12, 1996, the National Assembly repealed the 1987 FIL in its entirety and adopted its replacement anew (the "1996 FIL"). The 1996 FIL was amended on June 9, 2000, by the National Assembly under Law No. 18/2000/QH10 (the "2000 Amendments"). Pursuant to the Law on Investment approved on December 25, 2001, and fully enforced on July 1, 2006, the FIL and its various amendments is amended and supplemented at www.tnamlaws.com/freelaws/Lw59na29Nov05CIL%5B10Apr06%5D.pdf.

[2]China's economic history has cautioned that country on the potential pitfalls of foreign investment. Accordingly, investment law in China has traditionally sought to limit the amount of majority control that foreign investors may have in Chinese enterprises. But in May 2010 the State Council issued its Opinions on encouraging and Guiding the Healthy Development of Private Investments, which further encouraged investments in areas where existing PRC law does not expressly prohibit private investment. The State will, according to the Opinions, encourage investment in basic industries, infrastructures, public utilities, policy-related housing projects, public service, financial service, trade-related business management and logistics, "national defense science" and technology. China's bilateral investment treaty with Chile is shown in Table 5.2.

[3]The use of these treaties has increased in recent years. Many of these BITs are posted on the UNCTAD Web site at www.unctad.org/en/docs/poiteiiad2.en.pdf.

FIGURE 5.1

AFL-CIO Director of International Affairs Cathy Feingold Speaks at a Rally Protesting the Pacific Rim on December 15, 2001

Source: Ron Carver

were filed between Western nations. Of the 111 cases pending before ICSID tribunals in June 2007, none was against a Group of Eight (G8) nation.[4]

Two authors from NGOs critical of corporate power wrote in 2007 that "[t]he rules are weighted heavily in favor of global corporations and against the mostly poor countries caught up in disputes. ICSID hears cases brought by private investors against sovereign governments . . . 93 percent of the cases involve low- or middle-income developing countries . . . about 70 percent, involve private investment in public services [and] in too many cases, the World Bank or other international financial institutions required privatization of public services as a loan condition. In many of these loans, these funds then enable multinational corporations with poor environmental and public health records to assume control or management of local water supplies."[5]

As an illustration, ICSID was hearing a case in December of 2011 that brought protestors to Washington D.C. (see Figure 5.1 and Reading 5-1). The ICSID got the case though a multilateral

Reading 5-1 Pacific Rim Mining v. El Salvador: An ICSID Arbitration under the U.S.-Dominican Republic Central American Free Trade Agreement (DR-CAFTA)

Like the North American Free Trade Agreement ("NAFTA"), the treaty that DR-CAFTA is based upon, DR-CAFTA's Chapter 10 includes extensive investor rights provisions. These clauses, designed to encourage foreign investment, allow multinational corporations to settle investor disputes with an international tribunal rather than dealing directly with the host country's government. The first arbitration under DR-CAFTA began when Pacific Rim Mining Corporation ("Pacific Rim"), a Vancouver-based gold exploration company, filed a petition for arbitration against the government of El Salvador for allegedly failing to grant exploration permits by the government of El Salvador.

The corporation has asked for at least U.S. $77 million, the amount of money it claims to have lost while waiting for its mining permit to be issued.

Mining and the Environment

At the center of the controversy is the El Dorado mine, located in the Cabañas department of El Salvador. As El Dorado is Pacific Rim's "flagship" mining operation, the company has a huge stake in starting the process of gold extraction. But El Salvador's Ministry of the Environment denied Pacific Rim an exploitation permit for the El Dorado mine after finding the Environmental Impact Assessment ("EIA") unsatisfactory. An examination conducted by independent hydrologist, Robert Moran, confirmed El Salvador's approach; Moran wrote that "[the] EIA would not be acceptable to regulatory agencies in most developed countries." He noted that, while Pacific Rim claims to have conformed to World Bank

[4]The Group of Eight consists of the governments of Canada, France, Germany, Italy, Japan, Russia, the United Kingdom, and the United States. Together, these countries represent about 65 percent of the world economy. Formerly, it was known as the Group of Seven, until Russia's admission in 1997 (a decision that continues to have its detractors). Each year, a G8 summit is attended by the heads of government from each member state. The EU is also represented at these meetings. The University of Toronto maintains a Web site on the G8 at www.g7.utoronto.ca.

[5]The NGOs are the Institute for Policy studies and the Food & Water Watch. See www.commondreams.org/cgi-bin/print.cgi?file=/news2007/0430-05.htm.

Group's mining safety guidelines, "these guidelines are, in many respects, much weaker than those that would be required to operate a mine in Canada or the U.S.A."

Operations in Cabañas began in 1993, when Mirage Resources and Dayton Mining began exploration in the region; they found high-grade gold veins during the exploratory drilling phase. Pacific Rim had acquired the mine in 2002 through its merger with Dayton Mining. According to Cameron Herrington, an organizer with the Committee in Solidarity with the People of El Salvador, the community in Cabañas became concerned with the potential negative impacts of the gold mine during the early phases of exploration. Although the company had only carried out the exploratory drilling activities, villagers noticed that their wells were going dry.

Cabañas is located on the Rio Lempa, a major river in El Salvador and the country's main source of fresh water. Gold processing requires a large input of cyanide, which Pacific Rim planned to detoxify through a decontamination process. But Moran learned that the company's impact assessment did not provide for remediation measures in the case of a cyanide spill into a river or lake. If gold processing chemicals were to contaminate the Rio Lempa, thousands of Salvadorans would be directly affected.

Even without a serious spill, the mine itself could adversely affect available water supplies in the region. Pacific Rim estimates that the plant would require 10.4 liters of water per second. If the plant ran full time, that would amount to over 320 million liters each year. One day of the mine's operations would use a 20 year supply of water for one Salvadoran family. Also, contamination of the Rio Lempa could destroy the local community's ability to support itself by farming and fishing, leading to economic ruin.

Long Term Damage, Short Term Gain

Commentators have criticized El Salvador for failing to grant the mining permit to Pacific Rim, suggesting that gold mining has a positive impact on the country's economy. But the extent of economic benefit is a matter for debate; for example, the San Martin mine that operated in Honduras from 2000–2007 and has been the basis of international criticism due to the health problems it has spawned: "the local community experienced very little long-term economic development benefit from the mine. Yet many community members allege that contamination from the mine has contributed to serious water pollution and community health problems." Without careful environmental protections in place, Cabañas could face the same situation.

Getting Political

The initial exploration permit was granted to Mirage Resources in 1996, during the administration of President Armando Calderón Sol. Calderón promoted neo-liberal economic programs during his presidency, hoping to stimulate investment—especially from newly resurgent foreign companies—after the country's Civil War devastated its economy. Pacific Rim inherited the mining permits when it merged with Dayton mining; however, when it came time for Pacific Rim to reapply for exploitation permits in 2006, then-President Antonio Saca, was sufficiently wary of the mining company and refused to issue the permits. Saca's actions earned him criticism among more conservative circles, but his administration's decision to stop the El Dorado mining project was very popular among those who would be directly affected by the project, particularly those citizens living in Cabañas.

The mining issue became politicized as the 2009 Salvadoran presidential election approached. As Pacific Rim threatened to file international arbitration proceedings using Chapter 10 of DR-CAFTA, a member of the ARENA party proposed a new mining law with new regulatory standards. If approved, this effort may have led to the granting of new permits for the El Dorado mine. These maneuverings put pressure on President Saca to privately settle the case with Pacific Rim so as to avoid voter backlash; but ultimately, President Saca did not yield to the political pressure, and Pacific Rim officially filed for arbitration against the government on April 30, 2009. Just over a month earlier, in the elections that took place in El Salvador on March 15, 2009, the Frente Farabundo Martí para la Liberación Nacional ("FMLN") party candidate, Mauricio Funes, won with 51.3% of the vote. He has continued President Saca's mining policies, refusing to grant Pacific Rim a license to begin exploitation of the El Dorado mine.

The issue of gold exploration has also caused increased violence in the Cabañas region. To date, three prominent anti-mining activists have been killed in Cabañas: the tortured body of activist Marcelo Rivera was found in a community well in June 2009, and Ramiro Rivera Gomez and Dora "Alicia" Recinos Sorto—both outspoken critics of the gold mine—were murdered in December.

The El Dorado mine has never been operational—and therefore has not been profitable—since President Saca refused to issue the company the necessary exploration permits. In 2008, Pacific Rim made serious cutbacks to the El Dorado project, and "does not intend to resume significant exploration work at the El Dorado project until such time as the environmental permit is received and the exploration concession is granted." Pacific Rim now hopes to avoid the Salvadoran government's decision by appealing directly to ICSID by using the investor rights provisions of DR-CAFTA.

International Interests with a Powerful Voice in Cabañas

Pacific Rim Mining Corp. operates the El Dorado mine through their wholly owned subsidiary Pac Rim Cayman, LLC ("Pac Rim"), based in Nevada. The El Dorado project, located about an hour outside of San Salvador, is Pacific Rim's "flagship exploration asset and has received the bulk of the Company's exploration efforts over the past 7 years," according to the company's web site.

Canada is not a signatory of DR-CAFTA, so Vancouver-based Pacific Rim is filing the suit through its Nevada subsidiary, Pac Rim. Until 2007, the Pac Rim subsidiary was located in the Cayman Islands; some have asserted that the company moved the subsidiary so that it could be eligible to file suit under DR-CAFTA. Under the treaty, investment disputes must be settled in an international tribunal. The International Center for Disputes (ICSID), an institution of the World Bank Group located in Washington, DC, is often the final destination for international resource cases.

The Pacific Rim case is not the first international resource dispute to be resolved in ICSID arbitration. The number of ICSID arbitration cases has gone up considerably over the past ten years. According to a report by the Institute for Policy Studies (IPS), there were 32 pending cases related to oil, mining, and gas in the ICSID in 2011, whereas in 2000, there were only three pending cases of a similar nature.

DR-CAFTA's investor rights provision stipulates that "each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors." Pacific Rim believes and alleges that the government of El Salvador failed to uphold its own laws by not granting the second round of mining concessions. The ICSID must decide if El Salvador violated Chapter 10 of DR-CAFTA by treating Pacific Rim differently than it would treat a Salvadoran mining company.

Conclusion

The international tribunal's decision on the *Pacific Rim v. El Salvador* case is likely to be an important precedent globally if the tribunal rules in favor of Pacific Rim. It will likely set a precedent for numerous arbitral claims already filed with ICSID regarding resource exploration in Latin America.

investment treaty, the U.S.-Dominican Republic Central America Free Trade Agreement (DR-CAFTA), rather than a BIT, but the arbitration process (private, and often thought by critics to favor the investor) is essentially the same.

Because of long delays in completing multilateral negotiations during the WTO's Doha Round, the United States and other nations have accelerated the pace of concluding BITs, and working out regional free trade agreements (NAFTA and CAFTA). Whether this is a positive situation for developing nations or for global free trade is much debated.

Developing nations that have emerged over the past 30 years to take a leading role in the global economy are difficult to categorize as "developing" nations at this time. China, Brazil, and India are foremost in this emergence. China has concluded over 127 BITs,[6] and has included dispute resolution procedures that involve the ICSID in 90 of them. Foreign investment in China has been expanding considerably since 1990. China and the United States do not have a BIT, but in 2002 China became a member of the WTO (see Chapter 7). India has concluded 63 BITs. Table 5.1 shows India's current BITs and when they were both signed and ratified.

TABLE 5.1

India's BITs

Parties	Signature	Entry into Force
Argentina	Aug. 20, 1999	Aug. 12, 2002
Armenia	May 23, 2003	May 30, 2006
Australia	Feb. 26, 1999	May 04, 2000
Austria	Nov. 08, 1999	Mar. 01, 2001
Bahrain	Jan. 13, 2004	Dec. 5, 2007
Belarus	Nov. 26, 2002	Nov. 23, 2003
Belgium-Luxembourg	Oct. 31, 1997	Jan. 08, 2001
Brunei Darussalam	May 22, 2008	Jan. 18, 2009
Bulgaria	Oct. 29, 1998	Sep. 23, 1999
China	Nov. 21, 2006	Aug. 1, 2007
Croatia	May 04, 2001	Jan. 19, 2004
Cyprus	Apr. 09, 2002	Jan. 12, 2004
Czech Republic	July 8, 2010	Mar. 24, 2011
Denmark	Sep. 06, 1995	Aug. 28, 1996
Egypt, Arab Republic of	Apr. 09, 1997	Nov. 22, 2000
Finland	Nov. 07, 2002	Apr. 09, 2003
France	Sep. 02, 1997	May 17, 2000
Germany	Jul. 10, 1995	Jul. 13, 1998
Iceland	Jun. 29, 2007	Dec. 16, 2007
Hungary	Nov 03, 2003	Jan. 02, 2006
Indonesia	Feb. 10, 1999	Jan. 22, 2004
Israel	Jan. 29, 1996	Feb. 18, 1997
Italy	Nov. 23, 1995	Mar. 26, 1998
Jordan	Dec. 01, 2006	Jan. 22, 2009
Kazakhstan	Dec. 09, 1996	Jul. 26, 2001
Korea, Republic of	Feb. 26, 1996	May 07, 1996
Kuwait	Nov. 27, 2001	Jun 28, 2003
Kyrgyzstan	May 16, 1997	Apr. 10, 1998
Lao People's Democratic Republic	Nov. 09, 2000	Jan. 05, 2003
Latvia	Feb. 18, 2010	Nov. 27, 2010
Macedonia TFYR	Mar. 17, 2008	Nov. 17, 2008
Malaysia	Aug. 01, 1995	Apr. 12, 1997
Mauritius	Sep. 04, 1998	Jun. 20, 2000
Mexico	May 21, 2007	Feb. 23, 2008
Mongolia	Unknown	Apr. 29, 2002

[6]www.unctad.org/sections/dite_pcbb/docs/bits_china.pdf.

Parties	Signature	Entry into Force
Morocco	Feb. 13, 1999	Feb. 22, 2001
Netherlands	Nov. 06, 1995	Dec. 01, 1996
Oman	Apr. 02, 1997	Oct. 13, 2000
Philippines	Jan. 28, 1997	Jan. 29, 2001
Poland	Oct. 07, 1996	Dec. 31, 1997
Portugal	Jun. 28, 2000	Jul. 19, 2002
Qatar	Apr. 7, 1999	Dec. 15, 1999
Romania	Nov. 17, 1997	Dec. 09, 1999
Russian Federation	Dec. 23, 1994	Aug. 05, 1996
Saudi Arabia	Jan. 25, 2006	May 20, 2008
Serbia	Jan. 31, 2003	Feb. 24, 2009
Slovakia	Sep. 25, 2006	Sept. 27, 2008
Spain	Sep. 30, 1997	Dec. 15, 1998
Sri Lanka	Jan. 22, 1997	Feb. 13, 1998
Sweden	Jul 04, 2000	Apr 01, 2001
Switzerland	Apr. 04, 1997	Feb. 16, 2000
Syrian Arab Republic	June 18, 2008	Jan. 22, 2009
Taiwan Province of China	Oct. 17, 2002	Nov. 28, 2002
Tajikistan	Dec. 13, 1995	Nov. 14, 2003
Thailand	Jul. 10, 2000	Jul. 13, 2001
Trinidad and Tobago	Mar. 12, 2007	Oct. 7, 2007
Turkey	Sep. 17, 1998	Oct. 18, 2007
Turkmenistan	Sep. 20, 1995	Feb. 27, 2006
Ukraine	Dec. 01, 2002	Aug.12, 2003
United Kingdom of Great Britain and Northern Ireland	Mar. 14, 1994	Jan. 06, 1995
Uzbekistan	May 18, 1999	Jul. 28, 2000
Vietnam	Mar. 08, 1997	Dec. 01, 1999
Yemen, Republic of	Oct. 1, 2002	Feb. 10, 2004

Source: World Bank, International Center for the Settlement of Investment Disputes. www.worldbank.org/icsid/treaties/india.htm.

Excerpts from China's BIT with Chile from 1994 are shown in Table 5.2 and include provisions for the ICSID to settle investment disputes over the issue of expropriation. Direct investment in China has soared since 1990; according to the Ministry of Commerce, direct investment in 1990 totaled 3.5 billion, while the figures for 2006, 2007, and 2008 are $63 billion, $74.8 billion, and $92.4 billion, respectively.

National Foreign Investment Policies

The precise form of foreign investment regulations will vary from state to state, but the underlying purposes of these regulations are much the same worldwide. These include (1) promoting local productivity and technological development, (2) encouraging local participation, and (3) minimizing foreign competition in economic areas already well served by local businesses.[7]

[7]These can be seen in the criteria set out in Canada's Foreign Investment Review Act (1973–1974) for the screening of foreign investment applications: "(a) the effect of the acquisition or establishment on the level and nature of economic activity in Canada, including, without limiting the generality of the foregoing, the effect on employment, on resource processing, on the utilization of parts, components and services produced in Canada, and on exports from Canada; (b) the degree and significance of participation by Canadians in the business enterprise or new business and in any industry or industries in Canada of which the business enterprise or new business forms or would form a part; (c) the effect of the acquisition or establishment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada; (d) the effect of the acquisition or establishment on competition within any industry or industries in Canada; and (e) the compatibility of the acquisition or establishment with national industrial and economic policies, taking into consideration industrial and economic policy objectives enunciated by the government or legislature of any province likely to be significantly affected by the acquisition or establishment." *Statutes of Canada*, vol. 1973–1974, chap. 46, §2(2), p. 620.

TABLE 5.2

Chile and China's BIT

ARTICLE 8

Disputes Between the Contracting Parties

(1) Any dispute between the Contracting Parties concerning the interpretation or application of this Agreement shall, as far as possible, be settled by consultation through the diplomatic channel.

(2) If a dispute cannot thus be settled within six months, it shall, upon the request of either Contracting Party, be submitted to an ad-hoc arbitral tribunal.

(3) Such tribunal comprises of three arbitrators. Within two months from the date on which either Contracting Party receives the written notice requesting for arbitration from the other Contracting Party, each Contracting Party shall appoint one arbitrator. Those two arbitrators shall, within further two months, together select a third arbitrator who is a national of a third State which has diplomatic relations with both Contracting Parties. The third arbitrator shall be appointed by the two Contracting Parties as Chairman of the arbitral tribunal.

(4) If the arbitral tribunal has not been constituted within four months from the date of the receipt of the written notice for arbitration, either Contracting Party may, in the absence of any other agreement, invite the President of the International Court of Justice to appoint the arbitrator(s) who has or have not yet been appointed. If the President is a national of either Contracting Party or is otherwise prevented from discharging the said function, the next most senior member of the International Court of Justice who is a national of either Contracting Party shall be invited to make the necessary appointments.

(5) The arbitral tribunal shall determine its own procedure. The tribunal shall reach its award in accordance with the provisions of this Agreement and the generally recognized principles of international law.

(6) The tribunal shall reach its award by a majority of votes. Such award shall be final and binding on both Contracting Parties. The ad-hoc arbitral tribunal shall, upon the request of either Contracting Party, explain the reasons of its award.

(7) Each Contracting Party shall bear the cost of its appointed arbitrator and of its representation in arbitral proceedings. The relevant costs of the Chairman and the tribunal shall be borne in equal parts by the Contracting Parties.

ARTICLE 9

Settlement of Disputes Between an Investor and a Host State

(1) Any dispute between an investor of one Contracting Party and the other Contracting Party in connection with an investment in the territory of the other Contracting Party shall, as far as possible, be settled amicably through negotiations between the parties to the dispute.

(2) If the dispute cannot be settled through negotiations within six months, either party to the dispute shall be entitled to submit the dispute to the competent court of the Contracting Party accepting the investment.

(3) If a dispute involving the amount of compensation for expropriation cannot be settled within six months after resort to negotiations as specified in Paragraph 1 of this Article, it may be submitted at the request of either party to an international arbitration of the International Centre for the Settlement of Investment Disputes (ICSID), created by the Convention on the settlement of investment disputes between States and Nationals of other States, opened for signature at Washington on March 18,1965. Any dispute concerning other matters between an investor of either Contracting Party and the other Contracting Party may be submitted by mutual agreement to an ad-hoc arbitral tribunal. The provisions of this Paragraph shall not apply if the investor concerned has resorted to the procedure specified in Paragraph 2 of this Article.

(4) Such an ad-hoc arbitral tribunal shall be constituted for each individual case in the following way; each party to the dispute shall appoint an arbitrator, and these two shall select a national of a third State which has diplomatic relations with the two Contracting Parties as Chairman. The first two arbitrators shall be appointed within two months of the written notice for arbitration by either party to the dispute to the other, and the Chairman [shall] be selected within four months. If within the period specified above, the tribunal has not been constituted, either party to the dispute may invite [the] Secretary General of the International Centre for the Settlement of Investment Disputes to make the necessary appointments. If the Secretary General is a national of either Contracting Party or is otherwise prevented from discharging the said function, the next most senior member of the International Centre for the Settlement of Investment Disputes who is not a national of either Contracting Party shall be invited to make the necessary appointment(s).

(5) That ad-hoc arbitral tribunal shall determine its own procedure. However, the tribunal may, in the course of determination of [the] procedure, take as guidance the Arbitration Rules of the International Center for Settlement of Investment Disputes.

(6) The ad-hoc arbitral tribunal shall reach its decision by a majority of votes. Such decision shall be final and binding on both parties to the dispute. Both Contracting Parties shall commit themselves to the enforcement of the decision in accordance with their respective domestic law.

(7) The ad-hoc arbitral tribunal shall adjudicate in accordance with the law of the Contracting Party to the dispute accepting the investment including its rules on the conflict of laws, the provisions of this Agreement as well as the generally recognized principles of international law.

(8) Each party to the dispute submitted to the ad-hoc tribunal shall bear the cost of its appointed member of the tribunal and of its representation in the proceedings. The cost of the appointed Chairman and the remaining costs shall be borne in equal parts by the parties to the dispute.

(9) The decisions by the arbitral tribunal of the International Centre for the Settlement of Investment Disputes shall be final and binding on both parties to the dispute. Both Contracting Parties shall commit themselves to the enforcement of the decision in accordance with their respective domestic law.

(10) Neither Contracting Party shall pursue through diplomatic channels any matter referred to arbitration until the proceeding have terminated and a Contracting Party has failed to abide by or to comply with the award rendered by the Arbitral Tribunal.

ARTICLE 10

More Favourable Treatment

If the treatment to be accorded by one Contracting Party in accordance with its laws and regulations to investments or activities associated with such investments of investors of the other Contracting Party is more favourable than the treatment provided for in this Agreement, the more favourable treatment shall be applicable.

To achieve these purposes, investment laws establish basic policies for screening and regulating foreign investment applications. These generally fall into three categories. The first is to encourage investments through incentives and minimal regulations. Most states with this policy are located in sub-Saharan Africa and the Far East. The second is to use investment incentives but also to require local participation quotas. Countries with this policy are generally found in the Middle East and North Africa. The third is to allow foreign investment subject to local screening and supervision. States with this policy have often been found in Latin America.[8]

Regional Investment Policies

Nations in a geographic region may agree on general standards for investment in the region. The ASEAN (Association of Southeast Asian Nations) area is one such region (Table 5.3). The ASEAN region is a leading recipient of foreign direct investment (FDI) flows in the developing world. The ASEAN countries have undertaken collective as well as individual measures to attract investment. Individual nations have created policies to attract FDI to help them recover from the economic crisis of 1997–98. Also, the member countries are collectively promoting ASEAN as a single investment area. Regional cooperation facilitates more cost-effective industrial and production activities in ASEAN, providing firms with greater synergy and a more competitive edge in servicing both global and regional markets. The major ASEAN economic integration schemes include the ASEAN Investment Area (AIA), the ASEAN Free Trade Area (AFTA), the ASEAN Industrial Cooperation (AICO) scheme, the ASEAN Economic Ministers (AEM), the ASEAN Ministers on Energy Meeting (AMEM), the ASEAN Ministerial Meeting on Agriculture and Food (AMAF), the ASEAN Finance Ministers Meeting (AFMM), the ASEAN Ministerial Meeting on Minerals (AMMin), the ASEAN Mekong Basin Development Cooperation (AMBDC), the ASEAN Transport Ministers Meeting (ATM), the ASEAN Telecommunications and IT Ministers Meeting (TELMIN), and the ASEAN Tourism Ministers Meeting (M-ATM).

The United States, Canada, and Mexico not only created an investment alliance or pact, but entered into a formal trade agreement (the North American Free Trade Agreement) that provides significant protections for investors of nations that are members of WTO. A dispute resolution process was created in NAFTA's Chapter Eleven, and investors from the United States, Canada, and Mexico have brought a variety of actions in claiming violations of NAFTA's investor protection provisions.[9]

---

[8] *Id.*

[9] See www.naftalaw.org/disputes.htm.

TABLE 5.3

ASEAN investment area

Pursuant to the mandate of the Fifth ASEAN Summit, ASEAN ministers signed the Framework Agreement on the AIA on October 7,1998, in Manila.

Investment Incentives

The AIA aims to make ASEAN a competitive, conducive and liberal investment area through the following measures:

a. Implementing coordinated ASEAN investment cooperation and facilitation programmes;
b. Implementing a coordinated promotion programme and investment awareness activities;
c. Immediate opening up of all industries for investment, with some exceptions as specified in the Temporary Exclusion List (TEL) and the Sensitive List (SL), to ASEAN investors by 2010 and to all investors by 2020;
d. Granting immediate national treatment, with some exceptions as specified in the Temporary Exclusion List (TEL) and the Sensitive List (SL), to ASEAN investors by 2010 and to all investors by 2020;
e. Actively involving the private sector in the AIA development process;
f. Promoting freer flows of capital, skilled labour, professional expertise and technology amongst the member countries;
g. Providing transparency in investment policies, rules, procedures and administrative processes;
h. Providing a more streamlined and simplified investment process; and
i. Eliminating investment barriers and liberalizing investment rules and policies in the sectors covered by the Agreement.

Investment Benefits

The AIA will have important implications for investment strategies and production activities in the region. For instance, the AIA will encourage investors to think increasingly in the regional terms and to adopt a regional investment strategy and network of operations. It will provide greater scope for division of labour and industrial activities across the region, creating opportunities for greater industrial efficiency and cost competitiveness. In addition, current and potential investors will benefit from the AIA arrangements in the following ways:

a. greater investment access to industries and economic sectors as a result of the opening up of industries under the AIA arrangements, if investors qualify as ASEAN investors;
b. national treatment, if investors qualify as ASEAN investors;
c. greater transparency, information and awareness of investment opportunities in the region;
d. more liberal and competitive investment regimes; and
e. lower transaction costs for business operations across the region.

An ASEAN investor is defined as being equal to a national investor in terms of the equity requirements of the member country in which the investment is made. Thus, a foreign firm with a majority interest can avail itself of national treatment and investment market access privileges, in addition to the other benefits provided under the AIA Agreement and other regional economic schemes.

Exemptions

The privileges offered by the AIA in investment market access and the granting of national treatment take immediate effect for ASEAN investors,with the exception of those sectors in the list of exclusions.

Screening Foreign Investment Applications

Most (but not all) countries require foreign investors to (1) register with the government and (2) obtain governmental approval of their proposed venture.

The Screening Agencies Foreign investors will ordinarily register and file proposals with a single central agency set up specifically to facilitate foreign investments. The central agency may conduct the screening, or it may instead coordinate the process. In the Philippines and South Korea, the central agency has a multidisciplinary staff that is organized to independently evaluate most proposals.[10] In Chile, India,

[10]Philippines Omnibus Investments Code of 1987 (Executive Order No. 226), arts. 3–9; available in the Chan Robles Virtual Law Library at www.chanrobles.com/default8eono226.htm. South Korea, Foreign Investment Promotion Act (Revised Act No. 5982, 24, 1999), art. 27; available on the South Korean Ministry of Finance and Economy's Web site at http://untreaty.un.org/cod/avl/pdf/ls/Shin_RelDocs.pdf.

Kenya, and Mexico, on the other hand, the role of the central agency is primarily a coordinating one, with most of the evaluation being done by other specialized departments and agencies.[11]

Not all countries have a central agency. In Brazil and Nigeria, for instance, the evaluation of proposals is handled directly by the departments and agencies concerned. If coordination is needed, they will directly contact other governmental units as necessary for advice and assistance.[12]

Proposals Requiring Screening The criteria for determining which proposals need screening vary greatly. A few states may subject all foreign investment to some form of screening. Other states limit their reviews to proposals seeking investment incentives to those that involve a certain percentage of foreign investment, or to those whose projected investment exceeds a certain amount of capital.[13] In Brazil, for example, no governmental authorization is needed unless a foreign investor wants to take advantage of certain industrial incentives.[14]

The Board of Investments of the Philippines screens all new investments in which foreigners have a 40 percent or greater share and all expansions or additional investments in existing firms that have foreign ownership of 40 percent or more.[15]

In Argentina, investments of less than U.S. $5 million do not require approval unless a majority of the shares in a locally owned company is to be bought by foreigners.

Several countries follow different procedures, depending on the magnitude of the investment. In Argentina, new foreign investments of more than U.S. $20 million or the foreign acquisition of a majority interest in a locally owned company worth more than U.S. $10 million require prior approval of the president. Investments of lesser amounts—but greater than the minimum amount of U.S. $5 million for new investments—require approval of the Under-Secretariat of External Investments.

In Algeria, the prefect of the *département* concerned screens investments that do not exceed 500,000 Algerian dinars and that do not contain a request for financial incentives. Otherwise, the Secretariat of the National Investment Board must review the application. France has a similar arrangement. Investments of more than 10 million francs are screened in Paris; others are reviewed locally.

Proposals Requiring Special Screening In many countries, certain kinds of foreign investment proposals require the approval of specialized agencies. Commonly, investments in natural resource–based industries (e.g., hydrocarbons, minerals, and forestry) need the approval of agencies that formulate special criteria tailored to the specific requirements of the industries involved. In South Korea, investments in certain strategic industries need special government authorization.

Information That Must Be Disclosed Foreign investors are required to supply screening agencies with quite detailed information about their proposals. This typically includes the following:[16]

a. The industry to be established and the nature of the product to be produced
b. A financial plan, showing the amount of investment in external and local capital
c. A production scheme showing the annual volume and value of the production
d. A services scheme showing what services will be created and their volume and value
e. The owners, the management structure, and the relative share of local and foreign control
f. Machinery and equipment needed, and their sources and cost
g. An import and export scheme showing the expected volume of imports and exports
h. The extent that local inputs (including raw materials) will be used and an estimate of the local value added

[11]Center on Transnational Corporations, National Legislation and Regulations Relating to Transnational Corporations, p. 10 (UN Doc. ST/CTC/26, UN Sales No. E. 83. II. A. 7, 1983).

[12]*Id.*

[13]*Id.*

[14]*Id.*

[15]Philippines Omnibus Investments Code of 1987 (Executive Order No. 226), art. 32. The code is available in the Chan Robles Virtual Law Library at www.chanrobles.com/default8eono226.htm.

[16]Center on Transnational Corporations, *National Legislation and Regulations Relating to Transnational Corporations*, p. 11 (UN Doc. ST/CTC/26, UN Sales No. E. 83. II. A. 7, 1983).

i. An employment scheme, including a program for training nationals to operate and manage the enterprise
j. A marketing study of the domestic and export market
k. Product pricing and projected profits and rate of return
l. The proposed location of the industry

Evaluation Criteria A foreign investment proposal is judged, in general, on its congruence with a country's national development objectives. Some investment laws establish standards for screening projects in general or for granting incentives in particular. The criteria, of course, vary greatly, depending on a country's goals. Nevertheless, certain broad criteria are considered by the screening agencies of most countries as follows:[17]

a. The impact on the balance of payment
b. The number of jobs created
c. The impact of technical know-how and the training program for indigenous employees
d. The impact on the local market (including any possible negative consequences for already established national enterprises)
e. The contribution to the development of less economically developed zones or regions
f. The ratio between foreign and national capital contribution
g. The export diversification and stimulation, and import substitution
h. The use of national inputs and components in the manufacture of the product
i. The effect on price levels and the quality of the product

Formal and Informal Application Processes

The investment application submitted by a foreign investor must demonstrate two things to the regulatory authority: First, that the proposed investment fits the guidelines of the investment law; second, and most important, that the investment agrees with the investment philosophy of the host country.

Although compliance with the statutory provisions is reasonably straightforward, conforming to the regulatory philosophy can prove difficult. It may be difficult because the regulatory authority is often secretive and may not be sympathetic to foreign investors. Or it may be difficult because the investor is insensitive to the investment environment in the host country.

In Europe, the controversy over GMOs is hardly over. The European Union has established a legal framework regulating genetically modified (GM) food and feed in the EU. The EU is a party to the Cartagena Protocol on Biosafety annexed to the UNEP's Convention on Biological Diversity, which entered into force on September 11, 2003. The overall purpose of this United Nations agreement is to establish common rules to be followed in transboundary movements of GMOs in order to ensure, on a global scale, the protection of biodiversity and of human health. The Cartagena Protocol on Biosafety is incorporated into EU legislation through a wide range of legislative measures governing the use of GMOs within the European Union. The cornerstone of this legal framework is Directive 2001/18/EC on the deliberate release into the environment of genetically modified organisms.

Directive 2001/18/EC is supplemented by the Regulation on the transboundary movements of GMOs, which was adopted in June 2003.[18]

The main features of the Regulation are:

- the obligation to notify exports of GMOs intended for deliberate release into the environment and secure express consent prior to a first transboundary movement;
- the obligation to provide information to the public and to our international partners on EU practices, legislation, and decisions on GMOs, as well as on accidental releases of GMOs;
- a set of rules for the export of GMOs intended to be used as food, feed, or for processing;
- provisions for identifying GMOs for export.

---

[17] *Id.*, p. 12.

[18] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:287:0001:0010:EN:PDF.

European Commission Site on GM Food and Feed is at
http://ec.europa.eu/food/food/biotechnology/index_en.htm.

Approval of Foreign Investment Applications

After the screening process is done, the host state will approve or disapprove a foreign investor's proposal. If the proposal did not ask for the host to grant any incentives, and if the host state does not insist upon any concessions from the investor, the approval will often be in the form of a letter from the appropriate agency. If the host state grants an incentive or the investor agrees to some concession, the arrangement will be set out in a formal investment agreement. Typically, the agreement will be governed by the host state's contract laws, and any disputes will be resolved in that state's courts unless the parties agree otherwise. As a French court ruled in *Arab Republic of Egypt v. Southern Pacific Properties, Ltd. et al*. (Case 5-1), the burden for ensuring that the proper approval has been granted rests with the investor.

In Brief: CASE 5-1 Arab Republic of Egypt v. Southern Pacific Properties, Ltd., et al.

France, Court of Appeal of Paris, 1984

MAP 5.1

Egypt (1984)

Facts

Southern Pacific Properties (SPP) entered into two contracts that involved the construction of a tourist center near the pyramids of Giza. The first was between SPP, the Egyptian General Organization for Tourism and Hotels (EGOTH, an Egyptian state-owned corporation), and the Egyptian minister of tourism, who had signed as a representative of the Egyptian government. It provided that SPP would establish a local holding company to operate the center. The second contract was between SPP and EGOTH. This contract provided, among other things, for arbitration in the event of a dispute. The Egyptian minister of tourism endorsed it with the words "approved, agreed and ratified."

Because of protests from environmentalists, the Egyptian government withdrew its approval for the tourist center. SPP and its holding company then initiated arbitration against both EGOTH and the Egyptian government. The arbitration tribunal held that it had jurisdiction over both EGOTH and the government, and it awarded a judgment in favor of SPP. The government brought suit in a French court of appeal to have the tribunal's judgment set aside.

Issue

Was the Egyptian government a party to the arbitration agreement?

Holding

No.

Law

Egyptian law requires that the minister of tourism has to approve all agreements relating to tourism in Egypt.

Explanation

By endorsing the second contract, the minister of tourism was giving the endorsement required by law. He was not making the government a party to the contract. Accordingly, the arbitration tribunal had no power over the Egyptian government.

Order

The judgment against the Egyptian government is set aside.

Business Forms

International investors seeking to set up a foreign operation may be limited in the kinds of business forms they are allowed to use. Most states generally prefer that foreigners limit themselves to businesses that (1) have local participation and (2) fully disclose their activities to the public. Local participation usually means some form of joint venture, which can be organized either as a partnership, a limited liability company (LLC), or a publicly traded stock corporation. Saudi Arabia, for example, allows a foreign company to set up a local branch without any Saudi participation, but the company is not eligible for any of the incentives to which a company that has at least 25 percent Saudi ownership is entitled.[19] Tax holidays and other incentives are available only to investors who form a local company and register with the Saudi Ministry of Commerce. Additionally, Saudi government contracts are granted to companies in the following order of preference: (1) 100 percent Saudi owned, (2) more than 50 percent Saudi owned, (3) 50 percent Saudi owned, (4) less than 50 percent Saudi owned, and (5) 100 percent foreign owned.[20] (In Saudi Arabia, this is an important consideration because the government is by far the biggest purchaser in the country.) As a consequence, the most common company form used by foreign investors in Saudi Arabia is the LLC.[21] Host state laws requiring public disclosure of the activities of large firms or firms with foreign ownership is a second factor affecting the choice of business form. In Pakistan, for example, companies that have more than 20 million rupees in assets cannot be organized as LLCs (which do not have to prepare financial prospectuses or make their prospectuses available to the public); they must be set up as stock companies that offer their shares on the local stock exchange. Pakistan

[19]See the Saudi Arabian Regulations for Companies, §228, Royal Decree No. M/6 of 22.3. 1385 A.H. (1968) or at www.saudia-online.com/regulations%20for%20companies.htm. See also the Saudi Arabian Foreign Capital Investment Code, Royal Decree No. M/4 of 2.2.1399 A.H. (1979) online at www.saudia-online.com/foreign_investment.htm.

[20]Saudi Arabian Tender Regulations, Article 1(d)(3), Royal Decree No. M/14 of 7.4.1397 A.H. (1977).

[21]See Frederick W. Taylor Jr., "Alternative Structures for Doing Business in Saudi Arabia: Distributorship, Agency, Branch, Joint Venture, and Professional Office," *Case Western Reserve Journal of International Law*, vol. 12, p. 77 at p. 90 (1980); Center on Transnational Corporations, *National Legislation and Regulations Relating to Transnational Corporations*, pp. 44–45 (UN Doc. ST/CTC/26, UN Sales No. E. 83. II. A. 7, 1983).

MAP 5.2

Locations of Offshore Tax Havens

also encourages all firms that have more than a token amount of foreign participation to organize themselves as stock companies.[22]

Not all countries encourage their companies to disclose their financial and other activities. So-called tax haven countries, which try to attract foreign multinational investment, commonly impose no disclosure requirements (see Map 5.2). Indeed, some (including the Bahamas, Bermuda, the Cayman Islands, the Turks and Caicos Islands, and Vanuatu) tacitly encourage the organization of partnerships and LLCs (which are not required to disclose their financial activities).[23] Tax-haven

[22]Center on Transnational Corporations, *National Legislation and Regulations Relating to Transnational Corporations*, p. 58 (UN Doc. ST/CTC/26, UN Sales No. E. 83. II. A. 7, 1983).

[23]The encouragement results in part from the reluctance of these countries to cooperate with foreign tax authorities in providing those authorities with income statements of local companies.

countries pose a problem for many industrialized democracies and the rule of law: by mandating secrecy, these nation-states make it more difficult for other nations to track criminal activity (including drug and weapons dealers) as well as to fairly tax the activities of multinational corporations.[24]

Limitations on Foreign Equity

Foreign investment laws frequently forbid or limit the percentage of equity that foreigners may own in local businesses. Percentages have changed on a fairly regular basis, as conditions and preferences in host countries change. Even with general restrictions, it is fairly common to see exceptions made for the purpose of attracting capital to selected industries and sectors.

Sectoral Limitations

Foreign investment is commonly restricted by economic sector. Regulations typically (1) reserve certain sectors of the economy exclusively to the state or its nationals, (2) permit a limited percentage of foreign capital participation in certain sectors, or (3) define certain sectors in which full or majority foreign ownership is allowed or encouraged.

closed sectors Sectors of a state's economy that are not open to foreign investors.

Closed Sectors Most states close certain economic sectors to foreign ownership. Among those most often closed are

- Public utilities
- Vital or strategic industries[25]
- Industries that are sufficiently developed[26]
- Medium- or small-scale industries that can be developed by domestic entrepreneurs[27]

To illustrate, Cuba forbids foreign investment in education, defense, and health care.[28] Mexico reserves the following industries to the state: petroleum and other hydrocarbons, basic petrochemicals, nuclear energy, electric power, and telegraphic and postal services. In addition, the following industries are reserved for Mexicans or Mexican companies: radio and television, railroads, urban and interurban land transportation, and retail gasoline sales. Until recently, Russia had excluded foreign investment in the insurance industry, in securities exchanges, and in brokerages.[29]

restricted sectors Sectors of a state's economy that are not fully open to foreign investors.

Restricted Sectors Many states limit the percentage of foreign investment allowed in certain economic sectors. Commonly, this is done to limit the influence that foreigners have in domestic political, social, and economic affairs. Australia, for instance, limits foreign investment in its radio and television companies to 35 percent. Canada restricts the amount of equity ownership that foreigners may have in television broadcasting; insurance; local and trust companies; fishing; newspapers;

---

[24]See generally Raymond Baker, *Capitalism's Achilles Heel: Dirty Money and How to Renew the Free-Market System* (2005).

[25]France reserves broadcasting, postal and telecommunications, railroads, gas, and electricity exclusively to state agencies or state-owned companies. Center on Transnational Corporations, *National Legislation and Regulations Relating to Transnational Corporations*, p. 16 (UN Doc. ST/CTC/26, UN Sales No. E. 83. II. A. 7, 1983).

[26]Foreign investment in flour milling, for example, is forbidden in Ireland. See Organization for Economic Cooperation and Development, *Controls and Impediments Affecting Inward Direct Investment*, pp. 13, 45 (1987) and www.oecd.org/dataoecd/22/20/33638671.pdf; and foreigners may not participate in leather and leather products manufacturing in Japan, *id*., pp. 13, 48 (1987).

[27]Tanzania at one time reserved the following areas for local investors: the retail and wholesale trade; product brokerage; business representation of foreign companies; public relations firms; taxis; barber shops, hairdressing, and beauty salons; butcheries; and ice cream making and ice cream parlors. See Tanzania, National Investment (Promotion and Protection) Act of 1990, *International Legal Materials*, vol. 30, p. 890 at p. 912 (1991) (since replaced by the Tanzania Investment Act, 1997, available at www.parliament.go.tz/Polis/PAMS/Docs/26-1997.pdf).

[28]Cuba, Foreign Investment Act, 1995, art. 10; the English translation is online at the unofficial Republic of Cuba Web site at http://natlaw.com/interam/cu/fi/st/tncufi1.htm.

[29]*Guide to International Business Practices*, p. 300 (William S. Hein & Co., 1997). But see "Results of Bilateral Negotiations on Russia's Accession to the World Trade Organization (WTO), Bilateral Market Access Agreement on Services, November 19, 2006," at www.ustr.gov/sites/default/files/PR.pdf (granting foreign investment in banking and securities, insurance, telecommunications, audiovisual services, distribution, express delivery, energy services, and environmental services). See also www.usrbc.org/pics/File/Member%20Contributions/legal/Foreign_InvestmentInStrategicSectors.pdf.

banks; and federal oil, gas, and mining leases. France caps foreign investment in media at 20 percent, transportation at 59.6 percent, and light manufacturing at 80 percent.[30]

Foreign Priority Sectors Foreigners are often encouraged to invest in sectors where local development resources are limited, where foreign investment will increase the number of local jobs, and where the foreign export trade will grow. Developing countries, especially, allow foreign capital participation in *pioneer* industries and in industries that are capital intensive, use advanced technology, increase employment, are export oriented, and have products with a high degree of local value added. Tanzania, for instance, encourages foreign participation in agriculture and livestock development, natural resources, tourism, manufacturing, petroleum and mining, construction, transport, transit trade with neighboring countries, and computers and high technology.[31] Reading 5-2 explores some of the restrictions and intricacies of foreign direct investment in India, where the legal and policy landscape changes fairly frequently.

foreign priority sectors Sectors of a state's economy in which foreigners are encouraged to invest.

Reading 5-2 Foreign Direct Investment in India

Ethan S. Burger and Andy Reger
Based on reading by Ethan S Burger.

Background

As the world's largest democracy, combined with the expectation that legal outcomes will be determined by the application of the rule of law, there is an understandable tendency to hope that India will emerge as the principal economic power in Asia in the future. At the same time, given its significant social and religious stratification and its reputation for corruption, India is often frustrating even to its partisans.

Given its size and diversity, India defies generalization. In recent years, the Indian economy has experienced unprecedented growth in certain sectors, while at the same time its inadequate infrastructure and social problems have operated as brakes on its economic development. Those who have been following India's economic performance and politics at a macro-level on a day-to-day basis run the risk of becoming manic: encouraged by positive developments one day, only to feel let down by poor implementation or a lack of political will on the part of the Indian leadership to overcome the narrow interests of local elites on another. From the long-term perspective, however, India may nonetheless seem economically enticing.

The attitudes of both the Indian Government and its business community have undergone notable change in recent years. Although many of its institutions (e.g., the court system and bureaucracy) retained aspects of the legacy of British rule, India's first Prime Minister, Jawaharlal Nehru (1947–1964), also found aspects of the Soviet economic model appealing, a model that emphasized a centrally-planned economy for major industries and public-ownership of infrastructure. Nehru also saw benefits in the Soviet Union's placing the country's economic autonomy as a major objective.

Politically, India saw itself as the leader of the non-aligned world, beholden to neither the United States nor the Soviet Union, and economically independent from its former colonial ruler, Great Britain. With the break-up of the Soviet Union in late 1991, India needed a new economic model and new economic relationships. In an increasingly economically independent world, this meant, in part, making the country more attractive to direct foreign investment.

Still, the Indian bureaucracy did not want to lose its status and power, nor did the major domestic Indian industries want to encounter stiff foreign competition in their home markets. Unlike many countries with economies that were export oriented, India enjoys a large domestic market of people who maintain at least a middle class life-style. The size of that market is currently estimated to number between 300–350 million individuals. Traditionally, Indian businesses could operate profitably selling to this market so long as there were high barriers to entry for foreign firms in the form of high import duties and bureaucratic/legal hurdles to direct investment in place. At the same time, many Indian companies are increasingly looking to acquire stakes in foreign firms that complement their existing business activities.

Although English is the legal language of India (a distinct advantage in international business and attracting direct foreign investment), generally only educated individuals speak and read English, and their skills are highly variable. The bulk of the Indian population speaks local languages as well as dialects of such languages. While the large number of English speakers is often cited as one of the factors behind the decision of certain western companies to outsource their call centers in India (as well as other "back office" work; see Figure 5.2),[32] India's literacy rate is not universal, and has improved significantly since the Indian call center phenomenon began. In 2006, only slightly over half of the country's population could read and write any language with any degree of skill.[33] The Indian literacy rate has increased to 74%—with 82% for men and 65% for women.[34] But, given its very large

[30]An excellent chart detailing many countries' FDI restrictions can be found on pages 25–26 at http://iab.worldbank.org/~/media/FPDKM/IAB/Documents/IAB-report.pdf.

[31]www.iornet.com/newiornet/cp/tanzania23.htm.

[32]See Paul Gladder and Peter Monocot, "Why Private Colleges Are Surging in India," *Wall Street Journal*, March 29, 2007, at B1.

[33]See information gathered from Probe's Public Report on Basic Education, available at www.ashanet.org/stats/PROBE.html (last accessed July 10, 2007).

[34]www.censusindia.gov.in/2011-prov-results/indiaatglance.html.

FIGURE 5.2

Indians Work at a Call Center in New Delhi Where Business Is Outsourced from Western Companies

Source: Fredrik Renander/Alamy

population, India still has the highest number of illiterate people of any nation in the world.[35]

While India does possess a sizeable domestic market, more than two-fifths of the country's population lives in varying degrees of poverty. Those who are impoverished in India typically lack the education[36] and skills to produce goods or generate services that are internationally competitive. In view of both the endemic poverty and also the potential of India, over the first seven years of this century, the World Bank had a record amount of loans to India amounting to $3.8 billion, a large share of which is for health and irrigation projects. According to India's Representative on the World Bank's Board, programs for India's poor generally cannot attract private capital.[37]

I. The Legal Environment for Foreign Investment: An Overview

The Indian political leadership saw that the country would obtain significant economic, social, and political benefits if India became more attractive to foreign goods and investors. This has led to the adoption of policies that could be characterized as "two steps forward, followed by one step back." For example, foreign-controlled companies were previously not permitted to operate in certain sectors without a special license, or locate within 25 kilometers of a major city; these restrictions today apply only to 3 sectors where government licensing remains compulsory. Yet new bureaucratic requirements continue to appear from time to time, requirements that prove frustrating to foreign investors, particularly in the labor area.

In addition, the Indian government has not completely abandoned the protection of certain small industries. In the past, retailing was one area where Indian businessmen had been successful in keeping out foreign competition—but with Walmart[38] and Marks & Spencer's[39] casting their eyes on the Indian market,[40] it seems as if the era where wholly-owned Indian firms had a monopoly of the retail trade both in dry goods and food products[41] is in the process of coming to a close. Still, that process is political, and attempts in 2010 to open up food and grocery markets to international competitors ran into roadblocks. Considerable progress is also needed in the area of personal finance, advertising/marketing, and distribution for the Indian consumer market to fulfill its promise in this area.[42]

India has divided the economy into three categories for foreign investment: the first category is where 100% foreign investment is permitted. Second are those industries in which foreign investment is permitted, but may not exceed a fixed percentage. Finally, the third category is industries in which foreign investment is entirely prohibited. There are special rules where the foreign investors are so-called "non-resident" Indians (or "NRIs"). How the government determines which category to assign a particular industry will change from time-to-time. Among the factors that influence such decisions can include domestic factors (lobbying, or even bribery) as well as the perceived need to attract foreign investment to increase the competitiveness of Indian enterprises either within the domestic market or for purposes of export.

The U.S. and other foreign governments publish a wealth of materials concerning doing business in India and the Indian market in general. Department of Commerce personnel can prove invaluable in helping identify potential business partners and customers. The U.S. Foreign Commercial Services maintains up-to-date information on its website that should always be consulted before making preliminary decisions about entering a particular market. It is entirely possible to spend days or weeks studying business opportunities and risks in a particular country.[43] In addition, the U.S. Department of State collects and disseminates large amounts of information about India that discusses economic/commercial and social issues. It is strongly suggested to visit the Department of State's website on India before pursuing commercial activities in India.[44] McKinsey & Co. also does an excellent

[35]www.rediff.com/news/2007/nov/20illi.htm.

[36]Ben Phillips (Letter), "Greater Education Investment Needed," *Financial Times*, March 27, 2006, at 16.

[37]Krishna Guam and Amy Yee, "World Bank Loans to India Climb 170%," *Financial Times*, July 6, 2007, at 6. According to World Bank estimates, approximately 300 million Indians survive on less than $1 per day—a figure equivalent to that of sub-Saharan Africa.

[38]Eric Bellman, "A Dollar Store's Rich Allure in India—A U.S. Franchise's Success Shows 'Made in America' Sells; Lessons for Wal-Mart's Entry?" *Wall Street Journal*, January 23, 2007, at B4.

[39]Elizabeth Rigby and Maggie Uri, "M&S Looks to India and China for New Growth," *Financial Times*, May 23, 2007, at 25.

[40]Amy Yee, "Birla Plans Chain of Indian Stores," *Financial Times*, May 19, 2007, at 9.

[41]Jo Johnson, "India Opens Western-Style Supermarkets," *Financial Times*, January 30, 2007, at 6.

[42]Jo Johnson, "India Needs Reforms to Make Big Jump as Consumer Market," *Financial Times*, May 7, 2007, 8.

[43]This portion of the U.S. Foreign Commercial Service's Web site is available at http://export.gov/india/ (last accessed July 10, 2007).

[44]The Department of State maintains its information about India at www.state.gov/r/pa/ei/bgn/3454.htm (last accessed July 10, 2007).

job monitoring business developments in India. Its website is an excellent resource on developments in this area.[45]

II. Governmental Actors

At the federal level, the amount of deregulation of foreign investment has decreased significantly since 1992. The Reserve Bank of India (RBI), the country's central bank, exercises the leading role in overseeing foreign investment in the country.[46] As a general rule, income received by foreign investors can be repatriated; the RBI remains involved in the regulatory process in part to prevent wrongdoing (such as money laundering).[47]

In addition, the Indian government regulates areas such as environmental protection, foreign trade, labor protection, tax collection, etc. These functions are performed at different levels: federal, state,[48] and local.[49]

Foreign investors risk encountering considerable problems and costly delays if they ignore state and local requirements. Although, in most instances, federal law is superior to state and local law, there are numerous areas of the law where regulatory authority is decentralized officially or *de facto*. This usually necessitates obtaining local counsel when pursuing a major investment project because lawyers in New Delhi may not be familiar with all local practices.

III. Forms for Doing Business

Foreign investors examining the possibility of establishing a business presence in India have to consider a wide-range of factors before reaching a decision. Perhaps the first decision is whether it is desirable to form a permanent presence in the country. A common first step is to establish a liaison office in India. Liaison offices are also referred to as "representational offices." They are officially precluded from conducting business, but may serve to identify potential customers and business partners for a foreign legal entity.

Foreign investors are also permitted to establish branch offices in India for limited purposes after obtaining RBI's permission. Branch offices are permitted to engage in manufacturing, providing services and engaging in trading activity. They may also engage in research in India, which will almost certainly present intellectual property issues.

Under Indian laws, one drawback to establishing a branch office in India is that it exposes the parent to liability in India. As a result, some foreign investors will create special purpose entities that in turn will open a branch office in India. This is done not merely as part of a strategy to limit liability to a parent organization, but also because it may be desirable to establish the special purpose entity in a jurisdiction that has a favorable double taxation treaty with India (for example, Mauritius).[50]

Some foreign corporations choose to select a project office within India to pursue specific opportunities. Generally, project offices are permitted to engage in commercial activity in India and so long as they provide detailed reports to the RBI on their activities.

Under certain provisions of the Indian Companies Act (a piece of legislation that is frequently amended), a foreign investor may choose to establish a domestic company in India. Such companies may be organized either as public or private companies (with more extensive reporting requirements with respect to the former entity). In all respects such an entity is treated as an Indian legal entity, with the exception of restrictions on the amount of foreign investment permitted in certain sectors.

Some corporations prefer to carry out their business activity through wholly-owned entities. That is, they wish to pursue a "green fields" strategy so that they do not encounter difficulties that might arise as a result of forming joint ventures.[51] They also are able to avoid problems that may arise in certain cases due to successor liability.

Companies that favor a "green fields" approach prefer to exercise complete control over their subsidiary's operations, including personnel policy. They can "cherry pick" the most desirable employees and have an easier time instilling a corporate firm culture.

IV. Obstacles to Foreign Investment in India

The World Bank's International Finance Corporation, the U.S.–India Chamber of Commerce, and numerous other organizations have identified barriers to doing business in South Asia, including India.[52] Inadequate infrastructure, corruption, and a poorly educated workforce are frequently identified as factors retarding the growth of the Indian economy. The failure to provide adequate intellectual property protection is also a common complaint.[53]

Poor infrastructure has plagued Indian development. The lack of quality at (and number of) airports, insufficient numbers of hotels, schools for the

[45]McKinsey & Co.'s Web site is at www.mckinsey.com/locations/india/mckinseyonindia (last accessed July 10, 2007).

[46]In recent days, the RBI has become increasingly concerned about the overheating of the Indian economy and the rising value of the rupee—it has taken the step of increasing Indian interest rates. See Jo Johnson, "Delhi Aims to Rein in Economy," *Financial Times*, April 24, 2007, at 7.

[47]A large body of information concerning the RBI's functions is set out on its Web site, www.rbi.org.in/home.aspx (last accessed July 10, 2007).

[48]It is useful to keep in mind that Indian states from both a population and size perspective typically are larger than many European countries.

[49]For the portal for the Indian Government, visit http://goidirectory.nic.in (last accessed July 10, 2007).

[50]"India Finance and Investment Guide: Taxation," available at http://finance.indiamart.com/taxation/taxtreaties.html (last accessed July 10, 2007). Tax-News.com, "Singapore and Mauritius Vie to Supply India's FDI," available at www.tax-news.com/news/Singapore_And_Mauritius_Vie_To_Supply_Indias_FDI____21536.html (last accessed July 10, 2007).

[51]See Peter Wonacott and Eric Bellman, "Politics and Economics: Foreign Firms Find Rough Passage to India—Barriers, Rules Taint Allure of Partnerships as Entry Point to Fast-Growing Market," *Wall Street Journal*, February 1, 2007, at A6.

[52]International Finance Corporation, "Doing Business in South Asia, 2007" (updated on an ongoing basis), available at http://siteresources.worldbank.org/SOUTHASIAEXT/Resources/Publications/448813-1171300070514/regionalpr.pdf and at the Web site of the U.S.–India Chamber of Commerce, www.usibc.com/about (last accessed July 10, 2007).

[53]See Jeanne Whalen and Peter Wonacott, "Novartis Angers Critics in India—Challenge of Patent Laws Creates Uproar Among Public-Health Advocates," *Wall Street Journal*, March 5, 2005, at A10, and USTR, "Trade Facts: U.S. India Policy Forum, June 2006," available at www.ustraderep.gov/assets/Document_Library/Fact_Sheets/2006/asset_upload_file321_9583.pdf (last accessed July 10, 2007).

poor (particularly for girls), ports, good roads, quality health care, telecommunications, and an under-supply of adequate affordable housing, as well as potable water are all deficiencies that hinder the development of the Indian economy. Yet such insufficiencies also provide business opportunities. A wide variance in the quality of India's infrastructure has contributed to certain parts of the country receiving the bulk of the foreign investment.

Ironically, despite these problems a large number of foreign investors see significant investment opportunities as a result of money generated by outsourcing back-office work, informational technology, and software development.[54] In recent years, however, there has been some concern about the volume and quality of Indian employees to staff these operations. Foreign investors have witnessed not only a dramatic rise in the salaries of their skilled Indian personnel, but also a disturbing lack of corporate loyalty, the effect of which is not merely to make corporations question the wisdom of investing in the training of their personnel, but also whether the costs and risks involved in moving overseas can be justified. The apparent impending shortage has led some companies to scale back on their plans to shift operations to India.[55]

At the same time, as noted above, some Indian companies are pursuing strategic acquisitions to complement their existing business. For example, the Tata Group acquired Corus, and Mittal purchased Arcelor. These actions reflect the desire of senior management in certain companies to compete globally, rather than merely producing for domestic and foreign markets.[56]

V. Keeping Up with the Chinese

In recent years, Indian gross domestic product has been growing in the 6–8% range. The growth in services and manufacturing has been roughly 2% greater than the economy as a whole.[57] India remains the second fastest growing economy in Asia, behind China—which, as Indian Prime Minister Manmohan Singh indicates, simultaneously serves as a competitor as well as a model from which to learn.

There is a natural tendency to compare the evolution in the Indian economy to that of China, despite significant differences in the countries' political systems, the ethnic/linguistic/religious composition of their respective populations, and their historical views of their country's place in the world. India and China share some common characteristics, such as a population in excess of one billion people, the sustained rise in average living standards, and the unequal distribution of wealth throughout the different social strata and geographic regions in each nation.

The two countries have pursued different industrial policies and economic strategies. China remains principally a command economy at the commanding heights, while industry in India is primarily privately owned (but heavily regulated). Whereas China exports approximately 30% of its domestic product, the comparable figure for India is just below 20%. This in part can be explained by the more democratic nature of Indian society that manifests itself in part by a sizeable domestic market. That is, India's capitalists not only are less dependent on foreign direct investment than their Chinese rivals, they are also more inclined to look locally for their goods.

In addition, the nature of Chinese and Indian exports varies. The World Bank notes that whereas China largely exports finished products, India exports intermediate inputs. Furthermore, China's exports are largely labor-intensive goods, though becoming increasingly sophisticated over time, while India exports reflect a larger share of capital and skill intensive products[58]. Both countries are encountering greater price-competition for labor intensive goods from countries such as Indonesia and Vietnam.

VI. Conclusion

In the last few centuries, European countries have dominated the world economic and political scene. This has not been the case throughout history. Since the formation of states, the principal "economic and political" powers have changed. Rome rose and fell, as have other dominant civilizations.

While factors such as weather, population size, religion, and the manner in which society is organized are important, Daniel Cohen in his *Globalization and Its Enemies* argues that a civilization's ability to innovate and assimilate technology is the most powerful explanation why powers rise and fall.[59]

What does the future hold for China and India? Both are countries with populations of over a billion people. Each civilization at one time seemed extraordinarily advanced compared to the rest of the world. Is either country on a path towards greater economic and political world dominance? Is it either premature or foolish to consider such questions? The degree to which China and India can innovate new technologies, and the degree to which their political systems can accommodate change may prove decisive.

This will in large part depend on how successful both states are in attracting foreign direct investment and then assimilate and make advancements on the technologies they have acquired. It is certainly arguable that political stability and peaceful relations with other states are preconditions for this to occur.

---

[54] *Financial Times*, Investors Chronicle (Special Supplement), *The Rise of India*, March 23, 2007.

[55] Brian Hook, "Time to Focus on Core Functions," *Financial Times*, March 13, 2007, at 3, and Michael Totty, "Technology (A Special Report)—Outside Chance: Why Outsourcing IT Often Doesn't Save as Much as It Could, " *Wall Street Journal*, January 29, 2007, at R7. Jackie Range, "India's Technology Firms Arrive at a Critical Hour—Rising Rupee, Higher Wages, Slowdown in U.S. Economy Put 3-Year Boom to the Test," *Wall Street Journal*, April 13, 2007, at B4; but see Joe Leahy, "India Rejects Uncompetitiveness Claims," *Financial Times*, July 3, 2007, at 24; Joe Leahy, "Unleashed: Why Indian Companies Are Setting Their Sights on Western Rivals, Western IT Consultancies Take the Fight to India IBM and Others Are Cutting Costs by Building Up Their Presence in the Subcontinent," *Financial Times*, June 5, 2007, at 15; and Peter Marsh, "India Set for Big Gain in Electronics Outsourcing," *Financial Times*, May 23, 2007, at 12.

[56] Joe Leahy, "World Is Moving into Synch with Tata's Global Ambitions," *Financial Times*, January 26, 2007, at 2, and *Financial Times*, Investors Chronicle (Special Supplement), *The Rise of India*, March 23, 2007.

[57] Barry Wheelock, "Manufacturing Drives Economic Growth," *India—2005 Country Briefings Limited*, February 9, 2005.

[58] The differing strengths in the two economies offer a rationale [for] why companies should not pursue opportunities in one country to the exclusion of the other. See Anil K. Gupta and Haiyan Wang, "Business Insight (A Special Report)—How to Get China and India Right: Western Companies Need to Become Smarter—and They Need to Do It Quickly," *Wall Street Journal*, April 28, 2007, at R4.

[59] *See* Daniel Cohen, *Globalization and Its Enemies* (2007).

Geographic Limitations

A few countries limit the geographic areas in which foreign investors may conduct business or own land. Argentina, for example, restricts foreign ownership of land and businesses adjacent to its land and ocean frontiers.[60] Chile does not allow foreigners to participate in coastal trade, except for very small vessels.[61] And Indonesia forbids foreigners from owning land.[62] Moreover, some countries forbid foreign investment in their entire territories. This was true of the Soviet Union (the Union of Soviet Socialist Republics) and its allies prior to the mid-1980s.

The right of a state to restrict foreign investment in particular geographic areas is respected by other states as an expression of the state's sovereign authority, as Case 5-2 points out.

CASE 5-2 Brady v. Brown

United States, Ninth Circuit Court of Appeals
Federal Reporter, Third Series, vol. 51, p. 810 (1995)

MAP 5.3

Mexico (1995)

Opinion by Judge Boochever

Facts and Procedure

In 1969, California businessmen William T. Brady ("Brady") and James Cardwell ("Cardwell") decided to acquire coastal land in Mexico. Through Guido Natali ("Natali"), a Mexican attorney, Brady and Cardwell learned that a parcel of more than 3300 hectares [63] with seventeen kilometers of beachfront on the Gulf of California (the "Boca property") was available. Brady and Cardwell retained Fred A. Orleans ("Orleans"), a lawyer licensed to practice in Texas and in Mexico, to help them obtain an interest in the Boca property. Orleans hired Chester Brown ("Brown"), the appellant in this action, to perform services in Mexico in connection with the purchase and development of the land. Brown is a United States citizen, a resident of Mexico, and a United States–trained lawyer licensed to practice in Mexico.

---

[60]*Guide to International Business Practices*, p. 29 (William S. Hein & Co., 1997).

[61]*Id.*, p. 67. Belize forbids foreign commercial fishing inside its barrier reef. *Id.*, p. 40.

[62]*Id.*, p. 398. Thailand restricts the purchase of land by foreigners. *Id.* at p. 469. Tunisia does not allow foreigners to own agricultural land. *Id.* at p. 544.

[63]A *hectare* is a unit of land measure equal to 10,000 square meters, or 2.471 acres. The land eventually transferred amounted to 3,570 hectares.

In early September 1969, Brown advised Orleans that foreigners could not hold an ownership interest in the Boca property. The Boca property was in Mexico's "Forbidden Zone," an area within fifty kilometers of the shore in which the Mexican Constitution prohibited foreigners from acquiring ownership interests. Based on advice from Brown, Orleans wrote Brady and Cardwell proposing the formation of a corporation wholly owned by Mexican citizens to acquire the land:

> It should be kept in mind that legally you can never own shares in the land owning corporation and while there are instances where Mexican citizens have permitted foreigners to use their names to acquire land in the forbidden zone, thus violating the Mexican Constitution, this should not be done. Instead you can obtain better results by associating with bona fide Mexican investors to develop the land and taking their just share in the profits.

Orleans wrote Brown, identifying Brady, Cardwell, and the Mexican participants in the proposed transaction. Brown drew up three agreements, each called "Contract of Association in Participation," sending a draft to Brady on October 24, 1969. In an accompanying letter, Brown advised Brady:

> [I]t would be a serious mistake to attempt to purchase land in the forbidden zone in open defiance of the Mexican Constitution. To use Mexicans who are willing to lend you the use of their names as a subterfuge would merely lay you open to the eventual confiscation of the land if the authorities became aware of the subterfuge . . .
>
> ***
>
> I believe you can accomplish what you want without violating any law whatsoever by resorting to the use of legitimate contractual relations. Your purpose in any case is to promote the use and sale of the land, and possibly its prior development. It is quite common for promoting and developing groups to associate with property owners to develop land and after recovering their costs, to share the profits with the owners.

Brady, Cardwell, and the four Mexican citizens selected by Orleans (three lawyers associated with Orleans, and Natali's wife) signed the agreements on November 3, 1969 (the "November 1969 agreements"). The November 1969 agreements provided that the Mexican citizens would purchase the Boca property with money contributed by Brady and Cardwell, and would eventually sell or lease the land to Mexican corporations that would be formed to hold and develop the property. The agreements also gave Brown irrevocable powers of attorney from the Mexican citizens over future transactions. The four Mexican citizens purchased the entire Boca property shortly thereafter. Later in November, Brown ended his relationship with Orleans and became Brady and Cardwell's lawyer.

In 1972, the Mexican government published new controls forbidding the use of "straw men," Mexican citizens who would hold title to Forbidden Zone property for foreigners. The regulations, which became law in 1973, authorized the Ministry of Foreign Affairs to grant permits to Mexican credit institutions to buy in trust coastal land intended for tourist activities, to be held for the benefit of foreign nationals such as Brady and Cardwell (an arrangement called a "*fideicomiso*").[64] The new law also required the Ministry's authorization before a foreigner could acquire or lease more than 25 percent of the capital, or 49 percent of the assets of a business enterprise.

Brown sent a copy of the regulations to Brady and Cardwell, but did not advise them to create a trust. Although the law as eventually enacted provided that those required to register their investments had 180 days in which to do so, Brown told Brady and Cardwell they could not benefit from such an arrangement. Instead, he counseled Brady and Cardwell that the new regulations prevented them from owning more than 49 percent of any Mexican business or enterprise, and advised them to sign a new Contract of Association in Participation.

Subsequently, through a complex series of transactions, Brown used his power of attorney to orchestrate the transfer of the property to his family and to business entities controlled by his family, all of whom were Mexican citizens. First, on December 15, 1972, Brady and Cardwell signed the new participation contract, which transferred partial ownership of the Boca property to Brown's son, Eric Brown, and Brown's wife, Maria Brown.

---

[64] A *fideicomiso* is a statutory 50-year renewable trust in which a bank serves as trustee.

In early 1973, Maria Brown entered into an agreement with Robert Gooden ("Gooden"), a U.S. citizen, for hotel development on 32 hectares of her Boca property. Gooden formed a California limited partnership, Bahia Ventana Company ("Bahia"), which then formed with Maria Brown a Mexican limited partnership, Cueva del Leon, in which Maria Brown was the general partner with a 51 percent interest, and Bahia was the limited partner with a 49 percent interest. Maria Brown invested no money, and made no decisions regarding the partnership.

In 1975, Brown exercised his power of attorney to transfer to his daughter, Lorna Brown, the remaining interest in the Boca property. The district court found that the Brown defendants paid a total of only $19,200 for the entire Boca property, while Brady and Cardwell eventually invested over $1 million in the purchase and development of the Boca land.

Gooden withdrew from the hotel development project in 1977, and Brady and Cardwell acquired his interest in the project and in Bahia. Later in the year, Dar-Kel Corporation ("Dar-Kel"), a California corporation formed by Brady and Cardwell, signed a contract styled as a non-recourse loan to Maria Brown, transferring funds to Mexico to build the Hotel Las Arenas ("Hotel"). Construction continued from 1977 to 1980.

In 1980, Cueva del Leon became a Mexican corporation, Hotel Las Arenas, S.A.de C.V. (the "Hotel corporation"), with Maria Brown as its majority shareholder. That same year, Maria Brown, as administrator of the Hotel corporation, signed a "Commission Agency Contract" with Dar-Kel, to provide a method for Dar-Kel to receive funds from the Hotel's operation. She also executed a contract related to the loans from Dar-Kel and leased the Hotel to the Hotel corporation. All this was done under Brown's direction, with the ostensible purpose of giving Brady and Cardwell the benefits of ownership without any conflict with Mexican law.

The Hotel opened in 1980. After several years of operation, Brady and Cardwell argued with Brown and Maria Brown regarding ownership and management issues. In 1985, Maria Brown called a shareholders meeting of the Hotel corporation, and claimed control of and title to the Hotel as majority shareholder.

In September 1985, Brady, Cardwell, and Dar-Kel filed suit against Brown, Maria Brown, Eric Brown, Lorna Brown, and Nelly Brown (Eric Brown's wife) alleging . . . state law claims of fraud, conversion, constructive trust, and breach of fiduciary duty. Brown filed a cross-claim against the Hotel Las Arenas corporation, and Maria Brown filed a counterclaim against Brady, Cardwell, and Dar-Kel, alleging . . . fraud.

After an early settlement fell through, the case was eventually tried before the district court from October 5, 1988, to January 17, 1990. The court issued findings of fact and conclusions of law in final form on February 3, 1992. The district court granted summary judgment to Brady and Cardwell on Maria Brown's counterclaim on September 10, 1992. Brown's cross-claim was dismissed on January 31, 1993.[65] Final judgment was entered March 26, 1993. The court found Brown liable for fraud, and found the other Brown defendants were not bona fide purchasers of the Hotel and the Boca property. As a remedy, the district court imposed a constructive trust to avoid unjust enrichment, ordering all the defendants to execute irrevocable powers of attorney to an agent to transfer the Hotel and the Boca property into a Mexican government-approved trust, or "*fideicomiso*," for the benefit of Brady and Cardwell.

Chester Brown appeals from the final judgment as do the other Browns (hereinafter collectively referred to as Brown's family), who also appeal from the district court's grant of summary judgment on their counterclaim.

Discussion

***

II. Comity

Brown argues that Brady and Cardwell's actions, and the court's eventual remedy, violated the Mexican prohibition of the ownership of coastal land by foreigners. Brown's family joins in his argument. Brown asserts that the California law[66] of comity requires the district court to apply

[65]Brown does not appeal the dismissal of his cross-claim.

[66]Brown does not dispute the district court's conclusion that California law applies to the comity issue. We thus apply California law to determine whether comity considerations bar Brady and Cardwell's state law claims.

Mexican law, and therefore to refuse to grant Brady and Cardwell any interest in the property. This court reviews the district court's interpretation of foreign law *de novo*.[67]. . .

The doctrine of comity [according to *Wong v. Tenneco, Inc*.] is based on "respect for the sovereignty of other states or countries," and under it "the forum state will generally apply the substantive law of a foreign sovereign to causes of action which arise there."[68] California courts therefore defer to Mexico's laws prohibiting foreign ownership or control of Mexican land.

At the time that Brady and Cardwell entered into the November 1969 agreements drafted by Brown, Article 27, Section I of the Mexican Constitution provided: "Under no circumstances may foreigners acquire direct ownership of lands or waters within a zone of . . . fifty kilometers along the shores of the country." Acts done and contracts made in violation of the prohibition were absolutely void. Later legislation continued to limit foreign investment. . . .[69]

California courts have deferred to Mexican law and declined to enforce California citizens' claims of ownership of Mexican property and businesses in violation of Mexican law. In *Stockton v. Ortiz*,[70] a California businessman created two Mexican corporations to take title to coastal property in Mexico, and operated a motel business on the property. When the business suffered adversity, Stockton sued to recover his investment. Because he was not listed anywhere as having a legal interest in the corporations that owned the property, the California Court of Appeal held that he had no derivative cause of action. It also held that the attempt to acquire the land through the corporations was illegal and void under the Mexican Constitution and laws in effect before 1973. While citing the principle of comity as justification for denying any relief and for "leav[ing] the parties where we found them," the court noted: "This does not mean that a person innocently defrauded into believing he can own or lease certain Mexican land cannot seek redress in California courts. Each case must be decided on its own facts."

Also citing comity considerations, the California Supreme Court in *Wong* denied recovery to a California grower who lost his illegal farming operation in Mexico. Wong used Mexican citizens as front men to lease farmlands and hold title in and run his produce farming operation in Mexico, an arrangement Wong knew violated Mexican law. Wong's marketing agreement with

---

[67]From Latin: "from new" or "from the beginning." A *de novo* review is a completely new review conducted by the appellate court as if it were the trial court.

[68]*California Reporter*, vol. 216, p. 412 at p. 417 (California Supreme Ct., 1985).

[69]The 1973 "Law to Promote Mexican Investment and to Regulate Foreign Investment" provides:

ARTICLE 5 . . . In cases where legal provisions or regulations do not specify a given percentage, foreign investment may hold up to 49 percent of the capital of business enterprises provided it is not empowered, by any title, to control the management of the business enterprise . . .

ARTICLE 7. Foreigners, foreign companies, and Mexican companies without an exclusion of foreigners clause may not acquire direct dominion (title) over land and water in a 100-kilometer strip along the country's borders or in a 50-kilometer strip inland from its coast.

Foreign companies may not acquire dominion over land and water or obtain concessions for water exploitation.

Foreign individuals may acquire dominion over the properties to which the preceding paragraph refers by permission from the Ministry of Foreign Affairs and after signing the agreement to which Section 1, Paragraph 4, of Article 27 of the Political Constitution of the United Mexican States refers.

ARTICLE 8. Authorization by the corresponding Ministry, according to the economic activity involved, shall be required where one or more of the individuals or companies to which Article 2 refers, in one or several actions, or a succession of actions, acquires or acquire more than 25 percent of the capital, or over 49 percent of the fixed assets of a business enterprise. The leasing of a business enterprise or of essential assets required for its functioning shall be considered equivalent to the acquisition of assets.

Also requiring authorization are actions by which the administration of a business enterprise is acquired by foreign investors, or by which foreign investment is empowered, by any title, to control the management of the business enterprise. The authorization to which this Article refers shall be granted when it is considered in the interest of the country, pursuant to ruling by the National Commission of Foreign Investment.

Actions undertaken without such authorization shall be null and void . . .

ARTICLE 18. In accordance with Section 1, Article 27, of the Political Constitution of the United Mexican States and its Organic Law, the Ministry of Foreign Affairs is hereby empowered to decide, in each case, the advisability of granting credit institutions the authorization to acquire in trust the title to real estate intended for industrial and tourist activities, within a strip of 100 kilometers wide along Mexico's borders and 50 kilometers wide inland from its coasts, provided that the purpose of the acquisition is to permit the use of such real estate by the trust beneficiaries without thereby creating ownership rights over it. For this purpose the trustee may issue nominal, nonamortizable participation certificates.

National Commission for Foreign Investment, *Foreign Investment: Legal Framework and Its Application* (1986).

[70]*California Appellate Reports, Third Series*, vol. 47, p. 183 (California Ct. of Appeal, 1975).

a produce broker soured when the broker bypassed Wong to remit the sales proceeds directly to the Mexican growers, treating them as the true owners of the farming operation. After a jury verdict for Wong in his action for breach of contract against the produce broker, the trial judge barred Wong from recovery because the entire arrangement was illegal under Mexican law.

The California Supreme Court affirmed, holding that "[t]he trial court properly declined to involve our courts in this flagrant effort to circumvent Mexican law."[71] Comity teaches that a contract . . . made with a view of violating the law of another country, though not otherwise obnoxious to the law . . . of the forum . . . will not be enforced"[72] and Wong's violation of Mexican law rendered all his transactions related to the Mexican operation illegal. As in Stockton, the court left the parties where it found them.

Brown argues that because Brady and Cardwell attempted to acquire ownership interests in violation of Mexican law, all of their actions were null and void, and the district court should have followed *Wong* and *Stockton* to leave the parties where they were (in this case, apparently with Brown's family holding title to the Boca land, and the controlling interests in the Hotel and the Hotel corporation). Brady and Cardwell sought to avoid the application of *Wong* and *Stockton* on several grounds. First, they sued for fraud, not for breach of contract. Second, they argue that the relief ordered does not offend comity, as Mexican law authorizes such trust arrangements.

A. Fraud Brady and Cardwell distinguish their fraud action from *Wong* and *Stockton*, in which the plaintiffs attempted to enforce contracts that were illegal under Mexican law. They point out that the California courts did not bar recovery for fraud in either case: in *Wong* the plaintiff made no fraud claim similar to Brady and Cardwell's,[73] and the *Stockton* court considered the plaintiff's fraud allegation and found it without merit, because Stockton knew of the legal problems with holding title to Mexican lands. They point out that Stockton suggested the possibility that an innocent party could maintain a fraud action.

We find that this argument has merit. *Stockton* expressly reserves judgment on whether an innocent party could maintain a suit for fraud, stating that "[e]ach case must be decided on its own facts."[74] *Wong* leaves open the question whether comity would bar an action for fraud, emphasizing that in Wong's case his "purposeful violation of Mexican law is clear" because Wong, far from attempting to comply with the law, "concocted an elaborate scheme" to deceive the Mexican authorities.[75] The court found that Wong entered into the marketing contract "with full knowledge that the farming operations upon which the agreement depended were being carried out in violation of Mexican law."[76]

In this case, Brady and Cardwell do not allege that Brown breached any of the contracts related to the Boca property, and the district court did not find that those contracts were illegal under Mexican law. Instead, the fraud claimed by Brady and Cardwell and found by the district court is that Brown advised Brady and Cardwell to sign the 1969 agreement, assuring them that it was entirely legal; three years later, when the new Mexican foreign investment law was published, he misrepresented to them that they could not profit from a trust arrangement under the new Mexican law; and instead of suggesting such a trust, Brown manipulated the subsequent agreements to transfer all the rights in the property to him and his family and to the detriment of Brady and Cardwell, claiming throughout that he was doing so to comply with Mexican law.

On the facts as found by the district court, the doctrine of comity does not require us to apply Mexican law to bar Brady and Cardwell from recovering on their fraud claim.

B. The Nature of the Relief Brown and the other defendants argue that the relief ordered by the district court violates Mexican law, because the district court attempted to give Brady and

[71] *California Reporter*, vol. 216, p. 412 at p. 417. The court also noted that although the 1973 Law to Promote Mexican Investment and to Regulate Foreign Investment was not in effect when Wong began operation, he could have complied with the law by registering during the 180-day grace period provided for in the transitional rules. *California Reporter*, vol. 216, p. at p. 415 n. 2.

[72] *Id*. at p. 418.

[73] Wong's contract suit was against the produce broker who had bypassed him to deal directly with the Mexican citizens holding title to the farmland; he did not name the Mexican citizens themselves.

[74] *California Reporter*, vol. 120 at p. 465 n. 5.

[75] *Id*., vol. 216 at p. 418.

[76] *Id*. at p. 417.

Cardwell "all of the attributes of ownership of the Boca land." The court did not do so. Instead, it ordered Brown to execute a power of attorney so that the defendants' interest in the land and the Hotel could be transferred into a trust with a bank approved by the Mexican government for the benefit of Brady and Cardwell.

The remedy devised by the district court is essentially a "*fideicomiso*," authorized by Article 18 of the 1973 foreign investment law. Brown's statement to Brady and Cardwell that they could not benefit from such a trust is a basis of the district court's finding of fraud. Such an arrangement, if it can be accomplished, does not violate Mexican law.

Moreover, the district court retained jurisdiction to consider alternative remedies if the trust could not be established under Mexican law. We find that the district court's judgment did not violate Mexican law.

C. The Brown Defendants Other Than Chester Brown Brown's family claims that because the district court found that only Chester Brown was liable on the fraud claim, *Wong* and *Stockton* bar the action against his family, because the contracts were illegal under Mexican law. The district court, however, did not find that the various contracts were illegal. Rather, the court granted Brady and Cardwell relief against Brown's family on the basis of unjust enrichment. The court's finding of unjust enrichment is affirmed in the memorandum disposition filed concurrently with this opinion.

Wong and *Stockton* do not bar the action against Brown's family.

Conclusion

The district court properly exercised pendent jurisdiction over Brady and Cardwell's state law claims. *Wong* and *Stockton* do not bar Brady and Cardwell from recovering against Brown and his family. We AFFIRM the district court's judgment after trial in favor of Brady and Cardwell and its grant of summary judgment against Maria Brown on her counterclaim.

Casepoint

Comity is based on respect for the sovereignty of other countries. It requires the forum state to apply the substantive law of a foreign country to resolve disputes that arise there. As for contracts, if a contract is entered into with the purpose of violating another country's law, it will not be enforced. The parties will be left where they stand. However, if an innocent party was induced to enter into such a contract by fraud, comity does not prevent the forum state court from granting appropriate relief.

Free Zones

free zones
Geographical areas wherein goods may be imported and exported free from customs tariffs and in which a variety of trade-related activities may be carried on.

Virtually all states encourage multinational enterprises to invest in their economies by setting up **free zones**[77]—that is, geographical areas wherein goods may be imported and exported free from customs tariffs and in which a variety of trade-related activities may be carried on (from simple storage to manufacturing and retailing). One writer has described the free zone as

> a neutral, stockaded area which offers trade-related services and exemptions from laws for the specific purposes of attracting direct foreign investment, encouraging exports, or promoting trade in general. The zone is authorized by the law of the country where the

[77]In 1967, the United Nations Economic and Social Council (ECOSOC) adopted a resolution encouraging the use of free zones in developing countries as a tool for promoting exports (Resolution of August 4, 1967, United Nations Economic and Social Council Plenary Session No. 1056). In 1970, the United Nations Industrial Development Organization also made the same recommendation. UNIDO, *Free Trade Zones Around the World and Their Use for Export-Oriented Industrial Operations*, UN Document 1D/WG.112/26 (1972).

More recently, the use of free zones has been criticized. Alex Rubner, *The Export Cult: A Global Display of Economic Distortions*, p. 165 (1987), writes: "Free Trade Zones . . . are very much in vogue because they enable governments to flout the spirit of GATT by bestowing distinctive favors on exporters. . . . [T]he FTZ is also a useful device to assuage the nationalist and/or socialist susceptibilities of politicians. By creating a ghetto, in which manufacturers produce either exclusively or predominantly for export, a country puts up with 'obnoxious' corporate practices that would sully the politicians' social conscience if carried on outside the ghetto."

zone is to be located and can [be] either privately or publicly owned. The users of the zone generally pay rent for their usage of space and services.[78]

These zones can be categorized by their geographical size and by the kinds of activities that may be carried on within them.[79]

For more information about free trade zones, see www.foreign-trade-zone.com.

Free Zones Categorized by Size Free zones vary greatly in size, from large multistate regions to small subzones located in a single building. The largest are called **free trade areas (FTAs)** and are made up of two or more states that have agreed to let some or all of each other's enterprises carry on their trades across and within each state's borders free from customs tariffs and other restrictions. For example, both NAFTA and the European Community Treaty establish FTAs.[80]

free trade areas (FTAs)
Geographical areas made up of two or more states that have agreed to let some or all of each other's enterprises carry on their trades across and within each state's borders free from customs tariffs and other restrictions.

A state may provide for its entire territory to open up some or all of its economic sectors to international trade. An example is Singapore.[81] Similarly, it may open certain regions. Examples are China's special economic zones[82] and the free perimeters (*perímetros libres*) found along the international borders of some Latin American countries.[83]

The oldest type of free zone is the **free city** (or *free port*), in which a port city is opened to international trade. Historical examples include Hamburg, which was granted a city charter in 1189 by Frederick I, emperor of the Holy Roman Empire, exempting it from collecting customs duties from merchant ships operating on the lower Elbe River, and the free cities of Bremen, Copenhagen, Genoa, Leghorn, and Trieste.[84] A more modern example is Hong Kong,[85] at least until the handover of Hong Kong by Britain to the PRC.

free city
An entire port city that has been opened to international trade.

The **free trade zone** (or *foreign trade zone* [*FTZ*], as it is known in the United States) is the modern variant of the free city. Rather than granting free trade status to an entire city, states instead designate smaller areas, usually within or near port cities,[86] as free trade zones. In the United States, for example, there are now more than 180 FTZs.[87] In addition to FTZs, some states also create special-purpose **subzones** associated with, but physically apart from, those zones to accommodate limited-purpose trading activities (such as a single manufacturing plant). To illustrate, the United States had 256 subzones in 2005.[88]

free trade zone
A free zone located within or near a port city.

subzone
A special-purpose free zone associated with, but physically apart from, a free trade zone, in which limited-purpose trading activities are carried on.

In Case 5-3, the question arose as to whether goods imported into a U.S. subzone would be subject to customs duties.

[78] Bettwy, "Mexico's Development: Foreign Trade Zones and Direct Foreign Investment," *Comparative Juridical Review,* vol. 22, p. 49 at pp. 54–55 (1985).

[79] The terms used to describe the various types of free zones are not consistently applied in the literature or from country to country. The terms used here were chosen because they seem to be most commonly used and/or to best describe the particular zone.

[80] The EU, a common market, is both an FTA (in which goods, services, and labor move freely among its 15 member states) and a customs union (in that the EU applies a common external tariff for all member states). See Chapter 7.

[81] Walter H. Diamond and Dorothy B. Diamond, *Tax-Free Trade Zones of the World*, p. xi (1987).

[82] See Sonoko Nishitateno, "China's Special Economic Zones: Experimental Units for Economic Reform," *International and Comparative Law Quarterly*, vol. 32, p. 175 (1983).

[83] Mexico, for example, has a free perimeter some 20 kilometers wide that parallels its international borders with the United States, Guatemala, and Belize. Michael J. Tucker, "Foreign Trade Zones in Latin America: A Spectrum of Possible Uses," *Texas International Law Journal*, vol. 23, p. 117 at p. 118 (1988). The southern extremity of Argentina is also a free perimeter. *Id*.

[84] Most of the free cities of Europe lost their free trading privileges before 1900, and all lost them prior to World War II. Alfred L. Lomax, *The Foreign-Trade Zone*, pp. 8–9 (1947).

[85] Walter H. Diamond and Dorothy B. Diamond, *Tax-Free Trade Zones of the World*, p. xi (1987).

[86] In the United States, FTZs must be within 60 miles or 90 minutes' driving time of a port of entry. Regulations of the Foreign-Trade Zones Board, *Code of Federal Regulation*, Title 15, §400. 21(b)(2)(i). http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?sid=65027985a35c6134f6e25312a5838831&c=ecfr&tpl=/ecfrbrowse/Title15/15tab_02.tpl.

[87] A list of U.S. FTZs can be found in Helen K. Bonk, *Foreign Trade Zones and Subzones: Their Uses and Effects for U.S. Manufacturers*, App. A, pp. 203–225 (1992).

[88] See http://ia.ita.doc.gov/ftzpage/annualreport/textar-05.html.

CASE 5-3 Nissan Motor Mfg. Corp., U.S.A. v. United States

United States Court of Appeals, Federal Circuit, 1989
Federal Reporter, Second Series, vol. 884, p. 1375 (Federal Circuit Ct. of Appeals, 1989)

MAP 5.4

Tennessee (1989)

Opinion by Judge Archer

Nissan Motor Mfg. Corp., U.S.A. (Nissan) appeals from the summary judgment of the United States Court of International Trade holding that machinery imported by Nissan from Japan into a foreign trade zone subzone for use in the production of motor vehicles is subject to duty as prescribed by the United States Customs laws.[89] We affirm.

Background

The Foreign Trade Zones Act[90] authorizes the establishment of foreign trade zones within the United States. The Act is administered by a Board which has authority "to grant to corporations[91] the privilege of establishing, operating, and maintaining foreign trade zones in or adjacent to ports of entry under the jurisdiction of the United States.[92] "Merchandise" may be brought into a foreign trade zone for the purposes set forth in the statute "without being subject to the customs laws of the United States."[93]

According to the trial court:

> In 1952, the Board promulgated regulations pursuant to *United States Code*, title 19, §81h to authorize "zones for specialized purposes" or "subzones" in areas separate from existing free trade zones "for one or more of the specialized purposes of storing, manipulating, manufacturing, or exhibiting goods" when the Board finds that existing or authorized zones will not serve adequately the convenience of commerce with respect to the proposed purposes.[94] In contrast to general purpose zones where a municipal corporation leases a portion of the zone to firms that subsequently locate within that zone, subzones are generally used by a single firm.[95]

A foreign trade zone subzone was established at Nissan's motor vehicle manufacturing and assembly plant in Smyrna, Tennessee. Nissan imported production machinery for use in the subzone which consisted of a highly automated, integrated system of industrial robots, automated

[89]Nissan Motor Mfg.Corp., *U.S.A. v. United States*, *Federal Supplement*, vol. 693, p. 1183 (Ct. of Int'l Trade, 1988).

[90]*United States Code*, Title 19, §§81a–81u (1982).

[91]"Public" and "private" as defined in the Act, *id.*, §81a.

[92]*Id.*, §81b(a).

[93]*Id.*, §81c (1982).

[94]*Federal Register*, vol. 17, §5316 (June 11, 1952), now codified without amendment at *Code of Federal Regulations*, vol. 15, §400.304 (1988).

[95]*Federal Supplement*, vol. 693 at p. 1185.

conveyor and stamping systems, and a complex computerized interface. Nissan requested a ruling from the United States Customs Service[96] regarding its obligation for duties. Nissan noted that it was uncertain whether the proposed final configuration of the machinery would be capable of full-scale production of motor vehicles and that the machinery needed to be assembled, installed and tested. Nissan stated that based on these tests some or all of the machinery might be returned to the foreign manufacturers, replaced, redesigned, or scrapped.

Customs decided, based on these facts, that production equipment imported into Nissan's subzone was not "merchandise" for purposes of the Foreign Trade Zones Act and was therefore dutiable. Customs deferred assessment of duties, however, until the machinery was completely installed and tested in full-scale production of motor vehicles in the subzone.[97]

After installation and testing, Customs required that formal duty-paid entries be made even though the equipment was to remain in the subzone. The production equipment was valued at approximately $116,314,883 with over $3,000,000 in assessed duties. Nissan entered the merchandise as required by Customs and, upon liquidation, filed a protest. The protest was denied and Nissan commenced this proceeding. The Court of International Trade held that "[b]ased on the language of the Foreign Trade Zones Act, as amended, and the relevant legislative history . . . [Nissan's] production machinery and related capital equipment are dutiable."[98] Congress authorized the creation of foreign trade zones in the Foreign Trade Zones Act of 1934.[99] In 1950, section 3 of the Act was amended to provide:

> Foreign and domestic *merchandise of every description*, except such as is prohibited by law, may, without being subject to the customs laws of the United States, except as otherwise provided in this chapter, be brought into a zone and *may be stored, sold, exhibited, broken up, repacked, assembled, distributed, sorted, graded, cleaned, mixed with foreign or domestic merchandise, or otherwise manipulated, or be manufactured* except as otherwise provided in this chapter, and be exported, destroyed, or sent into customs territory of the United States therefrom, in the original package or otherwise; but when foreign merchandise is so sent from a zone into customs territory of the United States it shall be subject to the laws and regulations of the United States affecting imported merchandise.[100] . . .

Nissan contends that the trial court erred in concluding that Customs could properly impose a duty on the equipment, because a foreign trade zone is considered to be outside the Customs territory of the United States. It argues that merchandise entered into a zone becomes subject to duty only if the merchandise is thereafter sent "into the customs territory of the United States."

The government urges that the Foreign Trade Zone Act does not authorize the use of a foreign trade zone to avoid or defer payment of duties on production equipment installed, used and consumed in the foreign trade zone. Such equipment, according to the government, is not "merchandise" within the meaning of the Act and the installation and use of the equipment are not covered by the activities enumerated in the Act.

The Court of International Trade rejected Nissan's position and held that "imports . . . used or intended to be used to produce motor vehicles" are not within the activities enumerated in *United States Code*, title 19, §81c (1982).[101] Applying a general rule of statutory construction that the expression of one thing is the exclusion of the alternative, *expressio unius est exclusio alterius*, the court stated that "[n]one of the activities that Congress identified in its comprehensive list permit [sic] installation or operation of production equipment without payment of duties."[102] The court also pointed to the legislative history of the 1950 amendment,[103] which stated that "[t]he amended proviso would not authorize consumption of merchandise in a zone . . ."

---

[96]Under *Code of Federal Regulations*, vol. 19, §177.1(a)(1) (1988).

[97]Customs Service Decision 82–103, *Customs Bulletin & Decisions*, vol. 16, p. 869 at p. 870 (March 4, 1982).

[98]*Federal Supplement*, vol. 693 at p. 1189.

[99]Public Law No. 566, *Statutes at Large*, vol. 64, p. 249 (1950) (codified as amended at *United States Code*, Title 19, §81c (1982)).

[100]*Id*. (emphasis added).

[101]*Federal Supplement*, vol. 693 at p. 1186.

[102]*Id*.

[103]Senate Report No. 1107, 81st Congress, 2d Session, reprinted in *United States Code, Congressional and Administrative News*, vol. 1950, p. 2533 at pp. 2535–2536 (1950).

Nissan's reading of the Act to mean that duties cannot be imposed on any article brought into a foreign trade zone unless or until it is sent into the Customs territory of the United States is overbroad. The Court of International Trade was correct in our view in determining that Congress signaled its intention to make the imposition of immediate duties dependent on the operations that occur in a foreign trade zone when it listed the activities that could be performed on merchandise brought into a zone. The fact that a comprehensive listing is set forth in the statute indicates that Congress did not intend a blanket exclusion from Customs duties irrespective of what is done with the imported merchandise.

The activities performed by Nissan in the foreign trade zone subzone with the imported equipment are not among those permitted by a plain reading of the statute. Section 81c provides that merchandise brought into a foreign trade zone may be "stored, sold, exhibited, broken up, repacked, assembled, distributed, sorted, graded, cleaned, mixed with foreign or domestic merchandise, or otherwise manipulated, or be manufactured . . . "[104] The Act does not say that imported equipment may be "installed," "used," "operated" or "consumed" in the zone, which are the kinds of operations Nissan performs in the zone with the subject equipment. Alternative operations of a different character should not be implied when Congress has made so exhaustive a list.[105]

. . . The Customs Service, in a decision relating to other production machinery from Japan, has similarly ruled that "the list [of activities] does not permit an article to be brought into a zone, free of duty, to be used as production equipment to make other articles."[106]

Nissan relies upon the case of *Hawaiian Independent Refinery v. United States*[107] in support of its position. The merchandise there involved was crude oil which was entered into a foreign trade zone for manufacture into fuel oil products. This, of course, is an activity delineated by the Act and entry into the zone was exempted from Customs duties. Thereafter, a portion of the crude oil was consumed in the manufacturing process and Customs assessed duty on the theory that there had been a "constructive" entry into the Customs territory of the United States. In holding that the assessment was improper, the Court of International Trade did not have to deal with the question at issue here of whether the initial entry into the zone was exempt. Clearly, in that case the crude oil was exempt at the time of entry. Thus, the Court of International Trade properly concluded that the *Hawaiian Independent Refinery Case* was not dispositive of this case.

We are convinced that the Court of International Trade correctly determined that the importation by Nissan of the machinery and capital equipment at issue into the foreign trade zone subzone was not for the purpose of being manipulated in one of the ways prescribed by the statute. Instead it was to be used (consumed) in the subzone for the production of motor vehicles. Under the plain language of the 1950 amendment to the Act and the legislative history of that amendment, and Customs' published decision interpreting the Act as amended, such a use does not entitle the equipment to exemption from Customs duties. Accordingly, the judgment of the Court of International Trade is affirmed.

Casepoint

The import of production equipment into an FTZ subzone is dutiable. U.S. law provides that goods may be brought into an FTZ subzone without the payment of customs duties for the purpose of being "stored, sold, exhibited, broken up, repacked, assembled, distributed, sorted, graded, cleaned, mixed with foreign or domestic merchandise, or otherwise manipulated, or . . . manufactured." It does not say that imported equipment may be "installed," "used," "operated," or "consumed" in the zone, which are the kinds of operations Nissan performs in the zone with its production equipment. To infer this from the law (which contains an exhaustive list of activities that may be done without making the goods subject to customs tariffs) is unreasonable.

[104] *United States Code*, Title 19, §81c.

[105] See *United States v. Douglas Aircraft Co., Federal Reporter, Second Series*, vol. 510, p. 1387 at p. 1392 (Ct. of Customs and Patent Appeals, 1975).

[106] See Customs Service Decision 79–418, *Customs Bulletin & Decisions*, vol. 13, p. 1627 at pp. 1629–1630 (May 24, 1979). See also Senate Report No. 308, 98th Congress, 2d Session, pp. 35–36, reprinted in *United States Code, Congressional and Administrative News*, vol. 1984, p. 4910 at pp. 4944–4945, which, in discussing the 1984 amendments to the Foreign Trade Act, described the "current law" as providing that the "exemption does not apply to machinery and equipment that is imported for use (for manufacturing or the like) within a foreign trade zone."

[107] *Federal Supplement*, vol. 460, p. 1249 (Customs Ct., 1978).

Free Zones Categorized by Activities The range of activities that can take place within a free zone includes storage, distribution, manufacturing, and retailing; however, not all zones permit all of these activities. What is allowed varies both according to the state in which the zones are located and according to the type of zones. Typically, the full range of these activities is allowed in a free trade zone, as, for example, in U.S. FTZs.[108] Examples of zones with a more limited range of activities are export processing zones and free retail zones.

Export processing zones (EPZs) are free zones in which manufacturing facilities process raw materials, or assemble parts imported from abroad and then export the finished product. For customs purposes, the materials and parts are treated as if they never entered the host country at all. Thus, no tariffs or other duties are paid either when they are imported or when they are exported.[109]

EPZs have proven to be popular in developing states because they are specifically designed to encourage foreign multinational enterprises to employ local workers and, at least in some states, to take on local joint venturers.[110] An important example of the successful use of export processing zones is Mexico's *maquiladora* program. A *maquiladora*[111] is a Mexican business entity—usually organized as a wholly owned subsidiary of a foreign multinational enterprise—that assembles, refines, or finishes goods imported from abroad and then exports all of its production (see Figure 5.3). The major advantage for the parent multinational is that it can use inexpensive Mexican labor to assemble its products without having to pay Mexican tariffs. For Mexico, the *maquiladora* program has led to the creation of many new jobs.[112] **Free retail zones** (or *duty-free zones*) are found in international airports and harbors and near some border crossings. They cater to tourists and other travelers who are leaving a country by offering them goods free of local sales and excise taxes. These zones are usually of little economic significance in industrial countries, but they are often an important source of income in countries that depend on tourism, especially in the Caribbean.

export processing zones (EPZs)
Free zones in which manufacturing facilities are allowed to process foreign goods and materials for export without paying tariffs or duties either when the goods or materials are imported or when they are exported.

free retail zones
Areas in international airports and harbors where travelers can buy goods free of local sales and excise taxes.

FIGURE 5.3

Production Floor at the Flextronics *Maquiladora* in Guadalajara, Jalisco, Mexico

Source: Keith Dannemiller/ Alamy

[108]United States Foreign Trade Zones Act of June 18, 1934 , *Statutes at Large*, vol. 48, pp. 998–1003, *United States Code*, Title 19, §§81a–81u, and available online at www.ia.ita.doc.gov/ftzpage/ftzact.htm.

Retail trade is allowed only by special permit, and it may involve only domestic or duty-paid or duty-free merchandise that entered the zone from a U.S. Customs territory. *Id*., at §81o(d).

[109]Antoine Basile and Dimitri Germidis, *Investing in Free Export Processing Zones*, p. 20 (1984).

[110]*Id*. at p. 22.

Some states that had required joint venture participation have modified their rules and now allow wholly owned foreign subsidiaries to operate within their zones. For example, the Emirate of Dubai, part of the United Arab Emirates, which created the Jebel Ali Free Zone in 1985 to encourage international trade and the use of the Jebel Ali Port, authorized the establishment of wholly owned foreign subsidiaries within the zone as of 1992. Dubai was the first Persian Gulf nation to do so. Hassen A. Ferris and Joe M. Hawbaker, "100% Foreign Ownership Allowed in Jebel Ali," *Middle East Executive Reports*, vol. 15, no. 11, p. 9 (November 1992).

[111]From Spanish *maquila:* the charge collected by millers in Colonial Mexico for processing grain. *Maquiladora* is used today as a generic term for those firms that "process" (assemble and/or transform in some way) components imported into Mexico and then reexported.

[112]As of 2001, on average, some 2,834 *maquiladora* plants employed more than 992,877 workers. Instituto Nacional de Estadística, Geografía e Informática, Indicadores de la industria maquiladora: Establecimientos y empleo para estados y municipios fronterizos (2002), posted on the Network of Border Economics/Red de la Economía Fronteriza Web site at www.nobe-ref.org/pdf/Projects/NAFTAStudy.pdf.

bonded warehouse
A facility at a port of entry where shippers can store goods until they clear customs.

Analogous to free zones, but somewhat different, are **bonded warehouses.**[113] These facilities are found at the ports of entry of most countries. Privately owned and operated by transportation firms, they provide a place where shippers can store goods from the time of their arrival from overseas to the time they clear customs and are taken away by importers. They are not intended to be places for trade or business, but address a problem that customs authorities would otherwise have if they had to provide storage and access to foreign goods while they were being processed for entry into the country. An importer who uses a bonded warehouse cannot avoid tariffs, quotas, or any other form of regulation. Customs forms have to be filled out when goods enter the warehouse and when they leave, and the goods are maintained under guard while they are there. Goods can be stored only for a limited time, and permission from the customs authorities has to be obtained before they can be cleaned, packaged, sorted, labeled, repaired, or destroyed. No manufacturing activities are allowed inside bonded warehouses.[114]

Foreign Investment Guarantees

Host countries provide a variety of guarantees to foreign investors to make investment in their territories more attractive. The most important guarantees relate to the following:[115]

- Compensation in the event of nationalization of a foreign-owned enterprise and repatriation of the payments made
- Repatriation of the proceeds upon the sale of the enterprise
- Repatriation of profits and dividends
- Repatriation of other forms of current income (such as royalties, licensing fees, and fees for managerial and other services)
- Repatriation of the principal and interest from loans
- Nondiscriminatory treatment
- Stabilization of taxes and other regulations
- Convertibility of local currency

Guarantees are granted either (1) automatically when an investment application is *approved* or *certified* by the appropriate host state agency or (2) on an *ad hoc* basis.

Particular guarantees are found in the constitutions, legislation, policy statements, and legal and administrative practices of countries.[116]

nationalization
Acquisition by a state of property previously held by private persons or companies, usually in exchange for some consideration.

expropriation
Depriving a person or company of private property without compensation.

Constitutional provisions most commonly deal with the compensation due foreign investors in the event of **nationalization** or **expropriation.** These describe how property is to be taken and, sometimes, how it is to be paid for. India's constitution provides only that no person shall be deprived of his property except by the authority of law. The German constitution requires that a taking be in the public interest and pursuant to the law. Mexico's constitution says that private property cannot be expropriated except for public use and upon payment of compensation. The constitutions of Argentina, Iraq, Malaysia, the Philippines, the Sudan, and Yugoslavia all say that a taking must be in the public interest, by means of a law or procedures established by law, and that "fair," "just," or "adequate" compensation must be provided. Kenya's constitution states that a taking has to be in the public interest and be such as to afford "reasonable justification for the hardship caused to the owner," and also that compensation must be "prompt" and "full" and able to be remitted freely within a reasonable period. Both Ghana and Kenya add specific guarantees assuring access to their countries' highest courts for anyone whose interests are affected.[117]

---

[113]www.cbp.gov/linkhandler/cgov/newsroom/publications/trade/bond_warehouses.ctt/bonded_20wh2.pdf.

[114]Helen K. Bonk, *Foreign Trade Zones and Subzones: Their Uses and Effects for U.S. Manufacturers*, p. 14 (1992).

[115]Center on Transnational Corporations, *National Legislation and Regulations Relating to Transnational Corporations*, pp. 48, 50 (UN Doc. ST/CTC/26, UN Sales No. E. 83. II. A. 7, 1983).

[116]Foreign investment guarantees are also granted through bilateral investment-protection agreements. Generally, these give foreign investors protection or guarantees with respect to (a) nationalization and compensation, (b) repatriation and transfer of funds, (c) national treatment, (d) most-favored-nation treatment, (e) subrogation, and (f) dispute settlement. Center on Transnational Corporations, *National Legislation and Regulations Relating to Transnational Corporations*, p. 51 (UN Doc. ST/CTC/26, UN Sales No. E. 83. II. A. 7, 1983). Also, with the adoption of the General Agreement on Trade in Services (GATS), many of these agreements are incorporated in the Schedules of Commitments that WTO member states have annexed to GATS. See Chapter 8.

[117]*Id*., p. 48.

The guarantees found in legislation—especially in foreign investment laws—tend to be both more detailed and more extensive than those found in constitutions. The procedures to be followed in the event of nationalization, for instance, are more detailed. Russia's Federal Law on Foreign Investment provides that foreign investors will be fairly compensated for property that is nationalized and that disputes with investors will be resolved as provided for by international treaties or Russian law.[118] Indonesia's Foreign Capital Investment Law provides that compensation should be mutually agreed upon in accordance with international law and that any disagreements shall be resolved by binding arbitration. Ghana's Capital Investment Decree directs that disputes about compensation are to be referred to an arbitrator appointed by the parties or, should they be unable to agree upon an arbitrator, then to arbitration held under the auspices of the ICSID.

Foreign investment laws also deal with guarantees that are not always found in constitutions, especially repatriation guarantees, assurances of nondiscrimination, and stability clauses.

The most common **repatriation guarantees** relate to the right of foreign investors to remit profits and investment capital to their home country in the event of the partial or complete termination of their enterprise.[119] Less common are guarantees relating to the repatriation of other kinds of current income (such as royalties, licensing fees, and fees for managerial and other services) and to the remittance of the principal and interest from loans.[120]

repatriation guarantee
The assurance of a host state government that foreign investors will be able to take out of the state both the investment capital they brought in and the profits they earned.

In many countries, monetary remittances abroad are subject to a variety of qualifications. Some of the more common are as follows:

1. Transfers may be limited or forbidden in case of very tight foreign exchange situations.
2. The transfer of capital may be restricted for a certain period after an investment is made.[121]
3. Transfers of profits and dividends or other forms of income will be subjected to the requirement of paying taxes and complying with auditing requirements.[122]
4. The transfer of proceeds from the sale or liquidation of an investment may require governmental approval.

Nondiscrimination guarantees are found in many investment laws, as well as in the constitutions of several countries, especially in Latin America. The constitutional provisions generally are guarantees that foreign investors will be treated in the same manner as national investors. The statutory provisions often specify that equality of treatment relates to ownership rights, taxation, and, sometimes, social matters.[123]

nondiscrimination guarantee
The assurance of a host government that foreign investors will be treated the same way as local investors.

[118]Federal Law on Foreign Investment in the Russian Federation of July 2, 1999, arts. 8 and 10; English translation in *International Legal Materials*, vol. 39, p. 894 (2000) and online at http://en.fas.gov.ru/legislation/legislation_50727.html.

[119]See Federal Law on Foreign Investment in the Russian Federation of July 2, 1999, art. 11; English translation in *International Legal Materials*, vol. 39, p. 894 (2000) and online at http://en.fas.gov.ru/legislation/legislation_50727.html.

[120]Center on Transnational Corporations, *National Legislation and Regulations Relating to Transnational Corporations*, pp. 49, 50 (UN Doc. ST/CTC/26, UN Sales No. E. 83. II. A. 7, 1983). Sometimes host countries will underwrite foreign loans; that is, they will guarantee the repayment of foreign loans and interest. Algeria, Brazil, Ghana, Kenya, Saudi Arabia, and the Sudan have such a guarantee in their investment promotion laws. *Id*., p. 50.

[121]The Chilean Foreign Investment Statute of 1977 does not allow capital to be transferred abroad until three years after it is first brought into the country. Net income, however, can be remitted at any time. *Id*., p. 49.

[122]*Id*., p. 49. Algeria's investment laws state that the investors' share in distributed profits that can be transferred abroad may not exceed the ratio of the investors' contribution in imported capital to the total investment capital of an enterprise; and, in any event, the maximum amount that can be repatriated in any year is 15 percent of the investors' equity participation. *Id*.

[123]Algeria's investment laws guarantee equality before the law for investors, especially in relation to taxation. *Id*., p. 50.

The Argentine Foreign Investment Law of 1977 promises that foreign investors have the same rights and obligations that the constitution and national laws grant to national investors, subject to any qualifications in that law and to rules provided by special and promotional statutes. *Id*.

Brazil's Foreign Capital Investment Law states that foreign capital is to receive the same treatment before the law as that accorded Brazilian capital under similar situations, and that any discrimination not specifically provided for in the law is prohibited. *Id*.

Chile's Foreign Investment Statute guarantees that foreign investments will be subject to the same general regulations that apply to national investments and that there is to be no discrimination, direct or indirect, except that access by foreign investors to internal credit may be limited. *Id*.

Tunisia's Investment Code of January 1, 1994, recognizes the principle of nondiscrimination and equality before the law for foreign investors, especially in tax and social matters. *Id*.

Russia's Federal Law on Foreign Investment in the Russian Federation of July 2, 1999, art. 5 provides that foreign investors will be treated the same as Russian investors. See English translation in *International Legal Materials*, vol. 39, p. 894 (2000) and online at http://en.fas.gov.ru/legislation/legislation_50727.html.

Stabilization clauses are a special kind of investment guarantee provided by a few countries. Such a clause promises foreign investors that the host government will not change its tax, foreign exchange, or other legal régime for a certain period of time, or that changes subsequent to the establishment of an enterprise will not affect that enterprise. For example, Algeria's investment code contains a clause that promises that any future changes in the code will not affect an enterprise that has already been approved under the existing code, unless the conditions benefit the enterprise.[124]

A stabilization clause, like any contractual provision, can be changed by the mutual agreement of the parties. Changes in the surrounding circumstances and changes in the way the parties perform may also modify such a clause.

A stabilization clause cannot prevent a state from nationalizing or expropriating a foreign investment. Under international law, every state ultimately has the power to nationalize property. The violation of a stabilization clause, however, may change the character of a nationalization decree, from lawful to a breach of contract. Nevertheless, while a state may surrender its right to nationalize, it cannot surrender its power.

B. Supervision of Foreign Investment

Start-Up Standards

The foreign investor whose application has been approved by the host state is usually subject to some time limit in which to start construction and/or begin operation. Saudi Arabia, for example, gives licensed investors six months in which to implement an approved project; otherwise, their license may be revoked. In Tunisia, the period is one year, whereas Chile requires foreign investors to fully capitalize their investments within six years (or eight years in the case of mining ventures).[125]

Additionally, most countries require investors to submit periodic reports during the start-up period that describe their progress in importing capital (including capital goods), constructing facilities, hiring and training personnel, and beginning production. For example, in Indonesia, during the construction and trial production period, investors have to submit monthly reports to the Bank of Indonesia, so that the bank can track the amount of foreign currency brought into the country, and semiannual reports to the Investment Coordinating Board so that the board can follow the operational progress of the project.[126]

Operational Reviews

Once a foreign-owned enterprise is in full operation, it is usually subject to periodic monitoring. This may involve the submission of information (commonly on a yearly basis) on various aspects of the enterprise's business activities, plus regular inspections of its plant, facilities, and records to ensure that it is in compliance with the local investment regulations and, if appropriate, a specific investment agreement. If a single central agency is responsible for approving and supervising foreign investments, it will commonly collect the reports and conduct the inspections. Otherwise, a variety of specialized agencies may be involved. In Tanzania, for example, the Investment Promotion Center monitors and enforces compliance with the country's investment regulations.[127] In Saudi Arabia, both the Investment Bureau and the Ministry of Industry and Electricity share such responsibility.[128]

[124]*Id.*, p. 50; and see Federal Law on Foreign Investment in the Russian Federation of July 2, 1999, art. 9.

[125]Center on Transnational Corporations, *National Legislation and Regulations Relating to Transnational Corporations*, p. 12 (UN Doc. ST/CTC/26, UN Sales No. E. 83. II. A. 7, 1983).

[126]*Id.*, p. 13.

[127]Tanzania, National Investment (Promotion and Protection) Act of 1990, § 4(2)(m), *International Legal Materials*, vol. 30, p. 890 at p. 898 (1991).

In Indonesia the Investment Coordinating Board performs these duties, and in Ghana they are performed by the Capital Investment Board. Center on Transnational Corporations, *National Legislation and Regulations Relating to Transnational Corporations*, p. 13 (UN Doc.ST/CTC/26, UN Sales No. E. 83. II. A. 7, 1983).

[128]*Id.*

Modification of Foreign Investment Agreements

Investment laws usually provide that any modification to an investment agreement, including an increase or decrease in the size or scope of a project, has to be approved by the host state. Sudan's Encouragement of Investment Act of 1980,[129] for example, provided that any change in the size or purpose of a project has to be approved by the minister of finance and national economy. Any transfer of ownership of all or any part of a project also needs the minister's approval.

Investment laws and investment agreements usually require the host state to act in good faith on requests for modification. This is also the rule applied by courts and tribunals in cases where an investment law or agreement sets no standard, as Case 5-4 explains.

CASE 5-4 Arbitration Between Wintershall AG et al. and the Government of Qatar

Ad Hoc Arbitral Tribunal, 1988. *International Legal Materials*, vol. 28, p. 795 (1989).

MAP 5.5

Qatar (1988)

In 1976, the government of Qatar (the respondent) entered into an "Exploration and Production Sharing Agreement" (EPSA), with Wintershall AC, International Ocean Resources, Inc., Veba Oel AG, Deutsche Schactbau-und Tiefbohrgesellschaft mbH, and Gulfstream Resources Canada, Ltd. (the claimants). The EPSA granted the claimants the exclusive right to explore, drill, and produce petroleum in a defined area offshore of Qatar (the Contract Area).

The term of the EPSA was for thirty years, beginning June 18, 1973. After five years, however, the claimants were required to relinquish 50 percent of the Contract Area to the respondent. Three years later they were required to relinquish an additional 20 percent. Additionally, if the claimants failed to discover commercially viable quantities of crude oil or non-associated natural gas within the first eight years of the term, the respondent was entitled to terminate the EPSA. Twelve years into the EPSA (i.e., on June 18, 1985), the claimants were entitled to retain only the producing areas.

The claimants never discovered crude oil in commercial quantities. However, due to a boundary dispute between Qatar and Bahrain, the respondent never allowed them to drill in an area known as Structure A that the claimants thought was likely to contain crude oil.

[129]See http://assets.cambridge.org/97805218/17721/frontmatter/9780521817721_frontmatter.pdf for an article on foreign investment in Sudan.

In 1980, the claimants informed the respondent that they had discovered natural gas in substantial quantities in the Contract Area and that they considered the utilization of such gas to be economical. The EPSA specified that, in such an event, the natural gas was to be extracted either "pursuant to further contractual arrangements to be mutually agreed to" or pursuant to a so-called "go it alone" provision that authorized the claimants to extract the natural gas on their own.

On June 19, 1985, following years of intermittent discussions relating to the extraction of natural gas, the respondent sent the claimants a telex advising them that "the term of this Agreement [the EPSA] expired on the 18th day of June 1985. Accordingly, this Agreement is terminated with effect from this date." Notwithstanding this telex, the claimants tendered, and the respondent accepted, the annual rental fee (U.S. $100,000) contemplated by the EPSA, and neither party treated the EPSA as expired or terminated.

After the discussions concerning projects for the utilization of natural gas ended unsuccessfully, the claimants referred this dispute to arbitration. They claimed that the respondent breached the EPSA and expropriated the claimants' contractual rights and economic interests by denying them permission to explore for petroleum in the Structure A area and by failing to agree with the claimants on further contractual arrangements for the utilisation of the natural gas discovered by claimants.

Opinion of the Tribunal

(1) No Breach of the EPSA. On the basis of the documentary and testimony evidence submitted to the Tribunal, including the technical and economic background evidence, the Tribunal's construction of the relevant provisions of the EPSA and giving effect to the applicable Qatari law, the Tribunal has concluded that there was no breach of the EPSA.

It is the Tribunal's view that the provisions of Article XV.3 of the EPSA are applicable to a non-associated natural gas finding, which is the situation we are considering here; that the respondent did not agree that the utilization of non-associated natural gas was economical; did not elect to participate in the construction and installation of facilities for utilizing this natural gas pursuant to an agreed utilization plan; and that the parties did not enter into further contractual arrangements for the utilization of such natural gas. including mutually acceptable provisions regarding the division of costs and revenues and with respect to duration.

In . . . Article XV.3 of the EPSA . . . it is stated that:

> Should government and contractor mutually agree that the utilization of *non-associated natural gas is economical they shall thereafter participate in the construction and installation of facilities for utilizing such gas pursuant to an agreed utilization plan*. It is hereby agreed that it is the intention of the parties to enter into further contractual arrangements *for the utilization of such gas*, including mutually acceptable provisions *regarding the division of costs, revenues and duration, with a view to achieving economic results on a basis equivalent to those provided herein concerning crude oil*. . . . (emphasis added)

The Tribunal does not consider that it was necessary under the provisions of Article XV.3 for the respondent to notify the claimants within four years that the utilization of such natural gas was not economical nor that its silence constituted acceptance. On the other hand, the failure of the respondent to notify [the] claimants that the natural gas was not utilizable until following the termination of this four-year period resulted, as the expert legal witness for the claimants has stated, in the loss of respondent's right to participate in the development of these resources other than if claimants exercised the "go it alone" option, as provided in the last paragraph of Article XV.3.

Since the respondent did not agree that the claimants' finding of non-associated natural gas was economically utilizable. The respondent had no further duties to the claimant under Article XV.3 other than as provided in the last paragraph of Article XV.3 if the claimants elected the "go it alone" option. However, even if the respondent had agreed or was deemed to have agreed as to the economic utilizability of the natural gas, the Tribunal holds that the respondent did not agree to a utilization plan or further contractual agreements, the second and third conditions for an agreed joint venture under Article XV.3. The Tribunal does not agree that it was necessary, in order for the respondent to agree that there had been an economically feasible find of natural gas, for the claimants to present a utilization plan. However, in fact, the Tribunal finds that respondent did not so agree.

The Tribunal, moreover, is of the view, after a thorough examination of all the evidence, particularly the very detailed examination of claimants' principal witness, . . . by the respondent's counsel, that there was not a violation by the respondent of any duty to negotiate in good faith regarding this matter. Even accepting the view of the expert legal witness for the claimants that there was such a duty to negotiate in good faith, it is clear that such a duty does not include an obligation on the part of the respondent to reach agreement with respect to the proposals made by the claimants. To the extent that there was a duty to negotiate under Qatari law on this matter, the Tribunal finds that the refusal by the respondent to accept proposals by the claimants was made in good faith and was justified under normal commercial practice.

With respect to the claimants' allegation that the respondent's delivery to claimants of a notice of termination of the EPSA in June 1985 is a breach of the EPSA, the Tribunal does not agree. In the first place, this is properly regarded not as a notice of termination but rather as a notice that relinquishment was required under Article XI of the EPSA, an understanding of the nature of the notice with which the claimants agreed by their subsequent payment in July 1985 of the annual rental payment of $100,000. Secondly, this notice that relinquishment was required was ineffective with respect to claimants' rights under the "go it alone" option . . .

While the basic reasons for the Tribunal's decision are set forth above, there are certain points that underlie that decision that deserve particular emphasis. These include: first, the finding by the Tribunal that any proposals by the claimants relating to the joint development of the government area beyond the Contract Area were clearly no more than offers by the claimants and their acceptance was not required by the duty of good faith negotiation under the EPSA; secondly, that the claimants' rights under the EPSA do not include any rights relating to developing the government area beyond the Contract Area: and thirdly, there was no legal duty on the part of the government to unitize the area and to accept proposals from the claimants relating to the unitization of the area.

(2) No Expropriation of Claimants' Contractual Rights or Economic Interests. With regard to the alleged claim that the respondent expropriated the claimants' contractual rights and economic interest under the EPSA, the Tribunal expressly rejects any such assertion.

In the prior section, the Tribunal has found that claimants' contractual rights under the EPSA were honored. The claimants' economic interest under Article II of the EPSA related solely to the right, within the Contract Area, to explore, drill for and produce petroleum and the storing, transfer and selling of petroleum.

The only proposal by the claimants relating solely to the petroleum in the Contract Area . . . was reasonably rejected by the respondent on technical grounds and abandoned by the claimants, presumably for commercial reasons, in favor of suggestions relating to developments in the government area outside the Contract Area. The refusal of [the] respondent to accept claimants' proposals in an area outside the Contract Area in no sense constituted an expropriation of claimants' contractual rights, since the claimants had no legal rights under the EPSA to jointly develop the area outside the Contract Area.

(3) No Breach of EPSA Provisions Relating to Structure A Area and No Expropriation of These Rights. With respect to the claimants' alleged right to utilize the Structure A area under the EPSA and respondent's alleged expropriation of this right, the Tribunal finds that the refusal by the respondent to permit exploration in this area was not a violation of the claimants' contractual rights under the EPSA. Under Article XL of the EPSA, the government was expressly authorized to limit the claimants' operations and, in doing so, was exercising its express contractual rights under the EPSA. However, respondent failed to advise the claimants of its dispute with Bahrain regarding this area prior to the signing of [the] EPSA . . .

Accordingly, [because of the failure of the respondent to adequately inform the claimants of the dispute between Qatar and Bahrain at the time the EPSA was drafted,] the application of the relinquishment provisions of the EPSA to the Structure A area under these conditions would result in an unduly harsh application of the EPSA provisions. The Emir himself indicated [this in a statement to the claimants]. . . . [The Emir said that he] would not like the claimants to drill now in the western part of their Contract Area, especially on Structure A, because he would "like to live in peace with his neighbor. . . ." but that he hoped the problem could be solved in the near future and the claimants could drill on Structure A. In effect, he indicated that a harsh application of the relinquishment provisions would not at that time be insisted upon by the respondent. Thereafter, the relinquishment provisions with respect to the Structure A area were not implemented by the parties.

Accordingly. . . . the Tribunal declares that . . . relinquishment provisions . . . apply to . . . Structure A only from the date that claimants are permitted to exploit this area under the EPSA provisions.

The government of Qatar had a duty to negotiate in good faith on the joint development of the natural gas find. Its rejection of the claimants' proposal was based on its belief that the find was not economically usable.

Because Qatar had misled the claimants about the competing claims of Bahrain to the territory within Structure A, the claimants were entitled to explore and exploit that area under the provisions of the EPSA once Qatar settled its political dispute with Bahrain.

Casepoint

A government (here, Qatar) has a duty to negotiate in good faith on the joint development of a natural gas field within its boundaries. The tribunal found that Qatar had negotiated in good faith, but (1) because Qatar was in a boundary dispute with Bahrain at the time the Exploration and Production Sharing Agreement was signed and (2) because Qatar did not notify Wintershall AG et al. at the time that areas in Structure A could not be explored, Qatar's notice of relinquishment after twelve years was ineffective in regard to Structure A areas.

Protection of Subsidiaries

Foreign investors, whether natural persons or companies, are generally recognized as having the same right to manage a company in a host state as do local persons and companies. At the same time, foreigners are not allowed to take advantage of the fact that they are not physically present in the host state as a way of escaping full responsibility for their investments. They and the subsidiary firms they establish are subject to the same obligations as local firms. In addition, they are subject to a variety of special regulations designed to prevent them from abusing either their local subsidiaries, their subsidiaries' employees, or their subsidiaries' creditors.

The OECD guidelines for parent companies and their subsidiaries are posted at www.oecd.org/dataoecd/10/16/2090148.pdf.

Disclosure of Information All firms, whether foreign subsidiaries or domestic enterprises, are subject to basic disclosure obligations. The reason companies are required to disclose information about their organizational structure and their activities is to serve one basic purpose: protection of the public (i.e., shareholders and creditors) from fraud and misrepresentation.

There are two basic sets of disclosure rules: (1) initial or organizational disclosure reports that must be made when a company is first organized and (2) periodic reports that require companies to update changes in their organization and activities. In federal states, such as Argentina, Brazil, and the United States, the constituent federal states enact the initial or organizational disclosure rules, and the central (or federal) government enacts the periodic disclosure laws. In unitary states, both sets of rules are enacted by the national government.

In common law countries, a company's Memorandum of Association and/or Articles of Incorporation are filed with a registrar who maintains a copy that can be examined by the public. In civil law countries, the organizational documents are notarized and entered in the Commercial Register, which is also open to the public. Additionally, most countries, in both systems, now require that a company's organizational documents be published in a state or national gazette or in a newspaper of general circulation.

Along with the organizational documents, the information that a company has to submit as part of its initial disclosure—whether registration takes place through the Registrar of Companies or the notarization process—generally includes the following:

a. Names, nationality, and domicile of the shareholders of the company
b. Purpose or objectives of the company

c. Company name or designation
d. Amount of capital and classes of shares and any division therein
e. Amount of contribution of each shareholder in cash and the method of calling for unpaid subscriptions
f. Manner in which the company will be managed and powers of the board of directors or its equivalent
g. Rights and liabilities of shareholders and creditors
h. Appointment of executives and staff
i. Method of distributing profits and losses
j. Circumstances under which a company may be dissolved and liquidators appointed

The information that companies have to provide annually usually includes the following:

a. Balance sheet
b. Profit and loss account
c. Directors' report
d. Auditors' report

The detail of information in these reports varies from country to country, as do the accounting methods used.

The annual reporting procedures also vary. In Ghana, for example, an annual report has to be published in the national gazette and in one national newspaper. In Brazil, company reports are published in the national gazette and a local newspaper and are made available to shareholders. In India, corporate reports are filed with the Registrar of Companies and sent to holders of shares and debentures.[130]

Publicly traded companies, as mentioned earlier, generally have to provide more extensive information in their annual reports. Privately held companies are usually required to file only limited information. In India, for example, a private company files only a balance sheet and an auditor's report.

Foreign-owned corporations in some countries (such as Argentina, Ghana, and Malaysia) are subject to the same disclosure requirements as domestic companies. In a few countries, they are also subject to special additional reporting requirements. For example, in India, a foreign branch has to submit both its own annual financial statements and that of its head office to the Registrar of Joint Stock Companies.

Some attempts have been made to harmonize the information collected by different countries. On April 1, 2001, the International Accounting Standards Board (IASB)[131] assumed accounting standard-setting responsibilities from its predecessor body, the International Accounting Standards Committee. The IASB is committed to developing, in the public interest, a single set of high-quality, understandable, and enforceable global accounting standards called International Financial Reporting Standards (IFRS) that require transparent and comparable information in general-purpose financial statements. The International Federation of Accountants (IFAC),[132] with 118 member countries, has established international auditing guidelines. Through its independent standard-setting boards, IFAC develops international standards on ethics, auditing and assurance, education, and public sector accounting standards. It also issues guidance to support professional accountants in business, small- and medium-sized practices, and developing nations.

In the 1980s, the United Nations established an Ad Hoc Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting. This group was to have reviewed existing arrangements, and it planned to issue a code that would provide for greater harmonization of international standards.[133]

---

[130] In addition to annual reports, several countries require special reports on various aspects of a company's activities. *Id.*

[131] The home page of the IASB is at www.iasb.org/Home.htm.

[132] The home page of the IFAC is at www.ifac.org/About.

[133] United Nations Center on Transnational Corporations, *National Legislation and Regulations Relating to Transnational Corporations*, p. 47 (UN Doc. ST/CTC/26, UN Sales No. E. 83. II. A. 7, 1983).

Compliance with a country's disclosure requirements is generally enforced both by the agencies that collect the disclosure reports and by the country's Department or Ministry of Justice. In Argentina, for example, corporate activities are regulated through the office of the syndic (*sindicatura*) and a vigilance council (*consejo de vigilancia*). Both agencies have extensive investigatory powers. They may inspect records and solicit information necessary to conduct their investigations satisfactorily. The General Inspection Service (Inspección General de Personas Jurídicas), a division of the Ministry of Justice, has supervisory, investigatory, and enforcement powers. It must approve all of a company's organizational documents before the company can commence business, as well as any amendments that affect the company's powers. It has extensive subpoena powers that enable it to examine a company's books and investigate a company's affairs. It also may initiate suits to ensure that a company observes the law.[134]

In addition to these basic disclosure requirements, many European countries require affiliated companies to file consolidated financial statements or, as a minimum, to submit information on the financial status of the entire group. In the Netherlands, for example, a Dutch parent may choose between publishing consolidated annual accounts or publishing the accounts of all of its subsidiaries.

Protection of the Subsidiary The laws of several countries, including Belgium, France, Germany, Norway, and Switzerland, provide some protection for subsidiaries from the disadvantageous decisions of their parent company. In general, these provisions try to preserve the capital basis and financial viability of the subsidiary.

German law, for example, treats parent and subsidiary companies as *de facto* combines and requires the parent to compensate its subsidiaries for any disadvantageous effects that result from its instructions. If a parent and its subsidiaries enter into a formal *contract of domination*, this formal combine is subject to special rules. The subsidiary is required to set up a special reserve; the amount of profits that can be transferred to the parent is limited; and the parent company must assume the annual losses of the subsidiary.

Protection of a Subsidiary's Minority Shareholders Corporate law, securities regulations, or stock exchange rules often grant minority shareholders appraisal rights or rights to minimum guaranteed dividends. **Appraisal rights** are the rights of a dissenting shareholder to require the company to purchase his or her shares at their fair market value. Under German law, for instance, minority shareholders can exercise their appraisal rights whenever a subsidiary enters into a special contract of domination with its parent involving, for example, a transfer of profits. Alternatively, they can demand adequate compensation for their investment in the form of guaranteed minimum dividends.

appraisal right
The right of a dissenting shareholder to require the company to purchase his or her shares at their fair market value.

In addition, in Belgium, France, and other countries, a minority shareholder is entitled to initiate a legal action against decisions imposed on a subsidiary by a controlling parent company if the decisions are manifestly contrary to the subsidiary's interests.[135]

Protection of a Subsidiary's Creditors Parent companies are sometimes held responsible for the debts of their subsidiaries or, in the event of liquidation of the subsidiary, the parent's claims will be subordinated to those of other creditors. In Portugal, for example, affiliates of a *complementary group of enterprises* are mutually liable for each other's debts in the case of insolvency of any member of the group.

Like minority shareholders, creditors are often entitled to bring actions to enjoin a subsidiary from complying with the instructions of a parent. In addition, the host state may intervene, through

[134] *Id.*, p. 45.

[135] For example, in *Fruehauf v. Massardy*, in Dalloz-Sirey, *Jurisprudence*, vol. 1968, p. 147 (1965), the Paris Court of Appeals accepted a complaint brought by minority shareholders who contested the instructions of an American parent that had ordered its French subsidiary to breach a contract with a company in a third country in order to comply with trade restrictions based on U.S. law. The court held that the parent, as the majority shareholder, had abused its position because the breach would have resulted in the subsidiary being liable for damages that would have threatened its very existence. The court, accordingly, appointed a judicial administrator to carry out the contract. *Id.*, p. 12.

the appointment of a temporary or permanent administrator to operate the subsidiary, to protect the interests of the minority shareholders and local creditors.[136]

Protection of a Subsidiary's Tort Victims If a subsidiary injures persons within the host state in tort or in delict, the host state may assume responsibility for acting on their behalf and pursuing remedies in the local courts and in foreign courts as well. The landmark decision upholding the right of a national government to take over the suit of victims injured by the subsidiary of a multinational enterprise is the *Bhopal* case. The Supreme Court of India's rationale for its decision is set out in the following excerpt (see Case 5-5).

CASE 5-5 The Bhopal Case

Charan Lal Sahu v. Union of India
India, Supreme Court, 1989
All India Reporter, Supreme Court, vol. 1990, p. 1480 (1989); *International Law Reports*, vol. 118, p. 451 (2000)

MAP 5.6

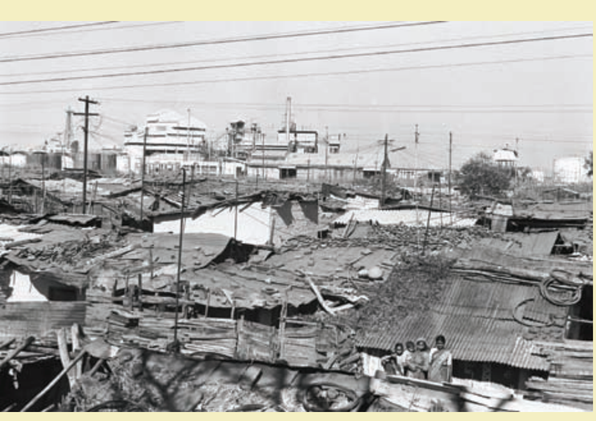
India (1984)

[136]An example is the *Badger Case*. See Stephen Lee Smith, "Badger Revisited," *International Tax and Business Law*, vol. 11, pp. 125–130 (1983). The *Badger* case addressed whether a corporate headquarters is financially responsible for the debts of its subsidiaries. Badger was a Belgian subsidiary of an American company. When Badger closed its doors in the 1980s, it dismissed 250 employees and filed for bankruptcy. Belgian law entitled employees to compensation in this instance. The Belgian subsidiary of Badger, however, claimed to have insufficient funds to provide compensation, and the U.S. parent refused to pay. The issue was what conditions must exist for a parent company to pay the debts of its bankrupt subsidiary. The Belgian appellant supported its argument with Paragraphs 7 and 8 of the Introduction to the OECD *Guidelines*. The OECD's Committee on International Investment and Multinational Enterprises (CIME, pronounced "seemay") is ultimately responsible for adjudication and development of the *Guidelines*. CIME's review concluded that although the *Guidelines* do not imply an unqualified principle of parent-subsidiary responsibility, there is a principle of qualified responsibility by the parent that exceeds the scope of national law.

FIGURE 5.4

The Union Carbide Plant at Bhopal

Source: Chris Rainier/Corbis



On December 2, 1984, enormous amounts of lethal gas leaked from the storage tanks of Union Carbide, Ltd., in Bhopal, India, causing death and injury to a large number of people living nearby (see Figure 5.4). Union Carbide (I) was incorporated in India as a subsidiary of the Union Carbide Corporation of New York.

After cases were brought on behalf of the victims in the United States by American lawyers, the Indian Parliament adopted the Bhopal Gas Disaster Leak (Processing of Claims) Act of 1985 ("Bhopal Act"). This act authorized the Indian central government, the Union of India, to take over the claims of the victims of the gas leak, and it promptly brought suit for damages in the District Court of Bhopal. Soon thereafter, the attorneys for plaintiffs in the cases that had been taken over filed petitions with the Supreme Court of India challenging the constitutionality of the Bhopal Act.

Opinion by Chief Justice Sabyasachi Mukharji

Before we deal with the question of constitutionality, it has to be emphasized that the Act in question deals with the Bhopal gas leak disaster and it deals with the claims . . . arising out [of] or connect[ed] with the disaster for compensation of damages for loss of life or any personal injury. . . . The Act in question does not purport to deal with . . . criminal liability. . . . The Act does not, either, expressly or impliedly deal with the extent of the damages or liability. . . . The expression:

> "the Central Government shall, and shall have the exclusive right to represent, and act in place of (whether within or outside India) every person who has made, or is entitled to make, a claim for all purposes connected with such claim in the same manner and to the same effect as such person" . . .

means that the Central Government is substituted and vested with the exclusive right to act in place of the victims. This happens by operation of . . . the legislation in question. . . . However, in cases where . . . suits or proceedings have been instituted before the [enactment] of the Act in any court or before any authority outside India, . . . the Central Government . . . has the right to act in place of, or along with, such claimant, provided such court or authority so permits. . . . Therefore, the Central Government is authorized to act with the claimants in respect of proceedings instituted outside India subject to the orders of such courts or authorities. Is such a right valid and proper?

There is the concept known both in this country and abroad, called *parens patriae*.[137] Dr. B.K. Mukherjuea,[138] referring to the concept of *parens patriae*, has noted that in English law, the Crown as *parens patriae* is the constitutional protector of all property subject to charitable trusts, such trusts being essentially matters of public concern. . . . In the *Words and Phrases*

[137]From Latin: "parent of the country." The expression refers to the role of the state as sovereign and guardian of persons under disabilities.

[138]"Hindu Law of Religious and Charitable Trusts," *Tagore Law Lectures*, p. 454 (5th ed.).

permanent edition[139] it is stated that *parens patriae* is the inherent power and authority of a legislature to provide protection to the person and property of persons *non sui juris*,[140] such as minor, insane, and incompetent persons. . . . *Parens patriae* jurisdiction, it has been explained, is a right of the sovereign and imposes a duty on the sovereign, in the public interest, to protect persons under a disability who have no rightful protector. . . . [Thus,] the Government is within its duty to protect and to control persons under a disability . . .

Our Constitution makes it imperative for the state to secure to all its citizens the rights guaranteed by the Constitution and, where the citizens are not in a position to assert and secure their rights, the state must come into the picture and protect and fight for the rights of the citizens. The preamble to the Constitution, read with the Directive Principles, Articles 38, 39, and 39A, enjoins the state to take up these responsibilities. It is necessary for the state to ensure the fundamental rights in conjunction with the Directive Principles of State Policy to effectively discharge its obligations and for this purpose, if necessary, to deprive some rights and privileges of the individual victims or their heirs to protect their rights better and secure these further.

Reference may be had to *Alfred L. Snapp & Sons, Inc. v. Puerto Rico*[141] in this connection. There it was held by the Supreme Court of the United States of America that the Commonwealth of Puerto Rico had standing to sue as *parens patriae* to enjoin apple growers [from discriminating] against Puerto Rico migrant farmworkers. . . . Justice White [in a separate opinion] emphasized that the *parens patriae* action had its roots in the common-law concept of the "royal prerogative." The royal prerogative included the right or responsibility to take care of persons who were legally unable, on account of mental incapacity, whether it proceeds from nonage, idiocy, or lunacy, to take proper care of them[selves] and their property. This prerogative of *parens patriae* is inherent in the supreme power of every state, whether that power is lodged in a royal person or in the legislature, and is a most beneficent function. . . . Justice White [further] observed . . . that in order to maintain an action in *parens patriae* the state must articulate an interest apart from the interests of particular parties, i.e., the state must be more than a nominal party. The state must express a quasi-sovereign interest . . .

Therefore, conceptually and from the jurisprudential point of view, especially [in light of] . . . the preamble to the Constitution of India and mandate of the Directive Principles, it is possible [for Parliament] to authorize the Central Government to take over the claims of the victims . . .

Ms. Indira Jaising, . . . on behalf of some [of the] victims, . . . drew our attention to the fact that the Act was [adopted] to meet a specific situation that had arisen after the tragic disaster and the [appearance] of American lawyers seeking to represent the victims in American courts. The Government's view, according to her, as was manifest from the . . . debates of the Parliament, etc., was that the interests of the victims would be best served if the Central Government was given the right to represent the victims in the courts of the United States as they would otherwise be exploited by "ambulance chasers" working on contingency fees. The Government also proceeded initially on the hypothesis that the U.S. was the most convenient forum in which to sue the Union Carbide Company. The Government, however, feared that it might not have *locus standi* [142] to represent the victims in the courts of the United States of America unless a law was passed to enable it to sue on behalf of the victims. The dominant object of the Act, therefore, according to her, was to give the Government of India *locus standi* to sue on behalf of the victims in a foreign jurisdiction, a standing which it otherwise would not have had. According to her, the Act was never intended to give exclusive rights to the Central Government to sue on behalf of the victims in India or abroad. . . . We are unable to agree. As we have indicated before, conceptually and jurisprudentially . . . the Government [may] represent the victims in a domestic forum if the situation so warrants . . .

***

It was contended that the procedure evolved under the Act for the victims is peculiar and has a good deal of disadvantages for the victims. Such [a] special[ly] disadvantageous procedure

[139]Vol. 33 at p. 99.

[140]From Latin: "not his own master." Term describing someone who lacks the capacity to act for himself.

[141]*United States Reports*, vol. 458, p. 592 (U.S. Supreme Ct., 1982).

[142]From Latin: "a place for standing." The term refers to the right of a person to appear in court, or before a legislative body, in a given case or dispute.

and treatment is unequal treatment, it was suggested. It was therefore violative of Article 14 of the Constitution[143]; that is the argument advanced.

The Act does provide for a special procedure in respect of the rights of the victims and to that extent the Central Government takes upon itself the rights of the victims. It is a special Act providing a special procedure for a kind of special class of victims. In view of the enormity of the disaster, the victims of the Bhopal gas leak disaster, as they were placed against a multinational and a big Indian corporation, and in view of the presence of foreign contingency lawyers to whom the victims were exposed, the claimants and victims can legitimately [be] described as a class by themselves, different and distinct, and sufficiently identifiable to be entitled to special treatment for the [most] effective, speedy, equitable, and . . . advantageous settlement of their claims. There indubitably is differentiation. The disaster being unique in its character and in the recorded history of industrial disasters, situated as the victims were against a mighty multinational with the presence of foreign contingency lawyers looming on the scene, in our opinion, there were sufficient grounds for such differentiation and different treatment. In treating the victims of the gas leak disaster differently and providing them with a procedure which was just, fair, [and] reasonable . . . was not unwarranted or unauthorized by the Constitution . . .

***

In this connection, the concept of *parens patriae* in [procedural] jurisprudence may be examined. . . . It was asserted on behalf of the victims by learned counsel that the concept of *parens patriae* . . . can only be applied in cases of persons who [are] under a disability and would not be applicable in respect of those who are able to assert their own rights. It is true that the victims or their representatives are . . . not legally incapable of suing or pursuing the remedies for their rights; yet they are at a tremendous disadvantage in the broader . . . sense of the term. The victims cannot be considered to be any match to the multinational companies or the government with whom [they]—in the conditions that the victims or their representatives were after the disaster, physically, mentally, financially, economically and also because of the [location] of the litigation—would have to contend. In such a predicament, the victims can legitimately be considered to be disabled. They were in no position by themselves to look after their own interests effectively or purposefully. . . . In the situation in which the victims were, the state had to assume the role of a parent protecting the rights of the victims who must come within the protective umbrella of the state of the common sovereignty of the Indian people. As we have noted, the Act is an exercise of the sovereign power of the state. It is an appropriate . . . expression of sovereignty in the situation that had arisen. We must recognize and accept it as such.

***

[*The applicants' petition is dismissed*.]

Justice Singh

***

The Bhopal gas tragedy has raised several important questions regarding the function of multinationals in third world countries. After the Second World War, colonial rule came to an end in several parts of the globe as a number of nations secured independence from foreign rule. The political domination was over, but the newly born nations were beset with various problems on account of lack of finance and development. A number of multinationals and transnational corporations offered their services to the underdeveloped and developing countries to provide finances and technical know-how by setting up their own industries in those countries on their own terms that brought problems with regard to control over the functioning of the transnational corporations. Multinational companies in many cases exploited the underdeveloped nations and in some cases they influenced political and economic policies of host countries which subverted the sovereignty of those countries. There have been complaints against the multinationals for adopting unfair and corrupt means to advance their interests in the host countries.

[143]Article 14 of the Constitution of India stipulates "Equality before law—The State shall not deny to any person equality before the law or the equal protection of the laws within the territory of India."

Since this was a worldwide phenomenon, the United Nations took up that matter for consideration. The Economic and Social Council of the United Nations established a Commission on Transnational Corporations to conduct research on various political, economic, and social aspect[s] relating to transnational corporations. On a careful and detailed study the Commission submitted its Report in 1985 for evolving a Code of Conduct for Transnational Corporations. The Code was adopted in 1986 to which a large number of countries of the world are signatories. Although it has not been fully finalized as yet, the Code presents a comprehensive instrument formulating the principles of a Code of Conduct for transnational corporations carrying on their enterprises in underdeveloped and developing countries. . . . The Code also laid down guidelines for the determination of settlement of disputes arising out of accident and disaster and also for liability of transnational corporations and the jurisdiction of courts. The Code is binding on the countries which formally accept it. It was stated before us that India has accepted the Code. If that be so, it is necessary that the Government should take effective measures to translate the provisions of the Code into specific actions and policies backed by appropriate legislation and enforcing machinery to prevent any accident or disaster and to secure the welfare of the victims of any industrial disaster.

In the context of our national dimensions of human rights—right to life, liberty, pollution-free air and water guaranteed by the Constitution under Articles 21, 48A, and 51(g)—it is the duty of the state to take effective steps to protect the guaranteed constitutional rights. The rights must be integrated and illumined by the evolving international dimensions and standards, having regard to our sovereignty, as highlighted by . . . the UN Code of Conduct of Transnational Corporations. . . . A transnational corporation should be made liable and subservient to the laws of our country and its liability should not be restricted to an affiliate company only, but the parent corporation should also be made liable for any damage caused . . .

. . . The Government and the Parliament should therefore take immediate steps for enacting laws, having regard to these suggestions, consistent with the international norms and guidelines contained in the United Nations Code of Conduct for Transnational Corporations.

With these observations, I agree with the order proposed by my learned brother, Chief Justice Sabyasachi Mukharji.

Casepoint

The doctrine of *parens patriae* allows the state to act as a guardian of persons under disabilities. The Indian constitution requires the government to take action to guarantee the rights of Indian citizens. The Supreme Court of India holds that principles of natural justice are fundamental in the constitutional setup of the country, and no man's right should be affected without an opportunity to express his views. The Court also held that the government's obligation to protect fundamental rights requires it to protect the environment.

***

Remarkably, litigation over Bhopal has continued for well over 25 years. Some Indian claimants still have standing and potential to recover in the U.S. court system.[144]

Penalties for Noncompliance

Investment laws usually establish a variety of penalties for foreign investors who violate the law or fail to comply with an investment agreement. Violators may be subject to penalties ranging from fines to the suspension of their right to engage in business or to the revocation of the facilities they were granted.[145]

[144]See, e.g., "Federal Appeals Court Reinstates Parts of Suit Against Union Carbide for Toxic Pollution in India," at the EarthRights International Web site at www.earthrights.org/legal/federal-appeals-court-reinstates-parts-suit-against-union-carbide-toxic-pollution-india.

[145]Center on Transnational Corporations, *National Legislation and Regulations Relating to Transnational Corporations*, p. 13 (UN Doc. ST/CTC/26, UN Sales No. E. 83. II. A. 7, 1983).

C. Securities Regulations

National governments ordinarily regulate securities transactions. This includes defining the form that securities take, overseeing the markets in which securities are traded, establishing disclosure requirements to protect buyers and sellers, adopting clearance and settlement procedures, limiting insider trading, and regulating takeovers.

security
A share, participation, or other interest in an enterprise or other property, or a debt obligation.

stock
Share in the ownership of a company that entitles its owner to rights in the company, including a proportionate part of the dividends and, upon liquidation, of the capital assets.

Securities

Businesses raise much of their operating capital by issuing securities. A **security** is (1) a share, participation, or other interest in an enterprise or other property or (2) a debt obligation.[146] **Stock** (or an equity security) represents an ownership interest in a business, and a **bond** (or debt security) represents an obligation to pay money.

A security can take several forms. If it is in the form of the "type commonly dealt in on securities exchanges,"[147] it is called a **certificated security.** Such a security is a negotiable instrument that can be transferred by negotiation. If it is made out to a named owner, it is called a **registered security** because the issuer must maintain a register with the names of the owners of such certificates. If it is made out to *bearer* (i.e., to whomever is properly in possession of the certificate), it is a **bearer security** and no register of owners is maintained.

Most countries authorize the use of both registered and bearer securities. Some, however, insist that stock certificates be registered securities. Bearer securities (see Figure 5.5) commonly have

FIGURE 5.5

A U.S. Bearer Bond

Source: PhotoSpin, Inc/Alamy

[146]United States Uniform Commercial Code, §8.102(1). An investment contract is "a contract, transaction, or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party. . ." *Securities and Exchange Commission v. W. J. Howey Co.*, *United States Reports*, vol. 328, p. 293 (U.S. Supreme Ct., 1946).

[147]United States Uniform Commercial Code, §8.102(1).

coupons attached to them that can be detached so that the bearer can send them to the issuer to collect dividends or interest as they come due. In a few countries, such as Mexico, registered stock certificates must also have coupons.[148]

Many nations have "dematerialized" stock ownership, meaning that it is no longer necessary to have physical possession of stock. Where there is a certificate representing the security, transfer can be accomplished by (1) endorsement directly on the certificate and (2) delivery of the certificate. The new owner then sends the endorsed certificate to the issuer for registration and to obtain a new certificate made out to himself. Bearer securities are transferred simply by delivery of the certificate. In most countries, a bona fide purchaser of a bearer security acquires ownership even if the transferor was not the owner.[149] A **bona fide purchaser** is someone who buys in good faith, pays value, and is unaware that the transferor is not the rightful owner.

Securities do not have to be put into tangible form. An **uncertificated security** is one whose ownership is recorded only on the books of the issuer. Most developed countries authorize companies to use uncertificated certificates.[150] For most holders of stock or interests in mutual funds, actual share certificates are not given.

With the growth of interest in Indian companies, markets in India had become overwhelmed by the paperwork involved in maintaining and transferring paper share certificates. Fake and stolen shares, fake signatures, duplication of shares, and other transfer problems plagued the old system, and both individual and institutional investors were wary of entering Indian capital markets.

In the 1990s, the Indian Government set up a fully automated exchange model whereby shares and securities are represented and maintained electronically. After the introduction of the depository system by the Depository Act of 1996, the process for sales, purchases, and transfers of shares became significantly easier and most of the risks associated with paper certificates were mitigated.

Trading in Securities

Most nations limit the persons who may trade in securities. Typically, these are brokers and dealers who have registered with a commission that oversees traders and exchanges.[151] Additionally, banks, lawyers, accountants, and other experts are commonly allowed to provide advice about securities transactions, but only if this is incidental to their principal business.[152]

Securities Exchanges

Securities brokers and dealers have grouped together in many countries to form **securities exchanges,** that is, marketplaces where member brokers and dealers buy and sell securities on behalf of investors. These marketplaces exist because they make it easier for securities' issuers to find investors and for investors to exchange their securities.[153] The six largest (in annual trading volume), respectively, are

bond
Contractual obligation of a company (or government) to repay the holder the amount of his or her original investment plus interest at a specified future date.

certificated security
A security that is in the form of a negotiable instrument of the type commonly dealt in on securities exchanges.

registered security
A certificated security made out to a named owner and registered on the books of the issuer.

bearer security
A certificated security made out to "bearer." It is not registered on the books of the issuer.

bona fide purchaser
Someone who buys a security or other negotiable instrument in good faith, pays value, and is unaware that the transferor is not the rightful owner.

uncertificated security
A security whose ownership is recorded only on the books of the issuer.

securities exchange
Marketplace where member brokers and dealers buy and sell securities on behalf of investors.

148 "Mexico Law Digest," *id.*, p. MEX-2.

149 See "Netherlands Law Digest," *id.*, p. NTH-2.

150 *Uncertificated security* means a security that is not represented by a certificate. See United States Uniform Commercial Code §8.102(1) at www.law.cornell.edu/ucc/8/article8.htm#s8-102.

151 See, for example, Canadian Securities Act, §25 posted at http://web2.gov.mb.ca/laws/statutes/ccsm/s050e.php and *Revised Statutes of Canada*, chap. C-44, posted at www.canlii.org/ca/sta/c-44.

152 *Id.*, §34. In Germany, trading in securities is done by banks that buy and sell securities on exchanges for their customers through registered brokers. "Germany Law Digest," *Martindale-Hubbell International Law Digest*, GER-8 (2001).

153 Businesses, of course, do not have to sell their securities on an exchange. They can sell them privately or arrange for an equity stock trade. Private sales (in most countries) are subject to few governmental regulations, so that method is often preferred. It is often difficult, however, to raise large sums of money privately. For example, equity stock trades are a convenient device for setting up a joint venture with a host country firm but are of little value in acquiring cash for the actual operation of a business.

TABLE 5.4

The ten largest securities exchanges

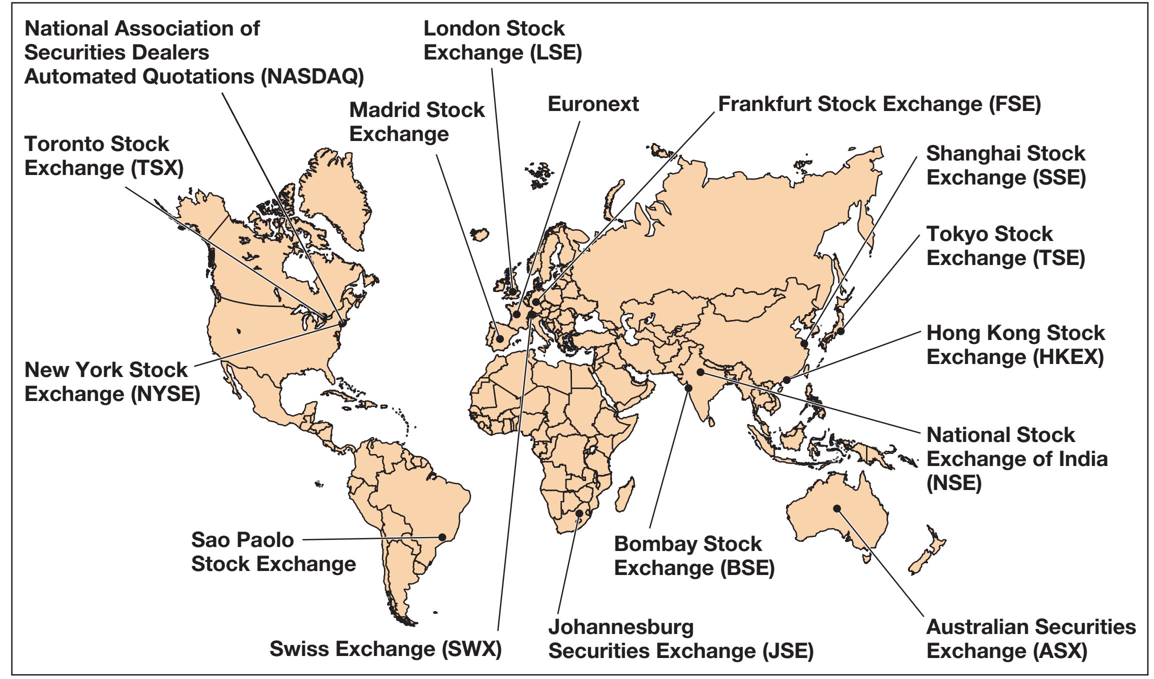
	Exchange	End-June 2010	End-June 2009	% Change in USD	% Change in Local Currency
1	NYSE Euronext (US)	11794	9864	19.60%	19.60%
2	Tokyo Stock Exchange	3277	3204	2.30%	–6.20%
3	NASDAQ OMX (US)	3165	2590	22.20%	22.20%
4	London Stock Exchange	2407	2198	9.60%	20.60%
5	NYSE Euronext (Europe)	2295	2197	4.50%	19.60%
6	Hong Kong Exchange	2200	1825	20.50%	21.10%
7	Shanghai Stock Exchange	2051	2329	–12.00%	–12.60%
8	TSX Group	1635	1281	27.70%	16.80%
9	Bombay Stock Exchange	1376	992	38.80%	34.60%
9	National Stock Exchange of India	1341	925	45.00%	40.50%
10	BM & FBOVESPA	1151	911	26.40%	16.20%

prospectus
Printed statement given to prospective securities investors setting out a full, true, and plain disclosure of all material facts relating to the securities and the issuer.

the New York Stock Exchange, the NASDAQ Stock Market, the Tokyo Stock Exchange, the London Stock Exchange, the Frankfurt Stock Exchange, and the Paris Stock Exchange. Together, they account for close to 90 percent of all securities transactions in the world. Table 5.4 lists the world's 10 largest securities exchanges. Map 5.7 illustrates the largest stock exchanges as of 2009.

Issuance of Securities

In order for a corporation to offer securities to the public, it must prepare and register a prospectus to accompany the offer. A **prospectus** is a printed statement setting out a "full, true, and plain disclosure of all material facts" relating to the securities and the issuer.[154] The required contents of



MAP 5.7

Where the Largest Securities Exchanges Are Located

[154]Canadian Securities Act, §56, *Revised Statutes of Canada*, chap. C-44.

prospectuses are generally quite similar from country to country.[155] Germany, for example, requires prospectuses to set out:

1. A history of the issuer and a description of its purpose and goals
2. A description of the issuer's business and its present and anticipated course
3. A current financial statement with an explanation of all significant transactions
4. Profits earned and dividends paid for the previous three years[156]

Prospectuses must be signed by the officers and directors of the issuer[157] and by any promoters[158] and underwriters[159] who may be involved. By signing, they certify that a prospectus constitutes, to the best of their knowledge, full, true, and plain disclosure of all material facts relating to the securities being offered.

Finally, to be effective, a prospectus must be registered. In some countries, for example Germany, a prospectus is submitted to the listing committee of the securities exchange on which it will be offered; in others it is filed with a national supervisory agency, such as the Securities and Exchange Commission in the United States. The waiting period during which the listing committee or supervisory agency reviews the filing varies in length from 10 (Canada, for instance) to 20 (the United States, for instance) days. During the waiting period an issuer may offer its securities orally, by distributing a preliminary prospectus (called a *red herring prospectus* in the United States because it must bear a legend in red ink stating that it is not final), and by means of a limited advertisement (colloquially known as a *tombstone advertisement*) that identifies the security, its price, and who will execute orders. Only after the listing committee or supervisory agency approves the prospectus may sales of the securities take place.

Exemptions from Registration Certain kinds of securities and certain transactions are exempt from registration. Exempt securities typically include those issued by governmental bodies, by banks, and by not-for-profit corporations.[160] Exempt transactions commonly include nonpublic offerings and limited offerings. In Poland, for example, offerings circulated to fewer than 300 persons are not public offerings and are exempt from registration.[161] Limited offerings are those for small monetary amounts. Thus, in the United States, offerings of less than $1 million in a 12-month period are exempt from registration.[162]

Foreign Registration Securities may be offered on a foreign exchange so long as they are registered locally. To simplify this process, many countries allow an issuer to use the

[155]The contents of prospectuses may vary, depending on the kind of issuer involved. Senior issuers (those who have issued securities in the past and who have a substantial market valuation) in some countries are allowed to use *short-form* prospectuses (e.g., *id*., §74). Also, senior issuers may be excused from issuing a new prospectus for every issuance of shares. In such instances, they may sell securities "off the shelf" on a delayed or continuous basis so long as an original prospectus is kept current and accurate. The registration of such a prospectus is known as *shelf registration* (e.g., United States Securities and Exchange Commission Rule 415).

[156]Germany, Securities Prospectus Act of December 13, 1990, *Bundesgesetzblatt*, vol. I, p. 2749 (1990), cited in "Germany Law Digest," *Martindale-Hubbell International Law Directory*, p. GER-8. The required contents of a U.S. prospectus are described in the U.S. Securities Act of 1933, App. A.

[157]The particular officers and the minimum number of directors vary from country to country.

[158]A promoter is any person who associates him- or herself with a firm for the purpose of organizing a company, securing a charter, issuing a prospectus, raising subscriptions, and so forth.

[159]An underwriter is any person, bank, or syndicate that guarantees to furnish an agreed-upon amount of money by an agreed-upon date to an issuer of securities in exchange for the securities.

[160]For example, United States Securities Act of 1993, §3.

[161]Poland, Law of March 22, 1991, on Public Trading in Securities and on Trust Funds, cited in "Poland Law Digest," *Martindale-Hubbell International Law Directory*, p. POL-10, and at www.worldbank.org/ifa/rosc_cg_poland.html.

[162]United States Securities and Exchange Commission Rule 504, posted at www.sec.gov/info/smallbus/qasbsec.htm. Other limited offerings are allowed if some or all of the purchasers are *accredited investors*, such as banks, registered brokers and dealers, and persons with a net worth of more than $1 million and an annual income in excess of $200,000. If no more than 35 purchasers are unaccredited, the offering may be up to $5 million in a twelve-month period. *Id*., Rule 505. If all the purchasers are accredited investors, there is no monetary limit. Securities Act of 1933, §4(6).

same prospectus it registered in its home country. For example, the United States allows a foreign issuer to register a copy of its home-country prospectus plus a report (Form 20-F) that essentially explains the differences between its home-country prospectus and the American prospectus.[163]

Clearance and Settlement Procedures

clearance and settlement
Procedure by which a buyer turns over the purchase price and the seller turns over the securities in a securities transaction.

Clearance and settlement is the procedure by which a buyer turns over the purchase price and the seller turns over the securities in a securities transaction. This procedure differs from country to country. A securities *transaction* is actually a contract to be performed in the future—at the time the buyer delivers the purchase price and the seller delivers the debt or equity certificate. In the United States, the National Securities Clearing Corporation (NSCC),[164] a nationwide clearinghouse, handles the clearance and settlement of all securities traded on American exchanges. Since the 1970s, settlement has occurred in the United States by entries made on the books of the Depository Trust and Clearing Corporation (DTCC), of which NSCC is a subsidiary.[165] The DTCC holds global certificates for publicly traded firms, and settlement is done simply by debiting the account of a seller and crediting the account of a buyer on the DTC's books.[166] It was created to reduce costs and provide clearing and settlement efficiencies by immobilizing securities and making *book-entry* changes to ownership of the securities. It provides settlement services for all NSCC trades and for institutional trades, which typically involve money and securities transfers between custodian banks and broker/dealers. Similar procedures are followed in other developed countries.[167] In most developing countries, however, the buyer's and seller's brokers must get together and make an actual trade. Although sales are settled within five business days in developed countries, the settlement process can take several weeks in developing countries.[168]

International Clearance and Settlement Two international clearinghouses handle the clearance and settlement of securities sold internationally: Euroclear and Clearstream (formerly known as Cedel bank). Euroclear, which has its operating offices in Brussels, deals in more than 100,000

[163]Robert G. Pozen, "Disclosure and Trading in the International Security Market," *International Lawyer*, vol. 15, p. 84 (1981).

[164]See the NSCC Web site at www.nscc.com.

[165]The Depository Trust Company's home page is at www.dtcc.com.

[166]The Uniform Commercial Code §8–320(1) provides: "In addition to other methods, a transfer, pledge, or release of a security or any interest therein may be effected by the making of appropriate entries on the books of a clearing corporation reducing the account of the transferor, pledgor, or pledgee and increasing the account of the transferee, pledgee, or pledgor by the amount of the obligation or the number of shares or rights transferred, pledged, or released, if the security is shown on the account of a transferor, pledgor, or pledgee on the books of the clearing corporation; is subject to the control of the clearing corporation; and (a) if certificated [i.e., it is in the form of a negotiable instrument], (i) is in the custody of the clearing corporation, another clearing corporation, a custodian bank, or a nominee of any of them; and (ii) is in bearer form or endorsed in blank by an appropriate person or registered in the name of the clearing corporation, a custodian bank, or a nominee of any of them; or (b) if uncertificated, is registered in the name of the clearing corporation, another clearing corporation, a custodian bank, or a nominee of any of them."

[167]Companies performing the same function as the Depository Trust Company include:

- CIK, Caisse Interprofessionnelle de Dépots de Virements de Titres S.A., Brussels, Belgium
- DBC, Deutsche Börse Clearing, Frankfurt, Germany
- JSCC, Japan Securities Clearing Corporation, Tokyo, Japan
- Monte Titoli S.p.A., Milan, Italy
- NECIGEF, Nederlands Centraal Instituut voor Giraal Effectenverkeer B.V., Amsterdam, Netherlands
- OEKB, Oesterreichische Kontrollbank AG, Vienna, Austria
- SEGA, Schweizerische Effekten-Giro AG, Zurich, Switzerland
- SICOVAM, Socièté Interprofessionnelle pour la Compensation des Valeurs Mobilières, Paris, France

[168]See Brandon Becker and Thomas C. Etter, Jr., "International Clearance and Settlement," *Brooklyn Journal of International Law*, vol. 14, p. 283 (1988), and Robert P. Austin, "Regulatory Principles and the Internationalization of Securities Markets," *Law and Contemporary Problems*, vol. 50, p. 221 at pp. 234–237 (1987).

securities from 80 different countries. Its 2006 turnover, or the value of securities transactions settled, was EUR 451.7 trillion. Most transactions are domestic securities traded in over 25 equity markets and over 30 bond markets worldwide.[169] Founded in September 1970 by participants in the Eurobond market, Cedel provided clearing, settlement, and custody for a wide range of internationally traded Eurobonds, domestic bonds, and equities. Since July 2002 it is a division of Deutsche Börse and is known as Clearstream.[170] It ensures that cash and securities are promptly and effectively delivered between trading parties. It also manages, holds for safekeeping, and administers the securities that it holds on behalf of its customers. Backed by flexible securities lending and collateral management services, Clearstream offers one of the most comprehensive international securities services available. For 2011, Clearstream processed 37.9 million international transactions, an increase of 2 percent compared to 2010. The purpose of Clearstream is to facilitate money movements around the world, particularly by handling the resolution of sales of European stocks and bonds.

The Emerging Markets Clearing Corporation (EMCC) provides trade matching, clearance, settlement, and risk management services to global dealers, interdealer brokers, and correspondent clearing firms involved in emerging markets debt instruments. Established in 1997, EMCC is owned by firms active in this market and is a U.S.-registered clearing agency. The International Securities Clearing Corporation (ISCC), a wholly owned subsidiary of NSCC, acts as a facilities manager.

Depository Receipts To facilitate foreign trading in shares, brokerage firms use depository receipts. A **depository receipt** is a negotiable instrument issued by a bank that represents a foreign company's publicly traded securities and that, in turn, is traded on a local securities exchange. A depository receipt is created by a broker purchasing a company's shares in its home country, depositing them in a custodian bank in that country in the name of a depository bank in another country, and then instructing the depository bank to issue the receipt.[171] When the depository bank is a U.S. bank, the instruments are known as American Depository Receipts. European Depository Receipts are issued by European banks and Global Depository Receipts by other banks.

depository receipt
A negotiable instrument issued by a bank that represents a foreign company's publicly traded securities and that, in turn, is traded on a local securities exchange.

Depository receipts are convenient because the shares of the company do not have to leave the home state—it is the receipt that is sent abroad. Additionally, the physical delivery requirements of many countries can be avoided by trading the receipt on an American securities exchange. Also, the stock transfer taxes imposed by some home states can be avoided in part because the stock itself remains registered in the name of the depository bank.

Depository receipts are not identical, of course, to the securities themselves. The law of the state where an issuer is incorporated sometimes specifically defines the rights of depository receipt holders. In the Netherlands, for example, only shareholders may vote in corporate elections; depository receipt holders may not.[172] In addition, the deposit agreement between the broker, custodian bank, and depository bank may define the rights of the holders of such receipts, as Case 5-6 points out.

Insider Trading Regulations

Insider trading occurs when someone takes advantage of material nonpublic information about a corporation or the securities market to buy or sell securities for personal benefit. Some countries

insider trading
The use of material nonpublic information about a company or the securities market to buy or sell securities for personal gain.

[169] See the Euroclear Web site at www.euroclear.com.

[170] See the Clearstream home page at www.clearstream.com/ci/dispatch/en/kir/ci_nav/home.

[171] In the past, depository receipts were sometimes created without the participation of the issuer. Known as *unsponsored depository receipts*, they are now seldom used. Virtually all depository receipts are created on behalf of the issuer, and they are known as *sponsored depository receipts*. www.allbusiness.com/business-finance/equity-funding-stock/733850-1.html.

[172] "Listing of a Dutch company on the NASDAQ Stock Market," Bernard Spoor and Bartheke Weerstra, De Brauw Blackstone Westbroek, New York, posted at www.nasdaq.com/about/GP2005Europe_Chapter_14.pdf.

CASE 5-6 Batchelder v. Kawamoto

Ninth Circuit Court of Appeals
Federal Reporter, Third Series, vol. 147, p. 915 (1998)

MAP 5.8

California and Japan (1998)

Opinion by Circuit Judge O'Scannlain

We must decide whether the holder of an American Depository Receipt has standing to bring a shareholder derivative action against a Japanese corporation.

I

This is a derivative action brought by Harry C. Batchelder, Jr. on behalf of Honda Motor Company, Ltd. ("Honda Japan") and American Honda Motor Company, Inc. ("American Honda") for wrongs allegedly committed by directors, officers, and employees of Honda Japan and American Honda (the "Director Defendants"), and by certain third parties, including Lyon & Lyon and Roland Smoot (collectively, "Lyon & Lyon"). Honda Japan was incorporated under the laws of Japan. It is the sole shareholder of American Honda, a California corporation.

Harry C. Batchelder, Jr., alleges that at all times relevant to this case he owned 1,246 American Depository Receipts ("ADRs"), each of which reflects ownership of ten shares of stock in Honda Japan. The ADRs are issued by the depository, Morgan Guaranty Trust Company of New York. Batchelder purchased his ADRs under the terms and conditions of a deposit agreement ("Deposit Agreement") with Honda Japan and Morgan Guaranty. Batchelder alleges that the directors of both Honda Japan and American Honda breached their fiduciary duties by failing adequately to protect the companies from harm caused by the actions of certain American Honda employees who were involved in a bribery and kickback scheme. Batchelder also purports to bring suit against the law firm of Lyon & Lyon, American Honda's former general counsel, and two of its partners, Roland Smoot and James Short, who, Batchelder claims, assisted in "covering up" the fraudulent scheme. Batchelder has asserted "shareholder" derivative claims for breach of duty, waste of corporate assets, abuse of control, constructive fraud, mismanagement, and dissemination of false and misleading proxy statements in violation of *United States Code*, title 15, §78n(a).

Following the Director Defendants' motion to dismiss, the district court entered a scheduling order staying all discovery in the case pending its resolution. Thereafter, American Honda and Lyon & Lyon also filed motions to dismiss on numerous grounds. Following a hearing, the district court dismissed Batchelder's complaint with prejudice. The district court ruled that Batchelder's complaint failed as a matter of law because, *inter alia:* (1) based on the Deposit Agreement, Batchelder's standing to bring a derivative action must be determined under Japanese law; [and] (2) under Japanese law, Batchelder is not a shareholder and therefore lacks standing to bring a derivative action on behalf of Honda Japan. . .

Batchelder timely appealed.

II

Batchelder maintains that the district court erred in holding that he lacks standing to bring a share holder derivative action on behalf of Honda Japan and American Honda. According to Batchelder, the district court erroneously held that his "standing and his right to bring a derivative action . . . must be determined under Japanese law," and wrongly concluded that, as an owner of Honda Japan ADRs, he "is not a shareholder and lacks standing to bring a derivative action on behalf of Honda . . . under governing Japanese law." Batchelder contends that whereas Japanese law provides the substantive law to adjudicate his claims against the Director Defendants, it does not control his standing to bring California and federal claims on behalf of Honda Japan and American Honda. According to Batchelder, the district court must perform "the requisite conflicts of law analysis" to determine what law governs his right to bring a derivative suit. Batchelder contends that either the *Federal Rules of Civil Procedure*, Rule 23.1 ("Derivative Actions by Shareholders") or the California *Corporation Code* §800 ("Shareholder Derivative Actions") provides the standing requirements for his claim, not Japanese law.

A

Batchelder's right to bring derivative claims on behalf of Honda Japan and American Honda is indeed governed by Japanese law. Batchelder purchased his ADRs pursuant to the Deposit Agreement, which expressly provides that the law of Japan governs shareholder rights. Section 7.07 of the Deposit Agreement, entitled "Governing Law," states:

> This Deposit Agreement and the [American Depository] Receipts and all rights hereunder and thereunder and provisions hereof and thereof shall be governed by and construed in accordance with the laws of the state of New York, United States of America. It is understood that notwithstanding any present or future provision of the laws of the state of New York, *the rights of holders of Stock and other Deposited Securities, and the duties and obligations of the Company in respect of such holders, as such, shall be governed by the laws of Japan*. (emphasis added)

The first sentence of §7.07 provides that contract rights contained in the Deposit Agreement itself or in the ADR certificates, as well as the construction of the Deposit Agreement, are to be governed by the laws of New York. The second sentence of §7.07, however, explicitly provides that Japanese law governs shareholder rights and the rights of holders of other Deposited Securities, including ADRs. Thus, if an ADR holder seeks to assert a right belonging to shareholders or a right not specifically granted to ADR holders in the Deposit Agreement, the laws of Japan apply. Section 7.07 is simply a choice-of-law clause.

1. We analyze the validity of choice-of-law clauses under *The Bremen v. Zapata Off-Shore Co.*,[173] in which the Supreme Court stated that courts should enforce choice-of-law and choice-of-forum clauses in cases of "freely negotiated private international agreements." There is every reason to believe that the Depository Agreement was such an agreement. . .

Batchelder has never contended that the Deposit Agreement itself grants ADR holders the right to bring shareholder derivative claims. He argues instead that he is entitled to bring derivative claims because he "is a Honda shareholder" through his ownership of ADRs. Because Batchelder is attempting to assert a right not expressly granted to him by the Deposit Agreement—the right to bring a derivative suit—the plain language of the second sentence of §7.07 directs this court to apply Japanese law to determine the existence and scope of Batchelder's right. No conflicts-of-law analysis is required.

***

III

Batchelder next argues that, even under Japanese law, he is a Honda Japan shareholder who is entitled to bring suit on behalf of the parent company *and* assert a double derivative claim on

[173] *United States Reports*, vol. 407, p. 1 (Supreme Ct., 1972).

behalf of its subsidiary, American Honda. According to Batchelder, the district court "ignored the fact that ADRs are the equivalent of shares of a foreign corporation and ADR holders are equivalent to a shareholder [sic] of that corporation, whether under Japanese law or U.S. law." Batchelder further maintains that the district court erred in finding that he failed properly to assert "double derivative" claims on behalf of Honda Japan and American Honda. He contends that the district court also "ignored the fact that California substantive law applies to derivative claims asserted by Batchelder on behalf of American Honda" as well as "numerous precedents recognizing the validity of 'double derivative' claims under these circumstances."

Article 267 of the Japanese *Commercial Code*, which establishes the derivative remedy, states:

1. Any shareholder who has held a share continuously for the last six months may demand, in writing, that the stock company institute an action to enforce the liability of directors.
2. If the stock company has failed to institute such action within thirty days from the date on which the demand referred to in the preceding paragraph was made, the shareholder referred to in the preceding paragraph may institute such action on behalf of the company.

Notwithstanding his concessions that he holds ADRs, not shares, in Honda Japan, and that Article 267 confers derivative standing only on "any shareholder," Batchelder claims, that as an ADR holder, he is "equivalent to a shareholder" and should have been permitted to proceed with his derivative suit. The weight of authority, however, is against him.

Honda's Japanese law experts testified that only shareholders appearing on Honda Japan's shareholders' register may institute a derivative action under Article 267(1). "ADR holders are not shareholders of record" under Japanese law and therefore "are not allowed to make the demand and then institute a derivative action." According to one of Honda's experts, Professor Kitazawa, "the law on this point is undisputed; I know of no case or scholarly opinion that argues otherwise." Another of Honda's experts stated unequivocally that "Under Japanese law, a holder of [ADRs] would not be considered under Japanese law to be a registered shareholder and, therefore, would have no right or power to make the requisite pre-suit demand or to initiate the instant derivative litigation."

Batchelder has submitted no authority to compel a different conclusion.

***

In light of the foregoing, the district court correctly found that Batchelder lacked standing as an ADR holder under Japanese law to bring his shareholder derivative action on behalf of Honda Japan.

***

For the foregoing reasons, we conclude that the district court did not err in holding that Batchelder, as an ADR holder, lacks standing to bring a shareholder derivative suit on behalf of Honda Japan. . . . The district court's dismissal of Batchelder's action is therefore AFFIRMED.

Casepoint

A U.S. citizen holding an ADR receipt for shares of a Japanese company has rights defined by the deposit agreement. In this case, the agreement specified that shareholders' rights are defined by Japanese law. Thus, there is no "conflicts-of-law" analysis to perform here; under Japanese law, an owner of an ADR is not a shareholder of record and cannot bring a shareholder's derivative suit.

Many depository agreements include a disclaimer that there is no guarantee that ADR holders will receive proxy materials in sufficient time to vote. It is a standard term of depository agreements that ADR holders will have the right to vote only if the issuer formally requests the depositary to ask ADR holders for their votes. Some agreements even provide that if ADR holders do not vote, these shares will be assigned to the issuer's management to vote at its discretion.[174]

[174]See generally Vincent Duhamel, "Shareholder Rights and the Equitable Treatment of Shareholders, Fourth Asian Roundtable on Corporate Governance," available at www.oecd.org/dataoecd/49/12/2484854.pdf, p. 6 (2002).

(notably the United States, Canada, the United Kingdom, and Germany)[175] regard insider trading as unjust and dishonest. For example, during the U.S. congressional hearings leading up to the adoption of the 1934 Securities Exchange Act that criminalized insider trading, a Senate committee observed:

> Among the most vicious practices unearthed at the hearings before the subcommittee was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid them in their market activities.[176]

This is not the uniform view, however. Many other countries look upon insider trading as a normal business practice.[177]

The U.S. prohibitions against insider trading are found in Section 10(b) of the Securities Exchange Act of 1934 and in the Securities and Exchange Commission's Rule 10b-5, which implements Section 10(b) of the 1934 act.[178] These forbid an **insider** (e.g., a corporate officer, director, or majority shareholder) who has access to material nonpublic information from buying or selling shares for his or her own account when the person knows that the information is unavailable to the person or persons with whom he or she is dealing. In addition, a **tipper** who has inside information that he or she discloses to a tippee and a **tippee** who acts on that information, knowing that it is not available to the public, are both liable for the profits made by the tippee.[179]

Courts interpreting these provisions have held that information is **material** when it is such that a reasonable investor would act upon it, and information becomes *public* once it becomes available to the general public (although an insider must refrain from trading for a "reasonable waiting period" to allow news to be translated into investment action).

The United Kingdom's prohibitions on insider trading are found in the 1985 Company Securities (Insider Dealing) Act, in particular Chapter 8, Section 1. Insiders are defined as persons who are knowingly connected with a company (or were knowingly connected with a company in the past six months). They are forbidden from trading in the shares of the company if they have information that they know to be generally unavailable and that is likely to materially affect the price of the company's shares.[180] Insiders are also forbidden from trading in the shares of another company when they acquire information about that company as a result of its negotiations with their own firm. Additionally, tippees are forbidden from using the information they obtain from these insiders.

Whereas the British law has some similarities to the American law, it is also very different. Individual victims have no civil remedy in Britain (as they do in the United States). Also, the **materiality** of inside information is ascertained by a different standard. Rather than looking to whether "a reasonable man would attach importance [to the particular information] in determining his choice of action in the transaction in question,"[181] as is done in the United States, the British law

insider
A person, such as a corporate officer, director, or majority shareholder, who has access to material nonpublic information about a company or the securities market.

tipper
A person who has access to material nonpublic information about a company or the securities market and who discloses it to a tippee.

tippee
A person who acts for his or her personal account on information received from a tipper knowing that the information is not available to the public.

material
According to U.S. law, when something is of significance to a reasonable person (i.e., an investor);

material
According to British law, when the price of something (i.e., a security) would be significantly affected.

[175]The German Securities Trading Act defining and criminalizing insider trading came into effect on August 1, 1994. *Bundesgesetzblatt*, vol. I, p. 1749. India adopted similar legislation that came into effect in February 1992. See www.itcportal.com/insider-trading-caution.aspx.

[176]Report of the Committee on Banking and Currency, "Stock Exchange Practices," Senate Report No. 1455, 73rd Congress, Second Session, p. 55 (1934).

[177]Countries with small exchanges generally pay little attention to insider trading because few companies are publicly owned and those that are publicly traded are generally owned by only a limited number of individuals. For a recent comparative study of insider trading, see "Do Insider Trading Laws Matter? Some Preliminary Comparative Evidence" by Laura Nyantung Beny in the *American Law and Economics Review*, vol 7, pp. 144–183 (Spring 2005).

[178]See www.sec.gov/answers/insider.htm.

[179]Usually insider traders are persons with an employment or other relationship of trust with the corporation, but they do not have to be. Thus, in *United States v. Carpenter*, *United States Reports*, vol. 484, p. 19 (1987), the U.S. Supreme Court held that a columnist for the *Wall Street Journal* who tipped information about what would be in his investment advice column to tippees before the column appeared in print was liable, as an insider and a tipper, for the profits made by the tippees.

[180]In the United Kingdom, the relevant laws are the Financial Services Act of 1986 and the Financial Services and Markets Act of 2000, which defines an offense of market abuse. It is not illegal to fail to trade based on inside information (whereas without the inside information the trade would have taken place, because from a practical point of view this is too difficult to enforce). It is often legal to deal ahead of a takeover bid, where a party deliberately buys shares in a company in the knowledge that it will be launching a takeover bid.

[181]*List v. Fashion Park, Inc.*, *Federal Reporter, Second Series*, vol. 340, p. 457 at p. 462 (2nd Circuit Ct. of Appeals, 1965), *certiorari* denied, *United States Reports*, vol. 382, p. 811 (Supreme Court, 1965).

asks whether the information would affect the price of a security.[182] Finally, violation of the law does not, of itself, make a transaction void.

Japan's insider trading provisions are found in Article 58 of its Securities and Exchange Law. This article parallels Section 10(b) of the United States Securities Exchange Act, making insider transactions voidable if they are based on deceit and making directors liable for damages if their conduct amounts to bad faith or gross negligence. However, like the British act, Article 58 does not provide for civil remedies.

Despite the existence of this legislation, traditionally Japanese law did not view insider trading as improper, and its insider trading provisions were seldom enforced. In the late 1980s, however, several scandals—including one that involved the passing of insider information to politicians—brought about calls for reform; and in 1988 the Securities Exchange Law was amended to give it more teeth. The Ministry of Finance, the agency responsible for enforcing the law, can now require "the issuer of a security listed on the stock exchange, as well as the stock exchange itself, to submit reports concerning the operation of the exchange . . . "[183] In 2006, Japan's Upper House of Parliament passed legislation bringing stiffer penalties for insider trading, market manipulation, and accounting fraud as a direct result of the scandals involving Yoshiaki Murakami, former head of MAC Asset Management, and Livedoor's ex-CEO, Takafumi Horie. The revised penalties include a maximum five-year prison sentence for insider trading or a ¥5 million (U.S. $43,900) fine, increased from three years and ¥3 million previously.[184]

France, like Japan, also had a tradition of ignoring insider trading violations that was brought to an end by scandals implicating some of its senior politicians.[185] In 1989, it amended its insider trading laws to give the Commission des Opérations de Bourse (the Stock Exchange Oversight Commission) authority "to require the production of documents and testimony from any person" and to impose civil sanctions, in addition to its existing authority to bring criminal charges.[186]

Takeover Regulations

Financiers became actively involved in foreign acquisitions, mergers, and takeovers in the 1980s. British, Canadian, and Japanese corporate raiders made headlines for bidding on or taking over American entertainment, liquor, and publishing businesses. At the same time, efforts by American raiders to reciprocate were usually rebuffed. T. Boone Pickens's failure to gain a seat on the board of directors of the Japanese firm of Koito Manufacturing in 1988 is one such example.

The reason foreign raiders were generally successful in the United States but unsuccessful elsewhere is that securities regulations outside the United States are biased against takeovers. Common barriers to takeover attempts are (1) restrictions on share transferability, (2) cross-ownership of shares, and (3) restrictions on the voting rights of publicly held shares.

In the United States and the United Kingdom, stock exchange listing requirements prohibit restrictions on the transferability of shares of publicly held companies.[187] This is not the case in other countries. In Canada, for example, publicly offered shares may contain restrictions prohibiting their sale to non-Canadians.[188] French law allows a *sociètè anonyme (SA)* to forbid the transfer of its shares

[182]Company Securities Act, 1985, chap. 8, §1(1)(c).

[183]Tomoko Akashi, "Regulation of Insider Trading in Japan," *Columbia Law Review*, vol. 89, p. 1296 at p. 1304 (1989).

[184]See www.asialaw.com/Article/649605/Article.html.

[185]James A. Kehoe, "Exporting Insider Trading Laws: The Enforcement of U.S. Insider Trading Laws Internationally," *Emory International Law Review*, vol. 9, p. 345 at pp. 356–357 (1995).

[186]Michael D. Mann and Lise A. Lustgarten, "Internationalization of Insider Trading Enforcement—A Guide to Regulation and Cooperation," in American Bar Association National Institute on White Collar Crime, *White Collar Crime*, p. 511 at p. 555 (1990).

[187]Deborah A. Demott, "Comparative Dimensions of Takeover Regulation," *Washington University Law Quarterly*, vol. 65, p. 69 at p. 76 (1987). In the United States, the New York Stock Exchange and the Pacific Exchange prohibit the listing of stock with limitations on transferability. Other exchanges permit such restrictions. *Id*., p. 74.

[188]See, e.g., Ontario Business Corporations Act, § 42(2), available at www.e-laws.gov.on.ca/html/statutes/english/elaws_statutes_90b16_e.htm.

without the company's consent.[189] And in Switzerland, a corporation may prohibit any transfer of registered shares.[190]

Cross-ownership of shares is the placing of large blocks of stock in friendly hands to protect against a hostile takeover. In Japan, cross-ownership of shares is a prevalent practice, although its use now is much less common than it was before World War II.[191]

Voting restrictions on publicly held shares also inhibit takeovers. Continental European corporation statutes impose caps on the total percentage of shares any one owner may vote. For example, in Belgium, no single shareholder may cast more than one-fifth of the total votes.[192] A similar restriction applies in Germany.[193]

In contrast to the countries with takeover barriers, the countries with an active acquisition marketplace—notably the United Kingdom and the United States—have legislation or exchange rules that directly regulate the takeover process.[194] The goal of such regulations is neutrality: to put the raider and the management of the target company on a roughly equal footing.

Without takeover barriers or takeover regulations, the takeover process is weighted heavily in favor of the raider. For example, in the United States, prior to the enactment of the Williams Act of 1968,[195] a tender offer (i.e., a raider's offer to buy publicly held shares) was governed by the principle of *caveat venditor*.[196] The offeror was free to define the terms and conditions of his offer and to hold offerees (shareholders) to a binding contract from the moment they accepted. Commonly, the offer was held open for only a short period of time to exclude the possibility that a competing offer might appear or that the target firm's management could take some defensive action. It was also subject to a variety of conditions that allowed the offeror to back out if he was unable to complete the takeover to his satisfaction. In essence, the offerees were faced with a take-it-or-leave-it proposition, and the target firm's management had little ability to protect itself, while the raider's risks were minimal.

In the United States, the **Williams Act** attempts to put the contestants on a level playing field by authorizing the Securities and Exchange Commission (SEC) to issue rules governing tender offers for securities of companies registered under the Securities Exchange Act of 1934. The Williams Act and the SEC's rules require an offeror to disclose information about his finances and his reasons for attempting a takeover either before or at the time he announces his offer, and the target's management must be given time to circulate its views on the proposal. The offer must be kept open for a minimum period, and if the offer is for less than all of a target's shares, it may not be accepted on a "first-come, first-served" basis. An oversubscribed offer must be allocated among tendering subscribers on a pro rata basis. Also, subscribers may withdraw the shares they have tendered within specified time limits. Finally, anyone who acquires more than 5 percent of a publicly traded company's equity securities must disclose his holdings within ten days after the acquisition.[197]

Williams Act
Law enacted by the United States in 1968 that authorizes the Securities and Exchange Commission to issue rules regulating takeover bids.

One important aspect of the Williams Act is that it does not restrict the ability of offerors to set conditions that allow them to withdraw their offer. As a consequence, American offerors commonly include in their offers terms that permit them to revoke their offers if financing is unavailable, too expensive, or if they are challenged in court.

[189]French *Code des Socièté*s, Article 274. For more details, see www.formacompany.com/en/france/france-company-formation.

[190]See "Doing Business in Europe," *Common Market Reporter*, Commerce Clearing House (1983), para. 29,215 (summarizing the Swiss Code of Obligations).

[191]For more details about cross-ownership of shares in Japan, read "Networking in Japan: The Case of Keiretsu," by Richard W. Wright.

[192]See "Doing Business in Europe," *Common Market Reporter*, para. 21,256 (summarizing the Belgian *Commercial Companies Code*).

[193]*Id*., at para. 23,213.

[194]An excellent summary and comparison of the takeover regulations of Australia, Canada, the United Kingdom, and the United States can be found in Deborah A. Demott, "Comparative Dimensions of Takeover Regulation," *Washington University Law Quarterly*, vol. 65, p. 69 (1987) and posted at http://eprints.law.duke.edu/archive/00000049/01/ 65_Wash._U._L._Q._69_(1987).pdf.

[195]See http://law.jrank.org/pages/11330/Williams-Act.html.

[196]From Latin: "let the seller beware."

[197]*United States Code*, Title 15, §78m(d) available at www.law.cornell.edu/uscode/usc_sup_01_15.html.

On the other hand, the Williams Act does not restrict the defensive actions that a target's management may take.[198] The restrictions that do exist are imposed by the states and principally by the state courts. In Delaware and New York, the two states whose courts have addressed the issue most extensively, management is allowed to take any defensive measure that complies with the business judgment rule. That rule allows management to exercise reasonable business discretion, so long as it does so in the best interest of the corporation as a whole.[199]

City Code on Takeovers and Mergers Rules of the London Stock Exchange issued by the Exchange's Panel on Takeovers and Mergers that regulate takeover bids.

Takeovers in the United Kingdom are regulated by the London Stock Exchange's **City Code on Takeovers and Mergers** that is issued by the Exchange's Panel on Takeovers and Mergers. The City Code is similar to the Williams Act in that it (1) requires extensive disclosure by offerors, (2) sets a minimum duration for offers, (3) requires prorated acceptance for oversubscribed partial offers, and (4) grants tendering shareholders limited withdrawal rights. Unlike the Williams Act, it regulates conditions set by the offeror, and it forbids conditions "depending solely on subjective judgments by the directors of the offeror." Also, partial offers may be made only with the consent of the panel, and an offeror who acquires more than 30 percent of the shares of a target must offer to buy out the remaining shareholders at the highest price paid during the previous year for comparable shares. Finally, the responses that a target's board of directors may take are more structured. The board, to which the offeror must initially make his offer, has to obtain "competent independent advice" on the offer and share that advice both with its own shareholders and, if requested, any other legitimate offeror. The target board must also obtain shareholder approval of any defensive action it takes that is intended to frustrate a takeover bid.

The text of the London Stock Exchange's City Code on Takeovers and Mergers is posted at www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/code.pdf.

D. Enforcement of Securities Regulations Internationally

International cooperation in the enforcement of securities regulations is a relatively recent development. In 1961, the OECD adopted a Code of Liberalization of Capital Movements,[200] which it hoped would abolish stock exchange restrictions among its member states. Many members, however, filed reservations to the code, demonstrating that attitudes about securities regulations were then too diverse for the international community to agree upon a single regulatory mechanism. Also, the code had no effective enforcement provisions, and the OECD member states, in practice, ignored it.[201]

Until the 1980s, no other attempts were made to establish any formal mechanism of international cooperation. Then the United States began pushing its major trading partners to enter into cooperative agreements, and the Council of Europe began work on an insider trading convention. An insider trading convention within the EU entered into force in 1991 and has been signed by eight nations.

---

[198]Examples of immediate defenses to a takeover bid are (a) the *self tender* (an offer by a target to buy its own stock from its shareholders to maintain control); (b) the *white knight* defense (the target arranges a favorable merger with another corporation); (c) the *Pac Man* defense (the target offers to purchase the raiding corporation); (d) greenmail (the target offers to buy the stock bought by the raider at a premium); and (e) a suit for an injunction (the target claims that the resulting merger or consolidation would violate some state or federal statute, such as the federal anti-trust laws).

Long-term tactics that make a corporation more generally unattractive to takeover bids are (a) the *scorched earth* ploy (the target arranges to sell off its principal assets or it has loans that become due immediately after a takeover occurs); (b) the *shark repellent* scheme (the target changes its charter or bylaws to require a higher than normal shareholder vote to approve a merger or consolidation); (c) the *poison pill* (the target's shares are redeemable for cash in the event of a takeover); and (d) *golden parachutes* (which provide for high payments to officers and directors in the event that they are discharged or demoted).

[199]See *Unocal Corp. v. Mesa Petroleum Co.*, *Atlantic Reporter, Second Series*, vol. 493, p. 946 (Delaware Supreme Ct., 1985); and *Norlin Corp. v. Rooney, Pace, Inc.*, *Federal Reporter, Second Series*, vol. 744, p. 255 (2nd Circuit Ct. of Appeals, 1984) (applying New York law).

[200]See www.oecd.org/document/39/0,3746,en_2649_34887_39665831_1_1_1_1,00.html.

[201]*International Capital Markets and Securities Regulations*, vol. 10, §2.02 (Harold S. Blumenthals and Samuel Wolff, eds., 1982).

International Enforcement Cooperation

The U.S. SEC was among the first securities regulators to receive the legal authority to assist their foreign counterparts in investigations of securities fraud. The SEC can now assist foreign securities authorities in their investigations using a number of tools, including exercising the SEC's compulsory powers to obtain documents and testimony. For example, Section 21(a)(2) of the Securities Exchange Act of 1934 authorizes the SEC to conduct investigations on behalf of foreign securities authorities (as defined by the Exchange Act) and compel the production of documents and testimony from any person and entity, irrespective of whether that person or entity is regulated by the SEC. The SEC may do so even if the conduct is not a violation of U.S. law.

The SEC has the ability to provide access to nonpublic information in its files with foreign persons. Section 24(c) of the Exchange Act and 17 C.F.R. §240.24c-1 provide that the Commission may, in its discretion and upon showing that such information is needed, provide such nonpublic information in its possession to specified foreign persons. The authority requesting such nonpublic information must establish and maintain such safeguards as are necessary and appropriate to protect the confidentiality of files. The Commission, to provide such assurances, will (1) make no public use of these files or information without prior approval of SEC staff, (2) notify the SEC of any legally enforceable demand for the files or information prior to complying with the demand, and assert such legal exemptions or privileges on the SEC's behalf as it may request; and (3) not grant any other demand or request for the files or information without prior notice to and lack of objection by SEC staff.

Mechanisms for Information Sharing in Securities Enforcement Matters The SEC has approached enforcement-related information-sharing on a multilateral, bilateral, and *ad hoc* basis. Multilateral and bilateral information sharing arrangements operate on the basis of memoranda of understanding (MOU) between securities authorities. Such MOUs delineate the terms of information-sharing between and among MOU signatories and create a framework for regular and predictable cooperation in securities law enforcement. Multilateral and bilateral MOUs detail the scope and terms of information-sharing among securities regulators.

In addition to multilateral, bilateral, and *ad hoc* understandings, the SEC also uses other mechanisms to facilitate information-sharing, such as requests to foreign criminal authorities through mutual legal assistance treaties (MLATs) administered by the U.S. Department of Justice, formal letters rogatory between a U.S. court and foreign judicial authorities.

In fiscal year 2008, the SEC made 594 requests to foreign authorities for enforcement assistance and responded to 414 requests from foreign authorities.

IOSCO Multilateral Memorandum of Understanding In 2002, the International Organization of Securities Commissions (IOSCO) created a Multilateral Memorandum of Understanding (MMOU), the first global multilateral information-sharing arrangement among securities regulators. The U.S. SEC was among the first signatories to the MMOU. As of June 2009, 51 securities and derivatives regulators had become signatories to the MMOU and 20 additional IOSCO members had expressed their commitment to become signatories.

Under the MMOU, signatories agree, among other items, to provide certain critical information, to permit use of that information in civil or administrative proceedings, to onward information-sharing with self-regulatory organizations and criminal authorities, and to keep such information confidential. In particular, the MMOU provides for (1) sharing information and documents held in the regulators' files, (2) obtaining information and documents regarding transactions in bank and brokerage accounts, and the beneficial owners of such accounts, and (3) taking or compelling a person's statement or, where permissible, a person's testimony.

The MMOU has significantly enhanced the SEC's enforcement program by increasing and expediting the SEC's ability to obtain information from a growing number of jurisdictions worldwide. Moreover, the MMOU has created incentives for jurisdictions that lack the legal ability to engage in effective information-sharing to enact legislation that will enable them to do so.

The MMOU builds on a body of work by IOSCO aimed at strengthening international cooperation in securities enforcement matters, including Principles of Memoranda of Understanding, adopted by IOSCO in 1991, and the Resolution on Principles for Record Keeping, Collection of Information, Enforcement Powers, and Mutual Cooperation to improve the Enforcement of Securities and Futures Laws, adopted in 1997.

Membership in the MMOU requires an objective showing of a nation's legal authority to comply with the key provisions. IOSCO has established verification teams to review applications, and the SEC participates in this review. Information regarding IOSCO membership and how to apply to be an MMOU signatory is available on the IOSCO Web site.

Bilateral Memoranda of Understanding Before the establishment of the IOSCO MMOU, the SEC signed bilateral information sharing MOUs with the securities authorities of 20 different countries. Bilateral MOUs have proven crucial to investigations undertaken by the Commission's enforcement staff and, as such, the SEC considers these bilateral arrangements to be an excellent supplement to the information-sharing mechanism of the IOSCO MMOU. In light of the IOSCO MMOU, the SEC staff now strongly recommends the negotiation of bilateral MOUs only if a foreign securities authority is empowered to provide assistance beyond that required by the IOSCO MMOU such as the ability to compel testimony or the gathering of Internet service provider, phone, and other records other than bank, broker, and beneficial owner information on behalf of the requesting authority. (See the Enhanced Enforcement Memorandum of Understanding between the SEC and the Australian Securities and Investments Commission, dated August 25, 2008.)

Generally, the bilateral MOUs contain detailed provisions on use and confidentiality of information. The assistance available under the current MOUs varies in scope depending on the underlying statutory authority of the regulators that are party to the MOU.

***Ad Hoc* and Other Arrangements for Enforcement Cooperation** Although MOUs and the MMOU facilitate enforcement cooperation, such arrangements are not a prerequisite for the SEC to cooperate with foreign authorities regarding enforcement matters. The SEC also has cooperated on an *ad hoc* basis with foreign regulators with whom it has no bilateral MOU or who are not yet signatories to IOSCO MMOU. In the past, such *ad hoc* arrangements have included communiqués and joint statements that express a desire to develop greater enforcement cooperation capabilities. The SEC also has entered into undertakings for the exchange of information where existing law in the foreign jurisdiction prevents information-sharing to the extent set forth in the IOSCO MMOU.

The Convention on Insider Trading

In 1983, the Council of Europe sponsored a colloquy in Milan, Italy, to review national regulations and to examine the deficiencies in international law with respect to insider trading. The colloquy led to the appointment of a Committee of Experts (drawn from the council's member states, Finland, the United States, and the Commission of the European Community) to draft a convention on insider trading. On April 20, 1989, the council formally adopted the Convention on Insider Trading[202] and opened it for signature. The nations that have signed are noted in Table 5.5.

The convention's purpose is to assist the regulatory agencies of its signatory states by establishing a mechanism for the exchange of information so that those agencies can better supervise their securities markets. In particular, "because of the internationalization of markets and the ease of present-day communications," it focuses on uncovering the insider trading activities "on the market of a state by persons not resident in that state or acting through persons not resident there."[203] The convention does not attempt to establish uniform enforcement provisions or sanctions.

In essence, the convention allows one state to request the assistance of another in uncovering conduct by an individual or individuals in the latter's territory that constitutes insider trading in the requesting state. The requesting state must make a full disclosure of the facts that lead it to believe that insider trading has taken place, and it must state what it will do with the information it receives.[204] The state receiving the request then follows the procedures set up by its own laws in responding to the request, subject to an overall obligation to keep both the request and the assistance it provides secret. The requested state can refuse to honor a request if it is too broad or if the conduct described does not constitute a violation of both states' insider trading rules.[205]

---

[202]See Council of Europe, Convention on Insider Trading (1989), available at http://conventions.coe.int/Treaty/en/Treaties/Html/130.htm.

[203]Council of Europe, Convention on Insider Trading, Preamble.

[204]*Id*., Exchange of Information, Article 5.

[205]By a special declaration, a signatory state can—subject to reciprocity—agree to provide information on all types of securities regulations, not just insider trading.

TABLE 5.5

National Signatories to the Council of Europe's Convention on Insider Trading

Country	Date of Ratification	Type of Reserve
Cyprus	1994-02-08	B
Czech Republic	2000-09-08	A, B, C
Finland	1995-09-13	B, C
Luxembourg	1997-08-29	B, C
Netherlands	1994-07-04	A, B, C, F
Norway	1990-04-11	B
Sweden	1991-06-03	A, B
United Kingdom	1990-12-21	B, C, D, E

Code Description

A Reservation or declaration made in accordance with Article 3 of the Convention.

B Reservation or declaration made in accordance with Article 4(2) of the Convention.

C Reservation or declaration made in accordance with Article 6(5) of the Convention.

D Reservation or declaration made in accordance with Article 16(2) of the Convention.

E One or many reservations or declarations have been withdrawn or amended.

F Other type of reservation or declaration.

Source: "Ratifications (or adhesions) and reservations (8 countries)," table from Juris International online. Copyright © 2002 by the International Trade Center. Reprinted with permission.

Extraterritorial Application of U.S. Securities Laws

One important example of the many attempts to apply securities regulations internationally has been the enforcement of U.S. securities laws extraterritorially. Consideration of this is especially important because U.S. laws apply to a much wider range of activities than those of any other country. The U.S. Securities Act of 1933 requires companies to disclose their financial standing before issuing new shares. The Securities and Exchange Act of 1934 requires managers and owners of large percentages of stock to disclose their ownership interests, and it forbids insider trading and other fraudulent securities transactions. The Williams Act requires corporate raiders to disclose their finances and their reasons for making a takeover bid.

To ensure that persons operating outside the United States do not avoid these laws, the SEC and the U.S. Department of Justice (which are responsible for their enforcement) have regularly instituted suits involving nonresident aliens. This has forced courts to determine if the U.S. securities laws give them the necessary jurisdiction to hear these cases. The principle of nationality objective territoriality jurisdiction can potentially subject non-U.S. companies to U.S. securities laws where the activities of those companies (or their personnel) have an "effect" on U.S. markets. Especially significant are the "foreign-cubed" securities litigation: where there are foreign plaintiffs who bought shares in a foreign company on a foreign exchange. Do U.S. courts have the authority to hear these types of cases? And, if so, do U.S. securities laws extend extraterritorially to reach such transactions?

In 2010, the U.S. Supreme Court answered these questions "Yes" and "No," respectively. In *Morrison v. National Australia Bank Ltd*., 561 U.S. ___, the Supreme Court narrowed the reach of key antifraud provisions of the Securities Exchange Act of 1934. The Court found that the antifraud provisions apply *only* with respect to (1) the purchase or sale of a security listed on a U.S. stock exchange or (2) the purchase or sale of any other security in the United States. In *Morrison*, the defendant was National Australia Bank, Ltd. ("NAB"). NAB is an Australian bank whose common stock is traded on the Australian Stock Exchange Limited and other non-U.S. securities exchanges. NAB's American Depositary Receipts (ADRs) are traded on the New York Stock Exchange, but the case did not involve purchases of ADRs. Rather, NAB's subsidiary, HomeSide Lending, Inc. (a mortgage service provider headquartered in Florida), allegedly used fraudulent accounting in the United States to overstate the value of its mortgage servicing rights. HomeSide sent those inflated figures to NAB in Australia, which disseminated them in public filings. NAB later announced two write-downs totaling $2.2 billion due to recalculations in the value of HomeSide's mortgage servicing rights. Non-U.S. investors who bought NAB stock on non-U.S. exchanges then sued NAB under anti-fraud provisions of the U.S. securities laws, principally Section 10(b) of the Exchange Act and SEC Rule 10b-5.

The Second Circuit Court of Appeals upheld the dismissal of the claims for lack of subject-matter jurisdiction based on its conclusion that the heart of the alleged fraud occurred abroad and

that the effects were felt abroad. The U.S. Supreme Court unanimously affirmed the dismissal of the complaint, but did so in a way that changed the prevailing law. A five-member majority of the Court rejected the various formulations of the "conduct" and "effects" tests previously used by most U.S. Circuit Courts of Appeals to analyze whether securities fraud claims could be brought based on securities transactions outside the United States. The Court instead adopted a bright-line transactional test to determine when Section 10(b) is applicable. Specifically, the Court ruled that Section 10(b) and Rule 10b-5 apply "only in connection with a purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States." Because the case did not involve any trades on a domestic exchange and the purchases occurred outside the United States, the Court held that the petitioners failed to state a claim on which relief could be granted.

The Court found that there was no affirmative indication in the text of the Exchange Act that Section 10(b) was intended to apply extraterritorially, and that absent such an indication the statute does not apply outside the territorial jurisdiction of the United States. Moreover, the Court stated that the focus of the anti-fraud provisions is not on where the deception at issue originates, but rather on fraud in connection with purchases and sales of securities in the United States. The Court also stressed the importance of avoiding interference with foreign securities regulation.

As the Court acknowledged, however, Congress could effectively overturn the decision in *Morrison* by amending the federal securities laws. The Dodd-Frank Wall Street Reform and Consumer Protection Act was passed with a provision regarding the extraterritorial reach of actions brought by the SEC or the United States under the antifraud provisions of the Exchange Act. The provision permits claims by the SEC and other U.S. enforcement agencies with respect to: "(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States." As this provision only affects actions brought by the SEC or the United States, it would have no effect on *Morrison* with respect to private actions. Still, it is unclear to what extent the Dodd-Frank provisions create liability to the SEC in "foreign cubed" cases.

Chapter Questions

Approval of Foreign Investment Applications

1. Overseas Investment Co. (OIC), a multinational enterprise with its headquarters in State W, entered into a joint venture with Investment Promotions Facility, Ltd. (IPF), a state-owned company whose board of directors and principal officers had been appointed by the minister of finance of State X. The joint venture agreement provided that, in the event of any dispute, the dispute would be resolved by arbitration. Additionally, because the law of State X says that all foreign investment agreements must be approved by the minister of finance, the minister was present at the signing of the agreement; and after representatives of the two parties put their signatures on the document, the foreign minister added the words "approved and ratified" and his own signature.

   Unfortunately, a dispute did arise, and OIC initiated an arbitration proceeding according to the procedures set out in the joint venture agreement, naming both IPF and State X as parties. State X responded by arguing that the arbitration tribunal has no jurisdiction over it. Should State X be excused from participating in the suit? Discuss.

Import Duties in Free Trade Zones

2. In *Nissan Motor Mfg. Corp., U.S.A. v. United States*, a Japanese company was required to pay customs duty in a foreign trade zone established in Tennessee. Does this defeat the purpose of a free trade zone? Was the case specific to U.S. law or do you think there are principles discussed that could be applied to similar disputes in other jurisdictions?

Modification of Foreign Investment Agreements

3. The Modern Exploration Co. (MEC), a firm organized in State P, entered into an investment contract with State Q to explore for and harvest magnesium nodules from the seabed of State Q's continental shelf. MEC agreed to pay State Q U.S. $100 million in advance for this privilege. State Q, however, did not inform MEC that it would be promulgating certain environmental protection laws within days after signing this contract that would make the endeavor so expensive that it would be effectively impossible for MEC to perform. When MEC discovered this, it asked State Q to either modify the environmental laws or give MEC back its money. State Q refused. MEC then initiated an arbitration proceeding under the auspices of the ICSID in accordance with the terms of the investment agreement and State Q law. How should the tribunal rule? Discuss.

Obligation of Parent for Subsidiary's Debts

4. Turnip Company, a multinational enterprise headquartered in State T, ordered its subsidiary in State R, the Radish Company, to close and to declare itself bankrupt. The Radish Company did

so. However, it did not give its employees adequate notice of its closing, and its assets were inadequate for funding the termination payments due the employees under State R law. In the bankruptcy proceeding, the employees asked the bankruptcy tribunal to order Turnip to fund the termination payments that Radish owed them. In support of this, the employees introduced evidence establishing that Turnip had known for some time that Radish was an unprofitable subsidiary and would have to be closed; and that, in anticipation of this, it had taken assets belonging to Radish out of the state so that they would be unavailable at the time of the bankruptcy liquidation. How should the tribunal rule? Discuss.

Takeover Defenses

5. Little, Ltd., is a small publicly traded stock company that owns a valuable patent. Little has approximately 1,000 shareholders and about 100,000 shares authorized and outstanding. Big Company would like to use the patent, but Little has refused to grant it a license. Big offered to buy out all of Little's assets, but Little's board of directors refused. Big has now tendered an offer to all of Little's shareholders to pay them U.S. $10 a share for their stock, a price that is slightly above the current fair-market price. What can Little do to prevent Big from succeeding? Discuss.

Insider Trading

6. A subsidiary of X Enterprises is registered with the London Stock Exchange and another subsidiary with the New York Stock Exchange. X Enterprises is an energy company that has planned on heavily investing in two simultaneous untested photovoltaic projects in a week's time through its subsidiaries in the United Kingdom and United States. Dr. Y is a technical consultant for both projects and holds 5% shares of both subsidiaries. The CEO of X Enterprises shares the date when the projects would be made public with Dr. Y. The day prior to this, Dr. Y sells all of his shares in the two subsidiaries, and the day the two projects are declared, the price of the each share drops by 0.5% in the New York Stock Exchange and 0.0001% in the London Stock Exchange. The securities regulatory agencies in both the United States and United Kingdom seek to prosecute Dr. Y on receiving a complaint from the CEO of X Enterprises. Do you think Dr. Y would be held liable for insider trading? Discuss.

CHAPTER

6

Money and Banking

Chapter Outline

A. Money
  - The Value of Money
  - The Choice of Money
  - Maintaining Monetary Value

B. The International Monetary Fund (IMF)
  - Origin of the IMF
  - IMF Quotas
  - Organization of the IMF

C. IMF Operations

D. Currency Exchange
  - Currency Exchange Obligations of IMF Member States
  - Enforcement of Exchange Control Regulations of IMF Member States
  - Enforcement of Exchange Control Laws in the Absence of IMF Membership
  - Enforcement of Other IMF Member State Currency Exchange Obligations
  - Exemptions for New Members from IMF Member State Currency Exchange Obligations

E. Currency Support
  - IMF Facilities
  - IMF Conditionality

F. Development Banks
  - Controversies at the World Bank

G. The Bank for International Settlements
  - The Central Banks' Bank
  - Promoter of International Monetary Cooperation
  - Agent for International Settlements
  - BIS and Basel III

H. Regional Monetary Systems

I. National Monetary Systems
  - National Monetary Organizations
  - Bank Deposits
  - Eurocurrency Deposits
  - The Interbank Deposit Market
  - The Foreign Exchange Market
  - Foreign Exchange Contracts
  - Arbitrage
  - The Transfer of Money
  - Branch Banking
  - Conflicts Between Host and Home State Regulations

Chapter Questions

The world's money and banking system is neither coherent nor well organized. In the absence of a convenient set of laws or regulations, custom and practice regulate much of it. The system is highly informal. On the international plane, its players include national institutions governed by national laws, as well as international agencies, such as the International Monetary Fund (IMF) and the Bank for International Settlements, whose operations are governed as often by informal agreements, plans, and accords as they are by treaties or conventions. On the domestic level, each country (or small group of countries) has its own national monetary system and its own specialized and often unique institutions.

A. Money

According to one dictionary, **money** is "anything customarily used as a medium of exchange and measure of value." Economists generally attribute three characteristics to money: it acts (1) as a means of exchange, (2) as a unit of measure or value, and (3) as a medium for storing value over time.[1]

money
Anything customarily used as a medium of exchange and a measure of value.

Money can be both private and official. Private money commonly consists of a basket of official currencies, but it can also be a stock of rare metal or any other commodity that is easily transferable and reasonably nonspoilable. Official money is a unit of exchange issued by a government agency (such as a treasury department) or government-controlled financial institution (such as a central bank).[2]

Private money can be used only for making payments between private parties who agree in advance to its use. Most official money (i.e., coins and currency) can be used to pay debts of any kind, whether private or public. However, some types of official money, known as *reserve currencies* (such as the IMF's Special Drawing Right—the SDR), may be used only by governments to pay other governments.

The Value of Money

While the value of property and services is measured by money, the value of money (i.e., official money) is *nominally* constant. That is, if one agrees to purchase something for 100 units of a specified currency (such as dollars, marks, pounds, or yen), the obligation can be discharged only by paying those particular 100 units. The obligation does not change because the purchasing power or conversion value of the currency has fluctuated. This principle is known as **nominalism.**[3]

nominalism
The principle that an obligation to pay a particular sum of money is fixed and does not change even if the purchasing power or foreign exchange rate of the money does change.

If the parties to a contract have not taken care to anticipate changes in the value of the currency they use, the principle of nominalism "puts the risk of depreciation on the creditor and the risk of appreciation (or revaluation) on the debtor and neither part[y] can be heard to complain about unexpected losses."[4] National law in a few countries has mediated the harshness of this rule in extreme circumstances. In Germany, for example, the courts are allowed to revalue money if a currency has totally or almost totally collapsed.[5] In Argentina, Belgium, Germany, and Uruguay, claims are allowed where one party suffers because another fails to pay in a timely fashion and the value of the currency depreciates in the meantime. In England, Italy, and the United States, on the other hand, revaluation is not allowed.[6]

[1]J. Carter Murphy, "International Moneys: Official and Private," *International Lawyer*, vol. 23, p. 921 at p. 923 (1989).

[2]The U.S. Uniform Commercial Code's definition is typical of most countries. Section 1–201(24) states: "'Money' means a medium of exchange authorized or adopted by a domestic or foreign government and includes a monetary unit of account established by an intergovernmental organization or by agreement between two or more nations."

[3]F. A. Mann, *The Legal Aspect of Money*, pp. 80–114 (4th ed., 1982).

[4]*Id*., p. 272.

[5]*Id*., p. 285.

[6]*Id*., pp. 286–287. Keith S. Rosenn, "The Effects of Inflation on the Law of Obligations in Argentina, Brazil, Chile and Uruguay," *British Columbia International and Comparative Law Review*, vol. 2, p. 274 (1979). In France the case law is inconsistent, and no settled rule has evolved. Mann, *The Legal Aspect of Money*, p. 287.

Application of the principle of nominalism can be avoided in the special case where currency is to be delivered not as money, but as a commodity. For example, the seller of a rare coin might be able to set aside the sale if he learns the coin is much more valuable than the agreed-upon price. In the case of *Richard v. American Union Bank*,[7] a dealer in foreign currency successfully argued that the currency he had agreed to buy was a commodity that had become worthless and therefore he was not obliged to accept delivery.

The Choice of Money

money of account The money used to define the amount of an obligation.

money of payment The money used to pay off an obligation.

In domestic transactions, obligations are paid in local currency. In international transactions, the parties must designate the money that the buyer has to deliver. Actually, two monies have to be selected. First is the **money of account.** This is the money that expresses the amount of obligation owed. Second is the **money of payment.** This is the money that the buyer must use to pay for the items purchased. In most situations, the money chosen for both will be the same, but it does not have to be. For example, a seller may agree to deliver a product worth 1 million Australian dollars, and a buyer may agree to pay for it in Swiss francs (see Figure 6.1).

In addition to selecting the money of account and the money of payment, contracting parties need to select the place of payment. This is important because virtually all countries allow a foreign money obligation to be satisfied by payment in the local currency at the exchange rate effective on the date payment is due.[8] Absent a selection by the parties, the courts will determine the place of payment, and that determination can vary from country to country.[9] For example, if the United Nations Convention on Contracts for the International Sale of Goods[10] applies, the place of payment will be the place of delivery (if such a place was designated); otherwise, it will be the seller's place of business (Article 57(1)).

By choosing a money of account, a money of payment, and a place for payment, the parties to a contract are also authorizing the courts in the states that issue those monies or the court in the state wherein payment is to take place to resolve disputes related to the interpretation or performance of the contract. This point is considered in Case 6-1.

Maintaining Monetary Value

A seller agrees to deliver 10,000 barrels of crude oil within three months to a buyer in Country X, with payment to be made in Country X's currency at the time of delivery. Country X's currency is inflating at 1,000 percent a year. How does the seller ensure that he will receive a fair price for the

FIGURE 6.1

Swiss Francs and Australian Dollars Can Be Used in the Same Transaction

Source: Glyn Thomas/Alamy

[7] *New York Reports*, vol. 253, p. 166 (1930).

[8] F. A. Mann, *The Legal Aspect of Money*, p. 308 (4th ed., 1982). The conversion rate for foreign currency is specified in the U.S. Uniform Commercial Code as "the current bank-offered spot rate at the place of payment for the purchase of dollars on the day on which the instrument is paid" §3–107. A similar formula is applied in most other countries.

[9] In some countries, payment is due at the seller's place of business; in others, at the buyer's place of business. F. A. Mann, *The Legal Aspect of Money*, pp. 214–219 (4th ed., 1982).

[10] The text of the convention is posted at www.uncitral.org/pdf/english/texts/sales/cisg/CISG.pdf.

CASE 6-1 Republic of Argentina et al. v. Weltover, Inc. et al.

United States Supreme Court
United States Reports, vol. 504, p. 607 (1992)

MAP 6.1

Argentina (1992)

Opinion by Justice Scalia

This case requires us to decide whether the Republic of Argentina's default on certain bonds issued as part of a plan to stabilize its currency . . . had a "direct effect in the United States" so as to subject Argentina to suit in an American court under the Foreign Sovereign Immunities Act of 1976.[11] . . .

Since Argentina's currency is not one of the mediums of exchange accepted on the international market, Argentine businesses engaging in foreign transactions must pay in U.S. dollars or some other internationally accepted currency. In the recent past, it was difficult for Argentine borrowers to obtain such funds, principally because of the instability of the Argentine currency. To address these problems, petitioners, the Republic of Argentina, and its central bank, Banco Central (collectively Argentina), in 1981 instituted a foreign exchange insurance contract program (FEIC), under which Argentina effectively agreed to assume the risk of currency depreciation in cross-border transactions involving Argentine borrowers. This was accomplished by Argentina's agreeing to sell to domestic borrowers, in exchange for a contractually predetermined amount of local currency, the necessary U.S. dollars to repay their foreign debts when they matured, irrespective of intervening devaluations.

Unfortunately, Argentina did not possess sufficient reserves of U.S. dollars to cover the FEIC contracts as they became due in 1982. The Argentine government thereupon adopted certain emergency measures, including refinancing of the FEIC-backed debts by issuing to the creditors government bonds. These bonds, called "Bonods," provide for payment of interest and principal

[11] *United States Code*, Title 28, §1602 et seq. posted at www.law.cornell.edu/uscode/28/usc_sec_28_00001602----000-.html.

in U.S. dollars; payment may be made through transfer on the London, Frankfurt, Zurich, or New York market, at the election of the creditor. Under this refinancing program, the foreign creditor had the option of either accepting the Bonods in satisfaction of the initial debt, thereby substituting the Argentine government for the private debtor, or maintaining the debtor/creditor relationship with the private borrower and accepting the Argentine government as guarantor.

When the Bonods began to mature in May 1986, Argentina concluded that it lacked sufficient foreign exchange to retire them. Pursuant to a Presidential Decree, Argentina unilaterally extended the time for payment, and offered bondholders substitute instruments as a means of rescheduling the debts. Respondents, two Panamanian corporations and a Swiss bank, who hold, collectively, $1.3 million of Bonods, refused to accept the rescheduling, and insisted on full payment, specifying New York as the place where payment should be made. Argentina did not pay, and respondents then brought this breach of contract action in the United States District Court for the Southern District of New York, relying on the Foreign Sovereign Immunities Act of 1976 as the basis for jurisdiction. Petitioners moved to dismiss for lack of subject matter jurisdiction, lack of personal jurisdiction, and *forum non conveniens*.[12] The District Court denied these motions, and the Court of Appeals affirmed. We granted Argentina's petition for *certiorari*,[13] which challenged the Court of Appeals' determination that, under the Act, Argentina was not immune from the jurisdiction of the federal courts in this case.

. . . The . . . question is whether Argentina's unilateral rescheduling of the Bonods had a "direct effect" in the United States.[14] . . . As the Court of Appeals recognized, an effect is "direct" if it follows "as an immediate consequence of the defendant's . . . activity."[15]

The Court of Appeals concluded that the rescheduling of the maturity dates obviously had a "direct effect" on respondents. It further concluded that the effect was sufficiently "in the United States" for purposes of the FSIA, in part because "Congress would have wanted an American court to entertain this action" in order to preserve New York City's status as "a preeminent commercial center."[16] The question, however, is not what Congress "would have wanted" but what Congress enacted in the FSIA. Although we are happy to endorse the Second Circuit's recognition of "New York's status as a world financial leader," the effect of Argentina's rescheduling in diminishing that status (assuming it is not too speculative to be considered an effect at all) is too remote and attenuated to satisfy the "direct effect" requirement of the FSIA.[17]

We nonetheless have little difficulty concluding that Argentina's unilateral rescheduling of the maturity dates on the Bonods had a "direct effect" in the United States. Respondents had designated their accounts in New York as the place of payment, and Argentina made some interest payments into those accounts before announcing that it was rescheduling the payments. Because New York was thus the place of performance for Argentina's ultimate contractual obligations, the rescheduling of those obligations necessarily had a "direct effect" in the United States: Money that was supposed to have been delivered to a New York bank for deposit was not forthcoming. We reject Argentina's suggestion that the "direct effect" requirement cannot be satisfied where the plaintiffs are all foreign corporations with no other connections to the United States. We expressly stated in *Verlinden* [*B.V. v. Central Bank of Nigeria*] that the FSIA permits "a foreign plaintiff to sue a foreign sovereign in the courts of the United States, provided the substantive requirements of the Act are satisfied."[18]

Finally, Argentina argues that a finding of jurisdiction in this case would violate the Due Process Clause of the Fifth Amendment [of the United States Constitution], and that, in order to avoid this difficulty, we must construe the "direct effect" requirement as embodying the

---

[12]From Latin: "inconvenient forum." Doctrine that a municipal court will decline to hear a dispute when it can be better or more conveniently heard in a foreign court.

[13]From Latin: "to be made certain" or "to be certified." It is an order from a superior to an inferior court requiring the latter to produce a certified record of a particular case tried therein.

[14]*United States Code*, Title 28, §1602(a)(2).

[15]*Federal Reporter, Second Series*, vol. 941, p. 145 at p. 152 (Second Circuit Court of Appeals, 1991).

[16]*Id*., at p. 153.

[17]*Id*.

[18]*United State Reports*, vol. 461, p. 480 at p. 489 (Supreme Court, 1983).

"minimum contacts" test of *International Shoe Co. v. [State of] Washington*.[19] Assuming, without deciding, that a foreign state is a "person" for purposes of the Due Process Clause,[20] we find that Argentina possessed "minimum contacts" that would satisfy the constitutional test. By issuing negotiable debt instruments denominated in U.S. dollars and payable in New York and by appointing a financial agent in that city, Argentina "purposefully avail[ed] itself of the privilege of conducting activities within the [United States]."[21]

We conclude that Argentina's issuance of the Bonods . . . [and] its rescheduling of the maturity dates on those instruments . . . had a "direct effect": in the United States; and that the District Court therefore properly asserted jurisdiction, under the FSIA, over the breach of contract claim based on that rescheduling. Accordingly, the judgment of the Court of Appeals is affirmed.

Casepoint

(1) If the place of performance of a contractual obligation is in the United States, there are direct effects in the United States and courts there will have personal jurisdiction; by designating the United States as the place of performance for a contractual obligation, a foreign entity (sovereign or otherwise) "purposely avails itself of the privilege of conducting activities within the U.S." (2) As a sovereign, Argentina is not entitled to immunity under the FSIA because its change in the maturity dates of the bonds was "commercial activity" that had a direct effect in the United States.

oil? Commonly, this is done by including a **maintenance of value clause** in the sales contract. Such a clause stipulates that the price is to be adjusted according to the inflation rate.[22]

A seller of commodities can also avoid the problem of inflation (and the buyer the problem of deflation) by designating a money of account that traditionally maintains its value. The currency most commonly used for this purpose is the American dollar, but the EU euro, the Japanese yen, and the British pound are also widely used.

A third mechanism for avoiding currency fluctuations is the use of a **currency basket.** That is, the money of account in a contract is defined by a weighted average of a selected group of currencies. The basket (or group of currencies) may be created *ad hoc* for a particular agreement. For example, the parties may agree that the money of account for their contract will be a currency basket made up of American dollars, British pounds, and Japanese yen, with the dollar making up 50 percent of the value, the pound 30 percent, and the yen 20 percent. More commonly, however, parties will use an official basket currency established by intergovernmental organizations, such as the IMF's SDR. The SDR is an international reserve asset that member countries can add to their foreign currency and gold reserves and use for payments requiring foreign exchange. Its value is set daily using a basket of four major currencies: the euro, Japanese yen, pound sterling, and U.S. dollar. The IMF introduced the SDR in 1969 because of concern that the stock and prospective growth of international reserves might not be sufficient to support the expansion of world trade. (The main reserve assets at the time were gold and U.S. dollars.) The SDR was introduced as a supplementary reserve asset, which the IMF could "allocate" periodically to members when the need arose and cancel as necessary. The SDR is also the IMF's unit of account.

maintenance of value clause
A contractual provision that says that the price will be adjusted according to the inflation rate.

currency basket
A selected group of currencies whose weighted average is used to define the amount of an obligation.

[19]*Id*., vol. 326, p. 310 at p. 316 (Supreme Court, 1945). Argentina concedes that this issue "is before the Court only as an aid in interpreting the direct effect requirement of the Act" and that "[w]hether there is a constitutional basis for personal jurisdiction over [Argentina] is not before the Court as an independent question." Brief for Petitioners, p. 36, n. 33.

[20]*Confirm South Carolina v. Katzenbach*, *id*., vol. 383, p. 301 at pp. 323–324 (Supreme Court, 1966) (states of the Union are not "persons" for purposes of the Due Process Clause).

[21]*Burger King Corp. v. Rudzewicz*, *id*., vol. 471, p. 462 at p. 475 (Supreme Court, 1985), quoting *Hanson v. Denckla*, *id*., vol. 357, p. 235 at p. 253 (Supreme Court, 1958).

[22]The inflation rate is typically ascertained by reference to a published index. Until the value of gold began to fluctuate dramatically in the 1970s, gold was commonly used as a standard for ascertaining inflation. F. A. Mann, *The Legal Aspect of Money*, pp. 138–156, 161–172 (4th ed., 1982). For more information on inflation, consult www.ofm.wa.gov/economy/econtopics/inflation/default.asp.

Originally, the SDR was created to permit governments to discharge their international obligations. However, because the IMF publishes daily quotations on the exchange value of the SDR, the SDR has become widely accepted as a private currency basket. Today, private banks commonly accept deposits denominated in SDRs; and loans, especially those made by governments dealing with the IMF, are denominated in SDRs. (The current SDR basket, past changes in the makeup of the basket, a current valuation of the SDR in U.S. dollars, and change in the valuation of the SDR over the past 30 years are shown in Table 6.1.)

TABLE 6.1

The IMF's special drawing right

Changes in SDR Basket

Date	Basket
January 1, 1970	0.088867088 grams (1/35 of an ounce) of gold.
July 1, 1974	Australian dollar, Austrian schilling, Belgian franc, British pound, Canadian dollar, Danish krone, Dutch guilder, French franc, German mark, Italian lira, Japanese yen, Norwegian krone, South African rand, Spanish peseta, Swedish krona, U.S. dollar.
July 1, 1978	Australian dollar, Austrian schilling, Belgian franc, British pound, Canadian dollar, Dutch guilder, French franc, German mark, Iranian rial, Italian lira, Japanese yen, Norwegian krone, Saudi Arabian riyal, Spanish peseta, Swedish krona, U.S. dollar.
January 1, 1981	British pound, French franc, German mark, Japanese yen, U.S. dollar.
January 1, 2001	British pound, European euro, Japanese yen, U.S. dollar.

SDR Valuation on July 10, 2002

Currency	Currency Amount[a]	Exchange Rate on July 10[b]	U.S. Dollar Equivalent[c]
European Union euro	0.4260	0.99450	0.423657
Japanese yen	21.0000	117.72000	0.178389
British pound	0.0984	1.55210	0.152727
U.S. dollar	0.5770	1.00000	0.577000
		Total	1.331773

[a]The currency components of the SDR basket.

[b]Exchange rates in terms of currency units per U.S. dollar, except for the pound sterling, which is expressed in U.S. dollars per pound.

[c]The U.S. dollar equivalents of the currency amounts divided by the exchange rates.

SDR Valuation on January 23, 2012

Currency	Currency Amount Under Rule 0–1	Exchange Rate on Jan. 23	U.S. Dollar Equivalent
European Union euro	0.4230	1.31020	0.549985
Japanese yen	12.1000	76.92000	0.157306
British pound	0.1110	1.55680	0.172805
U.S. dollar	0.6600	1.00000	0.66000
		Total	1.54010

Changes in SDR Valuation

Date	Valuation Basis	U.S. Dollar Equivalent
January 1, 1970	Gold	SDR 1.00 = U.S. $1.0000
July 1, 1974	Currency basket	SDR 1.00 = U.S. $1.2063
July 1, 1978	Currency basket	SDR 1.00 = U.S. $1.2395
January 1, 1981	Currency basket	SDR 1.00 = U.S. $1.2717
February 4, 1987	Currency basket	SDR 1.00 = U.S. $1.2677
August 26, 1991	Currency basket	SDR 1.00 = U.S. $1.3346
August 15, 1994	Currency basket	SDR 1.00 = U.S. $1.4561
August 28, 1998	Currency basket	SDR 1.00 = U.S. $1.3422

Changes in SDR Valuation		
Date	**Valuation Basis**	**U.S. Dollar Equivalent**
July 10, 2002	Currency basket	SDR 1.00 = U.S. $1.3318
March 1, 2004	Currency basket	SDR 1.00 = U.S. $1.4847
June 7, 2006	Currency basket	SDR 1.00 = U.S. $1.4878
August 8, 2008	Currency basket	SDR 1.00 = U.S. $1.5929
October 14, 2010	Currency basket	SDR 1.00 = U.S. $1.5797
January 9, 2012	Currency basket	SDR 1.00 = U.S. $1.5290

Sources: IMF Survey (January 1981), *IMF Survey* (September 1991), *IMF Survey* (Supplement, August 1994), Special Drawing Rights: A Factsheet (April 15, 2002) posted on the Internet at www.imf.org/external/np/exr/facts/sdr.htm, and SDR Valuation (July 10, 2002) posted at www.imf.org/external/np/tre/sdr/basket.htm. See generally IMF Data and Statistics, Exchange Rate Archives.

B. The International Monetary Fund (IMF)

Origin of the IMF

Because there is no single international currency that can be spent around the world, foreign currencies have to be converted into local currencies. The set of rules and procedures by which different national currencies are exchanged for each other in world trade is known as the **international monetary system.**The first modern international monetary system was the **gold standard.** In operation during the late nineteenth and early twentieth centuries, it provided for the free circulation between nations of gold coins of standard specification. The advantage of the gold standard was its stabilizing influence. If a state exported more than it imported, it would receive gold in payment for the difference. This influx of gold would raise domestic prices. These higher prices would then decrease demand for the state's exports and increase the state's internal demand for relatively cheap foreign imports. The result was an eventual return to the original price level. The principal disadvantage of the gold standard was its inherent lack of liquidity: The world's supply of money was necessarily limited by the world's supply of gold. Additionally, any sizable increase in the supply of gold, such as the discovery of a rich new mine, would cause prices to rise abruptly.

Because of its disadvantages, the gold standard broke down in 1914. It was replaced in the 1920s by the **gold bullion standard.** Under this system, states no longer minted gold coins; instead, they backed their paper currencies with gold bullion and agreed to buy and sell the bullion at a fixed price.[23]

With the onset of the worldwide Great Depression of the 1930s, the exchange of currencies became both unreliable and expensive. Deteriorating domestic economies[24] led to a widespread lack of confidence in paper money and a demand for gold that national treasuries could not meet. Nations with limited gold reserves, including the United Kingdom, were forced to abandon the gold standard, and because their money no longer bore a fixed relation to gold, its exchange became difficult.

Coupled with the difficulties of currency exchange were other detrimental Depression-era economic policies, including protectionist tariffs and truculent international trade policies. In July 1944, the United Nations convened a meeting in the small town of Bretton Woods, New Hampshire, for the purpose of creating a new international monetary system and an international organization to oversee that system. Representatives of 44 nations attended the UN Monetary and Financial Conference (known as the **Bretton Woods Conference**)[25] to draft the charter for the **International Monetary Fund (IMF).** The IMF came into being on December 29, 1945, when its charter, formally known as the Articles of Agreement of the IMF, was signed by 29 states. The organization itself began operations in May 1946 at headquarters in the city of Washington, D.C.[26] Today, virtually every country in the world is a member of the IMF.

international monetary system
The world's informal money and banking system.

gold standard
A monetary system that provided for the free circulation between states of gold coins of standard specification.

gold bullion standard
A monetary system that required states to buy and sell gold bullion with paper currency at a fixed price.

Bretton Woods Conference
UN-sponsored monetary and financial conference held in Bretton Woods, New Hampshire, in July 1944. It led to the creation of the International Monetary Fund and the World Bank.

International Monetary Fund (IMF)
Intergovernmental organization headquartered in Washington, D.C. Using funds contributed by its members, it will purchase a currency on the application of a member to help the member discharge its international indebtedness and stabilize its currency exchange rates.

[23] *The Columbia Encyclopedia*, p. 1349 (5th ed., 1993).

[24] Between 1929 and 1932, prices of goods fell 48 percent worldwide and the value of international trade fell 63 percent. David D. Driscoll, *What Is the International Monetary Fund?* p. 3 (1989).

[25] This conference also created the International Bank for Reconstruction and Development (popularly known as the World Bank). For more information, see www.ibiblio.org/pha/policy/1944/440722a.html.

[26] Driscoll, *What Is the International Monetary Fund?* p. 5 (1989); Margaret Garritsen de Vries, "Bretton Woods and the IMF's First 35 Years," *IMF Survey*, vol. 23, p. 217 (July 11, 1994).

The IMF's home page is at
www.imf.org.

The IMF was created to combat the international monetary and trade conditions that had helped to produce and prolong the Great Depression of the 1930s. The intellectual fathers of the IMF, British economist John Maynard Keynes and U.S. Treasury official Harry Dexter White (see Figure 6.2), identified two such conditions: (1) currency inconvertibility and (2) the lack of a standard for determining the value of national currencies (because of the collapse of the gold bullion standard). To correct these conditions, the IMF was made the overseer of its member states' monetary and exchange rate policies and the guardian of a code of conduct. In particular, the Articles of Agreement[27] establish a system of currency exchange (originally related to the value of gold but later, following an amendment to the Articles, based on exchange agreements) and a system for currency support (that allows the IMF to provide short-term financial resources to member states to help them correct payment imbalances).[28] The current status of the U.S. dollar as an international reserve currency is discussed in Reading 6-1.

The Articles of Agreement (as they are now amended) also establish a system of surveillance to ensure that member states abide by a code of conduct in their external monetary relations—specifically, that they do not borrow or lend at unsustainable levels, engage in protracted one-way interventions in the exchange market, or follow unwarranted monetary or fiscal policies for balance-of-payments purposes. Surveillance is the regular dialogue and policy advice that the IMF offers to each of its members. On a regular basis, usually once each year, the Fund conducts in-depth appraisals of each member country's economic situation. It discusses with the country's authorities the policies that are most conducive to stable exchange rates and a growing and prosperous economy. Members have the option to publish the Fund's assessment, and the overwhelming majority of countries opt for transparency, making extensive information on bilateral surveillance available to the public. The IMF also combines information from individual consultations to form assessments of global and regional

FIGURE 6.2

Harry Dexter White and John Maynard Keynes

Source: IMF

Harry Dexter White (1892–1948) and **John Maynard Keynes** (pronounced "canes," 1883–1946) were the two great intellectual founders of the IMF. Keynes, who served at the British Treasury before and during World War II, had revolutionized twentieth-century economics with his classic book *The General Theory of Employment, Interest and Money* (1936), in which he advocated government deficit spending during depressions. White was the chief international economist for the U.S. Treasury from 1942 to 1944 and assistant secretary of the treasury from 1944 to 1946. Both worked on developing a post–World War II economic system, and both agreed on the need for international cooperation and for a mechanism for controlling currency exchanges. Keynes advocated the creation of a world central bank that could regulate the flow and distribution of credit. White proposed the creation of an international equalization "fund" that would promote the growth of international trade and preserve the role of the U.S. dollar in international trade. White's proposal prevailed at the 1944 Bretton Woods Conference, where the IMF Charter was drafted, because the United States was the dominant economic power at that time. Ultimately, the link to the dollar proved untenable and the charter was amended in 1968 to provide for IMF's own reserve currency: the SDR.

[27]The text of the Articles of Agreement of the IMF is posted at www.imf.org/external/pubs/ft/aa/index.htm.

[28]Union of International Associations, *Yearbook of International Organizations 1994/1995*, pp. 968–969 (1994).

Reading 6-1 The U.S. Dollar as International Currency Reserve?

In February of 2011, the IMF called for Special Drawing Rights (SDRs) to replace the U.S. dollar as the world's reserve currency to shore up the global financial system.

"Over time, there may also be a role for the SDR to contribute to a more stable international monetary system," said Dominique Strauss-Kahn, then the managing director of the IMF. The IMF is also proposing SDR-denominated bonds, which would reduce the use of U.S. Treasuries. Oil and gold, currently traded in U.S. dollars, would be priced using SDRs.

The nominal value of an SDR is derived from a basket of currencies—specifically, a fixed amount of Japanese Yen, U.S. Dollars, British Pounds, and Euros. SDRs were originally intended to be the primary asset held in foreign exchange reserves under Bretton Woods, but after the collapse of that system in the early 1970s, SDRs took on a far less important role.

After the financial meltdown of 2008, many of the so-called BRIC countries—Brazil, Russia, India and China (led by China and Russia)—have called for replacing the dollar and moving into a global currency scheme.

In summer of 2011, Brazil was especially concerned with the increased role of devaluation of major currencies such as the Chinese yuan and the U.S. dollar in an ongoing trade war. As one of the world's biggest exporters, Brazil was raising the spectre of a currency war because of the interventions of Japan and China in the foreign exchange markets. With the global economic recovery slowing in 2011, Japan and China both had intervened in currency markets to weaken their currencies to boost exports and secure better balance of trade payments.

At the time, Brazilian Finance Minister Guido Mantega criticized these moves, noted that they had forced Brazil to consider new taxes on short-term fixed-income investments and other measures to stem a rally in the real, the country's currency.

"We're in the midst of an international currency war," Mr. Mantega said during a speech to a meeting of Brazilian industrial leaders. "This threatens us because it takes away our competitiveness."

His comments came at about the same time that the government of Brazil had vowed to use its sovereign wealth fund to weaken the real. Trading at or above above U.S. $1.71, the real was near its 10-month high and, according to Goldman Sachs Group, was the world's most-overvalued major currency.

Meanwhile, the United States has stepped up political pressure on China's currency, the yuan, which many economists were saying was undervalued. China's central bank said in June 2001 that it would let the yuan fluctuate more freely, but it rose just 1.8%. U.S. Treasury Secretary Timothy Geithner said in summer of 2011 that the level of the Chinese yuan relative to the dollar continued to have a negative impact on the U.S. economy.

The global economy needs the U.S. to prosper, but the U.S. also needs a weaker currency to help its manufacturing exports to promote its prospects for growth. But, with devaluation of the U.S. dollar, other countries must make adjustments, too.

In particular, lesser economies were starting to voice their opinion, with much of the concern directed towards China, who many felt could do more to strengthen its currency.

For its part, China has been calling for the end of the U.S. dollar as an international reserve currency. Early in 2009, China issued a call to dump the dollar and move into SDRs. "The role of the SDR has not been put into full play due to limitations on its allocation and the scope of its uses. However, it serves as the light in the tunnel for the reform of the international monetary system," said Zhou Xiaochuan, governor of the People's Bank of China.

With the current worldwide financial crisis that began in 2007–08, with all the government bailouts, the high debt load that the U.S. and European nations are carrying, the leaders of many countries are losing confidence in the dollar and want to see something that is more globally oriented.

The IMF plan would probably include the yuan, also known as the renminbi, among SDR currencies. But the IMF has so far held off on spiking international foreign exchange reserve assets with the yuan. The problem is that China has yet to "liberalize" its currency. In other words the authoritarian state has yet to allow central banks to hold yuan-denominated deposits without restriction.

In June of 2010 the United Nations called for abandoning the U.S. dollar as the main global reserve currency, saying it has been unable to safeguard value. Nobel Prize–winning economist Joseph Stiglitz, who previously chaired a U.N. expert commission that considered ways of overhauling the global financial system, has also advocated the creation of a new reserve currency system, possibly based on SDRs.

In the summer of 2011, the "big three" ratings agencies (Moody's, Fitch, and S&P) determined that countries with very large Debt-to-GDP ratios would be downgraded. Greece was downgraded, as was Ireland, Portugal, Spain, and Italy. Finally, even the U.S. lost its AAA status.

In short, the period of 2011–12 brought a mix of economic circumstances that might lead toward a non-dollar based global currency. The timing of this is far from clear, but unless major nations' currencies are willing to be "re-pegged" to gold, the volatility in international currency markets will continue, and sovereign defaults could create the conditions for an international currency.

developments and prospects. These views on the IMF's multilateral surveillance are published twice each year in the *World Economic Outlook* and the *Global Financial Stability Report*.[29]

In addition to currency exchange, currency support, and surveillance, the IMF maintains an extensive program of technical assistance through staff missions to member states. These staff missions help member states to reform their fiscal systems and budgetary controls and to establish or adapt institutional machinery, such as central banking and exchange systems.[30]

[29]For links to the *World Economic Outlook Reports*, see www.imf.org/external/ns/cs.aspx?id=29.

[30]Technical assistance is one of the benefits of IMF membership. It is normally provided free of charge to any requesting member country, within IMF resource constraints. More details are available at www.imf.org/external/np/exr/facts/tech.htm.

IMF Quotas

IMF quota
The amount of funds that a member of the IMF is required to contribute. It determines the voting rights of a member and the sum of IMF funds that a member may draw upon to stabilize its currency and to meet balance-of-payments obligations.

To become a member of the IMF, a state must contribute a certain sum of money (expressed in SDRs) called a quota subscription.[31] The **IMF quota** is based on the relative size of a member state's economy, and it serves various purposes. First, members' quotas make up a pool of funds on which the IMF can draw to lend to a particular member having financial difficulties. Second, quotas determine how much a contributing member can borrow from the IMF and how much it will receive in periodic allocations of SDRs. Third, quotas determine the members' voting power in the IMF.[32] Those who contribute the most to the IMF are given the greatest say in setting its policies. For example, the United States currently has about 371,743 votes, or about 16.83 percent of the total, while Palau has only about 281 votes (see Figure 6.3).[33] Currently, the IMF has a membership of 185 nations, the total number of quotas is SDR 2,208,981, and the total number of votes is 2,166,749.

Quotas for a state seeking to join the IMF are determined initially by the IMF staff based on formulas that take into consideration the state's gross domestic product, its current account transactions, the variability of its current receipts, and its official reserves. The results of the staff's initial calculations are adjusted both in light of data from existing members of comparable economic size and characteristics and through negotiations with the applicant state. Then the IMF Executive Board and finally the IMF Board of Governors must approve the quota.[34]

The Board of Governors is required to make a general review of quotas at intervals of not more than five years and propose any adjustments that it considers appropriate, taking into consideration the growth of the world economy and changes in the relative economic positions of the members. Any quota changes must then be approved by member states having at least 85 percent of the IMF's total votes. In addition, the change is not effective for a particular state until the state itself both approves of the change and pays for it.[35]

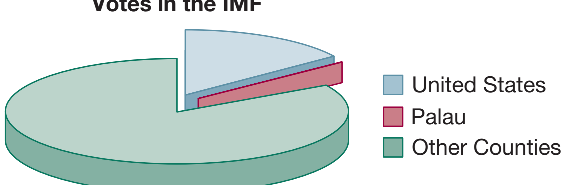
Reading 6-2 takes issue with the quota system as it stood in 2006. Reading 6-3, which immediately follows Reading 6-2, critiques the IMF's long-standing approach of imposing "austerity measures" in conditioning further loans to sovereign states, an issue that again came to prominence with the euro zone sovereign debt crisis (see Chapter 1).

Organization of the IMF

The Board of Governors is the highest authority of the IMF. It comprises a governor and an alternate governor representing each IMF member state. The individuals who serve as governors and alternate governors are usually the ministers of finance or the heads of the central banks of

FIGURE 6.3

The Portion of IMF Votes of the United States, Other Nations, and Palau (as of 2007)



[31] Seventy-five percent of a member's quota may be paid in its own currency; the other 25 percent has to be in a major convertible currency (such as British pounds, French francs, German marks, Japanese yen, or U.S. dollars). Articles of Agreement of the International Monetary Fund, Article III, §3(a).

[32] Every member is given 250 basic votes plus one vote for each SDR 100,000 of its quota. *Id.*, Article XII, §5(a).

[33] "IMF Members' Quotas and Voting Power, and IMF Governors" (April 02, 2007), posted at www.imf.org/external/np/sec/memdir/members.htm.

[34] "Where Does the IMF Get Its Money? A Factsheet" (April 2002) posted at www.imf.org/external/np/exr/facts/finfac.htm.

[35] Articles of Agreement of the International Monetary Fund, Article III, §§2(a), 2(c), and 2(d); "Member Countries' Quotas Guide Their Access to IMF Resources," *IMF Survey*, pp. 6–7 (Supplement, August 1994).

Reading 6-2 IMF Quota Reform is Inadequate; Reaction to IMFC Communiqué

"IMF Quota Reform is Inadequate: Reaction to IMFC Communiqué", statement from the Bretton Woods Project, September 18, 2006. Copyright © 2006 by the Bretton Woods Project. Reprinted with permission.

The Bretton Woods Project—a UK-based network of NGOs including Oxfam, ActionAid, Christian Aid, One World Trust and new economics foundation (nef)—called the IMF proposal to reform its voting structure completely inadequate to address the institution's problems. In reacting to the IMFC communiqué that hailed the reform proposal as a significant step forward, Peter Chowla, policy and advocacy officer at the Bretton Woods Project, stated: "It is a real shame that this proposal has succeeded despite the reservations of more than 50 developing countries. Anything short of fundamental reform of the IMF's governance structure will not restore its credibility."

The IMF proposal initially granted voting rights increases to just four countries—China, South Korea, Turkey, and Mexico—and called for a small increase to basic votes and a revamping of the way quotas are calculated. But the proposal does nothing to alter the imbalance of power in decision-making at the IMF or to give more "voice" to developing countries.[36] The balance of power at the IMF will not appreciably change with this measure, and developed countries will still maintain control over IMF decisions. Furthermore the revision of the quota formula may negatively impact the voting rights of many low- and middle-income countries.[37]

Mr. Chowla continued, "Developed countries seem determined to waste this opportunity for reform by pushing cosmetic changes that do nothing more than tinker at the edges. The increase in basic votes is just symbolic and will have no substantial affect on the inequality in decision-making at the IMF."

British NGOs—including Oxfam, ActionAid, Christian Aid and others—have thrown their support behind a proposal for comprehensive reform[38] and demand that the UK government step forward to propose wholesale changes at the IMF, rather than tinkering with quota adjustments within the two-stage process that has been proposed. Their request goes further than the Treasury Select Committee's conclusion that the UK needs to propose innovative solutions to the problem of voting weights because the current proposals do not address the underlying problems facing the IMF.

Jeff Powell, coordinator of the Bretton Woods Project, explained: "The governance of the IMF needs a fundamental rethink to bring it in line with democratic principles considered acceptable at the national level. This should have been part of a comprehensive package that also addressed the composition of the board and the lack of transparency at the institution."

"One of the most elegant ways to immediately patch up the problems in representation at the IMF would be a system of double-majority voting, so that no decision could be rammed through by rich countries holding most of the votes, nor by an unrepresentative group of small, poor countries," continued Mr. Powell. "This would also be much easier than trying to devise a quota formula that would satisfy all the different countries interested in IMF reform."

Reading 6-3 Calls for Debt Audit as IMF Austerity Fails

"Calls for Debt Audit as IMF Austerity Fails", press release from the Bretton Woods Project, April 6, 2011. Copyright © 2011 by the Bretton Woods Project. Reprinted with permission.

As IMF austerity policies fail to solve Greece's debt crisis, activists call for an audit commission. Despite ongoing public protests and increasing challenges from academia, old economic principles continue to guide Fund practices.

In mid March, the IMF completed the third review of Greece's Stand-by Arrangement. New conditions include another tranche of government guarantees worth €30 billion ($42 billion) to bail-out troubled banks. The bank guarantee will add another 10 per cent to the total government debt stock. Andy Storey of University College Dublin said, "This is the type of 'blank cheque' state guarantee of private debt that has bankrupted Ireland."

Disputes had previously erupted between the Greek government and EU and IMF reviewers over the country's privatization reforms, heavily pushed for by EU and IMF creditors. Greece has now committed to raise €15 billion through privatization by the end of the EU-IMF program in 2013—more than doubling last year's privatization pledges. Journalist Nick Malkoutzis, on his blog *Inside Greece*, commented in late February that "privatization may be a way of Greece taking ownership of its own debt problem. . . . However, this should not disguise the fact that privatization comes with many deep pitfalls."

Is Debt Sustainable?

Despite privatization pledges, concerns regarding Greece's ability to repay its loan have led the IMF to move Greece from the short-term Stand-by Arrangement to the medium-term Extended-Fund Facility. In mid March, eurozone governments agreed to extend Greece's loan repayment period from three to seven and a half years and—conditioned on the privatization scaleup—offered an interest rate cut from 5.8 to 4.8 per cent.

---

[36]The *ad hoc* vote increases for four countries and a doubling of basic votes (which would not be implemented for years) will decrease the voting weight of advanced economies from 62 percent of the total to just about 60.5 percent of the total. African countries will see their vote shares increase 0.5 percent to a total of about 6 percent.

[37]The third element of the proposal—a redesign of the formula that determines voting power—is hotly contested, and the last time the members of the IMF tried to reach consensus on a change, the issue became deadlocked. If the U.S. preference for a quota formula based almost entirely on GDP at market exchange rates is accepted, then countries like Nigeria, Indonesia, Venezuela, Malaysia, South Africa, and nearly every other African country would have diminished voting rights in the organization.

[38]The full statement from the Bretton Woods Project NGO can be found at www.brettonwoodsproject.org/ukimfreform.

A February briefing by Brussels-based think tank Bruegel criticizes EU/IMF loan policies for having "failed to recognize the possibility of insolvency" and recommends that "further lending without a large enough debt restructuring is not viable." Even if measures like lowering interest rates were applied, "the primary budget surplus requirement would still be unrealistically high." Bruegel economists estimate that in order to return to a debt-to-GDP ratio of 60 percent by 2034, Greece would need a 30 per cent public debt cut.

Warning of the social costs of excessive austerity due to high debt burdens, activist scholars in Greece including Costas Lapavitsas, Giorgos Mitralias and Leonidas Vatikiotis, supported by an international civil society coalition and academics like Slavoj Zizek and Noam Chomsky, called for an audit commission to examine Greece's public debt in February. Their petition states that "current EU and IMF policy to deal with public debt has entailed major social costs for Greece. Consequently, the Greek people have a democratic right to demand full information on public and publicly-guaranteed debt." Based on the commission's findings, recommendations can be made on how to deal with debt, "including debt that is shown to be illegal, illegitimate or odious." The audit commission for Greece could also serve as a prototype for other eurozone countries.

IMF Faces Public Anger

In late March, a bailout for Portugal was increasingly being called inevitable, as its parliament failed to agree on a new EU-demanded austerity plan, prompting the government to fall, with national elections to take place in June. As a result, the interest Portugal would be expected to pay on any new bonds has skyrocketed. Nick Dearden of UK NGO Jubilee Debt Campaign (JDC) said, "An EU and IMF bailout would be for private banks, not the Portuguese people." JDC finds that of the €216 billion gross public and private external debt, just €43 billion is owed by the Portuguese government. In late March, *New York Times* journalist Landon Thomas called the combination of bailouts and increased austerity in countries such as Portugal both "unworkable and unfair. . . . A cheaper way to attack the problem would be to go to the root of the issue and restructure the country's debt."

In Ukraine, in late February the Federation of Trade Unions urged the government to stop cooperation with the IMF. Worrying about IMF conditionality impacting wages, pensions and consumer prices, chairman Vasyl Khara said, "We have expressed a resolute protest . . . because the demands . . . on holding a preliminary dialogue with social partners ahead of determining terms of credit have been neglected again." In late March, more than 6,000 teachers took to the streets in Kiev to demonstrate against drastic cuts in education funding that the Ukraine government is planning to meet IMF austerity targets.

Also in March, over 7,000 people marched to the offices of Swaziland's prime minister demanding the entire cabinet resign, because of the fiscal adjustment roadmap presented to the IMF and World Bank to qualify for budget support. Protests were mainly directed against wage cuts for public workers.

Ears Kept Shut

In early March of 2011, the IMF hosted a conference on macroeconomic and growth policies after the crisis to tackle "some profound questions about the pre-crisis consensus on macroeconomic policies. The Washington event was organized by the director of the Fund's research department Olivier Blanchard, along with David Romer of University of California, Michael Spence of Stanford University, and Joseph Stiglitz of Columbia University—all economists associated with criticisms of mainstream economics.

One debate challenged former Fund consensus by arguing for the stabilising effects of counter-cyclical fiscal policy. The session on growth strategies included Dani Rodrik of Harvard University and Andrew Sheng of the China Banking Regulatory Commission advocated the greater use of industrial policies in developing countries. Sheng criticized "politically blind" analysis that ignores distributional consequences of growth policies.

Dean Baker of US-based Center for Economic and Policy Research called the conference a "glasnost" for IMF thinking, but was skeptical whether Fund "policies have undergone a similar adjustment." Baker finds that the IMF continues to promote "internal devaluation"—"forc[ing] workers to take pay cuts under the pressure of high rates of unemployment"—to confront economic crises, policies which have "led to an enormous economic and human disaster. The fact that many of the world's most prominent economists . . . can make policy prescriptions that are essentially ignored by those conducting policy, provides more evidence that policy is not being guided by neutral individuals seeking the best outcome."

their states.[39] They convene at an annual meeting and may participate in votes by mail or by other means during the remainder of the year. Many of the powers of the Board of Governors have been delegated to an Executive Board made up of 24 directors and a managing director, who serves as its chairman. The election of directors, the conditions for the admission of new members, the adjustment of quotas, and certain other important matters remain the responsibility of the Board of Governors.

The executive directors meet at least three times a week in formal sessions to oversee the implementation of the policies set by the Board of Governors. The other directors represent groupings of the remaining states. The Executive Board seldom makes decisions on the basis of a formal vote; instead, it acts only when its members reach a consensus, a practice that minimizes confrontations on sensitive issues and that ensures full cooperation on the decisions that are taken.

The Executive Board appoints a managing director to both chair the Executive Board and act as the IMF's head of staff. By tradition, the managing director is European. The international staff of some 2,716 from 165 countries is made up mainly of economists but also includes statisticians, researchers, experts in public finance and taxation, linguists, writers, and support personnel. Most of the staff are employed at the IMF's headquarters in Washington, but a few are assigned to small offices in Paris, Geneva, and New York. Unlike the executive directors, who represent particular

[39]"The IMF at a Glance: A Factsheet" (September 2011) posted at www.imf.org/external/np/exr/facts/glance.htm.

states or groups of states, the managing director and the staff are responsible to the member states as a whole in carrying out the policies of the IMF.

C. IMF Operations

A member state obligates itself upon joining the IMF to observe a code of conduct. This code requires the state to (1) keep other members informed of its arrangements for determining the value of its money relative to the money of other states, (2) refrain from placing restrictions on the exchange of its money, and (3) pursue economic policies that will increase in a constructive and orderly way both its own national wealth and that of all the IMF member states. It is important to note that observation of this code is essentially voluntary. The IMF has no mechanism for compelling member states to conform, although it can and does exert moral pressure to encourage its members to comply. Should a state persistently ignore the code of conduct, the Board of Governors may declare that it is ineligible to borrow money from the IMF; or, as a last resort, an offending member can be expelled from the IMF by a vote of "a majority of the Governors having 85 percent of the total voting power."[40]

Since the IMF's creation in 1945, its member states have given it a variety of responsibilities that have changed with the times. Today, the Fund is responsible for (1) supervising a cooperative system of currency exchange, (2) lending money to members in order to support their currencies and their economies, and (3) providing auxiliary services to assist members in establishing and carrying out their external debt and other financial policies.[41]

D. Currency Exchange

Currency Exchange Obligations of IMF Member States

The currency exchange mechanism established in 1945 by the Articles of Agreement of the IMF was called the **par value system.** That is, every member of the IMF, on joining the Fund, had to declare a value at which its currency could be converted into gold. The U.S. dollar, for example, was pegged at 1/35th of an ounce of gold. Members were obliged to keep the value of their currency within 1 percent of this par value, and only upon consultation with the IMF and the other members of the Fund could a member make a change.[42]

IMF par value system The currency exchange mechanism specified by the IMF prior to 1971, which required all members to declare a value (the par value) at which their currencies could be converted into gold.

The par value system worked well so long as inflation rates remained stable and unemployment was low in the major developed countries. It fell apart in the early 1970s, however, when inflation rates and unemployment grew sharply in the United States while remaining low in Europe and Japan. Foreign claims on American gold reserves increased[43] as the U.S. balance-of-payments deficit soared. The system effectively came to an end on August 15, 1971, when President Richard Nixon terminated the convertibility of the dollar into gold. Its final breakdown occurred in 1973, when the United States announced a 10 percent devaluation of the dollar.

Three years lapsed before the IMF system could be reformed. The member states adopted the **Second Amendment** to the Articles of Agreement in 1976, effective in 1978. This new accord, which remains in effect today, allows members to define the value of their currency by any criteria except gold. Many member countries peg their currencies to the currencies of other countries, or to the IMF's SDR, or to a currency basket. Others simply allow the value of their currencies to *float*, that is, to be determined by international supply and demand.[44]

IMF Second Amendment system The currency exchange mechanism established by the IMF in 1978 that allows members to define the value of their currency by any means other than by reference to the value of gold.

---

[40]Articles of Agreement of the International Monetary Fund, Article XXVI, §2(b).

[41]"The IMF at a Glance: A Factsheet" (September 2011), posted at www.imf.org/external/np/exr/facts/glance.htm.

[42]For the history of the IMF and the par value system, see David D. Driscoll, "What Is the International Monetary System?" (1989), posted at www.imf.org/external/pubs/ft/history/2001/index.htm, and "What Is the International Monetary Fund?" (September 2011), posted at www.imf.org/external/pubs/ft/exrp/what.htm.

[43]The exchange rate of $35 for an ounce made gold an irresistible bargain—so much so that U.S. gold reserves were inadequate to meet the demand.

[44]Articles of Agreement of the International Monetary Fund, Article IV, §2(b): ". . . [E]xchange arrangements may include (i) the maintenance by a member of a value for its currency in terms of the Special Drawing Right or another denominator, other than gold, selected by the member, or (ii) cooperative arrangements by which members maintain the value of their currencies in relation to the value of the currency or currencies of other members, or (iii) other exchange arrangements of a member's choice."

Although a member is free to adopt its own exchange arrangements, it is forbidden to "manipulat[e] exchange rates or the international monetary system in order to prevent effective balance-of-payments adjustment or to gain an unfair competitive advantage over other members."[45] A member is also required "to collaborate with the Fund to promote exchange stability, to maintain orderly exchange arrangements with other members, and to avoid competitive exchange alterations."[46] In addition, members with floating exchange rates are required to "intervene on the foreign exchange market as necessary to prevent or moderate sharp and disruptive fluctuations from day to day and from week to week in the exchange value of its currency."[47]

Enforcement of Exchange Control Regulations of IMF Member States

Article VIII, Section 2(b), of the Articles of Agreement of the IMF provides: "Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any member. . . ."

The purpose of this provision is twofold: (1) to prevent one IMF member from frustrating the legitimate exchange controls of another member and (2) to deter private persons from violating exchange control regulations. It can be invoked in three situations: (1) as a defense to a suit for the breach of an executory contract, (2) as a cause of action for a foreign government to compel rescission or to obtain damages after the execution of a contract that violated its exchange provisions, and (3) as a cause of action for a private person to compel rescission or to obtain damages after the execution of a contract that violates a foreign exchange provision.

The IMF Agreement grants to the Executive Board of the Fund the authority to interpret the provisions of the Agreement.[48] Pursuant to this authority, the directors have interpreted Article VIII, Section 2(b), to mean that the principle of unenforceability is "effectively part [of every member country's] national law."[49] Courts in France, Luxembourg, and the United States have held that they are bound by the directors' interpretation, and most commentators agree that the directors' interpretation is binding on all member states' courts and agencies.

The IMF directors have not interpreted the meaning of the term *exchange contracts*, although these words have been the focus of most of the litigation over Article VIII, Section 2(b). Courts on the European continent have generally given the term a broad meaning. In essence, they define **exchange contracts** as contracts that "in any way affect a country's exchange resources."[50]

Continental European definition of *exchange contract*
Any contract that in any way affects the currency exchange resources of a country.

American and British courts define the term **exchange contract** restrictively.[51] They hold that an exchange contract is one having as its immediate object the exchange of international mediums of payment, which is usually the exchange of one currency for another.[52] This interpretation excludes (1) securities contracts, (2) sales contracts (including sales of precious metals), and (3) loans

Anglo-American definition of *exchange contract*
A contract having as its immediate object the international exchange of mediums of payment.

[45] *Id.*, Article IV, §1(iii).

[46] The *1974 International Monetary Fund Annual Report*, p. 112 (1974).

[47] *Id.*, p. 113.

[48] Article XXIX(a).

[49] *International Monetary Fund Annual Report*, app. XIV, p. 82 (1949).

[50] F. A. Mann, "The Private International Law of Exchange Contracts under the International Monetary Fund Agreement," *International & Comparative Law Quarterly*, vol. 2, p. 102 (1953).

[51] In *Mansouri v. Singh*, *All England Law Reports*, vol. 2, p. 619 (1986), Lord Justice Neill stated for the English Court of Appeal: "The term 'exchange contract' in §2(b) of article VIII is to be interpreted narrowly. The term is confined to contracts to exchange the currency of one country for the currency of another; it does not include contracts entered into in connection with sales of goods which require the conversion by the buyer of one currency into another in order to enable him to pay the purchase price. . . . "

[52] This definition originated with Arthur Nussbaum in his article "Exchange Control and the International Monetary Fund," *Yale Law Journal*, vol. 59, p. 426 (1949). See John S. Williams, "Extraterritorial Enforcement of Exchange Controls under the International Monetary Fund Agreement," *Virginia Journal of International Law*, vol. 15, p. 333 (1975); and George B. Schwab, "The Unenforceability of International Contracts Violating Foreign Exchange Regulations: Article VIII, Section 2(b) of the International Monetary Fund Agreement," *Virginia Journal of International Law*, vol. 25, p. 982 (1985).

(including letters of credits).[53] Case 6-2 illustrates the reasoning used by courts for adopting the narrow interpretation of Article VIII, Section 2(b).

CASE 6-2 Wilson, Smithett & Cope, Ltd v. Terruzzi

England, Court of Appeal, 1976
All England Law Reports, vol. 1976, pt. 1, p. 817 (1976)

MAP 6.2

Italy and England (1976)

Opinion by Lord Denning

Signor Terruzzi lives in Milan. He is a dealer in metals, trading under the name Terruzzi Metalli. But he is also, it seems, a gambler in differences. He speculates on the rise or fall in the price of zinc, copper and so forth. He speculated in 1973 on the London Metal Exchange. He did so in plain breach of the Italian laws of exchange control. These provide that residents in Italy are not to come under obligations to non-residents save with ministerial authority. Signor Terruzzi never obtained permission.

In making his speculations, Signor Terruzzi established an account with London dealers, Wilson, Smithett & Cope, Ltd. He was introduced to them by their Milan agent, Signor Giuliani, and made his deals through him. All the transactions were in sterling and reduced into writing on the standard contract forms of the London Metal Exchange. Sometimes Signor Terruzzi was a "bull." That is, he thought that the price was likely to rise in the near future. So he bought metal from the London dealers at a low price for delivery three months ahead, not meaning ever to take delivery of it, but intending to sell it back to the London dealers at a higher price before the delivery date, thus showing him a profit in his account with the London dealers. At other times he was a "bear." That is, he thought that the price was likely to fall in the near future. So he sold metal "short" (which he had not got) to the London dealers at a high price for delivery

[53]See Arthur Nussbaum, "Exchange Control and the International Monetary Fund," *Yale Law Journal*, vol. 59, p. 426 (1949) (securities contracts); Wilson, Smithett & Cope, Ltd. v. Terruzzi, *All England Law Reports*, vol. 1976, pt. 1, p. 817 (1976) (sales of metals); and Libra Bank Ltd. v. Banco Nacional de Costa Rica, *Federal Supplement*, vol. 570, pp. 899–900 (U.S. District Court for the Southern District of New York, 1983) (loans). But compare United City Merchants (Investment) *Ltd. v. Royal Bank of Canada*, *All England Law Reports*, vol. 1982, pt. 2, p. 720 at p. 729 (1982), which held that a letter-of-credit transaction was a "monetary contract in disguise."

three months ahead, not meaning ever to deliver it, but intending to buy back from the London dealers a like quantity at a lower price before the delivery date, thus showing him a profit in his account with the London dealers. Such transactions would have been gaming contracts if both parties had never intended to make or accept delivery, and they would not have been enforced by the English courts. But the London dealers were not parties to any such intention. They always intended to make or accept delivery according to the contracts they made. So far as the London dealers were concerned, they were genuine commercial transactions. They were enforceable accordingly by the English courts.[54] But they were not enforceable in the Italian courts because they infringed the exchange control.

The critical months here were October and November 1973. The price of zinc was very high. The price for "forward" delivery (that is for delivery three months ahead) had been steadily rising from £465 on 18th October 1973 to £520 on 7th November. Signor Terruzzi thought that the price was much too high and that it was likely to fall soon. So he made a series of contracts with the London dealers whereby he sold to them 1,200 tons of zinc for delivery in the next three months. He sold "short," that is he had then no zinc to meet his obligations. Unfortunately for Signor Terruzzi, his forecast was wrong. Even after 7th November the price did not fall. It rose steeply. So much so that within a week it had risen to £650 a ton. By 12th November 1973 the London dealers were anxious as to the ability of Signor Terruzzi to meet his commitments. They asked him to provide a deposit or "margin" of £50,000, as they were entitled to do under the contracts. On the evening of Tuesday, 13th November, Signor Giuliani, on behalf of the London dealers, met Signor Terruzzi at the Café Ricci in Milan. He told him the state of the account. Signor Terruzzi flamed with anger. He said that he was not going to pay anything to the London dealers by way of margin, or otherwise, and they could take him to court. Signor Giuliani telephoned the London dealers. They were fearful that the price might go still higher. There were frantic telexes. In the result the London dealers "closed" the contracts with him, as they were entitled to do under the written terms thereof. They sold back to him 1,200 tons of zinc at the ruling price. They telexed him with details. The result showed a balance due to the London dealers amounting to £220,440.38; and credit was due to him on previous profits of £25,418.37. So on balance the sum of £195,022.01 was due from him to them. On 10th January 1974 they issued a writ against him for that amount in the High Court in England. He got leave to defend by swearing, quite untruly, that the transactions had been carried out without his knowledge or authority. Afterwards he took a different line. He said that the London dealers had failed to advise him properly about the transactions. The trial opened on 9th October 1974. He came to London for the first day. He went back to Italy for the weekend. He had a heart attack there. He never returned to the trial. All his defenses crumbled. So did his counterclaim. The only point which remained was that the contracts were "exchange contracts" and were unenforceable against him by reason of the Bretton Woods Agreements. Judge Kerr decided against him. Signor Terruzzi appeals to this court.

Now for the Bretton Woods Agreements. Bretton Woods is a small town in New Hampshire, U.S.A., but it has a place in history. During the Second World War, even in the midst of raging hostilities, there was a conference there attended by the members of the United Nations. The object was to organize their monetary systems so as to meet the post-war problems. At this conference the United Kingdom was represented by the distinguished economist, Lord Keynes, and by the legal adviser to the Foreign Office, Sir Eric Beckett. In July 1944, Articles of Agreement were drawn up and signed. By the Agreement the International Monetary Fund was established and provisions were made (amongst other things) "to promote international monetary cooperation" and "to promote exchange stability." In 1945, Parliament passed an Act to give effect to the Agreement. In January 1946, an order in council, the Bretton Woods Agreements Order in Council 1946, was made giving the force of law to this provision, among others:

> Article VIII, Section 2(b). Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member

[54]See *Bassett v. Sanker*, *Times Law Reports*, vol. 41, p. 660 (1925) (London Metal Exchange); *Weddle, Beck & Co. v. Hackett*, *All England Law Reports*, vol. 1928, p. 539 (1928) (London Stock Exchange); *Woodward v. Wolfe*, *All England Law Reports*, vol. 1936, pt. 3, p. 529 (1936) (Liverpool Cotton Exchange); *Garnac Grain Co., Inc. v. HMF Faure & Fairclough, Ltd., and Bunge Corp.*, *All England Law Reports*, vol. 1965, pt. 3, p. 273 (1965) (contracts for lard).

> maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any member . . . .

That provision is part of the law of England, but it has given rise to much controversy, particularly as to the meaning of the words "exchange contracts." There are two rival views. First, the view of Professor Nussbaum set out in 1949 in the *Yale Law Journal*.[55] He said that "an exchange contract" is exclusively concerned with the handling of international media of payment as such. Therefore, contracts involving securities or merchandise cannot be considered as exchange contracts except when they are monetary transactions in disguise. This view is in accord with the meaning given by Lord Radcliffe in *Re United Railways of the Havana and Regla Warehouses, Ltd*.[56]:

> . . . a true exchange contract . . . is a contract to exchange the currency of one country for the currency of another . . . .

Second, the view of Dr. F. A. Mann set out in 1949 in the *British Year Book of International Law* and in his book, *The Legal Aspect of Money*. He said that "exchange contracts" are contracts which in any way affect a country's exchange resources—a phrase which I accepted without question in *Sharif v. Azad*,[57] in the belief that, coming from such a source, it must be right. Dr. Mann recognizes that his view makes the word "exchange" redundant and thus seems counter to established methods of interpretation. But he contends that it is in better harmony with the purpose of the Agreements.

Dr. Mann suggests that the lawyers did not take much part in drafting the Bretton Woods Agreements. In this he is mistaken. I trust that I may be forgiven a digression if I borrow from the argument of counsel for the plaintiffs and recite part of the speech which Lord Keynes made at the Final Act of the Conference (as recorded by Sir Roy Harrod in his biography of Keynes):

> And, for my own part, I should like to pay a particular tribute to our lawyers. All the more so because I have to confess that, generally speaking, I do not like from results in this lawyer-ridden land, the *Mayflower*, when she sailed from Plymouth, must have been entirely filled with lawyers. When I first visited Mr. Morgenthau in Washington some three years ago accompanied only by my secretary, the boys in your Treasury curiously enquired of him—where is your lawyer? When it was explained that I had none—"Who then does your thinking for you?" was the rejoinder. . . . [O]nly too often [our lawyers] have had to do our thinking for us. We owe a great deal of gratitude to Dean Acheson, Oscar Cox, Luxford, Brenner, Collado, Arnold, Chang, Broches and our own Beckett of the British Delegation.[58]

So the lawyers did play a large part. I have no doubt that they had in mind an evil which was very much in evidence in the years after the First World War. It is strikingly illustrated by the notorious case of *Ironmonger & Co. v. Dyne*[59] in which a lady, Mrs. Bradley Dyne, speculated in foreign currency. She did it at the instance of prominent officials in the Foreign Office. She dealt with bankers in Throgmorton Street. She used to buy from the bankers French francs and Italian lira for delivery three months in the future; but, before the time for delivery arrived, she sold them again. If the price went up, she took the difference as a "profit." If the price went down, she was liable to pay the difference as a "loss." In no single case was any currency delivered. She operated on an enormous scale. In three years the turnover amounted to 421 million francs and 17 million lira, and large sums in other currencies as well. At the end she was much in debt to the bankers for her "losses." They sued her for it. She pleaded the Gaming Act. Her plea failed because, so far as the bankers were concerned, they were genuine transactions which created obligations to fulfill the contracts according to their tenor if circumstances required it. She was held liable. The British government declared that the transactions were a disgrace to the Civil Service and punished the Foreign Office officials who had engaged in them. But the case is

[55] *Yale Law Journal*, vol. 59, p. 421 at pp. 426, 427 (1949).

[56] *All England Law Reports*, vol. 1960, pt. 2, p. 332 at p. 350 (1960).

[57] *Id*., vol. 1966, pt. 3, p. 785 at p. 787 (1966).

[58] R. F. Harrod, *Life of John Maynard Keynes*, p. 583 (1951).

[59] *Times Law Reports*, vol. 44, p. 497 (1928).

important for present purposes because it shows the great mischief which can be done by such speculations. Lord Justice Scrutton described it in these words:

> The transactions in question were not of a pleasant nature. After the War, while Europe was recovering from the various upheavals which were the result of it, the value of currency fluctuated extremely. Contracts for the purchase or sale of currency, which, before the War had been a comparatively sober business, became very speculative in their making and their result. It was possible to make very large profits and equally possible to make very great losses, and, as was to be expected when great profits might be made, the birds of prey gathered together. Reckless speculators, absolutely indifferent to the damage that they were doing to the country in the currency of which they were dealing, began operations. People bought and sold currency to a very large extent, with the most disastrous results to the countries concerned. That was particularly the case with regard to the sales and purchases of French currency, which went near to bringing that country to ruin. People who indulged in those speculations were beneath contempt and ought to be condemned. They were utterly selfish, and had no regard at all to the enormous injury which they were inflicting on the legitimate trade of the country in whose exchange they were speculating.[60]

The mischief being thus exposed, it seems to me that the participants at Bretton Woods inserted Article VIII, §2(b), in the Agreement so as to stop it. They determined to make exchange contracts of that kind—for the exchange of currencies—unenforceable in the territories of any member. I do not know of any similar mischief in regard to other contracts, that is contracts for the sale or purchase of merchandise or commodities. Businessmen have to encounter fluctuations in the price of goods, but this is altogether different from the fluctuations in exchange rates. So far from there being any mischief, it seems to me that it is in the interest of international trade that there should be no restriction on contracts for the sale and purchase of merchandise and commodities; and that they should be enforceable in the territories of the members.

The Bretton Woods Agreements made provision to that end. Thus Article 1(ii) says that one of the purposes of the International Monetary Fund is to "facilitate the expansion and balanced growth of international trade. . . ." Article VI, §3, and Article VIII, §2(a), coupled with Article XIX(i), say that no member is to impose restrictions on payments due "in connection with foreign trade, other current business, including services, and normal short-term banking and credit facilities."

In conformity with those provisions, I would hold that the Bretton Woods Agreements should not do anything to hinder legitimate contracts for the sale or purchase of merchandise or commodities. The words "exchange contracts" in Article VIII, §2(b), refer only to contracts to exchange the currency of one country for the currency of another. The words "which involve the currency of any member" fit in well with this meaning, but it is difficult to give them any sensible meaning in regard to other contracts. They show that the section is only dealing with the currencies of members of the fund, and not with the currencies of nonmembers. The reference to regulations "maintained or enforced consistently with this Agreement" covers such regulations as those of Italy here.

It is no doubt possible for men of business to seek to avoid Article VIII, §2(b), by various artifices. But I hope that the courts will be able to look at the substance of the contracts and not at the form. If the contracts are not legitimate contracts for the sale or purchase of merchandise or commodities, but are instead what Professor Nussbaum calls "monetary transactions in disguise,"[61] as a means of manipulating currencies, they would be caught by §2(b).

I will not say more save to express my appreciation of the judgment of Justice Kerr. He has covered the whole subject most satisfactorily. In my opinion the contracts here were legitimate contracts for the sale and purchase of metals. They were not "exchange contracts." The London dealers are entitled to enforce them in this country. I would dismiss the appeal accordingly.

The appeal was dismissed and leave to appeal to the House of Lords was refused.

[60] *Id*., at p. 498.

[61] *Yale Law Journal*, vol. 59, p. 421 at p. 427 (1949).

Casepoint

The IMF's Article VIII (2)(b) is to be narrowly interpreted. English international lawyer Dr. F. A. Mann's assumption that since lawyers did not take much part in the drafting of the IMF Article of Agreement, the term *currency exchange contract* should be broadly interpreted is wrong. Lawyers did play a large part. As such, it seems that the lawyers had in mind a specific legal problem: currency speculation. It is this that IMF Article VIII(2)(b) addresses and nothing more. The words *exchange contracts* in Article VIII2 (b) refer only to contracts to "exchange the currency of one country for the currency of another."

Finally, the IMF's Articles of Agreement do not describe what constitutes currency exchange regulations, other than to note that they must be "maintained or imposed consistently" with the Articles of Agreement.[62] As with other regulations, however, it seems evident that they need to be adopted in accordance with a member state's constitution and laws and properly promulgated.

Enforcement of Exchange Control Laws in the Absence of IMF Membership

The provision in Article VIII, Section 2(b), of the IMF's Articles of Agreement requiring member states to give effect to the currency exchange regulations of other members is at odds with a long-standing choice of law rule that holds that states do not enforce the revenue laws of other states. The civil code in civil law countries often expressly prohibits the enforcement of foreign revenue laws, including currency exchange regulations. The common law countries apply a court-made rule to the same effect, which they trace to a now famous dictum by Lord Mansfield in an international smuggling case that "no country ever takes notice of the revenue laws of another."[63]

The rationale for this rule (both in civil law and common law countries) is that the enforcement of foreign revenue laws infringes on the sovereign rights of the forum state. The rule and the rationalization have been criticized, however, as legally and economically unsound in light of the contemporary interdependence of nations. Nevertheless, the rule continues to be universally observed.

However, because most nations of the world are members of the IMF, the provision in Article VIII, Section 2(b), of the IMF Articles of Agreement effectively overrides the traditional nonenforcement rule in most cases. Of course, not all countries are members of the IMF. When their currency exchange regulations are at issue, those regulations will not, as Case 6-3 illustrates, be enforced abroad.

CASE 6-3 Menendez v. Saks and Company

United States, Court of Appeals, Second Circuit, 1973
Federal Reporter, Second Series, vol. 485, p. 1355 (1973)

On September 15, 1960, the Cuban government "intervened"[64] in the operation of (i.e., it nationalized) the five leading manufacturers of Cuban cigars (F. Palacio y Compañia, SA; Tabacaler José L. Piedra, SA; Por Larranga, SA; Cifuentes y Compañia; and Menendez, Garcia y Compañia, Limitada). For many years these manufacturers had produced cigars of the highest quality and reputation and had sold them to importers in the United States, principally the parties being sued in this case, Faber, Coe & Gregg (Faber), Alfred Dunhill of London (Dunhill), and Saks & Company (Saks). The importers paid for the cigars in U.S. dollars by checks drawn on New York banks and made payable either (1) to the Cuban exporter, (2) to a New York bank acting as the exporter's collecting agent, or (3) to the order of the Cuban exporter and/or the New York collecting bank. Payments made to the New York collecting banks were transmitted by those banks to the Banco Nacional de Cuba, which in turn credited the exporters with pesos in their own Cuban banks.[65]

---

[62] Article VIII, §2(b).

[63] *Holman v. Johnson*, *English Reports*, vol. 98, p. 1120 at p. 1121 (1775).

[64] *Intervention* was the euphemistic term used for seizure of a business by the Cuban government in 1960.

[65] This method of making payment through a New York collecting bank was imposed on the exporters by the Castro government soon after it came to power to ensure that the dollars would be available to the Cuban government rather than be kept or used abroad by the exporters.

MAP 6.3

Cuba and the United States (1973)

Upon the Cuban government's intervention, the owners were immediately ousted and the government designated persons called interventors as its agents to manage the businesses. The interventors continued to operate the businesses and to export cigars under the same company names to the same importers in the United States. The importers continued to make some payments through their usual channels, but most of these payments were intended to cover only the amounts still owing for the preintervention shipments. Although the importers accepted the cigars shipped after the intervention, they did not pay for most of them. Shipments from Cuba to the U.S. importers continued until February 1961, when relations between the interventors and the importers deteriorated for various reasons. In February 1962, the U.S. government declared an embargo on future trade with Cuba.

Immediately after the Cuban government seized the cigar manufacturing companies, the owners of those businesses fled to the United States and brought actions in New York against the importers to collect the sums due for cigars shipped from their factories in Cuba. Shortly thereafter, the interventors sought to intervene in these actions to replace the owners in prosecuting claims against the importers. The government of Cuba also intervened to support the claims of the interventors.

The trial court held that the importers had to pay the original owners for the cigars exported to the United States before their companies were nationalized and the interventors for the cigars sold after that time. The importers were also allowed to offset monies they had previously paid the interventors. All of the parties appealed.

Opinion by Judge Mansfield

* * *

. . . The interventors insist that they, rather than the owners, are entitled to the proceeds paid or payable by the importers for the preintervention shipments. They claim that the owners' accounts receivable were included in the property effectively seized by the intervention. They further argue that even if the owners' accounts receivable were not effectively seized, the owners are entitled at most to Cuban pesos, which is all that they would have been permitted to retain had they collected on these accounts while still in Cuba, since Cuban currency regulations require a Cuban exporter who receives payment in a foreign currency to deliver the foreign currency to the "Cuban Stabilization Fund" for exchange into pesos.

* * *

[As for interventors' claim that they are entitled to the proceeds from the preintervention shipments of cigars, we are compelled to deny their request because of] our decision in *Republic of Iraq v. First National City Bank*.[66] Application of the principles of that case here satisfies us that

[66]*Federal Reporter, Second Series*, vol. 353, p. 47 (Second Circuit Ct. of Appeals, 1965), *certirorari* denied, *United States Reports*, vol. 382, p. 1027 (Supreme Ct., 1966).

since the owners' accounts receivable had their *situs*[67] in the United States rather than in Cuba at the time of intervention and since the Cuban government's purported seizure of them without compensation is contrary to our own domestic policy, the act of state doctrine does not apply, the confiscation was ineffective, and the interventors' claim must be rejected. The owners rather than the interventors remain entitled to collect these accounts.

***

. . . Cuba and the interventors argue that even if the intervention did not deprive the owners of their right to collect on their accounts receivable from the importers, the district court erred in failing to apply Cuban currency regulations, which would limit the owners to ultimate receipt of pesos rather than dollars for these accounts. . . . Relying on *Auten v. Auten*,[68] Cuba and the interventors insist that Cuban law was applicable because the contracts were made and were to be performed in Cuba. A Cuban currency regulation in effect since 1959 required all exporters who received payment in a foreign currency to deliver the currency within three days to the Cuban Currency Stabilization Fund for exchange into pesos. The interventors argue that by ignoring these and other regulations[69] the district court has given the owners an unwarranted windfall at the ultimate expense of the interventors and the Republic of Cuba.[70]

Neither the invoices nor other documents evidencing the agreement between the parties specify that payment was to be made in Cuba or in pesos. On the contrary, the business practice of the parties was that the importers for the most part would pay in dollars by checks drawn and delivered to collecting banks located in New York, which acted as the sellers' agents. In those instances where checks were sent directly to the exporters in Cuba, the checks were drawn on New York banks so that final payment was made in New York. Ordinarily, where a contract or agreement authorizes performance in any of several places, the law governing the agreement is that of the place of performance actually chosen.[71]

. . . Nor are we persuaded that Cuba's currency control regulations should here be given effect on the ground that not to do so would give the owners the benefit of a dollar windfall in lieu of the pesos which the Cuban government would have required them to accept in exchange for their dollars if they had remained in Cuba. The broad question of whether extraterritorial effect should be given to a foreign government's currency controls is not to be resolved on the basis of what the effect will be in a particular case but upon basic policy grounds. Currency controls are but a species of revenue law.[72] As a general rule one nation will not enforce the revenue laws of another,[73] at least in the absence of an agreement between the nations involved to do so.[74] While Article VIII of the Bretton Woods [IMF] Agreement evidenced a commitment on the part of signatory nations to enforce each other's exchange controls as a matter of international cooperation,[75] Cuba has long since withdrawn from the Fund Agreement. Cuba cannot, therefore, predicate its attempted enforcement of its currency regulations upon any treaty or international agreement with the United States.

. . . Here the agreement bound the importers to pay dollars, not pesos. . . . Although the effect of our judgment is to award to the owners dollars, which are worth more on the market

---

[67]From Latin: "situation" or "location." The location of a place of business.

[68]*New York Reports*, vol. 308, p. 155 (New York Ct. of Appeals, 1954), which holds that the law of the state with the most significant contacts governs contractual obligations.

[69]Other regulations or "instructions" established the method of payment through New York collecting banks whereby the exporters would receive only pesos.

[70]The theory of the interventors and Cuba is that if the owners had been awarded pesos rather than dollars, in effect they would have recovered nothing since presently there is no exchange between pesos and dollars. A nominal recovery by the owners, according to the theory, would have reduced the importers' setoff against the interventors.

[71]See, e.g., *Anglo-Continentale Treuhand, AG v. St. Louis Southwest Railway*, *Federal Reporter, Second Series*, vol. 81, p. 11 (Second Circuit Ct. of Appeals, 1936), *certirorari* denied, *United States Reports*, vol. 298, p. 655 (Supreme Ct., 1936).

[72]*Confirm Banco do Brasil, SA v. A. C. Israel Commodity Co.*, *New York Reports, Second Series*, vol. 12, p. 371 (New York Ct. of Appeals, 1963), *certirorari* denied, *United States Reports*, vol. 376, p. 906 (Supreme Ct., 1963).

[73]See *Colorado v. Harbeck*, *New York Reports*, vol. 232, p. 71 (New York Ct. of Appeals, 1921).

[74]See, e.g., Bretton Woods *International Monetary Fund Agreement*.

[75]See, e.g., Meyer, "Recognition of Exchange Controls After the International Monetary Fund Agreement," *Yale Law Journal*, vol. 62, p. 867 (1953).

than the pesos which the owners would be required by Cuban law to accept if they were in Cuba, this does not constitute a valid ground for enforcement here of Cuba's revenue laws. . . .

The judgment of the trial court was affirmed.

Casepoint

The accounts receivable have their *situs* in the United States, as payment was due in New York with U.S. dollars. Therefore, the intervention (expropriation) in Cuba by the Cuban government does not trigger the act of state doctrine, because the accounts receivable were effectively "in" the United States at the time of the Cuban government's purported seizure of them.

Where a contract or agreement authorizes performance in any of several places, the law governing the agreement is that of the place of performance actually chosen. Here the contracts were actually paid in New York, so the governing law is New York law. Thus, Cuban currency regulations would not apply.

Even if Cuban currency regulations did apply, as a general rule one nation will not enforce the revenue laws of another, at least in the absence of an agreement between the nations involved to do so.

Enforcement of Other IMF Member State Currency Exchange Obligations

The "General Obligations of Members" of the Fund are contained in Article VIII of the IMF Articles of Agreement. Section 2(b), as we have seen, makes exchange contracts that violate a member's currency regulations unenforceable in other member states. Section 2(a) forbids member states from imposing restrictions on the payments or transfers involving current international transactions. A **current international transaction** is any transaction other than the transfer of capital.[76] Restrictions on the transfer of currency between member countries are therefore forbidden on transactions that involve any of the following:

current international transaction
Any currency transaction other than the transfer of capital.

1. All payments due in connection with foreign trade, other current business, including services, and normal short-term banking and credit facilities.
2. Payments due as interest on loans and as net income from other investments.
3. Payments of moderate amount for amortization of loans or for depreciation of direct investments.
4. Moderate remittances for family living expenses.

Section 3 of Article VIII forbids a member from engaging in any "discriminatory currency arrangements" or "multiple currency practices,"[77] and Section 4 requires a member to buy its own currency from other members who have acquired it as the result of "current transactions." Sections 5, 6, and 7 require members to furnish information to the IMF, to consult with other members when adopting special or temporary currency exchange restrictions, to collaborate in promoting international liquidity, and to work with other members to make the "special drawing right the principal reserve asset in the international monetary system."

Except for Section 2(b) of Article VIII, the member states' obligations do not give rise to any private rights. As a consequence, the other provisions of the IMF Articles of Agreement are seldom the subject of court disputes.[78]

[76]Article XXX(d).

[77]*Multiple currency practices* is the maintenance of several different rates of exchange for a currency, such as one rate for nationals, another for foreign individuals, and a third for government agencies.

[78]Article IX, which establishes the fund's status, immunities, and privileges, was the focus of a dispute before the U.S. Federal Communications Commission (FCC) in International Bank for *Reconstruction and Development & International Monetary Fund v. All America Cables and Radio, Inc*., *Federal Communications Commission Reports*, vol. 17, p. 450 (1966). In that decision, the FCC held that the IMF was entitled to the same privileges for transmitting its international cables as those given to foreign governments.

Exemptions for New Members from IMF Member State Currency Exchange Obligations

Upon joining the IMF, a state does not have to accede to all of the currency exchange obligations set out in Article VIII (Sections 2, 3, and 4) of the IMF's Articles. Article XIV sets out transitional provisions that give a new member the option of maintaining the restrictions on payments and transfers for current international transactions in effect on the date it becomes a member. Only those restrictions may be maintained, however. Any later restrictions will automatically fall under Article VIII and will require IMF approval.

At the time the IMF Agreement was first signed in 1945, only the United States and nine other countries (all from Latin America) did not claim this exemption. As of 2007, more than 166 states (more than three-quarters of all IMF members) had agreed to comply with the obligations imposed by Article VIII, including many of the more advanced developing states. This is a significant development, as it indicates that most IMF members are committed to pursuing sound economic policies and will forgo any future reimposition of exchange restrictions.

E. Currency Support

In addition to its principal function as the regulatory body for the international currency exchange system, the IMF serves as a short-term source of funds for member states having difficulty meeting their balance-of-payments obligations. These funds are drawn principally from the quota subscriptions paid by members, although the IMF also borrows from commercial banks. As of June 2007, the total quota subscriptions amounted to 216.7 billion SDRs or U.S. $327.7 billion.[79]

IMF Facilities

The IMF's financial resources are made available to its members through a variety of **IMF facilities.** These facilities are funded from (1) the General Resources Account (consisting of funds from the members' subscriptions and funds borrowed from banks by the IMF), (2) the Special Disbursement Account (made up of funds derived originally from the sale of the IMF's gold holdings between 1976 and 1980, and later from interest paid by borrowers), and (3) the Enhanced Structural Adjustment Facility Trust Fund (which has resources from loans and donations from members). As of April 2007, the IMF had credits and loans outstanding of $78 billion to 74 countries.[80]

IMF facilities
The financial assistance programs available to IMF members.

The IMF provides regular, concessional, and special facilities for its member states.

Regular IMF Facilities Facilities available to all IMF member states include the following:

Reserve Tranche Each member has an IMF ***tranche*** that it may withdraw at any time and that technically does not constitute the use of an IMF credit. This *tranche* consists of that share of a member state's quota that it did not contribute in its own currency (i.e., 25 percent of its quota).[81]

tranche
(From French: "installment" or "block of shares.") A percentage of an IMF member's quota that it may withdraw to stabilize its currency or to meet balance-of-payments obligations.

Credit Tranche A member is entitled to four credit *tranches*, each equivalent to 25 percent of its quota. The first one is generally made available when a member faces relatively minor balance-of-payments difficulties and is subject to few conditions. Subsequent *tranches* (collectively known as *upper credit tranches*) are subject to progressively more stringent conditions.[82]

Extended Fund Facility These facilities help member states overcome balance-of-payments problems for longer periods (i.e., financing is available for up to three years) and for amounts larger (i.e., up to 140 percent of the member's quota) than those available under the credit *tranche*. [83]

---

[79] "IMF Members' Quotas and Voting Power, and IMF Governors," posted at www.imf.org/external/np/sec/memdir/members.htm.

[80] "The IMF at a Glance: A Factsheet" (September 2011) posted at www.imf.org/external/np/exr/facts/glance.htm.

[81] "Financial Organization and Operations of the IMF," p. 22 (IMF Pamphlet Series No. 45, 6th ed., 2001) posted at www.imf.org/external/pubs/ft/pam/pam45/contents.htm.

[82] *Id.*, p. 20.

[83] *Id.*, p. 42.

Standby Arrangements These are designed to help countries address short-term balance-of-payments problems. Standbys have provided the greatest amount of IMF resources. These facilities are in essence *bridging loans* provided to member states while the IMF deliberates about whether to provide other funds to the particular member state. Typically, they are granted for 12–24 months and repayment is normally expected within two to four years. Surcharges apply to high access levels.[84]

Concessional IMF Facility The IMF has one facility, established in 1987, enlarged and extended in 1994, and renamed and revised in 1999, that is designed for low-income member countries with protracted balance-of-payment problems. The Poverty Reduction and Growth Facility (PRGF) provides loans at concessional interest rates of 0.5 percent per annum to such countries. During 2006, some 78 low-income countries were eligible for PRGF assistance.[85]

Special IMF Facilities

Compensatory Financing Facility Created in 1963, this facility helps a country deal with a temporary depletion of its foreign exchange reserves when this comes about as the consequence of economic developments beyond its control (such as a crop failure or natural disaster).[86]

Supplemental Reserve Facility This facility provides short-term financial assistance for exceptional balance-of-payments difficulties due to a large short-term financing need that is the result of a sudden and disruptive loss of market confidence.[87]

Contingent Credit Lines Established in 1999 in response to the spread of turmoil through global financial markets during the Asian crisis, this is a precautionary facility designed to help members with strong economic policies and sound financial systems that find themselves threatened by a crisis elsewhere in the world economy—a phenomenon known as *financial contagion*.[88]

IMF Conditionality

Use of the IMF's resources is limited by the policies set out in the Articles of Agreement and the policies adopted under them. This requirement is known as **IMF conditionality.**

IMF conditionality
Principle that a member's right to the use of credit *tranches* and credit facilities will depend on its progress in regularizing its balance-of-payments obligations and developing sustained economic growth.

The essence of conditionality is that access to the IMF's credit *tranches* and other credit facilities is linked to a member's progress in implementing policies to restore balance-of-payments viability and sustainable economic growth. It is based not on a rigid set of operational rules but on a general set of guidelines. The guidelines, that the Executive Board adopted in 2002 provide four guiding principles: national ownership of the reform program, parsimony and clarity in the application of program-related conditions, tailoring of programs to the member's circumstances, and effective coordination between the IMF and other multilateral institutions.[89]

F. Development Banks

There exist on the international, regional, and national levels specialized financial organizations that promote economic development. The International Bank for Reconstruction and Development (IBRD)—known informally as the **World Bank**—was established, along with the IMF, at the United Nations meeting at Bretton Woods in 1944. Membership in the bank is restricted to the members of the IMF, and in essence, the bank operates as the development arm of the IMF.

World Bank
Informal name for the International Bank for Reconstruction and Development. An intergovernmental organization, headquartered in Washington, D.C., that provides development financing for its members.

[84]"How Does the IMF Lend? A Factsheet" (September 2006), posted at www.imf.org/external/np/exr/facts/howlend.htm.

[85]"The IMF's Poverty Reduction and Growth Facility (PRGF): A Factsheet" (August 2006), posted at www.imf.org/external/np/exr/facts/prgf.htm.

[86]"Organization and Operations of the IMF," pp. 44–45 (IMF Pamphlet Series No. 45, 6th ed., 2001) posted at www.imf.org/external/pubs/ft/pam/pam45/contents.htm.

[87]*Id*., p. 42.

[88]"The IMF's Contingent Credit Lines: A Factsheet" (March 2004), posted at www.imf.org/external/np/exr/facts/ccl.htm.

[89]Martin A. Weiss, New IMF Conditionality Guidelines, http://www.policyarchive.org/handle/10207/bitstreams/3666.pdf

Complementing the World Bank are two subsidiaries: the **International Development Agency (IDA)** and the **International Finance Corporation (IFC).** The World Bank provides development financing to the national governments and political subdivisions of its member states. The IDA provides less restrictive financing for less developed countries, and the IFC provides loans to private enterprises.[90] Together, the World Bank, the IDA, and the IFC are the world's largest providers of development assistance to developing countries and countries in transition, providing some $20 billion in new loans each year.

International Development Association (IDA)
A subsidiary of the World Bank that provides concessional development financing to less developed countries.

International Finance Corporation (IFC)
A subsidiary of the World Bank that provides development financing to private enterprises.

The World Bank is also responsible for managing the Trust Fund of the **Global Environment Facility (GEF).** The GEF, which became a permanent international facility in 1994, provides grant and concessional monies to developing countries to fund projects dealing with four global environmental problems: climate change, biological diversity, international waters, and ozone layer depletion. Only countries that are parties to the Climate Change Convention[91] or the Convention on Biological Diversity[92] are eligible to receive funds from the GEF. Unlike in other World Bank facilities, an independent Council made up of 32 states participating in the GEF determines which projects will be funded.[93]

Another international development organization, the **International Fund for Agricultural Development (IFAD),** was created by a special UN conference held in Rome in 1976. Membership is open to any UN member.[94] The IFAD's primary objective is to provide financing for projects that introduce, expand, and improve food production systems in its developing member states.

Regional development organizations exist to promote the economic and social development of regional groups. The names and purposes of the major regional organizations are listed in Table 6.2.

TABLE 6.2

Regional development organizations

Name	Objectives
African Development Bank	Complementary regional economic development
Asian Development Bank	Complementary regional economic development
Arab Bank for Economic Development in Africa	African economic independence through Arab-African cooperation
Arab Fund for Economic and Social Development	Joint Arab development projects
Caribbean Development Bank	Economic cooperation and integration
Central African States Development Bank	Multinational development projects leading to economic integration
Central American Bank for Economic Integration	Economic integration and balanced economic development
East African Development Bank	Regional economic development
Inter-American Development Bank	Economic growth and development
Islamic Development Bank	Economic development in accordance with Islamic law
Nordic Investment Bank	Nordic economic development and Nordic exports
OPEC Fund for International Development	Economic cooperation and development
Southern African Development Coordination	Regional economic integration Conference
West African Development Bank	Economic integration and development

Source: Based on Robert Fraser, *The World Financial System*, pp. 398–454 (Phoenix, AZ: Oryx Press, 1987).

[90]As of April 2007, the World Bank had 185 members, the IDA had 166, and the IFC had 179. The World Bank's Web site is at www.worldbank.org.

[91]The Climate Change Secretariat's home page, at www.unfccc.de, contains the full text of the United Nations Framework Convention on Climate Change. As of April 2007, there were 189 states parties.

[92]The Biological Diversity Secretariat's home page at www.biodiv.org has the full text of the convention. As of April 2007, there were 190 states parties.

[93]Instrument for the Establishment of the Restructured Global Environment Facility, Article I, §16. Any UN member may become a participant in the GEF by depositing an instrument of participation with the GEF Secretariat or by making a deposit in the Trust Fund. *Id.*, Article I, §7. As of November 2011, there were 182 member countries. See www.thegef.org/gef/member_countries.

[94]The IFAD has 161 member countries. See the IFAD home page at www.ifad.org.

Global Environment Facility (GEF)
A World Bank source of grant and concessional funding for protecting and improving the global environment.

International Fund for Agricultural Development (IFAD)
An intergovernmental organization, headquartered in Rome, that provides financing to its developing member states to promote food production.

National development agencies exist in virtually every developed country. The most important ones are discussed in Chapter 12.

Controversies at the World Bank

The oft-noted corruption at the World Bank was revealed by the World Bank itself in a 2005 study by its Department of Institutional Integrity. Fraud seems to be endemic in World Bank projects. As a *U.S. News and World Report* article outlined in 2007, the World Bank is a deeply troubled institution where corruption may have meant the loss of $100 billion or more over the years. It is also not clear to many what the $20 billion in loans and grants the bank makes each year are accomplishing. Middle-income nations can "tap global financial markets if they need a loan, and the aid money seems to be making little difference in the world's poorest countries."[95] From 1980 to 2002, 23 of 45 sub-Saharan African countries experienced negative compounded economic growth, when adjusted for inflation.[96]

While many may bid for a contract to build a road or to provide tractors, the bank provides the cash while the borrowing government chooses the winning bid. A 2005 article by Dr. Nathaniel Hobbs indicated that in 90 bank contracts (worth $90 million in total) in over 20 countries, a kickback was sought by local officials in every case. The kickbacks averaged 10–15 percent.

Some estimates indicate that the bank will finance 45,000 contracts a year. Rooting out corruption is a difficult process, and watching every cent is not possible, so the bank looks first at cases where the bank's staff may be involved or the reputation of the bank is at risk. If a scandal tainted a bank project with the U.S. Agency for International Development (US AID),[97] the bank would be quick to act and has made examples of some. A seven-year ban on Lahmeyer International (a German firm found to have bribed an official in Lesotho) has sent a definite signal to some potential bribers.

The themes of corruption and ethics brought the World Bank into greater public view in the spring of 2007 when Paul Wolfowitz, the president of the bank, was questioned for arranging a sweetheart deal for his companion, Shaha Ali Riza, who had worked at the bank for seven years before his arrival (see Figure 6.4). Because of their relationship, bank rules required that she leave the bank's employ. In arranging for her salary as a liaison to the State Department, he may or may not have violated bank procedures.[98] His resignation followed many weeks of controversy, some of it opaque, as to whether his own ethics were lacking. Ultimately, the board of the bank accepted his resignation with a statement issued May 17, 2007.

The board wrote that they had "considered carefully the report of the ad hoc group, the associated documents, and the submissions and presentations of Mr. Wolfowitz," and went on to note that Mr. Wolfowitz "assured us that he acted ethically and in good faith in what he believed were the best interests of the institution, and we accept that," while acknowledging that "a number of mistakes were made by a number of individuals in handling the matter under consideration, and that the Bank's systems did not prove robust to the strain under which they were placed." The board expressed gratitude for his service at the bank and noted achievements over a two-year period that included "the Multilateral Debt Relief Initiative, the Clean Energy Investment Framework, the Africa Action Plan, and the Avian Flu Initiative." The board also noted the value of emergency action programs in Liberia, the Democratic Republic of the Congo, and the Central African Republic, as well as the new strategy for the bank's efforts to improve governance and combat corruption.[99]

[95]James Pethokoukis, "The Post-Wolfowitz World Bank," *U.S. News & World Report*, May 17, 2007.

[96]*Id*.

[97]www.usaid.gov.

[98]Steven R. Weisman, "Bank's Report Says Wolfowitz Violated Ethics," *New York Times*, May 15, 2007.

[99]Statement of Executive Directors, available at http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/ 0,contentMDK:21339650∼menuPK:34463∼pagePK:34370∼piPK:34424∼theSitePK:4607,00.html.

FIGURE 6.4

Paul Wolfowitz and Shaha Ali Reza

Source: Sipa USA/Newscom

At the time of the Wolfowitz resignation, many critics of the bank were contending that it no longer had a useful role to play in global development. After World War II, the World Bank was often the lender of first resort. But the bank itself must raise funds from sometimes skeptical governments, and also faces stiffer competition for aid dollars than ever before. There are over 150 multilateral bodies—from the African Development Bank to the United Nations Children's Fund—and a host of funds, facilities, and initiatives dedicated to specific causes, such as the President's Malaria Initiative launched by George W. Bush. Also, as noted above, middle-income nations can go to global financial markets if they need a loan.

Yet, certain kinds of development loans seem unlikely to be made by the private sector. For example, in 2007 the bank approved a $45.65 million concessionary credit to Pakistan for a Land Record Management and Information System Project (LRMIS). LRMIS is aimed at improving a system of land titles that dates back to the nineteenth century. The inefficiencies and costs of the current system make it very difficult for Pakistanis in the Punjab region to get and maintain clear titles to real property. Having clear title to land is a formative and essential part of creating an entrepreneurial class.[100]

The credit comes from the bank's International Development Association (IDA) with thirty-five years' maturity and a ten-year grace period. Under the project, "service centres would be established where land records would be maintained and made available to the public in digital form and pilot linkages between the land records system and the system for registration of deeds."[101] Under the project, land records will be provided within 30 minutes of application at the service centres; currently, it can take weeks for this process to be completed. Transaction costs are expected to be reduced significantly, as well.

What the future role of the World Bank is for global development remains to be seen. It is less likely to put its financial muscle behind privatization or trade liberalization in countries that do not

[100]See Hernando DeSoto, *The Mystery of Capital* (2000).

[101]Misrar Khan, "World Bank to Give $45.65 Million for Punjab Land Record Management," *Business Recorder*, Jan. 27, 2007, p. 83.

want either. It may find more efficient ways of dealing with corruption, both inside the bank and without. It is likely to find a way to persist, if only because it has considerable institutional momentum. Still, the bank must find a way not only to accommodate the changing needs of a developing world, but also to achieve a closer understanding of its role *vis-a-vis* the IMF. The differences between the two are discussed in Reading 6-4.

Reading 6-4 The IMF and the World Bank: How Do They Differ?[102]

David D. Driscoll

Source: "The IMF and the World Bank: How do they Differ?" by David D. Driscoll, from the International Monetary Fund website. Copyright © by the International Monetary Fund. Reprinted with permission.

If you have difficulty distinguishing the World Bank from the International Monetary Fund, you are not alone. Most people have only the vaguest idea of what these institutions do, and very few people indeed could, if pressed on the point, say why and how they differ. Even John Maynard Keynes, a founding father of the two institutions and considered by many the most brilliant economist of the twentieth century, admitted at the inaugural meeting of the International Monetary Fund that he was confused by the names: he thought the Fund should be called a bank, and the Bank should be called a fund. Confusion has reigned ever since.

Known collectively as the Bretton Woods Institutions after the remote village in New Hampshire, U.S.A., where they were founded by the delegates of 44 nations in July 1944, the Bank and the IMF are twin intergovernmental pillars supporting the structure of the world's economic and financial order. That there are two pillars rather than one is no accident. The international community was consciously trying to establish a division of labor in setting up the two agencies. Those who deal professionally with the IMF and Bank find them categorically distinct. To the rest of the world, the niceties of the division of labor are even more mysterious than are the activities of the two institutions. (See Table 6.3.)

Similarities between them do little to resolve the confusion. Superficially the Bank and IMF exhibit many common characteristics. Both are in a sense owned and directed by the governments of member nations. The People's Republic of China, by far the most populous state on earth, is a member, as is the world's largest industrial power (the United States). In fact, virtually every country on earth is a member of both institutions. Both institutions concern themselves with economic issues and concentrate their efforts on broadening and strengthening the economies of their member nations. Staff members of both the Bank and IMF often appear at international conferences, speaking the same recondite language of the economics and development professions, or are reported in the media to be negotiating involved and somewhat mystifying programs of economic adjustment with ministers of finance or other government officials. The two institutions hold joint annual meetings, which the news media cover extensively. Both have headquarters in Washington, D.C., where popular confusion over what they do and how they differ is about as pronounced as everywhere else. For many years both occupied the same building and even now, though located on opposite sides of a street very near the White House, they share a common library and other facilities, regularly exchange economic data, sometimes present joint seminars, daily hold informal meetings, and occasionally send out joint missions to member countries.

Despite these and other similarities, however, the Bank and the IMF remain distinct. The fundamental difference is this: the Bank is primarily a development institution; the IMF is a cooperative institution that seeks to maintain an orderly system of payments and receipts between nations. Each has a different purpose, a distinct structure, receives its funding from different sources, assists different categories of members, and strives to achieve distinct goals through methods peculiar to itself.

Purposes

At Bretton Woods the international community assigned to the World Bank the aims implied in its formal name, the International Bank for Reconstruction and Development (IBRD), giving it primary responsibility for financing economic development. The Bank's first loans were extended during the late 1940s to finance the reconstruction of the war-ravaged economies of Western Europe. When these nations recovered some measure of economic self-sufficiency, the Bank turned its attention to assisting the world's poorer nations, known as developing countries, to which it has since the 1940s loaned more than $330 billion. The World Bank has one central purpose: to promote economic and social progress in developing countries by helping to raise productivity so that their people may live a better and fuller life.

The international community assigned to the IMF a different purpose. In establishing the IMF, the world community was reacting to the unresolved financial problems instrumental in initiating and protracting the Great Depression of the 1930s: sudden, unpredictable variations in the exchange values of national currencies and a widespread disinclination among governments to allow their national currency to be exchanged for foreign currency. Set up as a voluntary and cooperative institution, the IMF attracts to its membership nations that are prepared, in a spirit of enlightened self-interest, to relinquish some measure of national sovereignty by abjuring practices injurious to the economic well-being of their fellow member nations. The rules of the institution, contained in the IMF's Articles of Agreement signed by all members, constitute a code of conduct. The code is simple: it requires members to allow their currency to be exchanged for foreign currencies freely and without restriction, to keep the IMF informed of changes they contemplate in financial and monetary policies that will affect fellow members' economies, and, to the extent possible, to modify these policies on the advice of the IMF to accommodate the needs of the entire membership. To help nations abide by the code of conduct, the IMF administers a pool of money from which members can borrow when they are in trouble. The IMF

[102]This article can be found on the IMF Web site at www.imf.org/external/pubs/ft/exrp/differ/differ.htm.

TABLE 6.3

Compared: The World Bank and the IMF

World Bank	International Monetary Fund
➢ Principal aim of assisting the world's less developed nations through long-term financing of projects and programs.	➢ Oversees the international monetary system.
➢ Provides to the poorest developing countries special financial assistance through the International Development Association (IDA).	➢ Promotes exchange stability and orderly exchange relations among its member countries.
➢ Encourages private enterprises in developing countries through its affiliate, the International Finance Corporation (IFC).	➢ Assists all members experiencing temporary balance-of-payments problems with short- to medium-term lending.
➢ Acquires most of its financial resources by borrowing on the international bond market.	➢ Uses SDRs to supplement the currency reserves of members as needed, in proportion to their quotas.
➢ Has a staff of 7,000 drawn from 180 member countries.	➢ Has a staff of 2,300 drawn from 182 member countries.

Sources: Left picture: Wim Wiskerke/Alamy. Right picture: Lighttrace Studio/Alamy.

is not, however, primarily a lending institution, as is the Bank. It is first and foremost an overseer of its members' monetary and exchange rate policies and a guardian of the code of conduct. Philosophically committed to the orderly and stable growth of the world economy, the IMF is an enemy of surprise. It receives frequent reports on members' economic policies and prospects, which it debates, comments on, and communicates to the entire membership so that other members may respond in full knowledge of the facts and a clear understanding of how their own domestic policies may affect other countries. The IMF is convinced that a fundamental condition for international prosperity is an orderly monetary system that will encourage trade, create jobs, expand economic activity, and raise living standards throughout the world. By its constitution the IMF is required to oversee and maintain this system, no more and no less.

Size and Structure

The IMF is small (about 2,300 staff members) and, unlike the World Bank, has no affiliates or subsidiaries. Most of its staff members work at headquarters in Washington, D.C., although three small offices are maintained in Paris, [in] Geneva, and at the United Nations in New York. Its professional staff members are for the most part economists and financial experts.

The structure of the Bank is somewhat more complex. The World Bank itself comprises two major organizations: the International Bank for Reconstruction and Development and the International Development Association (IDA). Moreover, associated with but legally and financially separate from the World Bank are the International Finance Corporation, which mobilizes funding for private enterprises in developing countries, the International

Center for Settlement of Investment Disputes, and the Multilateral Guarantee Agency. With over 7,000 staff members, the World Bank Group is about three times as large as the IMF and maintains about 40 offices throughout the world, although 95 percent of its staff work at its Washington, D.C., headquarters. The Bank employs a staff with an astonishing range of expertise: economists, engineers, urban planners, agronomists, statisticians, lawyers, portfolio managers, loan officers, and project appraisers, as well as experts in telecommunications, water supply and sewerage, transportation, education, energy, rural development, population and health care, and other disciplines.

Source of Funding

The World Bank is an investment bank, intermediating between investors and recipients, borrowing from the one and lending to the other. Its owners are the governments of its 180 member nations with equity shares in the Bank, which were valued at about $176 billion in June 1995. The IBRD obtains most of the funds it lends to finance development by market borrowing through the issue of bonds (which carry an AAA rating because repayment is guaranteed by member governments) to individuals and private institutions in more than 100 countries. Its concessional loan associate, IDA, is largely financed by grants from donor nations. The Bank is a major borrower in the world's capital markets and the largest nonresident borrower in virtually all countries where its issues are sold. It also borrows money by selling bonds and notes directly to governments, their agencies, and central banks. The proceeds of these bond sales are lent in turn to developing countries at affordable rates of interest to help finance projects and policy reform programs that give promise of success.

Despite Lord Keynes's profession of confusion, the IMF is not a bank and does not intermediate between investors and recipients. Nevertheless, it has at its disposal significant resources, presently valued at over $215 billion. These resources come from quota subscriptions, or membership fees, paid in by the IMF's 182 member countries. Each member contributes to this pool of resources a certain amount of money proportionate to its economic size and strength (richer countries pay more, poorer less). While the Bank borrows and lends, the IMF is more like a credit union whose members have access to a common pool of resources (the sum total of their individual contributions) to assist them in times of need. Although under special and highly restrictive circumstances the IMF borrows from official entities (but not from private markets), it relies principally on its quota subscriptions to finance its operations. The adequacy of these resources is reviewed every five years.

Recipients of Funding

Neither wealthy countries nor private individuals borrow from the World Bank, which lends only to creditworthy governments of developing nations. The poorer the country, the more favorable the conditions under which it can borrow from the Bank. Developing countries whose per capita gross national product (GNP) exceeds $1,305 may borrow from the IBRD. (Per capita GNP, a less formidable term than it sounds, is a measure of wealth, obtained by dividing the value of goods and services produced in a country during one year by the number of people in that country.) These loans carry an interest rate slightly above the market rate at which the Bank itself borrows and must generally be repaid within 12–15 years. The IDA, on the other hand, lends only to governments of very poor developing nations whose per capita GNP is below $1,305, and in practice IDA loans go to countries with annual per capita incomes below $865. IDA loans are interest free and have a maturity of 35 or 40 years.

In contrast, all member nations, both wealthy and poor, have the right to financial assistance from the IMF. Maintaining an orderly and stable international monetary system requires all participants in that system to fulfill their financial obligations to other participants. Membership in the IMF gives to each country that experiences a shortage of foreign exchange—preventing it from fulfilling these obligations—temporary access to the IMF's pool of currencies to resolve this difficulty, usually referred to as a balance of payments problem. These problems are no respecter of economic size or level of per capita GNP, with the result that over the years almost all members of the IMF, from the smallest developing country to the largest industrial country, have at one time or other had recourse to the IMF and received from it financial assistance to tide them over difficult periods. Money received from the IMF must normally be repaid within three to five years, and in no case later than ten years. Interest rates are slightly below market rates, but are not so concessional as those assigned to the World Bank's IDA loans. Through the use of IMF resources, countries have been able to buy time to rectify economic policies and to restore growth without having to resort to actions damaging to other members' economies.

World Bank Operations

The World Bank exists to encourage poor countries to develop by providing them with technical assistance and funding for projects and policies that will realize the countries' economic potential. The Bank views development as a long-term, integrated endeavor.

During the first two decades of its existence, two thirds of the assistance provided by the Bank went to electric power and transportation projects. Although these so-called infrastructure projects remain important, the Bank has diversified its activities in recent years as it has gained experience with and acquired new insights into the development process.

The Bank gives particular attention to projects that can directly benefit the poorest people in developing countries (see Figure 6.5). The direct involvement of the poorest in economic activity is being promoted through lending for agriculture and rural development, small-scale enterprises, and urban development. The Bank is helping the poor to be more productive and to gain access to such necessities as safe water and waste-disposal facilities, health care, family-planning assistance, nutrition, education, and housing. Within infrastructure projects there have also been changes. In transportation projects, greater attention is given to constructing farm-to-market roads. Rather than concentrating exclusively on cities, power projects increasingly provide lighting and power for villages and small farms. Industrial projects place greater emphasis on creating jobs in small enterprises. Labor-intensive construction is used where practical. In addition to electric power, the Bank is supporting development of oil, gas, coal, fuelwood, and biomass as alternative sources of energy.

The Bank provides most of its financial and technical assistance to developing countries by supporting specific projects. Although IBRD loans and IDA credits are made on different financial terms, the two institutions use the same standards in assessing the soundness of projects. The decision [on] whether a project will receive IBRD or IDA financing depends on the economic condition of the country and not on the characteristics of the project.

Its borrowing member countries also look to the Bank as a source of technical assistance. By far the largest element of Bank-financed technical assistance—running over $1 billion a year recently—is that financed as a

(a)

(b)

FIGURE 6.5

Two World Bank Projects: (a) World Bank President Robert Zoellick Greets Resettled Villagers from a Dam Project in Laos; (b) Former World Bank President Paul Wolfowitz meets with Locals at a World Bank–Assisted Project in Bauchi, Nigeria

Source: top, David Longstreath/AP Images; bottom, AP Images

component of Bank loans or credits extended for other purposes. But the amount of Bank-financed technical assistance for free-standing loans and to prepare projects has also increased. The Bank serves as executing agency for technical assistance projects financed by the United Nations Development Program in agriculture and rural development, energy, and economic planning. In response to the economic climate in many of its member countries, the Bank is now emphasizing technical assistance for institutional development and macroeconomic policy formulation.

Every project supported by the Bank is designed in close collaboration with national governments and local agencies, and often in cooperation with other multilateral assistance organizations. Indeed, about half of all Bank-assisted projects also receive co-financing from official sources, that is, governments, multilateral financial institutions, and export-credit agencies that directly finance the procurement of goods and services, and from private sources, such as commercial banks.

In making loans to developing countries, the Bank does not compete with other sources of finance. It assists only those projects for which the required capital is not available from other sources on reasonable terms. Through its work, the Bank seeks to strengthen the economies of borrowing nations so that they can graduate from reliance on Bank resources and meet their financial needs, on terms they can afford directly from conventional sources of capital.

The range of the Bank's activities is far broader than its lending operations. Since the Bank's lending decisions depend heavily on the economic condition of the borrowing country, the Bank carefully studies its economy and the needs of the sectors for which lending is contemplated. These analyses help in formulating an appropriate long-term development assistance strategy for the economy.

Graduation from the IBRD and IDA has occurred for many years. Of the 34 very poor countries that borrowed money from IDA during the earliest years, more than two dozen have made enough progress for them no longer to need IDA money, leaving that money available to other countries that joined the Bank more recently. Similarly, about 20 countries that formerly borrowed money from the IBRD no longer have to do so. An outstanding example is Japan. For a period of 14 years, it borrowed from the IBRD. Now, the IBRD borrows large sums in Japan.

IMF Operations

The IMF has gone through two distinct phases in its 50-year history. During the first phase, ending in 1973, the IMF oversaw the adoption of general convertibility among the major currencies, supervised a system of fixed exchange rates tied to the value of gold, and provided short-term financing to countries in need of a quick infusion of foreign exchange to keep their currencies at par value or to adjust to changing economic circumstances. Difficulties encountered in maintaining a system of fixed exchange rates gave rise to unstable monetary and financial conditions throughout the world and led the international community to reconsider how the IMF could most effectively function in a regime of flexible exchange rates. After five years of analysis and negotiation (1973–78), the IMF's second phase began with the amendment of its constitution in 1978, broadening its functions to enable it to grapple with the challenges that have arisen since the collapse of the par value system. These functions are three.

First, the IMF continues to urge its members to allow their national currencies to be exchanged without restriction for the currencies of other member countries. As of June 2007, 166 members had agreed to full convertibility of their national currencies. Second, in place of monitoring members' compliance with their obligations in a fixed exchange system, the IMF supervises economic policies that influence their balance of payments in the presently legalized flexible exchange rate environment. This supervision provides opportunities for an early warning of any exchange rate or balance of payments problem. In this, the IMF's role is principally advisory. It confers at regular intervals (usually once a year) with its members, analyzing their economic positions and apprising them of actual or potential problems arising from their policies, and keeps the entire membership informed of these developments. Third, the IMF continues to provide short- and medium-term financial assistance to member nations that run into temporary balance of payments difficulties. The financial assistance usually involves the provision by the IMF of convertible currencies to augment the afflicted member's dwindling foreign exchange reserves, but only in return for the government's promise to reform the economic policies that caused the balance of payments problem in the first place. The IMF sees its financial role in these cases not as subsidizing further deficits but as easing a country's painful transition to living within its means.

How in practice does the IMF assist its members? The key opening the door to IMF assistance is the member's balance of payments, the tally of its payments and receipts with other nations. Foreign payments should be in rough balance: a country ideally should take in just about what it pays out. When financial problems cause the price of a member's currency and the price of its goods to fall out of line, balance of payments difficulties are sure to follow. If this happens, the member country may, by virtue of the Articles of Agreement, apply to the IMF for assistance.

To illustrate, let us take the example of a small country whose economy is based on agriculture. For convenience in trade, the government of such a country generally pegs the domestic currency to a convertible currency: so many units of domestic money to a U.S. dollar or French franc. Unless the exchange rate is adjusted from time to time to take account of changes in relative prices, the domestic currency will tend to become overvalued, with an exchange rate, say, of one unit of domestic currency to one U.S. dollar, when relative prices might suggest that two units to one dollar is more realistic. Governments, however, often succumb to the temptation to tolerate overvaluation, because an overvalued currency makes imports cheaper than they would be if the currency were correctly priced.

The other side of the coin, unfortunately, is that overvaluation makes the country's exports more expensive and hence less attractive to foreign buyers. If the currency is thus overvalued, the country will eventually experience a fall-off in export earnings (exports are too expensive) and a rise in import expenditures (imports are apparently cheap and are bought on credit). In effect, the country is earning less, spending more, and going into debt, a predicament as unsustainable for a country as it is for any of us. Moreover, this situation is usually attended by a host of other economic ills for the country. Finding a diminished market for their export crops and receiving low prices from the government marketing board for produce consumed domestically, farmers either resort to illegal black market exports or lose the incentive to produce. Many of them abandon the farm to seek employment in overcrowded cities, where they become part of larger social and economic problems. Declining domestic agricultural productivity forces the government to use scarce foreign exchange reserves (scarce because export earnings are down) to buy food from abroad. The balance of payments becomes dangerously distorted.

As an IMF member, a country finding itself in this bind can turn to the IMF for consultative and financial assistance. In a collaborative effort, the country and the IMF can attempt to root out the causes of the payments imbalance by working out a comprehensive program that, depending on the particulars of the case, might include raising producer prices paid to farmers so as to encourage agricultural production and reverse migration to the cities, lowering interest rates to expand the supply of credit, and adjusting the currency to reflect the level of world prices, thereby discouraging imports and raising the competitiveness of exports.

Because reorganizing the economy to implement these reforms is disruptive and not without cost, the IMF will lend money to subsidize policy reforms during the period of transition. To ensure that this money is put to the most productive uses, the IMF closely monitors the country's economic progress during this time, providing technical assistance and further consultative services as needed.

In addition to assisting its members in this way, the IMF also helps by providing technical assistance in organizing central banks, establishing and reforming tax systems, and setting up agencies to gather and publish economic statistics. The IMF is also authorized to issue a special type of money, called the SDR, to provide its members with additional liquidity. Known technically as a fiduciary asset, the SDR can be retained by members as part of their monetary reserves or be used in place of national currencies in transactions with other members. To date the IMF has issued slightly over 21.4 billion SDRs, presently valued at about U.S. $30 billion.

Over the past few years, in response to an emerging interest by the world community to return to a more stable system of exchange rates that would reduce the present fluctuations in the values of currencies, the IMF has been strengthening its supervision of members' economic policies. Provisions exist in its Articles of Agreement that would allow the IMF to adopt a more active role, should the world community decide on stricter management of flexible exchange rates or even on a return to some system of stable exchange rates.

Measuring the success of the IMF's operations over the years is not easy, for much of the IMF's work consists in averting financial crises or in preventing their becoming worse. Most observers feel that merely to have contained the debt crisis of the 1980s, which posed the risk of collapse in the world's financial system, must be counted a success for the IMF. The Fund has also gained some recognition for assisting in setting up market-based economies in the countries of the former Soviet Union and for responding swiftly to the Mexican peso crisis in 1994, but its main contribution lies in its unobtrusive, day-to-day encouragement of confidence in the international system. Nowhere will you find a bridge or a hospital built by the IMF, but the next time you buy a Japanese camera or drive a foreign car, or without difficulty exchange dollars or pounds for another currency while on holiday, you will be benefiting from the vast increase in foreign trade over the past 50 years and the widespread currency convertibility that would have been unimaginable without the world monetary system that the IMF was created to maintain.

Cooperation Between the Bank and IMF

Although the Bank and IMF are distinct entities, they work together in close cooperation. This cooperation, present since their founding, has become more pronounced since the 1970s. Since then the Bank's activities have increasingly reflected the realization that the pace of economic and social development accelerates only when sound underlying financial and economic policies are in place. The IMF has also recognized that unsound financial and economic policies are often deeply rooted in long-term inefficient use of resources that resists eradication through short-term adaptations of financial policies. It does little good for the Bank to develop a long-term irrigation project to assist, say, the export of cotton if the country's balance of payments position is so chaotic that no foreign buyers will deal with the country. On the other hand, it does little good for the IMF to help establish a sound exchange rate for a country's currency, unless the production of cotton for export will suffice to sustain that exchange rate over the medium to long term. The key to solving these problems is seen in restructuring economic sectors so that the economic potential of projects might be realized throughout the economy and the stability of the economy might enhance the effectiveness of the individual project.

Around 75 percent of the Bank's lending is applied to specific projects dealing with roads, dams, power stations, agriculture, and industry. As the global economy became mired in recession in the early 1980s, the Bank expanded the scope of its lending operations to include structural- and sector-adjustment loans. These help developing countries adjust their economic policies and structures in the face of serious balance of payments problems that threaten continued development. The main objective of structural-adjustment lending is to restructure a developing country's economy as the best basis for sustained economic growth. Loans support programs that are intended to anticipate and avert economic

crises through economic reforms and changes in investment priorities. By using so-called policy-based lending, the Bank stimulates economic growth in heavily indebted countries—particularly in Latin America and in sub-Saharan Africa—that are undertaking, often at much social pain, far-reaching programs of economic adjustment.

In addition to its traditional function as provider of short-term balance of payments assistance, the advent of the oil crisis in the mid-1970s and the debt crisis in the early 1980s induced the IMF, too, to rethink its policy of restricting its financial assistance to short-term lending. As balance of payments shortfalls grew larger and longer-term structural reforms in members' economies were called for to eliminate these shortfalls, the IMF enlarged the amount of financial assistance it provides and lengthened the period within which its financial assistance would be available. In doing so, the IMF implicitly recognizes that balance of payments problems arise not only from a temporary lack of liquidity and inadequate financial and budgetary policies but also from long-standing contradictions in the structure of members' economies, requiring reforms stretching over a number of years and suggesting closer collaboration with the World Bank, which commands both the expertise and experience to deal with protracted structural impediments to growth.

Focusing on structural reform in recent years has resulted in considerable convergence in the efforts of the Bank and IMF and has led them to greater reliance on each other's special expertise. This convergence has been hastened by the debt crisis, brought on by the inability of developing countries to repay the enormous loans they contracted during the late 1970s and early 1980s. The debt crisis has emphasized that economic growth can be sustained only when resources are being used efficiently and that resources can be used efficiently only in a stable monetary and financial environment.

The bedrock of cooperation between the Bank and IMF is the regular and frequent interaction of economists and loan officers who work on the same country. The Bank staff brings to this interchange a longer-term view of the slow process of development and a profound knowledge of the structural requirements and economic potential of a country. The IMF staff contributes its own perspective on the day-to-day capability of a country to sustain its flow of payments to creditors and to attract from them investment finance, as well as on how the country is integrated within the world economy. This interchange of information is backed up by a coordination of financial assistance to members. For instance, the Bank has been approving structural- or sector-adjustment loans for most of the countries that are taking advantage of financial assistance from the IMF. In addition, both institutions encourage other lenders, both private and official, to join with them in co-financing projects and in mobilizing credits to countries that are in need. Cooperation between the Bretton Woods institutions has two results: the identification of programs that will encourage growth in a stable economic environment and the coordination of financing that will ensure the success of these programs. Other lenders, particularly commercial banks, frequently make credits available only after seeing satisfactory performance by the borrowing country of its program of structural adjustment.

Cooperation between the Bank and the IMF has over the past decade been formalized with the establishment in the IMF of procedures to provide financing at below-market rates to its poorest member countries. These procedures enable the IMF to make available up to $12 billion to those 70 or so poor member countries that adjust the structure of their economies to improve their balance of payment position and to foster growth. The Bank joins with the IMF in providing additional money for these countries from IDA. But what IDA can provide in financial resources is only a fraction of the world's minimum needs for concessional external finance. Happily, various governments and international agencies have responded positively to the Bank's special action program for low-income, debt-distressed countries of the region by pledging an extra $7 billion for co-financing programs arranged by the Bank.

The Bank and the IMF have distinct mandates that allow them to contribute, each in its own way, to the stability of the international monetary and financial system and to the fostering of balanced economic growth throughout the entire membership. Since their founding 50 years ago, both institutions have been challenged by changing economic circumstances to develop new ways of assisting their membership. The Bank has expanded its assistance from an orientation toward projects to the broader aspects of economic reform. Simultaneously the IMF has gone beyond concern with simple balance of payment adjustment to interest itself in the structural reform of its members' economies. Some overlapping by both institutions has inevitably occurred, making cooperation between the Bank and the IMF crucial. Devising programs that will integrate members' economies more fully into the international monetary and financial system and at the same time encourage economic expansion continues to challenge the expertise of both Bretton Woods institutions.

G. The Bank for International Settlements

The oldest international organization involved in monetary cooperation is the **Bank for International Settlements (BIS),** headquartered in Basel, Switzerland.[103] Founded in 1930, it has three main purposes: (1) to act as a bank for the world's central banks, (2) to promote international monetary cooperation, and (3) to act as an agent for international settlements. It currently holds and invests between 10 and 15 percent of all of the world's monetary reserves. The legal structure of the BIS is somewhat unique. While it is clearly endowed with an international personality and the privileges and immunities of an international organization, it is also a limited company incorporated under Swiss law.[104] This structure is partly the result of historical accident and partly intentional. In 1930,

Bank for International Settlements (BIS) Intergovernmental organization, headquartered in Basel, that functions as a bank for the world's central banks.

[103]The BIS's home page is at www.bis.org.

[104]The current international status of the BIS is defined in the Swiss Headquarters Agreement of 1987, posted on the Internet at http://cryptome.org/0005/bis-legal.pdf.

most of the central banks that helped found the BIS were private corporations rather than public institutions.[105] More important, however, the bank's founders were concerned that the BIS should be insulated, as much as possible, from direct governmental influence. The BIS is structured, therefore, as a banking company limited by shares. Originally, when the BIS's initial capital was issued, part of the Belgian and French issues and all of the American issue were sold to the public. After an Extraordinary General Meeting held in January 2001, the BIS Statutes were amended to restrict ownership of shares exclusively to central banks, and the 14 percent of the shares that then remained in private hands were bought back. Now, all of the shares are owned solely by central banks.[106]

Today, the central banks of 58 countries are represented at the BIS. General meetings of shareholders are held at least once a year, and voting rights are exercised in proportion to the number of shares subscribed (including those held privately) in the state that a central bank represents. A board of directors is dominated by the largest European central banks. Its membership is made up of (1) the governors of the central banks of Belgium, France, Germany, Italy, and the United Kingdom and the chairman of the Board of Governors of the U.S. Federal Reserve; (2) for each of these governors, a second director of the same nationality appointed by that governor; and (3) up to nine additional directors elected by the board from among the governors of the central banks of other member states.[107] The board meets at least 10 times a year and makes decisions by majority vote from among those present or represented by proxy. The board selects the president of the bank from among its own members. The president serves both as the titular head of the bank and the chairman of the board. In turn, the president nominates a general manager, who is appointed by the board. The general manager is responsible for appointing the staff and carrying out the day-to-day operations of the bank.[108]

The Central Banks' Bank

One of the BIS's main functions is to serve as a bank for the world's central banks. It does so by helping some 140 central banks manage and invest their monetary reserves (now amounting to some SDR 133.2 billion).[109] Most of these funds are placed in the world's money market in the form of commercial bank deposits and short-term negotiable instruments (such as certificates of deposit).

BIS facilities
The financial assistance programs available to central banks from the BIS.

Beyond placing surplus funds in the international marketplace, the BIS occasionally makes liquid resources available to central banks. Such transactions (called **facilities**) include swaps of currency for gold, credits advanced against a pledge of gold or marketable short-term securities, and, less frequently, unsecured credits and standby credits. The bank also carries on exchange transactions in foreign currency and gold both with the central banks and with the markets.

bridging loan
Short-term loan that allows a debtor to meet its current obligations until a permanent loan can be obtained.

Recently, the bank has undertaken a new role as a source of large-scale, short-term **bridging loans** to help the central banks of developing countries with their balance-of-payments difficulties. These loans have helped the central banks of Latin American and Eastern European countries cope with cash flow problems pending the receipt of credits from the IMF.

Promoter of International Monetary Cooperation

The BIS undertakes a variety of functions to encourage cooperation among the world's bankers. The bank's offices in Basel regularly host meetings of the world's finance ministers, central bank governors, and banking experts. The BIS also staffs the permanent secretariats of the Committee of Governors of the EU's central banks, the Board of Governors of the European Monetary Cooperation Fund, and the Committee on Banking Regulations and Supervisory Practices of the so-called Group

[105]The National Bank of Belgium and the Bank of Switzerland remain limited companies that have legal status, bodies, and operating rules that discriminate them from other limited companies. The central banks of most countries have now been nationalized or, upon the establishment of their governments, were created as public institutions.

[106]BIS, *Profilae 2004*, p. 2 (June 2004) at www.bis.org/about/profil2004.pdf.

[107]Traditionally, the presidents of the Netherlands Bank and the Swiss National Bank, along with the governor of the Bank of Sweden, have been among these nine.

[108]*Id*.

[109]*Id*., p. 2. (SDR 133.32 billion is approximately 202.27 billion U.S. dollars.)

of Ten (G-10) countries.[110] These secretariats collect data on national banking regulations and national surveillance systems, identify problem areas, and suggest measures for safeguarding bank solvency and liquidity. In addition, the bank itself collects and publishes banking statistics on a quarterly basis.

Agent for International Settlements

Much of the impetus for the creation of the BIS came from the need to settle the problem of German reparations to the victorious allies in the aftermath of World War I. The solution the founders agreed to was the reduction and commercialization of the German payments under the supervision of the bank. The BIS was put in charge of the loans floated by Germany and Austria, and it managed them until the onset of World War II.[111]

From time to time since then, the bank has entered into settlement arrangements with various countries and international organizations. It managed the currency exchange settlements system set up by the European Payments Union and its successor, the European Monetary Agreement, during the 1950s and 1960s. During the 1970s, the bank managed the Organization for Economic Cooperation and Development's Exchange Guarantee Agreement, which again involved a multilateral system for settling currency exchanges. From 1973 to 1993, the BIS managed the European Monetary Cooperation Fund for the European Community.[112] And in 1994, the BIS assumed responsibility for rescheduling Brazil's external debt. It assumed similar responsibilities for Peru beginning in 1997 and for the Ivory Coast in 1998.[113]

BIS and Basel III

Within the BIS, the Basel Committee on Banking Supervision provides a forum for regular cooperation on banking supervisory matters. Its objective is to enhance understanding of key supervisory issues and improve the quality of banking supervision worldwide. It seeks to do so by exchanging information on national supervisory issues, approaches, and techniques, with a view to promoting common understanding. At times, the Committee uses this common understanding to develop guidelines and supervisory standards in areas where they are considered desirable. In this regard, the Committee is best known for its international standards on capital adequacy; the Core Principles for Effective Banking Supervision; and the Concordat on cross-border banking supervision.

The Committee's members come from Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Indonesia, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States.

The Committee encourages contacts and cooperation among its members and other banking supervisory authorities. It circulates to supervisors throughout the world both published and unpublished papers providing guidance on banking supervisory matters. Contacts have been further strengthened by an International Conference of Banking Supervisors (ICBS) that takes place every two years.

The Committee's Secretariat is located at the Bank for International Settlements in Basel and is staffed mainly by professional supervisors on temporary assignment from member institutions. In addition to undertaking the secretarial work for the Committee and its many expert subcommittees, it stands ready to give advice to supervisory authorities in all countries.

The Committee's work is organized under four main subcommittees:

- The Standards Implementation Group
- The Policy Development Group
- The Accounting Task Force
- The Basel Consultative Group

---

[110]The Group of Ten is made up of 11 industrial countries (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States) that consult and cooperate on economic, monetary, and financial matters.

[111]The old obligations were revived under new terms in 1953, and they were again managed by the BIS.

[112]Beginning January 1, 1994, the functions of the European Monetary Cooperation Fund were taken over by the European Monetary Institute.

[113]*Id.*

More information on each subcommittee can be accessed at the BIS Web site at www.bis.org.

Basel III is a comprehensive set of reform measures, developed by the Basel Committee on Banking Supervision, to strengthen the regulation, supervision, and risk management of the banking sector. These measures aim to:

- improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source;
- improve risk management and governance; and
- strengthen banks' transparency and disclosures.

The reforms target bank-level regulation, aiming to raise the resilience of individual banking institutions in periods of stress and systemwide risks. These reforms are complementary insofar as greater resilience at the individual bank level reduces the risk of systemwide shocks.

The Basel III framework can be accessed at www.bis.org/bcbs/basel3/b3summarytable.pdf.

The general idea is to raise reserve requirements for most banks, and impose even higher "loss absorbency capacity" for those financial institutions that pose systemic risks to the financial system. Global "systemically important financial institutions" (SIFIs) will be identified, and additional loss absorbency requirements are to be imposed. In view of the 2007–2008 financial crisis, banks will be required to make their own analyses of externally rated (e.g., Moody's, S & P) securitized investments. Most of the Basel II framework comes out of the Committee's 2008 guidance, *Principles for Sound Liquidity Risk Management and Supervision*, which is a fundamental review of best practices for managing liquidity risk in banking institutions.[114] Basel III is part of the Committee's continuous effort to enhance the banking regulatory framework. It builds on the International Convergence of Capital Measurement and Capital Standards document (Basel II).

H. Regional Monetary Systems

Several groups of countries have set up regional monetary organizations. These vary in their structure and evolution, from those that emulate the IMF in promoting currency exchange and financial support for balance-of-payments obligations to those that have established a complete monetary union.

Regional organizations that carry on many of the same functions as the IMF include the Central American Monetary Union (*Unión monetaria centroamericana*, or UMCA)[115] and the Arab Monetary Fund (AMF).[116] Both work to maintain the values of their members' currencies, stabilize their exchange ratios, jointly manage foreign exchange reserves, and promote eventual monetary union.

The most developed monetary unions are the West African Economic and Monetary Union (*Union economique et monétaire ouest-africaine*, or UEMOA), the Eastern Caribbean Currency Authority (ECCA), and the Economic and Monetary Community of Central Africa (or CEMAC)

[114]"Principles for Sound Liquidity Risk Management and Supervision" can be accessed at www.bis.org/publ/bcbs144.pdf.

[115]Established in 1964 by Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua.

[116]Established in 1976, its current members are Algeria, Bahrain, Comoros, Djibouti, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Palestine, Qatar, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, the United Arab Emirates, and Yemen. Goals of the AMF include "correcting disequilibria in the balances of payments of the member states," stabilizing currency exchange ratios, promoting economic integration, and "paving the way for the creation of a unified Arab currency." See www.amf.org.ae.

from its name in French, *Communauté Économique et Monétaire de l'Afrique Centrale*. Each has established a central bank, a common currency, and a single pool of exchange reserves.[117]

The EU is currently in the process of establishing a fully integrated economic and monetary union (known as the European Monetary Union, or EMU). The criteria for setting up the EMU were agreed to in 1992 with the adoption of the Maastricht Treaty.[118] At that time the members elected the president, vice president, and four other executive board members of a new European Central Bank (ECB).[119] The ECB came into being on June 1, 1998.[120]

Because the Maastricht Treaty envisioned that some EU member states would not be participating in the EMU, it established a rather complex structure to oversee the EU's monetary policies. This is known as the European System of Central Banks (ESCB) and is made up of the European Central Bank and the 27 EU national central banks (NCBs). (See Figure 6.6.)

The main responsibilities of the ESCB are (1) defining and implementing the monetary policy of the EU, (2) conducting foreign exchange operations, (3) holding and managing the official foreign reserves of the EU member states, and (4) promoting the smooth operation of payment systems. In

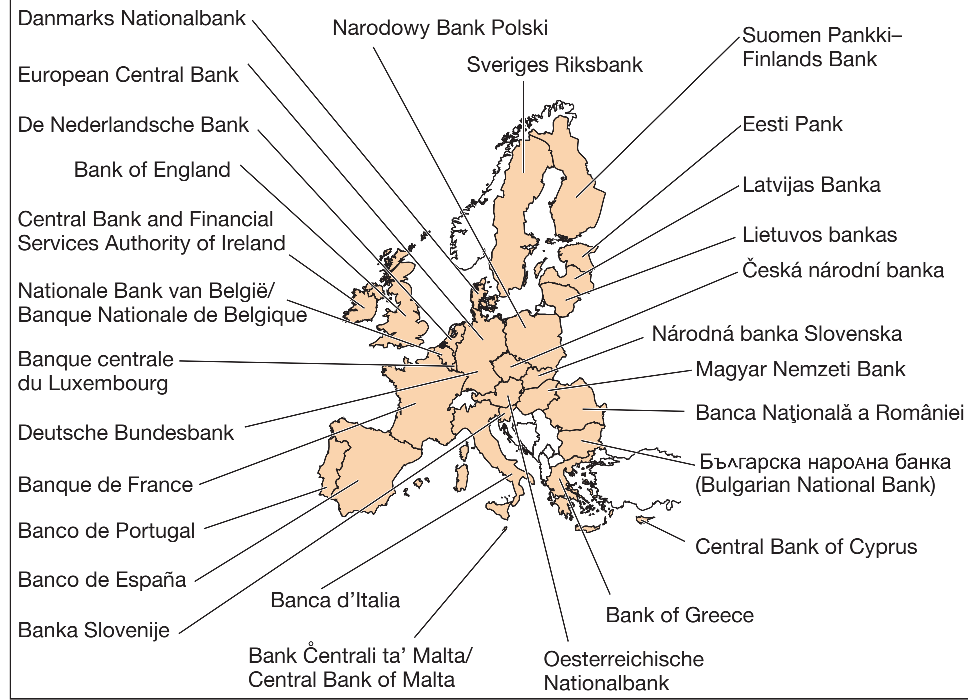


FIGURE 6.6

The Central Banks That Make up the ESCB

[117]Current members of UEMOA are Benin, Burkina Faso, Guinea-Bissau, Ivory Coast, Mali, Niger, Senegal, and Togo. Its bank is the Central Bank of West African States, and its currency is the franc. Current members of the ECCA are Antigua and Barbuda, Dominica, Grenada, Montserrat, Anguilla, Saint Kitts and Nevis, Saint Lucia, and Saint Vincent and the Grenadines. Its bank is the Eastern Caribbean Central Bank, and its currency is the dollar. See Frits van Beek et al., "The Eastern Caribbean Currency Union: Institutions, Performance, and Policy Issues," International Monetary Fund Occasional Papers No. 195 (August 11, 2000) at www.imf.org/external/pubs/nft/op/195. The CEMAC is an organization of states of Central Africa established to promote economic integration among countries that share a common currency, the CFA franc. CEMAC is the successor of the Customs and Economic Union of Central Africa (UDEAC), which it completely superseded in June 1999 (through an agreement from 1994).

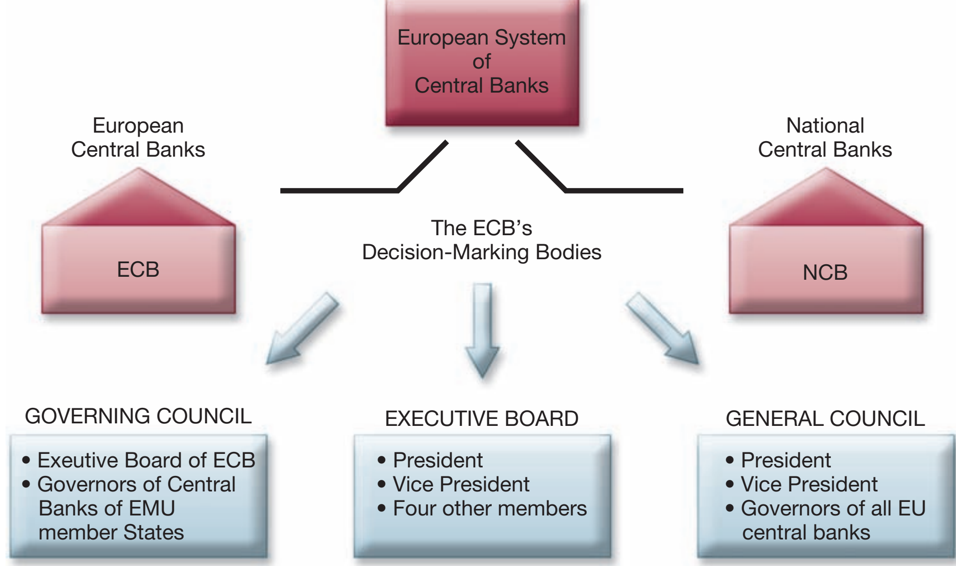
[118]The Treaty on European Union sets out the monetary policy of the EU in Articles 105–109. See http://eur-lex.europa.eu/en/treaties/dat/11992M/htm/11992M.html.

[119]The European Central Bank's Web site is at www.ecb.int.

[120]Between June 1, 1998, and January 1, 1999, the ECB took over the functions of the European Monetary Institute (established in 1993), which it replaced. These were (1) to strengthen central bank cooperation and monetary policy coordination and (2) to make the preparations required for the establishment of the European System of Central Banks (ESCB). See "Constitution of the ESCB: History—Three Stages towards EMU" at www.ecb.int/ecb/history/emu/html/index.en.html.

FIGURE 6.7

The Governance of the ECSB



addition, the ESCB advises the EU organs—the Commission, Council, Parliament, and so on—about the banking matters it is responsible for.

The ESCB is governed by the decision-making bodies of the ECB: the Governing Council, the Executive Board, and the General Council (see Figure 6.7). The Governing Council is made up of the six members of the Executive Board and the governors of the national banks of the 13 EMU states. It sets the monetary policy—including interest rates—for the EMU independent of the EU Commission, Council, and Parliament, much like the German central bank (the Bundesbank) on which it was modeled.[121] The Executive Board is then responsible for carrying out this policy.

The General Council of the ECB is made up of the president and vice president of the Executive Board and the governors of the 27 EU national central banks. It is responsible for establishing common accounting and reporting provisions for the EU, collecting and disseminating statistical information, and setting the capital contribution requirements for the ECB.

On January 1, 1999, the ESCB began functioning as the central banking authority for the EU. On that same date, the euro became the new currency for the EMU. Euro coins and notes, however, did not begin circulating until January 1, 2002. During the intervening three years, national currencies continued to be legal tender at permanent exchange rates that were based on the exchange rates that existed on December 31, 1998.

I. National Monetary Systems

National Monetary Organizations

There are three types of organizations that operate on the national plane to implement national monetary policies (see Figure 6.8). At the highest level is a political agency of the national government that sets national fiscal policy and carries on the financial functions of the government. In most countries, this is a cabinet-level agency, such as a Ministry of Finance or a Treasury Department.

At the next level is a **central bank,** such as the Bank of England, the Bank of Japan, or the U.S. Federal Reserve System.[122] In most countries, it is owned by the national government, but through a variety of mechanisms (such as lengthy fixed terms for directors), the bank is given some degree of independence from the government and from the day-to-day pressures of politics. Its most important

central bank
A state's bank that is responsible for issuing the state's currency, regulating the quantity of its money in circulation, maintaining currency reserves, and acting as a lender of last resort.

[121]The Governing Council, which uses English as its common language, meets every other Thursday, just as the German Bundesbank used to do. See www.ecb.int/ecb/orga/decisions/govc/html/index.en.html.

[122]A current listing of national central banks can be found at dir.yahoo.com/Business_and_Economy/Finance_and_Investment/Banking/Central_Banking.

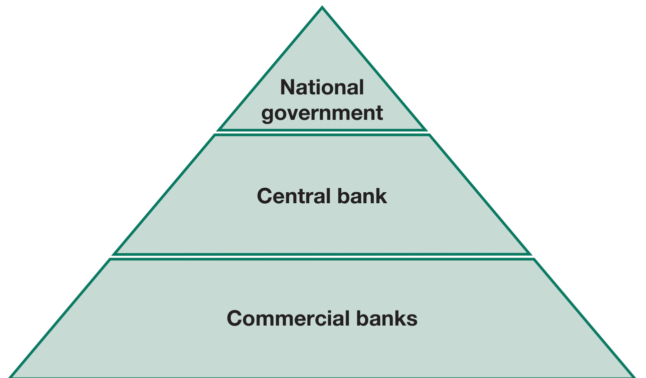


FIGURE 6.8

The Three Types of Organizations That Set National Monetary Policy

functions are (1) to issue bank notes and coins, (2) to regulate the quantity of money in circulation, (3) to maintain and invest currency reserves, and (4) to act as a lender of last resort.

At the third level are the **commercial banks** that accept and manage deposits, make loans, and offer trust services.[123] In the domestic arena one finds a variety of financial institutions (such as savings banks, savings and loan associations, and credit unions), but internationally, the commercial bank is the institution most likely to be involved. Commercial banks may be owned privately or by the government.[124]

commercial bank
A business firm that maintains custody of money deposited by its customers and pays on drafts written by its customers. It earns its profits by investing the money it has on deposit.

Bank Deposits

Bank deposits are monies placed with a bank for its use. The term *deposit* suggests the notion of a bailment,[125] which implies that a bank has an obligation to keep the funds it receives in a vault for safekeeping. This is not the case. Except for monies delivered for a designated purpose, deposits become a bank's funds. A bank can commingle them and use them as it sees fit. Most commonly, banks use these funds to make short- and medium-term loans. The depositor, in return for his or her deposit, receives a claim against the bank as a general, unsecured creditor. Additionally, for some accounts, a depositor acquires the authority to write checks, payment orders, or drafts for the benefit of third parties, with the value of the checks, orders, or drafts being deducted from his or her claim.[126]

Commonly, banks pay interest on the monies they hold on deposit. When large sums are deposited for short-term investment, banks typically issue certificates of deposit (CDs), which generally provide a higher rate of interest than funds left in a general deposit account. Not all banks, however, pay interest. As Reading 6-5 points out, interest payments are forbidden in countries following Islamic law. Instead of earning interest, depositors in Islamic banks become the equivalent of joint venturers in the investments that their banks underwrite.

bank deposit
Money held by a bank. The bank may freely use this money as it best sees fit. A depositor only has a claim against the bank as a general creditor and not as a bailor of specific property deposited with the bank.

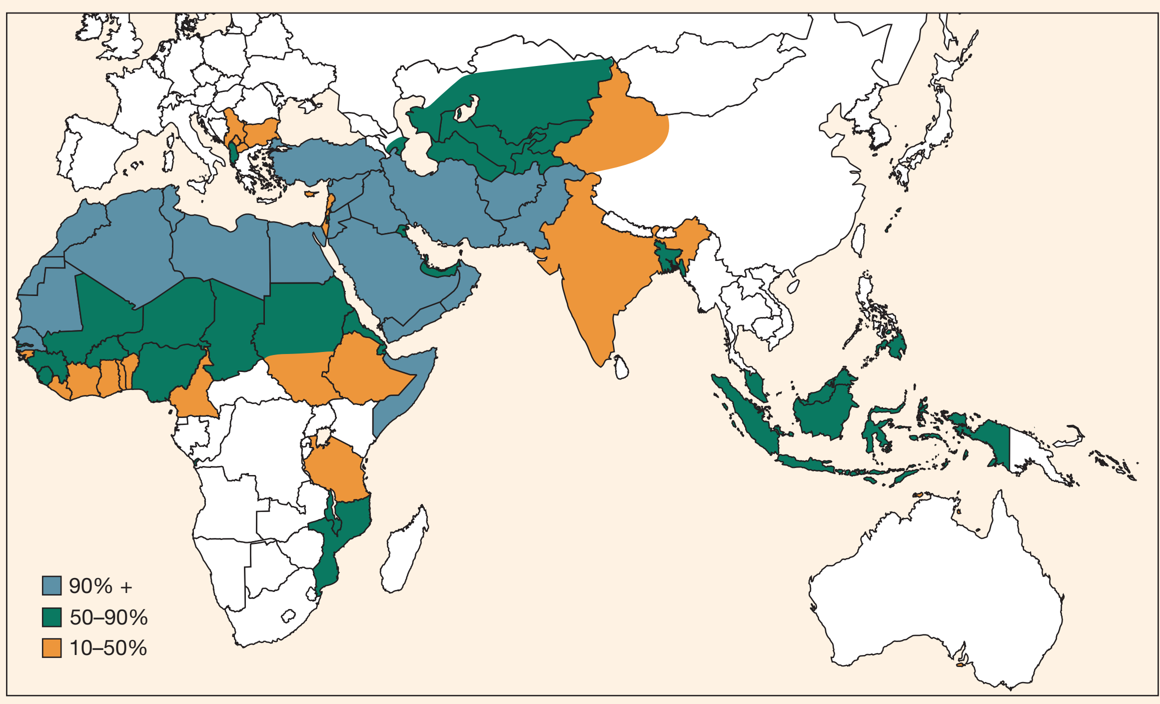
[123] See Yahoo!'s listing of commercial banks at dir.yahoo.com/Business_and_Economy/Shopping_and_Services/Financial_Services/Banking/Banks.

[124] A commercial bank's particular structural organization and its authority to participate in international banking depend on the laws of its home country. In the United States, a commercial bank's ability to operate abroad through branches is regulated by the Federal Reserve Act and Federal Reserve Board Regulations. *United States Code*, Title 12, §§601 and 604(a) and *Code of Federal Regulations*, Title 12, §211 et seq. The Edge Act of 1919 authorizes federally chartered corporations to engage in international banking and permits U.S. national banks to invest in them. *United States Code*, Title 12, §611. The International Banking Act of 1978 eliminates those provisions of the Edge Act (such as restrictions on liabilities and reserve requirements) that put American banks at a competitive disadvantage with foreign banks. *United States Code*, Title 12, §611a. Finally, since 1981, American banks are authorized to establish International Banking Facilities; that is, they can set up segregated asset and liability accounts for foreign customers that otherwise would be subject to the liability and reserve restrictions of domestic accounts. *Code of Federal Regulations*, Title 12, §§204 and 217.

[125] A bailment is an arrangement by which property is delivered in trust to another for a special purpose and for a limited time.

[126] The statutory provisions governing bank deposits in countries with major financial centers are reasonably consistent around the world. Most provide for charter supervision, liquidation, the regulation of business practices, and the status of depositors. However, with few exceptions, these statutes do not contemplate deposits made by foreign persons, deposits made at foreign branch banks, or the problem of conflicts with regulations issued by a foreign sovereign. Peter S. Smedresman and Andreas F. Lowenfeld, "Eurodollars, Multinational Banks, and National Laws," *New York University Law Review*, vol. 64, p. 733 at pp. 737–738 (1989).

Reading 6-5 Islamic Banking



MAP 6.4

The Islamic World (2012)

OECD (1983) Arab and Islamic Banks: New Business Partners for Developing Countries. Copyright © by the Organization for Economic Cooperation and Development. Reprinted with permission.

Underlying Concepts of Islamic Economics and Banking

Across the Muslim world there is a move to create Islamic financial institutions. This is but one manifestation of a much broader phenomenon, the revival of Islam and its values. The contribution of the Muslim world to a new international economic order could be based upon the application of the Shari'a to modern economic and financial transactions.

An Islamic economic order represents for the world's Muslims an alternative to capitalistic and socialist systems. Islamic concepts are different from capitalism by their opposition to excessive accumulation of wealth and, in contradiction to socialism, by their protection of the rights to property, including ownership of the means of production.

As defined by the "Egyptian Study," the Islamic economic system is based upon a number of principles that regulate human life. They constitute a sum of wisdom accumulated over the centuries by Islamic thinkers, who addressed themselves to broad political and economic issues and the history of human societies. For them, a true Islamic society must not be an arena where opposing interests clash, but rather a place where harmonious relations can be achieved through a sense of shared responsibilities. The individual's rights must be equitably balanced against those of society at large.

Islamic economics are regulated by [the] Shari'a, the laws derived from the Koran and Sunna. Unlike the Christian world, Islam makes no distinction between secular and religious law. It follows that the economic and financial practices of Islamic banks must abide by these guiding principles, although they do have a certain flexibility to adapt to new economic situations.

The traits that distinguish Islamic economy and finance from their Western counterparts reflect a different understanding of the value of capital and labor. In lieu of a lender–borrower relationship, Islamic finance relies on equitable risk-sharing between the person who provides the capital and the entrepreneur. This practice derives from the central tenet of Islamic banking based on the Koran, which forbids *riba*, that is, interest charges or payments.

Contrary to what Westerners often think, interest-free banking should not be considered as merely a concessionary or subsidized financial practice. Viewed in its historic context, Islamic law on interest was above all practical. The economy of the Arabian peninsula in the seventh century was that of trading city-states living in a hostile environment. In economic terms, the constraints were illiquidity and scarcity and the results were usury and hoarding. Islamic precepts aimed to control such undesirable social phenomena. If interest rates imposed on long-distance traders were too high, this either discouraged trade or substantially increased the cost

of commodities for investors as well as consumers, resulting in a net loss to the community.

The original ban on interest charges stemmed from the fact that moneylenders were exploiting the poor by charging usurious rates. Even if this may no longer apply to modern, monetized economies, a different rationale has evolved to justify the principle of banning interest. There is no need for loan financing, it is claimed, because an active involvement in a company through profit sharing is a superior way to direct capital into productive outlets without putting an additional financial burden on the community.

For Islamic economists, the economic rationale for profit sharing is not only distributive justice but efficiency, economic stability and growth. M. N. Siddiqui, for example, argues that interest financing can be very unfair when entrepreneurs alone incur the losses or, on the contrary, reap disproportionately high benefits. As far as public debts are concerned, interest financing is felt to be inequitable in the case of national emergencies, such as crop failures or floods, and inefficient for development aid purposes. The role of interest in international debt comes in for heavy criticism, as the following statement aptly sums up: "Three decades of debt financing did not help the debtor countries to become self-sufficient, or less dependent, or capable of generating a surplus to pay back."

As far as allocative efficiency is concerned, it is contended that debt financing usually goes to the most creditworthy borrower and not necessarily to the most productive and potentially profitable projects. As for stability, the argument is advanced that an interest-based economy has a built-in tendency towards inflation because the creation of money is not linked to productive investment at the level either of central banks or of commercial banks. Lastly, interest charges decrease the supply of risk capital and therefore hamper economic growth.

Some Islamic economists hold different views on the interdiction of interest in today's economies. Islamic "modernists" find a literal reading of the Koran too restrictive and favor an interpretation of the spirit of the law. They thus contend that the Koran has prohibited usury but not legitimate interest. Nevertheless, the vast majority of Islamic economists maintain—and Islamic banks concur—that interest should be prohibited.

Today no Islamic bank charges or pays interest, although certain fiduciary business operations allow partners to circumvent this difficulty. Charging interest is permissible for financial transactions with "Dar Al Harb," that is, non-Muslim countries, or for Muslims living beyond the rule of Islam, known as "Dar Al Islam."

A second tenet governing money matters is that it is forbidden to hoard. Men have a moral obligation to put money to productive use, for themselves and for the good of the community, by investing in profitable opportunities. Though Islamic banks are trying to promote such schemes, this is still an ideal. Until a complete Islamic system is instituted, hoarding continues to be widespread. It has been estimated that some $80 billion are sitting idle in Muslim countries. If Islamic banks could attract broader segments of the population, which have till now considered Western-style banking with distrust, it could mobilize this capital into productive outlets.

Another important aspect of Islamic finance is a tax called *Zakat*, in some ways similar to the Christian tithe. Paying *Zakat* is one of the five imperative religious obligations for a Muslim. It is levied on traded goods and revenues from business and real estate, but not on personal property like houses, furniture or jewelry. Computation is complex: as a rule, peasants pay anywhere from 5 to 10 percent on their produce, while the rest of the population contributes 2.5 percent of their revenues . . . .

Individuals may give their *Zakat* contribution directly to a beneficiary or else to a special institution set up to distribute funds. Most Islamic banks administer *Zakat* funds in a separate account and can use them, if necessary, to help out depositors in temporary difficulty. Contributions are over and above secular taxes.

Recent International Developments in Doctrine at the Intergovernmental Level

During the Seventies, several Muslim countries undertook various efforts at the international level to define basic concepts and applications of Islamic banking in today's world. These endeavors included conceptual studies, the establishment of an inter-governmental Islamic development bank, the creation of international training and research institutions as well as control by monetary authorities over Islamic institutions.

A study presented by the Arab Republic of Egypt on the "Institution of an Islamic Bank, Economics and Islamic Doctrine" was discussed and adopted on the occasion of the Third Islamic Conference of Foreign Ministers in Jeddah [in] 1972. Experts from 18 Muslim countries prepared this document under the leadership of the Egyptian Ministry of Economics. The basic issues addressed were the functioning and operations of Islamic banks. It was clearly postulated that loan finance based on interest should be replaced by profit-and-loss sharing participation schemes. Three phases were suggested to implement this novel financial concept.

As a first step, it was proposed that an Islamic advisory agency be established to deal with problems of Islamic economics and banking. Its mandate would be to help establish new Islamic financial institutions and advise them how to operate.

The second proposed step was to set up an international Islamic bank which would manage the income from interest received from non-Muslim countries, as well as from *Zakat* funds. Furthermore, it would serve as a clearinghouse for international payments between Muslim countries and finance reciprocal trade. At the national level, central agencies would be created to prepare for the subsequent establishment of local Islamic banks.

In a third step, Islamic savings, investment and development banks would be created to complement the umbrella institutions at the national and international levels.

What actually developed was somewhat different. The advisory agency, the International Association of Islamic Banks (IAIB), was established only in 1977, after the Islamic Development Bank (IsDB) in 1975 and then commercial Islamic banks had been set up in several countries. A central agency to help establish Islamic banks at the local level has yet to be founded in the various Muslim countries. Nevertheless, the "Egyptian Study" was instrumental in furthering the development and implementation of Islamic banks, and many of its conceptual proposals have been adopted along the lines laid down.

Traditional and New Islamic Financial Instruments

Since Islamic law does not recognize corporations in the Western sense, companies are based on partnerships, originally only between two individuals but later extended to more. Two legal forms are basically utilized to provide funds on the basis of profit-and-loss sharing: *Musharaka* and *Modaraba*. Both are old Arab/pre-Islamic constructions which were originally developed for the requirements of trading city-states in a hostile environment to cope with socially undesirable phenomena, like scarcity of goods and usury for credit.

The *Musharaka* contract is formally a limited partnership, whereby both the bank and the customer provide capital for a specific project. Another possibility is the participation of the bank in an existing enterprise by means of a capital contribution. The pro-rata distribution of profits between bank

and customer is subject to a contract between the parties. Losses are shared according to capital contribution. The bank may participate in the management, but it may also waive this right.

There exist *Musharaka* contracts with either constant or decreasing participation. The latter form is offered by the Jordan Islamic Bank, for example where the participation of the bank decreases over time. The bank keeps the profit share of the customer to pay back the capital contribution.

The *Modaraba* contract is formally a silent partnership with a clear distinction between the capital provider and the entrepreneur who controls the management of the project. Remuneration is again based upon a predetermined percentage of profits; losses have to be borne by capital providers alone. The entrepreneur then foregoes remuneration for his work.

Literature on Islamic banking has extensively commented on *Modaraba* contracts. Originally, the bank was the capital provider (*Raab Al-Mal*); it financed a project proposed by an entrepreneur (*Modareb*). Today, *Modarabas* can be applied to various economic activities, the most important of which are described below.

In banking, the institution offers its services as a manager of capital (*Mudareb*) and invites deposits from the public (*Raab Al-Mal*). The customer is offered a variety of fixed term instruments (e.g., security accounts, investment accounts, etc.) and shares with the bank the risk of the operations. He is guaranteed neither a profit nor the full return of his principal. In the case of current accounts, the bank assumes all risks alone, but does not share profits with the depositor (often Islamic banks specify a minimum balance above which no handling charges on current accounts are levied).

In investment, the bank issues nominal or bearer certificates (often negotiable) which entitle the holder to share in the profits of the activities being undertaken by the investment company. This can be specific to a single project or a general share in all activities. The duration can be for a fixed date, at fixed intervals, on call, etc.

For the supply of goods and equipment, Islamic banks use the *Murabaha* contract. The financial institution purchases raw materials, goods or equipment at cost and sells them to the client on a cost-plus-negotiated-margin basis. Other transactions are rental financing (*Ijara*), whereby the bank acquires equipment or buildings and makes them available to the client on a straightforward rental basis. In the case of hire-purchase financing (*Ijara Wa Iktina*), a similar construction is applied. The client, however, has the possibility of acquiring ownership of the rental equipment or buildings by paying installments into a savings account. The reinvestment of this accumulated capital works in favor of the client, allowing him to offset rental cost.[127]

Eurocurrency Deposits

Eurocurrency deposits Foreign currency on deposit in a bank, on which the bank pays interest in the same foreign currency.

Accounts in domestic banks that are maintained and paid in a foreign currency are generally known as **Eurocurrency deposits.**[128] Such deposits are commonly free of the monetary control restrictions imposed by their issuing country. American dollars (or *Eurodollars*[129]) are the most common Eurocurrency; however, British pounds, Canadian dollars, EU euros, Japanese yen, and Swiss francs are also used.

The Interbank Deposit Market

The worldwide economic expansion that began in the 1950s put such enormous financial demands on commercial banks that they were unable to service their *core* or customer-placed deposits. Because banks operating in the United States were (and are) generally forbidden to open branches and solicit deposits from outside the geographical area of their parent bank, they had to turn to other sources for raising funds.[130] Thus, they began to borrow from banks and corporations with short-term surpluses. By the 1970s, this interbank market had become international, with banks in New York, London, Tokyo, and the world's other financial centers operating as active international traders.[131] Trades are made throughout the day and night, every day of every year, by telephone and over the Internet in a global marketplace that is virtually unregulated.

certificate of deposit (CD) A promissory note issued by a bank in which the bank promises to repay money it has received, plus interest, at a certain time.

A variety of short-term liquid instruments are traded in this interbank market, but the most common is the **certificate of deposit (CD),** issued in multiples of U.S. $1 million for maturity periods of

[127]See also www.islamic-banking.com/what_is_ibanking.aspx.

[128]The *Euro* prefix stems from its origins in London's currency market and is, of course, no longer accurate. For a short history of the Eurocurrency market, see F. A. Mann, *The Legal Aspect of Money*, pp. 61–62 (4th ed., 1982).

[129]Eurodollars are financial assets denominated as U.S. dollars and having at any given time the same value as a U.S. dollar in the United States, but are not subject to the control exercised by the U.S. central bank (the Federal Reserve System) over either interest rates or money supply. Peter S. Smedresman and Andreas F. Lowenfeld, "Eurodollars, Multinational Banks, and National Laws," *New York University Law Review*, vol. 64, p. 733 at p. 744 (1989).

[130]*United States Code*, Title 12, §36(c) (1998), requires national banks to comply with the branch banking rules of the state in which they operate. Section 1831(u) allows banks to maintain branches in different states following a merger (occurring after June 1, 1997), but not if this would violate an express state prohibition.

[131]The top 10 banks in the interbank foreign exchange market as of May 2006 were (1) Deutsche Bank, (2) UBS, (3) Citigroup, (4) Barclays Capital, (5) Royal Bank of Scotland, (6) Goldman Sachs, (7) HSBC, (8) Bank of America, (9) JPMorgan Chase, and (10) Merrill Lynch.

one, three, and six months. A CD is a form of commercial paper, defined as "an instrument containing an acknowledgment by a bank that a sum of money has been received by the bank and a promise by the bank to repay the sum of money."[132] As such, it is a negotiable instrument. However, because interbank CDs have relatively short maturities, they are seldom transferred from one holder to another.

Banks are no longer the principal purchasers of CDs. Money market funds and corporations with excess cash have supplanted them, in part, because CDs held by American banks are not regarded (under the U.S. Federal Reserve System's regulations) as the equivalent of cash and, therefore, cannot be used to reduce a bank's obligation to maintain reserves.[133] Even so, banks do deposit huge sums of money in other banks as a means of rate positioning based on their differing perceptions about the market's direction. Often these trades are made in rapid-fire order and commonly without the use of certificates. In the fastest-moving sector of the interbank market, both the issuance and the safekeeping of certificates would be burdensome. Trades are made over the telephone, confirmed in brief messages sent by telex or fax, and then followed up with a written *ticket* that is mailed by the depositary to the depositor.

The Foreign Exchange Market

A buyer in Lusaka, Zambia, wants to buy 100,000 gallons of maple syrup from a seller in Toronto, Canada. The buyer is able to pay with Zambian kwachas, but the seller requires Canadian dollars. To carry out the purchase (which is called a **foreign exchange**), the buyer will contact his bank in Lusaka to buy the needed dollars. If the Lusaka bank does not have Canadian dollars on hand (which is likely the case), it will undertake to buy them on the world's **foreign exchange market.** Despite its name, the foreign exchange market does not exist in any place. It is, rather, an informal network of banks, foreign exchange brokers, and foreign exchange dealers. The Lusaka bank's foreign currency trader will contact them in the hopes of making an exchange. This may be difficult, however, because the international market for kwachas is limited, and the bank may only have a limited supply of other currencies (called *hard currencies*) that it can readily convert into Canadian dollars. *Hard currencies* (i.e., the currencies of the major free-market nations) are freely exchangeable. The currencies of developing countries, like Zambia's kwacha, are commonly called *soft currencies* because they are not freely exchangeable.

foreign exchange
The conversion of the money of one state into that of another state.

foreign exchange market
An informal network of banks, foreign exchange brokers, and foreign exchange dealers who facilitate the exchange of currencies.

If the Lusaka bank is unable to purchase sufficient Canadian dollars to carry out the transaction for the buyer, it will have to turn to Zambia's central bank for assistance. The Bank of Zambia may or may not have enough Canadian dollars or other hard currencies to sell to the Lusaka bank. If it does not, it may contact the Bank for International Settlements to exchange gold or whatever currencies it does have for dollars. Should this be impossible, the central bank will ask the Zambian government to exchange the SDRs that it holds in the IMF for Canadian dollars. If the central government does not have SDRs, it may arrange for a short-term loan from the IMF or the World Bank to acquire the needed dollars.

Once the dollars have been acquired, they will be deposited in a major bank in one of the major financial centers, such as New York, London, or Tokyo, for the account of the Lusaka bank. The major bank in this instance is known as a **correspondent bank.** When the buyer confirms that the seller has delivered the maple syrup, the Lusaka bank will instruct its correspondent bank to transfer the dollars to the seller's bank or to that bank's correspondent bank.

correspondent bank
A bank that acts as an agent of another bank, especially in carrying a deposit balance for the latter.

This somewhat simplified example of a foreign currency exchange highlights the principal participants involved in the transaction. Normally, the two major actors are commercial and central banks. In addition, arbitrageurs, importers, exporters, multinational firms, tourists, governments, and intergovernmental organizations may become involved. The transaction itself is generally unregulated, although governments in developing countries sometimes impose licensing requirements on banks and traders and often require that all exchanges be made through their central banks.

Commercial banks participate in the foreign exchange market both as intermediaries for importers, exporters, multinational corporations, and the like, and as correspondent banks in the interbank marketplace. In combination, they play three important roles: (1) they operate the payment mechanism, (2) they extend credit, and (3) they help to reduce the risk of international transactions.

[132] United States, *Uniform Commercial Code*, §3–104.

[133] United States, *Code of Federal Regulations*, Title 12, §204.3(f)(1) (1998).

Central banks participate as lenders of last resort and as regulators of currency exchange rates. In addition to providing funds for local transactions when no other funds are readily available, central banks may independently intervene in the foreign currency market to maintain orderly trading conditions. This sometimes involves the purchase of weaker currencies. For example, in the 1980s, Germany and Japan helped support the U.S. dollar by purchasing the American currency at a time when its value was falling. In 1992, the Bank of France spent billions of deutsche marks to help support the weaker pound, lira, and French franc, and in 2000 the U.S. Federal Reserve and the European Central Bank intervened successfully to stem the decline of the euro, which had fallen to 82 cents against the dollar.

In making currency exchanges, traders typically use a widely traded intermediary currency. For instance, in the previous example, the buyer's bank in Lusaka might purchase U.S. dollars, which in turn would be converted by the seller's bank in Toronto to Canadian dollars. The most commonly used *intermediary*, or international exchange currency, is the American dollar. Exchange rates for converting the dollar into the world's other hard currencies are published daily in major newspapers around the world. Exchange rates for other currencies are published weekly in major financial newspapers (such as the *Financial Times* and the *Wall Street Journal*) and can be obtained from major banks on a more frequent basis.

Foreign Exchange Contracts

spot contract
A contract for the immediate sale and delivery of a commodity, such as a currency.

future contract
A promise to buy or sell a commodity (e.g., a currency) for a specified price, with both delivery and payment to be made at a specified future date.

Foreign exchange contracts may be made as spot, future, forward, or option contracts. A **spot contract** is simply a transaction involving the immediate sale and delivery of a commodity, such as a currency.[134] A **future contract** (or *future*) is simply a promise to buy or sell a commodity (e.g., a currency) for a specified price, with both delivery and payment to be made at a specified future date. Because there is a market in futures (they are sold on commodity exchanges), such contracts are both standardized and transferable.[135] Trading in futures, however, seldom results in the physical delivery of the commodity. More often, the obligations of the parties are extinguished by offsetting transactions that produce a net profit or loss. Futures are used primarily as a way to transfer price risks from suppliers, processors, and distributors (called *hedgers* when they become parties to these *hedging* contracts) to those who are more willing to take the risk (called *speculators*).

The uses of hedging as well as the risks involved in such contracts are explored in Case 6-4.

In Brief: CASE 6-4 Hunt et al. v. Alliance North American Government Income Trust, Inc. et al.

United States, Court of Appeals, Second Circuit, 1998
Federal Reporter, Third Series, vol. 159, p. 723 (1988)

Facts

Plaintiffs are shareholders in Alliance North American Government Income Trust, Inc., an open-ended mutual fund formed to make investments in government securities in Canada, Mexico, and the United States. The fund sold shares pursuant to registration statements and prospectuses that stated that the fund managers would use hedging techniques to avoid the adverse consequences of currency fluctuations. In particular, the prospectuses said that the fund "may" enter into futures contracts and options on futures contracts, and that the fund intended to write covered put and call options on the government securities it was trading in.

[134]The Federal Reserve Bank of New York posts spot foreign exchange rates for the New York interbank market at www.newyorkfed.org/markets/fxrates/noon.cfm.

[135]Futures contracts are characterized as being fungible, that is, being readily transferable or exchangeable. *Salomon Forex, Inc. v. Tauber*, *Federal Reporter, Third Series*, vol. 8, p. 966, p. 967 (Fourth Circuit Ct. of Appeals, 1993).

MAP 6.5

The United States, Mexico, and Canada (1987)

Following Mexico's devaluation of the peso in December 1995, the net asset value of the fund decreased dramatically. The plaintiffs brought suit alleging (among other things) in a revised pleading that the fund had misrepresented that hedging techniques to reduce currency risk were available, when in fact the fund knew that they were not available (because they were too expensive). The trial court dismissed the complaint, stating that investors could not have been misled by the prospectuses and that the prospectuses gave "no assurances" that the hedging techniques they described could be effectively used. The plaintiffs appealed.

Issue

Did the prospectuses mislead investors into believing that hedging techniques were available to the fund when in fact they were not?

Holding

Yes.

Law

Cautionary language in a prospectus will not foreclose liability if it warns investors of liability from contingencies different than the contingencies described in the prospectus.

Explanation

Plaintiffs claim that the prospectuses promised that the fund would attempt to use hedging devices when in fact it could not. Because the prospectuses could have misled a reasonable investor, the plaintiffs have stated a cause of action for which relief can be granted. Their complaint, therefore, should not have been dismissed.

Order

District court's order is reversed.

forward contract
A contract in which a commodity is presently sold and the price presently paid but delivery is, by agreement, delayed to a later date.

option contract
A contract that creates the right—but not the obligation—to buy or sell a specific amount of a commodity (e.g., currency) at a fixed price within an agreed-upon period of time.

arbitrage
(From French *arbitrer*: "to arbitrate" or "to regulate.") The nearly simultaneous purchase of currencies (or other commodities) in one market and their resale in another in order to profit from the price differential.

instruction
Order to a bank to disburse funds to a particular person.

bill of exchange
(also known as a *draft*) A three-party instrument on which the drawer makes an unconditional order to a drawee to pay a named payee.

A **forward contract** (or, in the case of currency, a *cash forward contract*) is simply a transaction in which a commodity is presently sold and the price presently paid but the delivery is, by agreement, delayed to a later date. In comparison with a future contract, which is readily transferable, a forward contract is generally negotiated individually by the parties who will actually make and receive physical delivery of the goods involved.

An **option contract** (or *option*) creates the right—but not the obligation—to buy or sell a specific amount of a commodity (e.g., currency) at a fixed price within an agreed-upon period of time. If the right is to buy a commodity, the option is known as a *call*; if the right is to make a sale, the option is known as a *put*. If the right involves a combination of these—to either buy or sell—the option is known as a *straddle* or *spread eagle*. Unlike spot, futures, or forwards contracts, the holder of an option is not required to go through with the transaction. The holder must pay a fee or some other consideration to acquire the option, but the total risk assumed in purchasing it is the loss of that fee.

Arbitrage

Arbitrage is the nearly simultaneous purchase of a commodity (such as a currency) in one market and its sale in another to profit from the price differential. Because there are differences in the prices of the world's currencies, both over time and between locations, arbitrageurs are active participants in the international foreign exchange market. For example, suppose that the EU euro is trading among traders in London for U.S. $0.9725 and among traders in Tokyo for U.S. $0.9735. An arbitrageur would buy euros in London and sell them in Japan. For example, assuming that the arbitrageur purchases 1,028,278 euros (i.e., U.S. $1 million) in London and sells them in Tokyo, he will receive $1,010,286, for a net profit of $10,286 or 1.3 percent. Of course, the purchase of euros in London will drive up their price there, and their sale in Tokyo will drive down their price in Japan. The process will continue until the exchange rate becomes the same in both places.[136]

Today, arbitrageurs and other currency traders carry on their transactions at lightning speed using telephones and the Internet. The minimum contract is normally U.S. $25,000, but contracts of $1 million are more common. Offers have to be accepted immediately, and then performed regardless of a later dispute. If there is a dispute, traders commonly split the difference.

The Transfer of Money

A bank transfers money internationally by setting up a correspondent bank relationship with a foreign bank and depositing funds to its own account in that bank. When a customer goes to his or her own bank and asks to transfer money overseas, the bank accepts the customer's money at its domestic office, then arranges for the correspondent bank to disburse funds in the foreign country to whomever the customer has designated. This may be done by **instruction,** in which case the domestic bank directs its correspondent to pay funds directly to a particular payee, or by the use of a **bill of exchange** that is drawn on the domestic bank's account at the foreign correspondent bank. In the latter case, the bill of exchange is given to the customer, who in turn sends it to the payee. The payee then cashes it at the correspondent bank.

The actual physical delivery of currency internationally is seldom done. When required, it is arranged for by central banks and is commonly managed by the BIS.

Branch Banking

International banks, unlike most other multinational companies, prefer to operate in host countries through branches rather than subsidiaries. And in most major host countries, including France, Germany, Japan, Switzerland, the United Kingdom, and the United States, branch operations (without

[136]Arbitrageurs, by taking advantage of momentary discrepancies in prices between markets, perform the economic function of making these markets more efficient.

separate incorporation) are not only allowed, they are encouraged.[137] On the one hand, host countries impose few regulations limiting the operations of foreign banks. On the other hand, they assume few supervisory responsibilities. Thus, unlike domestic banks, foreign banks do not have to maintain reserves to cover potential losses. Foreign banks, however, cannot turn to the host country's central bank as a lender of last resort. From the perspective of the host country, a foreign bank is required to stand behind the local obligations of its branches with its entire worldwide assets.

Although host states generally impose minimal regulations on foreign branches, the presence of a foreign branch has sometimes been used as a means to obtain information from a foreign parent bank. In particular, the U.S. government, in an effort to curtail the use of foreign banks as conduits for laundering illegal profits from narcotics smuggling, income tax evasion, securities fraud, and other business crimes, has attempted to extend its regulatory jurisdiction over foreign banks by asking courts to issue subpoenas[138] exercisable against their U.S. branches.[139] Such subpoenas require the U.S. branch to obtain information from the parent and then turn it over to the American government. Needless to say, many countries regard the American actions as an invasion of their sovereign rights, and legislation to counter the U.S. efforts is not uncommon.[140]

Not only foreign countries but the U.S. courts as well have taken a dim view of this attempt by the political arms of the U.S. government to exercise extraterritorial jurisdiction over foreign banks. Case 6-5 illustrates the reaction of one appellate court to the U.S. government's use of a grand jury subpoena to compel one branch of a foreign bank to produce records held by its parent.[141]

CASE 6-5 In Re Sealed Case

United States, Court of Appeals, District of Columbia Circuit, 1987
Federal Reporter, Second Series, vol. 825, p. 494 (1987)

Per Curiam[142]

These consolidated appeals are taken from orders in a miscellaneous proceeding below collateral to a grand jury investigation. The government sought and obtained orders in the district court compelling appellants, a bank and an individual, to respond to a grand jury subpoena by producing documents and giving testimony. When appellants continued to refuse to respond to the grand jury's demands, the court found appellants in contempt. The grand jury investigation has not been completed, and the records in the district court and

---

[137] See, for example, U.S. Treasury Department, *Report to Congress on Foreign Government Treatment of U.S. Commercial Banking Organizations*, p. 19 (1979).

Prior to becoming a party to the North American Free Trade Agreement, Canada required local incorporation of banks. Canada Bank Act, *Revised Statutes of Canada*, vol. 1, chap. B-1, §302(1)(b) (1985). Now foreign banks may establish branches so long as the bank's home state provides like treatment for foreign banks. *Id*., vol. 1, chap. B-1.01, §24 (1991). Canada's statutes are posted on the Internet at http://laws.justice.gc.ca/PDF/B-2.pdf.

[138] A subpoena is a command to appear at a certain time and place to give testimony upon a certain matter.

[139] A report issued by the U.S. House of Representatives Committee on Banking and Currency in 1970 stated that secret foreign bank accounts encourage "white-collar" crimes. *House of Representatives Report No. 975*, 91st Congress, 2nd Session, p. 12 (1970).

[140] See, e.g., Foreign Proceedings (Prohibition of Certain Evidence) Act, 1976, *Acts of the Parliament of the Commonwealth of Australia*, No. 121; amended by Foreign Proceedings (Prohibition of Certain Evidence) Amendment Act, 1976, *id*., No. 202; repealed and replaced by Foreign Proceedings (Excess of Jurisdiction) Act, 1984, *id*., No. 3. Foreign Extraterritorial Measures Act, *Statutes of Canada*, chap. 49 (1984). Confidential Relationships (Preservation) Law, Cayman Islands Law 16 of 1976 and the Confidential Relationships (Preservation) (Amendment) Law, Cayman Islands Law 26 of 1979.

Sometimes, however, states other than the United States seek to obtain information from banks located abroad. See In re Request for Assistance from Ministry of Legal Affairs of Trinidad and Tobago, *Federal Reporter, Second Series*, vol. 848, p. 1151 (Eleventh Circuit Court of Appeals, 1988).

[141] An excellent discussion of the conflict-of-laws implications that arise from the use of subpoenas to compel foreign banks to produce evidence can be found in Silvia B. Piñera-Vàzquez, "Extraterritorial Jurisdiction and International Banking: A Conflict of Interest," *University of Miami Law Review*, vol. 43, p. 449 (1988).

[142] From Latin: "by the court." A phrase used to indicate that the whole court rather than any one judge wrote the opinion.

this court have been sealed. In order to maintain this secrecy, we do not identify the parties in this opinion.

* * *

I.

From the beginning, the manager and the bank have cooperated to a certain extent with the investigation. The manager has come to Washington several times to meet with the prosecutors and testify before the grand jury about his knowledge of the targets and their activities that he learned in his personal capacity (not through bank operations). Except for information concerning three customers from whom they obtained releases, however, the manager and the bank refused to testify before the grand jury about the targets' banking activities or produce documents on the ground that to do so would violate Country Y's banking secrecy laws and subject the manager and the bank to criminal prosecution in Country Y.

The bank has taken the position that the government should use other means to attempt to obtain the documents from Country Y, a course that the government believes is inappropriate and would be ineffective. The manager based his refusal to testify on Fifth Amendment grounds, claiming that the act of testifying would subject him to criminal sanctions in Country Y. The government secured use immunity for the manager but he continues to decline to answer on the ground that a United States court could not immunize him from criminal prosecution in Country Y. Since the act of testifying would violate the laws of Country Y, he contends that to require him to testify would violate his Fifth Amendment protection against self-incrimination.

* * *

II.

The manager's Fifth Amendment claim is based on his assertion that Country Y could convict him of a crime solely for revealing information protected by Country Y's banking secrecy law. He does not claim that the substance of his testimony would incriminate him for any crime that he has committed, under either the laws of the United States, of Country X, or of Country Y. The manager argues that, despite the district court's grant of immunity, his real and substantial fear of prosecution in Country Y cloaks his refusal to testify with Fifth Amendment protection. We disagree.

* * *

The district court concluded that even if the Fifth Amendment does apply to a situation in which the witness asserts the threat of foreign prosecution, it "[was] not convinced that the fear of prosecution in this case is 'real' as required by *Zicarelli v. New Jersey Comm'n of Investigation*."[143] . . . It based this finding on the strict secrecy provisions of Rule 6(e) of the Federal Rules of Criminal Procedure.[144]

We agree that the manager's fear of prosecution is not real, but for a different reason. The manager could only be prosecuted by Country Y as a result of his own voluntary act—returning

[143] *United States Reports*, vol. 406, p. 472 at pp. 478–81 (Supreme Ct., 1972).

[144] The secrecy provision of Rule 6(e) of the Federal Rules of Criminal Procedure is as follows—

a. No obligation of secrecy may be imposed on any person except in accordance with Rule 6(e)(2)
b. Unless these rules provide otherwise, the following persons must not disclose a matter occurring before the grand jury:
   I. a grand juror;
   II. an interpreter;
   III. a court reporter;
   IV. an operator of a recording device;
   V. a person who transcribes recorded testimony;
   VI. an attorney for the government; or
   VII. a person to whom disclosure is made under Rule 6(e)(3)(A)(ii) or (iii).

The text of the Federal Rules of Criminal Procedure is posted at www.utd.uscourts.gov/forms/crim2009.pdf.

to Country Y. We recognize his substantial connections to Country Y, but he no longer lives or works there. He is not himself a citizen of that country and his immediate family is with him in this country. As the manager concedes, the offense with which he could be charged by Country Y for his testimony here is not an offense for which he could be extradited. He could only be punished for this offense if he were to return voluntarily. "It is well established that the [Fifth Amendment] privilege protects against real dangers, not remote and speculative possibilities."[145] We only add that it does not protect against dangers voluntarily assumed. We, therefore, affirm the order of the district court holding the manager in contempt for refusing to testify before the grand jury.

III.

The bank argues that the district court erred in entering a civil contempt order[146] that compels it to act in violation of the laws of Country Y. The federal courts have disagreed about whether a court may order a person to take specific actions on the soil of a foreign sovereign in violation of its laws and about what sanctions the court may levy against a person who refuses to comply with such an order. . . .

. . . Be that as it may, here we simply conclude that even if a court has the power to issue such contempt orders under certain circumstances, on the peculiar facts of this case the order should not have issued. Most important to our decision is the fact that these sanctions represent an attempt by an American court to compel a foreign person to violate the laws of a different foreign sovereign on that sovereign's own territory. In addition, the bank, against whom the order is directed, is not itself the focus of the criminal investigation in this case but is a third party that has not been accused of any wrongdoing. Moreover, the bank is not merely a private foreign entity, but is an entity owned by the government of Country Y. We recognize that one who relies on foreign law assumes the burden of showing that such law prevents compliance with the court's order, . . . but here the government concedes that it would be impossible for the bank to comply with the contempt order without violating the laws of Country Y on Country Y's soil. The district court specifically found that the bank had acted in good faith throughout these proceedings. The executive branch may be able to devise alternative means of addressing this problem, but the bank cannot.

***

A decision whether to enter a contempt order in cases like this one raises grave difficulties for courts. We have little doubt, for example, that our government and our people would be affronted if a foreign court tried to compel someone to violate our laws within our borders. The legal expression of this widespread sentiment is found in basic principles of international comity. But unless we are willing simply to enter contempt orders in all such cases, no matter how extreme, in utter disregard of comity principles, we are obliged to undertake the unseemly task of picking and choosing when to order parties to violate foreign laws. It is conceivable that we might even be forced to base our determination in part on a subjective evaluation of the content of those laws; an American court might well find it wholly inappropriate to defer to a foreign sovereign where the laws in question promote, for example, torture or slavery or terrorism.

. . . We have no doubt that Congress could empower courts to issue contempt orders in any of these cases, or that the executive branch could negotiate positive agreements with other nations to the same end. If we were asked to act in accord with such a distinct and express grant of power, it would be our duty to do so. Indeed, any such measures would be a welcome improvement over the difficulties and uncertainties that now pervade this area of law.

[145] *Id*., at p. 478.

[146] Contempt of court is a court ruling that, in the context of a court trial or hearing, deems an individual as holding contempt for the court, its process, and its invested powers. In civil proceedings there are two main ways to be "in contempt" of court.

1. Failing to attend court despite a subpoena requiring attendance.
2. Failing to comply with a court order.

In sum, we emphasize again the limited nature of our holding on this issue. If any of the facts we rest on here were different, our holding could well be different. And though we reserve the district court's order holding the bank in civil contempt on the facts of this case, we of course intend no challenge to proposition that the vital role of grand jury investigations on our criminal system endows the grand jury with wide discretion in seeking evidence. It is therefore also relevant to our conclusion that the grand jury is not left empty-handed by today's decision. The manager will be available and able to testify as to many of the facts that the grand jury may wish to ascertain. The government may find alternative means to obtain additional information from or through the bank. Though we recognize that the grand jury's investigation may nonetheless be hampered, perhaps significantly, we are unable to uphold the contempt order against the bank.

Affirmed in part and reversed in part.

Casepoint

(1) With respect to prosecution in a foreign jurisdiction, a person wishing to claim the right not to be compelled to incriminate himself in a U.S. court has to be in "real and substantial fear" of being prosecuted in the foreign state. No real fear can exist where the person must voluntarily return to the foreign state to be prosecuted. The contempt order against the bank manager is therefore affirmed. (2) However, U.S. courts cannot compel the bank—an entity owned by the foreign state—to violate the laws of the foreign state; the contempt order against the bank is reversed.

From the perspective of the parent bank, the foreign branch is often treated as a separate business unit, with its own profit-and-loss statement, its own foreign tax liabilities, and its own separate account with the parent bank.[147] In terms of home state law, however, the treatment of foreign branches is not so easily described. Inconsistency is the common rule, both between and within states. Sometimes foreign branches are treated as peculiar separate entities. For example, statutes commonly require a parent bank to get permission from its home state banking authority before it may establish a foreign branch.[148] Similarly, some courts have refused to issue subpoenas directed against foreign branches,[149] and others have treated letter-of-credit transactions between a parent and a branch bank as if the two were unrelated entities.[150]

Sometimes, however, home country statutes and courts treat foreign branches as mere extensions of their parents. For example, in 1979, in response to the Iranian hostage crisis, the United States froze Iranian government assets held in U.S. banks and their foreign branches.[151] Courts, similarly, have held that a parent bank can be ordered to freeze the account of a foreign corporation held in the bank's foreign branches.[152] And courts commonly hold that a parent bank is liable for the debts

[147]Peter S. Smedresman and Andreas F. Lowenfeld, "Eurodollars, Multinational Banks, and National Laws," *New York University Law Review*, vol. 64, p. 733 at p. 742 (1989).

[148]*United States Code*, Title 12, §601 (1998), requires a federally chartered bank to obtain authorization from the Board of Governors of the Federal Reserve System before opening a foreign branch.

[149]In *McCloskey v. Chase Manhattan Bank*, *New York Reports, Second Series*, vol. 11, p. 936 (1962), the New York Court of Appeals held that an attachment served on a New York bank does not reach deposits made at its foreign branch.

[150]*Pan-American Bank & Trust Co. v. National City Bank of New York*, *Federal Reporter, Second Series*, vol. 6, p. 762 (Second Circuit Ct. of Appeals, 1925).

[151]See *Weekly Compilation of Presidential Documents*, vol. 15, p. 2117 (November 14, 1979), and *United States Code*, Title 50, §§1701–1706 (1982 and Supp. V, 1987).

[152]In *United States v. First National City Bank*, *United States Reports*, vol. 379, p. 378 (Supreme Ct., 1964), the U.S. Supreme Court reasoned that a foreign bank branch is not a separate entity and, therefore, its parent has both actual and practical control of its operations.

incurred by its foreign branches because the branch is subject to the supervision and control of the parent.[153]

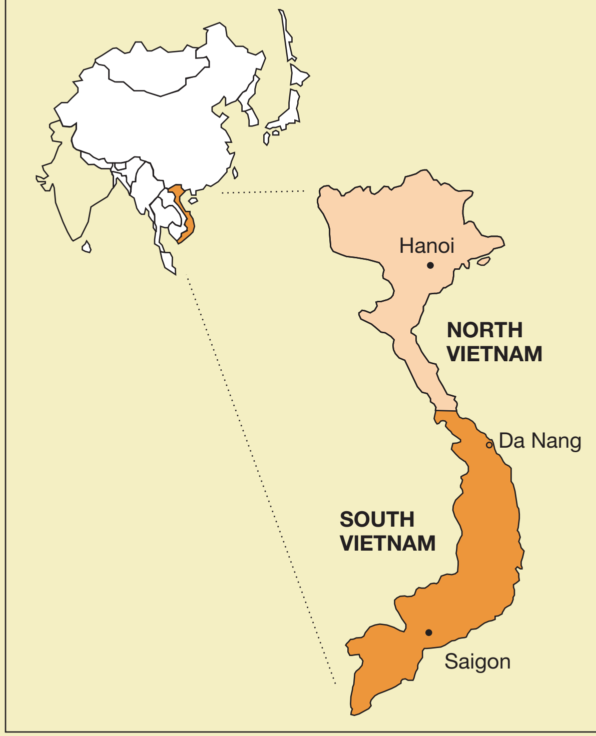
In Case 6-6, the U.S. Second Circuit Court of Appeals considered the responsibilities of a parent bank for funds deposited in a foreign branch when the foreign branch and its assets are seized by the host country.

Conflicts Between Host and Home State Regulations

State X enacts legislation requiring foreign branches of its domestic banks to comply with its rules regulating deposits. State Y enacts legislation requiring local branches of foreign parent banks to comply with State Y's rules regulating deposits. Bank P, with its headquarters in State X, has a foreign branch in State Y. Which law does the branch obey?

CASE 6-6 Vishipco Line et al. v. Chase Manhattan Bank, N.A.

United States, Court of Appeals, Second Circuit, 1981
Federal Reporter, Second Series, vol. 660, p. 854 (1981)



MAP 6.6

Vietnam (1975)

[153]*Sokoloff v. National City Bank of New York*, *New York Miscellaneous Reports*, vol. 130, p. 66 (New York Supreme Court, 1927). A different rationale was used in Wells Fargo Asia, *Ltd., v. Citibank*, N.A., *Federal Supplement*, vol. 695, p. 1450 at p. 1456 (1988). There the U.S. District Court for the Southern District of New York concluded that "under New York law, which governs this question, Citibank is liable for the debt of its Manila branch and plaintiff is entitled to look to Citibank's worldwide assets for satisfaction of its deposits." For additional similar cases, see Patrick Heininger, "Liability of U.S. Banks for Deposits Placed in Their Foreign Branches," *Law and Policy in International Business*, vol. 11, p. 903 (1979).

Opinion by Judge Mansfield

***

From 1966 until April 24, 1975, Chase operated a branch office in Saigon. Among its depositors were the ten corporate plaintiffs, which were principally engaged at that time in providing shipping services to the U.S. Government in Southeast Asia, and the individual plaintiff, who owned a 200 million piastre CD issued by Chase's Saigon branch. Chase's operations in Saigon came to an end at noon on April 24, 1975, after Chase officials in New York determined that Saigon would soon fall to the Communists. After closing the branch without prior notice to depositors, local Chase officials balanced the day's books, shut the vaults and the building itself, and delivered keys and financial records needed to operate the branch to personnel at the French Embassy in Saigon. Saigon fell on April 30th, and on May 1st the new government issued a communiqué which read as follows:

All public offices, public organs, barracks, industrial, agriculture and commercial establishments, banks, communication and transport, cultural, educational and health establishments, warehouses, and so forth—together with documents, files, property and technical means of U.S. imperialism and the Saigon administration—will be confiscated and, from now on, managed by the revolutionary administration.

Shortly thereafter, the French embassy turned over records from the Chase branch to the new government.

Tran Dinh Truong, who is a major shareholder of most, if not all, of the ten corporate plaintiffs and who represents them here, fled South Vietnam just prior to the Communist takeover, as did Nguyen Thi Cham, the individual plaintiff. After arriving in the United States, Truong and Cham demanded that Chase repay the piastre deposits made in Saigon, but Chase refused to do so. . . . Truong, acting under his powers of attorney, subsequently caused the plaintiffs to bring this action against Chase for breach of contract, seeking recovery of the dollar value of the piastre deposits held by its Saigon branch for them at the time it was closed, as well as the value of the certificate of deposit owned by Cham.The evidence was undisputed that on April 24, 1975, the ten corporate plaintiffs held demand piastre deposits (or overdrafts) with Chase in the following sums:

Name of Account	Balance
Vishipco Line VN	$22,995,328
Ha Nam Cong Ty	9,053,016
Dai Nam Hang Hai C.T.	9,397,598
Rang Dong Hang Hai C.T.	8,974,556
Mekong Ship Co. SARL	7,239,661
Vishipco SARL	(12,498,573)
Thai Binh C.T.	68,218
VN Tau Bien C.T.	5,925,249
Van An Hang Hai C.T.	87,439,199
Cong Ty U Tau Sao Mai	380,419

Chase also concedes that on November 27, 1974, it issued to Ms. Cham a CD in the sum of 200,000,000 Vietnamese piastres, payable on May 27, 1975, and that the CD bore interest at the rate of 23.5 percent per annum, payable at maturity.

***

Discussion

***

Chase . . . argues that the Vietnamese decree confiscating the assets which maritime corporations such as the corporate plaintiffs had left behind had the effect of seizing the piastre deposits at issue in this case. As a result, according to Chase, the corporate plaintiffs may not sue to recover the deposits because they no longer own them, and the act of state doctrine bars any challenge

to the validity of the governmental seizure. We disagree. There is no evidence that plaintiffs' existence as corporate entities was terminated. Moreover, it is only by way of a strained reading of the Vietnamese confiscation announcement that one can even argue that choses[154] in action were meant to be included. The plain meaning of the statement that

> the Saigon-Gia Dinh Management Committee quickly took over the management of all maritime transportation *facilities* abandoned by their owners. [original emphasis]

is that the seizures involved physical assets only and did not reach whatever claim the corporate plaintiffs might have on their departure for payment of the amounts owed to them by Chase.

More importantly, however, upon Chase's departure from Vietnam the deposits no longer had their *situs*[155] in Vietnam at the time of the confiscation decree. As we have said in the past, "[f]or purposes of the act of state doctrine, a debt is not 'located' within a foreign state unless that state has the power to enforce or collect it."[156] The rule announced in *Harris v. Balk*[157] continues to be valid on this point: the power to enforce payment of a debt depends on jurisdiction over the debtor. Since Chase had abandoned its Saigon branch at the time of the Vietnamese decree, and since it had no separate corporate identity in Vietnam which would remain in existence after its departure, the Vietnamese decree could not have had any effect on its debt to the corporate plaintiffs. As one qualified commentator has observed:

> The *situs* of a bank's debt on a deposit is considered to be at the branch where the deposit is carried, but if the branch is closed, . . . the depositor has a claim against the home office; thus, the *situs* of the debt represented by the deposit would spring back and cling to the home office. . . . [U]nder the act of state doctrine, the courts of the United States are not bound to give effect to foreign acts of state as to property outside the acting state's territorial jurisdiction.[158]

. . . Since in our case Chase's branch in Saigon was neither open nor operating at the time of the confiscation and had in fact been abandoned prior to that time, the Vietnamese decree was ineffective as against Chase's debt to the plaintiffs.

***

Chase next argues that under Vietnamese law its failure to repay plaintiffs' deposits in the period prior to May 1, 1975, was not a breach of its deposit contract, because the conditions prevailing in Saigon at the time rendered payment impossible. In support of this argument, Chase cites various sections of the South Vietnamese Civil Code which excuse performance under various extenuating circumstances, as well as the provisions included in the deposit contracts used by the Saigon branch which purported to discharge the bank's responsibility for losses to depositors resulting from a variety of unexpected and uncontrollable sources.

This argument must be rejected for the reasons that impossibility of performance in Vietnam did not relieve Chase of its obligation to perform elsewhere. By operating in Saigon through a branch rather than through a separate corporate entity, Chase accepted the risk that it would be liable elsewhere for obligations incurred by its branch. As the official referee in the *Sokoloff* [v. *National City Bank of New York*] case . . . summarized the law:

> [W]hen considered with relation to the parent bank, [foreign branches] are not independent agencies; they are, what their name imports, merely branches, and are subject to the supervision and control of the parent bank, and are instrumentalities whereby the parent bank carried on its business. . . . Ultimate liability for a debt of a branch would rest upon the parent bank.[159]

[154]From French: "a thing." A "chose in action" is a right to bring a suit or to recover a debt or money.

[155]From Latin: "location."

[156]*Menendez v. Saks and Co., Federal Reporter*, *Second Series*, vol. 485, p. 1355 at p. 1364 (Second Circuit Ct. of Appeals, 1973), reversed on other grounds in the case of *Alfred Dunhill of London, Inc. v. Republic of Cuba*, *United States Reports*, vol. 425, p. 682 (Supreme Ct., 1976).

[157]*United States Reports*, vol. 198, p. 215 (Supreme Ct., 1905).

[158]Patrick Heininger, "Liability of U.S. Banks for Deposits Placed in Their Foreign Branches," vol. 11, p. 903 at p. 975 (1979).

[159]*Sokoloff v. National City Bank of New York*, *New York Miscellaneous Reports*, vol. 130, p. 66 at p. 73 (New York Supreme Court, 1927).

U.S. banks, by operating abroad through branches rather than through subsidiaries, reassure foreign depositors that their deposits will be safer with them than they would be in a locally incorporated bank. . . . Indeed, the national policy in South Vietnam, where foreign banks were permitted to operate only through branches, was to enable those depositing in foreign branches to gain more protection than they would have received had their money been deposited in locally incorporated subsidiaries of foreign banks. Chase's defenses of impossibility and *force majeure*[160] might have succeeded if the Saigon branch had been locally incorporated or (more problematically) if the deposit contract had included an explicit waiver on the part of the depositor of any right to proceed against the home office. But absent such circumstances the Saigon branch's admitted inability to perform did not relieve Chase of liability on its debts in Saigon, since the conditions in Saigon were no bar to performance in New York or at other points outside of Vietnam. . . .

A bank which accepts deposits at a foreign branch becomes a debtor, not a bailee,[161] with respect to its depositors. In the event that unsettled local conditions require it to cease operations, it should inform its depositors of the date when its branch will close and give them the opportunity to withdraw their deposits or, if conditions prevent such steps, enable them to obtain payment at an alternative location. . . . In the rare event that such measures are either impossible or only partially successful, fairness dictates that the parent bank be liable for those deposits which it was unable to return abroad. To hold otherwise would be to undermine the seriousness of its obligations to its depositors and under some circumstances (not necessarily present here) to gain a windfall.

Reversed and remanded for further proceedings consistent with the foregoing.

Casepoint

(1) When a bank opens a branch in a foreign country, as opposed to incorporating a local subsidiary in that foreign country, the bank remains liable for obligations incurred by its branch. (2) The power to enforce a debt depends on jurisdiction over the debtor; the *situs* of a debt incurred by the branch in that foreign country which closes prior to a seizure order by the government will be where the parent resides. In this case, the court has jurisdiction over the parent bank in the United States. (3) The act of state doctrine does not apply here, because the *situs* of the debt is in the United States, and the Vietnam government decree cannot affect a right to recover a debt whose *situs* is no longer Vietnam.

Two commentators have suggested that a branch bank should be subject only to the rules and regulations of the host country, regardless of the directives given by the home country to the parent bank. They argue that such a rule "would most accurately reflect the expectations" of banks and depositors, and would be perceived by governments as the "most reasonable allocation" of their powers to regulate banks and bank deposits.[162] Their rule, however, is only a proposal. No case law has clearly emerged to cover this circumstance, although cases involving conflicting regulations have become more and more common in recent years.[163] Case 6-7 describes one British judge's solution to this enigma.

[160]From French: "superior force." An event or effect that cannot be anticipated or controlled.

[161]A bailee is a person to whom personal property is delivered that is to be returned to the person who delivered it, the bailor, after it has been held for some purpose.

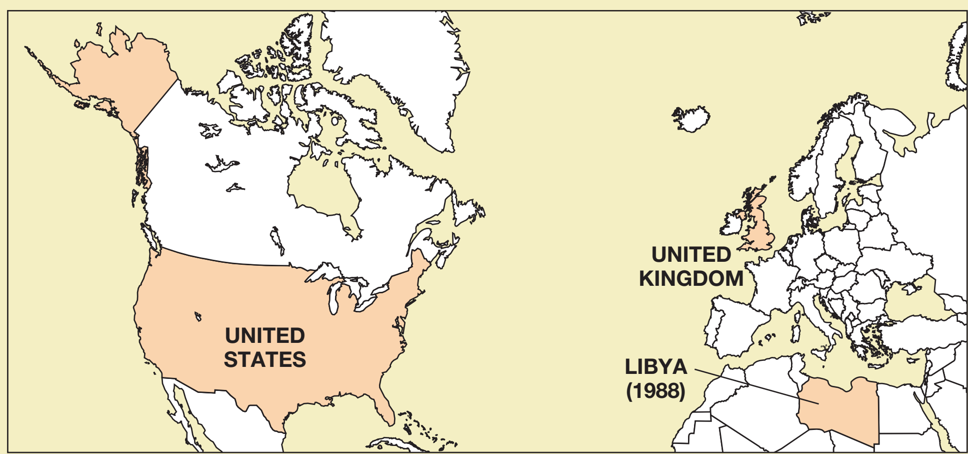
[162]Peter S. Smedresman and Andreas F. Lowenfeld, "Eurodollars, Multinational Banks, and National Laws," *New York University Law Review*, vol. 64, p. 733 at p. 800 (1989).

[163]In the United States, the court in *Wells Fargo Asia, Ltd. v. Citibank, N.A.*, *Federal Supplement*, vol. 695, p. 1450 (District Ct. for S. District of New York, 1988), reached a conclusion at odds with Smedresman and Lowenfeld's proposed rule. However, in the companion cases of *Braka v. Bancomer, SA*, *Federal Supplement*, vol. 589, p. 1465 (District Ct. for S. District of New York, 1984), affirmed in *Federal Reporter, Second Series*, vol. 762, p. 222 (Second Circuit Court of Appeals, 1985), and *Callejo v. Bancomer, SA*, *id*., vol. 764, p. 1101 (Fifth Circuit Court of Appeals, 1985), the decisions support the rule.

Some developments in reaching international accords for the joint supervision of branch banks, especially in the area of capital adequacy, have begun to take shape. The Committee of Banking Regulations and Supervisory Practices, established by the central banks of the member countries of the Group of Ten, has issued several reports suggesting how supervisory responsibility should be allocated. Several of the member countries, including the United States and the United Kingdom, have started the process of enacting the recommendations into law. See Joseph J. Norton and Sherry C. Whitley, *Banking Law Manual*, §15.09 (1990).

CASE 6-7 Libyan Arab Foreign Bank v. Bankers Trust Company

England, High Court of Justice, Queen's Bench Division, Commercial Court, 1987. *Lloyd's Reports*, vol. 1988, pt. 1, p. 259 (1988); *International Legal Materials*, vol. 26, p. 1600 (1987).



MAP 6.7

The United States, the United Kingdom, and Libya (1988)

On January 8, 1986, the Libyan Arab Foreign Bank (Libyan Bank)[164] had over $131.5 million deposited in a call account with the London branch of Bankers Trust Company (Bankers Trust), a New York corporation (and $161.4 million in a demand account in New York). On that day, effective 4:10 P.M., the president of the United States froze all Libyan assets in the United States. According to New York law, but not according to English law, that included the Libyan Bank's London deposit. The Libyan Bank sued Bankers Trust in the United Kingdom for, among other claims, recovery of its deposit. Bankers Trust argued that it was not liable because (1) New York law governed the deposit arrangement and (2) New York law prohibited it from making transfers out of the London account. In particular, Bankers Trust points to an agreement between the parties made in December 1980 (the managed account arrangement) that provided for the New York office of Bankers Trust to oversee the Libyan bank's accounts in both New York and London as support for its argument that New York law applied.

Opinion by Justice Staughton

As a general rule the contract between a bank and its customer is governed by the law of the place where the account is kept, in the absence of agreement to the contrary. . . . [T]here was no challenge to that as a general rule. . . .

That rule accords with the principle, to be found in the judgment of Lord Justice Atkin in *N. Joachimson v. Swiss Bank Corporation*,[165] and other authorities, that a bank's promise to repay is to repay at the branch of the bank where the account is kept.

In the age of the computer it may not be strictly accurate to speak of the branch where the account is kept. Banks no longer have books in which they write entries; they have terminals by which they give instructions; and the computer itself with its magnetic tape, floppy disc or some other device may be physically located elsewhere. Nevertheless it should not be difficult to decide where an account is kept for this purpose; and is not in the present case. The actual entries on the London account were, as I understand it, made in London, albeit on instructions from New York after December 1980. At all events I have no doubt that the London account was at all material times "kept" in London.

[164]The Libyan Arab Foreign Bank was a Libyan corporation wholly owned by the Central Bank of Libya. It carried on an offshore banking business and did not engage in domestic banking in Libya.

[165]*Law Reports, King's Bench*, vol. 1921, pt. 3, p. 110 at p. 127 (1921).

Mr. Sumption [the attorney representing Bankers Trust] was prepared to accept that the proper law governing the London account was English law from 1973 to December 1980. But he submitted that a fundamental change then took place, when the managed account arrangement was made. I agree that this was an important change, and demands reconsideration of the proper law from that date. That the proper law of a contract may be altered appears from *James Mill & Partners, Ltd. v. Whitworth Street Estates, Ltd.*[166]

Mr. Cresswell, for the Libyan Bank, submits that there then arose two separate contracts, of which one related to the London account and remained governed by English law; alternatively he says that there was one contract, again governed by English law; or that it had two proper laws, one English law and the other the law of New York. Mr. Sumption submits that there was from December 1980 one contract only, governed by New York law.

Each side has relied on a number of points in support of its contentions. I do not set them out, for they are fairly evenly balanced, and in my view do little or nothing to diminish the importance of the general rule, that the proper law of a bank's contract is the law of the place where the account is kept. Political risk must commonly be an important factor to those who deposit large sums of money with banks; the popularity of Swiss bank accounts with some people is due to the banking laws of the Cantons of Switzerland. And I have already found on the evidence of Bankers Trust, that the Iranian crisis was at the back of everyone's mind in 1980. Whatever considerations did or did not influence the parties to this case, I believe that banks generally and their customers normally intend the local law to apply. So I would require solid grounds for holding that the general rule does not apply, and there do not appear to me to be such grounds in this case.

I have, then, to choose between the first and third of Mr. Cresswell's arguments—two separate contracts or one contract with two proper laws. It would be unfortunate if the result of this case depended on the seemingly unimportant point whether there was one contract or two. But if it matters, I find the notion of two separate contracts artificial and unattractive. . . .

Mr. Sumption argues that difficulty and uncertainty would arise if one part of the contract was governed by English law and another by New York law. I do not see that this would be so, or that any difficulty which arose would be insuperable.

There is high authority that branches of banks should be treated as separate from the head office. See for example *R. v. Grossman*,[167] where Lord Denning, Master of the Rolls, said:

> The branch of Barclays Bank in Douglas, Isle of Man, should be considered as a different entity separate from the head office in London.

That notion, of course, has its limits. A judgment lawfully obtained in respect of the obligation of a branch would be enforceable in England against the assets of the head office. (That may not always be the case in America.) As with the theory that the premises of a diplomatic mission do not form part of the territory of the receiving state, I would say that it is *true for some purposes* that a branch office of a bank is treated as a separate entity from the head office.

This reasoning would support Mr. Cresswell's argument that there were two separate contracts, in respect of the London account and the New York account. It also lends some support to the conclusion that if, as is my preferred solution, there was only one contract, it was governed in part by English law and in part by New York law. I hold that the rights and obligations of the parties in respect of the London account were governed by English law.

The High Court allowed the Libyan Bank to recover the $131.5 million on deposit in the London branch of Bankers Trust as well as $161.4 million of the funds in the New York office because, according to the managed account arrangement, Bankers Trust was supposed to have transferred that sum from its New York office to its London branch on the morning prior to the presidential freeze, and it had no excuse for not having done so.

Casepoint

(1) The general rule is that a bank contract is governed by the law of the place where the account is kept. (2) For some purposes, a branch is treated as a separate entity from its home office. This rule has its limits—a home office is liable for the obligations of its branch.

[166] *Law Reports, Appeal Cases*, vol. 1970, p. 583 (1970), per Lord Reid at p. 603, Lord Wilberforce at p. 615.

[167] {195} *Law Reports*, *Criminal Appeal Reports*, vol. 73, p. 302 at p. 307 (1981).

Chapter Questions

Dealing with Currency Fluctuation

1. Consider the case of the *Republic of Argentina et al v. Weltover Inc. et al.* The United States used the Foreign Sovereign Immunities Act of 1976 to bring suit against Argentina for a default on bond repayment. Explain whether monetary effects or macroeconomic concerns in the United States were integral to the Supreme Court assuming jurisdiction over the Republic of Argentina.

2. X in State A and Y in State B plan to enter into a contract. What can they do to avoid the impact of a fluctuation in the value of their money of account?

Exchange Contracts and Exchange Control Regulations

3. The State of Q forbids its citizens to take more than 1,000 units of its currency out of the country in any one-month period. To avoid this limitation, Ms. Ecks, a State Q citizen who lives abroad in State X, engages in the following scheme with a friend, Mr. Zed, a travel agent in Tokyo, Japan. Ms. Ecks buys yen from Mr. Zed at a sizable premium. She pays for the yen with checks, made out to Mr. Zed, that she draws on her account with QueBank, located in the capital city of State Q. Mr. Zed regularly accompanies tour groups to State Q, and when he is there, he cashes Ms. Ecks's check at QueBank. Mr. Zed, accordingly, makes a nice profit from selling yen to Ms. Ecks, and Ms. Ecks is able to get as much money as she wants out of State Q. Somehow the government of State Q learned of this transaction, and it ordered QueBank to freeze Ms. Ecks's account so long as she is abroad. Mr. Zed, unable to cash Ms. Ecks's latest checks, sues Ms. Ecks in State X to get back the money he had already advanced her. Both State Q and State X, as well as Japan, are members of the IMF. Will Mr. Zed succeed? Explain. (Consider the *Wilson, Smithett & Cope, Ltd. v. Terruzi* case.)

Branch Banking

4. MultiBank is a large London bank with a branch office in Boston. The American government believes that a prominent American underworld figure, Mr. Z, has been depositing stolen money in MultiBank's Boston branch as well as with the bank's home office in London. The government's prosecutor has asked an American court to issue a subpoena ordering the manager of the Boston branch to turn over all records relating to Mr. Z from both the Boston branch and the London home office. Should the court issue the subpoena? Explain.

5. Q Bank, located in State A, has a branch in State B. X has State A currency on deposit in that branch. X directs the branch to transfer the funds to a branch of P Bank that is located in State B. P Bank itself is, like Q Bank, located in Country A. The customary method for making such a transfer is for Q Bank's branch to request its parent to make a transfer through State A's central bank, debiting its own account with its parent and crediting P Bank's account at the central bank. In turn, P Bank will credit its branch's account with the transfer. State A, however, has imposed an embargo on all transfers relating to monies belonging to X, and neither Q Bank nor P Bank will make the transfer. X files suit in State B and seeks an order for the two branches to make the transfer locally without going through their parent banks or State A's central bank. Will X be successful?

Arbitrage

6. General J is the president of the Republic of Jade. General J has investments in various branches of the Bank of America (whose main office is registered in Washington DC). The International Criminal Court has issued an arrest warrant against General J. The Bank of America sent a memoranda to all its branches to freeze General J's assets. General J was able to access his accounts online through a common interface operated by the registered office of the Bank of America but this has now been blocked. General J has approached the relevant commercial court in London requesting the London branch of the Bank of America to allow him to withdraw his deposit and allow online transactions. How should the court rule on this matter? Discuss.

CHAPTER

7

Trade in Goods

Chapter Outline

A. History of Contemporary International Trade Law
  - Protectionism
  - The Bretton Woods System
  - The 1947 General Agreement on Tariffs and Trade
  - Multilateral Trade Negotiations
  - The Uruguay Round

B. The World Trade Organization
  - The WTO Agreement
  - Membership of the WTO
  - Structure of the WTO
  - Decision Making within the WTO
  - Waivers
  - Dispute Settlement
  - Trade Policy Review

C. The 1994 General Agreement on Tariffs and Trade
  - Direct Effect
  - Nondiscrimination
  - Protection Only Through Tariffs
  - Transparency
  - Regional Integration
  - Commodity Arrangements
  - Escape Clause
  - Exceptions
  - Export Controls
  - Other Multilateral Export-Control Programs

D. Multilateral Trade Agreements
  - Customs Valuation
  - Preshipment Inspection
  - Technical Barriers to Trade
  - Sanitary and Phytosanitary Measures
  - Trade-Related Investment Measures
  - Import-Licensing Procedures
  - Anti-dumping
  - Subsidies and Countervailing Measures
  - Safeguards
  - Agriculture

Textiles and Clothing
Rules of Origin
Chapter Questions
Relevant Internet Sites

A. History of Contemporary International Trade Law

International trade has grown dramatically in the past 60 years. In great measure, this is because the world's nations have cooperated in eliminating protectionist domestic legislation and in promoting the free exchange of goods.[1] Indeed, one of the most remarkable trends in international law during the past six decades has been the steady movement away from tariffs and quotas and toward free trade among the nations of the world. Where once most nations maintained laws to promote and protect their own businesses and producers, since the 1940s there has been a continual shift toward multilateral efforts to reduce tariffs and other trade barriers. As is described below, the several GATT treaties, the EU, the WTO, and many other international agreements and organizations have resulted in a dramatic lowering of tariffs—each nation giving up a little in order to get reciprocal reductions—and a tremendous increase in international trade. Business now operates in a truly global economy.

However, we may have reached a point where future trade liberalization will be more difficult to achieve. As discussed below, the World Trade Organization has been trying since 2001 to reach agreement on further tariff cuts, subsidy reductions, and other issues as part of the Doha Development Program, but success has not yet been achieved. Within the past few years, many voices have been raised in protest of globalization. It is now clear that there are both winners and losers as trade becomes more free and more global. It appears that large multinational firms and large, powerful nations have received more benefits from the removal of trade barriers than smaller businesses, farmers, and nations. "The rich get richer" has become a battle cry for anti-globalization protesters at most large international economic and trade meetings.

Furthermore, the worldwide financial crisis of the last several years has exacerbated many of these anti-globalization feelings, as each nation, and indeed each individual, has been looking for ways to survive economically. Those of us living in the United States have seen a massive loss of jobs, significant loss of home equity and savings, and other serious negative consequences from the "Great Recession" of the past 3–4 years. As this chapter is being edited, several European nations are struggling to keep from defaulting on financial obligations—during the first half of 2012 Greek protestors have conducted violent demonstrations against austerity measures proposed by the European Union, the International Monetary Fund, and the government of Greece, as preconditions for extending billions of dollars in additional loans and credit. Other European nations, including Italy and Spain, also face serious economic problems. National leaders are concerned about their nations' own well-being and wary of extending "free trade" and additional economic benefits to other countries.

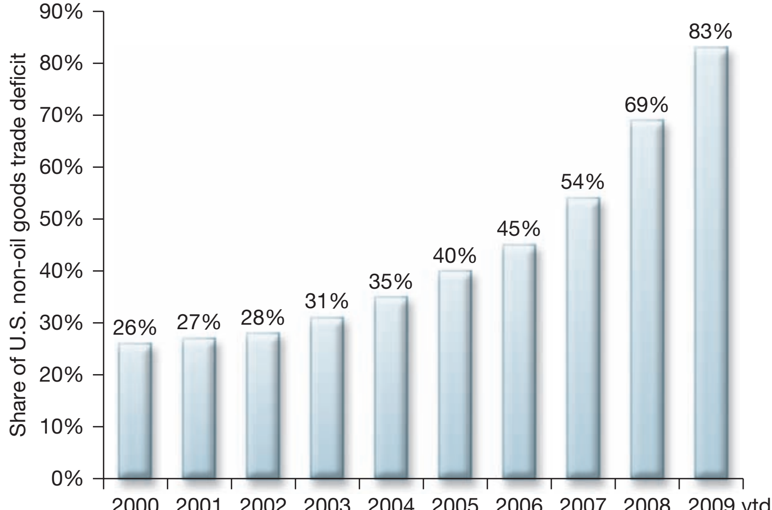
Certain public interest and labor groups have complained that "free trade" ignores important environmental and labor issues, with dire consequences for the environment and workers in developing countries. In addition, employee organizations in developed nations—Europe and the United States in particular—argue that free trade and globalization have led to the loss of thousands of good jobs, as manufacturing plants are moved and work is outsourced to lower-wage nations. Corporate profits in developed nations have increased in recent years, while wages in the developed world have stagnated. And as globalization moves forward, the trade deficit of the United States jumped, reaching a record $763 billion in 2006 as Americans purchased more and more goods manufactured abroad, particularly from China and other low-cost nations (see Figure 7.1). The U.S. trade deficit decreased from 2007–2009, but rose to slightly more than $500 billion in 2010. The United States imported $645,857 billion more in goods than was exported in 2010, but that deficit was somewhat

[1]For a brief history of developments leading up to the establishment of the World Trade Organization, see "Understanding the WTO" at www.wto.org/english/thewto_e/whatis_e/tif_e/tif_e.htm.

FIGURE 7.1

China's Growing Share of the Overall U.S. Trade Deficit 2000 to May 2009 (Non-Oil Goods)

Source: http://www.uscc.gov/annual_report/2009/annual_report_full_09.pdf



offset by a positive balance in the sale of services of $145,830 billion. The U.S. had a deficit of $273 billion in trade with China alone in 2010.

Americans have become more skeptical of "free trade" in recent years. A survey published in fall 2010 indicated that 53 percent of the respondents thought that free trade agreements had hurt the United States, and this percentage had increased sharply from 46 percent in 2007 and 32 percent in 1999.[2] Some 83 percent of American blue-collar workers surveyed felt that outsourcing of manufacturing jobs to countries with lower wages was a reason the U.S. economy was struggling and people were not being hired. The pollster who conducted the survey noted an important change as very well-educated and upper-income people had shifted positions in the last five years and were now expressing significant concern about free trade.[3] As the *Wall Street Journal* noted a few years ago in one article describing the topics and agenda of the World Economic Forum meetings in Davos, Switzerland, just before the world financial crisis:

> Globalization isn't working for everyone. Stagnating wages and rising job insecurity in developed countries are creating popular disenchantment with the free movement of goods, capital and people across borders. If unchecked, popular fears could turn into a political backlash that could lead to protectionism—or at least make broad free-trade agreements harder to achieve in the future.[4]

Nevertheless, despite the protests, it seems clear that globalization is here to stay. The clock cannot be turned back. The technical, social, and political developments of the past 60 years cannot be reversed—we now live and do business in a global marketplace (see Figure 7.2). So, now let us turn our attention to the long, steady series of events, treaties, agreements, and organizations that have created—and set the rules governing—the free trade world.

Protectionism

The Great Depression of the 1930s in many ways was a direct consequence of protectionism. When the United States raised tariffs on more than 900 items with the Hawley-Smoot Tariff Act of 1930, the other major trading nations of the world reciprocated with similar increases. The United Kingdom, for one, enacted its first major protective trade legislation of the twentieth century in 1931. That same year, the League of Nations tried to cool what had become a tariff war by convening a Tariff Truce Conference, but the effort failed. By 1932, world trade had fallen 25 percent from its 1929 level, and the world's industrial production had fallen 30 percent. In 1933, the last major prewar multilateral conference on trade, the World Monetary and Economic Conference, adjourned

[2] Sara Murray and Douglas Belkin, "Americans Sour on Trade," *Wall Street Journal*, October 2, 2010.

[3] *Id*.

[4] Marcus Walker, "Just How Good Is Globalization?" *Wall Street Journal*, January 25, 2007, p. A10.

FIGURE 7.2

Business Is Now a Global Phenomenon

Source: Iofoto/Fotolia

without results because the participants refused to relax their trade restrictions. Not until 1936 did industrial production return to its 1929 level, and not until 1940 did international trade return to its pre-Depression level.

Recovery from the Great Depression was U.S. President Franklin Roosevelt's main goal upon his election in 1932, and liberalization of international trade was at the heart of his program for achieving that end. Beginning in 1934, the United States entered into bilateral trade negotiations with its major trading partners to reduce tariffs on a reciprocal (instead of a unilateral) basis. The United States kept up this program until, during, and after World War II.

The idea that tariffs should be reduced through bilateral and multilateral negotiations became part of the Atlantic Charter, the declaration issued by President Roosevelt and British Prime Minister Winston Churchill in 1941 as a rallying cry for nations opposing the military and economic aggression of fascist Germany, Italy, and Japan. See Figure 7.3 showing the two leaders in conference. In addition to calling for the permanent renunciation of territorial aggrandizement and the disarmament of all aggressor states, the charter set out goals for the postwar era, many of which were based on international economic cooperation. Among these was the assertion that every nation has the right to expect that its legitimate trade will not be diverted or diminished by excessive tariffs, quotas, or restrictive unilateral or bilateral practices.

During World War II, the protectionist sentiments of the 1930s were rejected as destructive, and they were swept aside in a rush to arrange a comprehensive network of multilateral agreements to settle the world's political and economic problems. The nations fighting Germany, Italy, and Japan

FIGURE 7.3

U.S. President Franklin Roosevelt Conferring with British Prime Minister Winston Churchill

Source: Photos 12/Alamy

allied themselves as the United Nations, and in 1943 they called for the creation of a permanent international organization to replace the League of Nations and an integrated international system to encourage trade liberalization and multilateral economic cooperation. Both efforts began the following year. A first draft of a United Nations Charter was agreed to at a conference at Dumbarton Oaks (a mansion in Georgetown, Washington, D.C.) and an international conference on economic relations convened at Bretton Woods, New Hampshire. A final draft of the United Nations Charter was approved and adopted at San Francisco in 1945.

The Bretton Woods System

The negotiators who met for the United Nations Monetary and Financial Conference in Bretton Woods in July 1944 were determined to create a system that would promote trade liberalization and multilateral economic cooperation. The Bretton Woods System was meant to be an integrated undertaking by the international community to establish a multilateral institutional framework of rules and obligations.

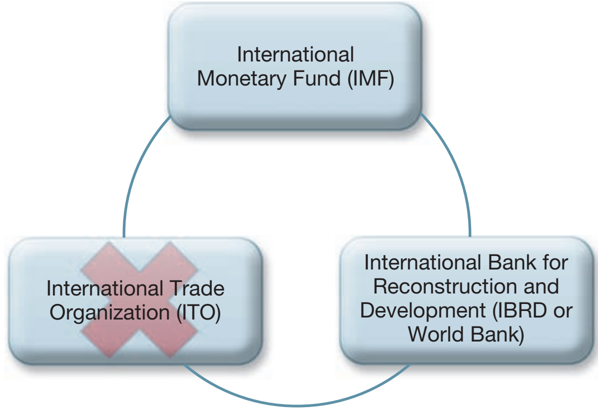
As originally planned, the Bretton Woods System was to have had at its core three major international organizations: the International Monetary Fund (IMF), the International Bank for Reconstruction and Development (IBRD or World Bank), and the ill-fated International Trade Organization (ITO). (See Figure 7.4.) Together they were to collectively administer and harmonize world trade. The IMF was to ensure monetary stability and facilitate currency exchange. The World Bank was to assist war-ravaged and developing countries to reconstruct or upgrade their economies. The ITO was to administer a comprehensive code governing the conduct of world trade. This code was to be broad and encompassing, dealing with a wide range of issues, including trade and trade barriers, labor and employment, economic development, restrictive business practices, and intergovernmental commodity agreements.

The Articles of Agreement of the IMF were adopted at Bretton Woods and ratified in 1945. The World Bank was organized and its Agreement ratified in 1945 as well. Not until 1946 did the United Nations Economic and Social Council (ECOSOC) appoint a Preparatory Committee to draft an agenda and set up a conference to create the ITO.

The strongest advocate of an ITO was the U.S. government, which produced a "Suggested Charter" for consideration by the committee that met in London in October 1946. After a second session in Geneva in 1947, the ITO Charter was adopted in a "Final Act" and its contents were agreed to by the 53 countries participating in a UN-sponsored Conference on Trade and Employment in Havana in 1948. But the American government, which had worked hard to create the ITO in 1946, withheld support in 1948. President Harry Truman, fearing that the ITO Charter (or Havana Charter) would be rejected by an opposition Congress that had become conservative and protectionist and that American foreign policy would be adversely affected, did not submit the ITO Charter to the Senate for ratification. All but two of the other participants at the Havana conference had waited to see if the United States would ratify the charter, and when it did not, no further effort was made to establish the organization. It would be nearly 50 years before the idea would come to fruition with the establishment of the World Trade Organization (WTO).

FIGURE 7.4

The Original Plan for the Bretton Woods System, Showing the Ill-Fated International Trade Organization



The 1947 General Agreement on Tariffs and Trade

Instead of creating an ITO, the developed market-economy countries entered into an accord in 1947 called the **General Agreement on Tariffs and Trade (GATT 1947)**.[5] The original contracting parties were the same states that had formed the Preparatory Committee that had drafted the ITO Charter, and they borrowed liberally from that document in drafting GATT 1947.[6]

GATT 1947 was a multilateral treaty that set out the principles under which its contracting states,[7] on the basis of "reciprocity and mutual advantage," were to negotiate "a substantial reduction in customs tariffs and other impediments to trade." With the addition of other states in subsequent years, GATT 1947 came to govern almost all of the world's trade.

The main principles of GATT 1947 were as follows: (1) Trade discrimination was forbidden. Each contracting state had to accord the same trading privileges and benefits (or **most-favored-nation status**) to all other contracting states equally; and, once foreign trade goods were imported into one contracting state from another, the foreign goods had to be treated (according to the **national treatment** principle) the same way as domestic goods. (2) With some exceptions, the only barriers that one contracting state could use to limit the importation of goods from another contracting state were customs tariffs. (3) The trade regulations of contracting states had to be **transparent**, that is, published and available to other contracting states and their nationals. (4) Customs unions and free trade agreements between contracting states were regarded as legitimate means for liberalizing trade so long as they did not, on the whole, discriminate against third-party states that were also parties to GATT. (5) GATT-contracting states were allowed to levy only certain charges on imported goods: (a) an import tax equal in amount to internal taxes, (b) anti-dumping duties to offset advantages obtained by imported goods that were sold below the price charged in their home market or below their actual cost, (c) countervailing duties to counteract foreign export subsidies, and (d) fees and other proper charges for services rendered.[8]

The legal framework established at Geneva in 1947 remained essentially unchanged until the creation of the World Trade Organization (WTO) in 1994. Even under that agreement, the substantive provisions of GATT 1947 live on, becoming one of the annexes to the Agreement Establishing the WTO (under the name GATT 1994).[9]

Multilateral Trade Negotiations

To keep GATT 1947 up-to-date, the contracting parties regularly participated in *multilateral trade negotiations* (informally called **rounds**). Including the Geneva Round in 1947, when GATT was originally adopted, eight rounds of MTNs were held. Most were held at Geneva, the location of the GATT headquarters.[10] The current "round," begun at Doha, Qatar (the "Doha Round"), has dissolved into a number of long-standing disputes, primarily over U.S. and EU subsidies for their own agricultural industries and increased market access in less-developed countries for the manufactured products of developed nations.

General Agreement on Tariffs and Trade (GATT) 1947
Multilateral agreement that set out the rules under which the contracting states parties were committed to negotiate reductions in customs tariffs and other impediments to international trade in goods.

most-favored-nation status
When a GATT member nation sets a favorable tariff rate on a particular type of goods imported from one GATT member, that member nation may not assess a higher tariff on the particular type of goods being imported from any GATT nation.

national treatment
Once goods are legally imported, they must be treated the same way as domestic goods (no additional requirements).

transparent
Trade regulations of GATT members must be published and available to all other GATT nations and their nationals.

round
A meeting of the contracting parties of GATT to participate in MTNs.

---

[5]The Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations (1994) refers to the original GATT as *GATT 1947* to distinguish it from the GATT annexed to the Agreement Establishing the World Trade Organization, which it calls *GATT 1994*. The same nomenclature will be used here.

[6]For a history of GATT through the completion of the Tokyo Round (1973–1979), see Frank Stone, *Canada, the GATT and the International Trade System* (1984) and "Understanding the WTO" at www.wto.org. See also Jeffrey J. Schott and Johanna W. Buurman, "The Uruguay Round: An Assessment" (1994) and "What Is the WTO?" at www.wto.org/english/thewto_e/whatis_e/whatis_e.htm#intro.

[7]There were 23 original contracting states parties to GATT 1947. At that time they accounted for 80 percent of the world's trade. There are now 153 members, who account for 97 percent of world trade.

[8]GATT 1947, in addition to these basic principles, contained various exceptions that could be invoked in special situations. These included balance-of-payments disequilibriums, serious and unexpected damage to domestic production, the need to promote economic development, the need to protect the production of domestic raw materials, and the need to protect domestic national security interests.

[9]The provisions of GATT 1947 are carried forward to GATT 1994 with few changes. Essentially, only the Protocol of Provisional Application was not readopted.

[10]The eight rounds were Geneva (parallel with the negotiation of GATT 1947); Annecy, France (1949); Torquay, England (1950–1951); Geneva (1955–1956); the Dillon Round in Geneva (1961–1962); the Kennedy Round in Geneva (1964–1967); the Tokyo Round in Geneva (1973–1979); and the Uruguay Round in Montevideo, Geneva, Montreal, and Marrakesh (1986–1994).

Since one of the main purposes of the GATT agreement was to reduce tariffs, the first five rounds were devoted almost exclusively to tariff reductions, while the last three completed rounds (the Kennedy, Tokyo, and Uruguay Rounds) expanded their agendas to nontariff matters. Negotiations in the early rounds were generally carried on bilaterally, on a product-by-product basis. That is, the two states most interested in a particular product would negotiate a bargain through the time-honored process of offer, counteroffer, and agreement. Agreed-upon concessions in the form of bound tariff rates were then extended to all other GATT contracting parties as a consequence of the most-favored-nation principle.

Kennedy Round GATT MTNs held from 1964 to 1967 that established the practice of setting an agenda for and defining the techniques to be used during GATT negotiations.

More comprehensive negotiating techniques were proposed and used for the first time in the **Kennedy Round** (1964–1967). At a plenary session of the contracting parties held immediately prior to this MTN, the contracting states issued a declaration defining the agenda and the negotiation techniques to be used. The declaration also called for two kinds of across-the-board tariff reductions. One was a uniform percentage reduction in tariffs among all contracting parties. The other was the use of various mathematical formulas to make the various tariff schedules more consistent; that is, higher tariffs were reduced more and lower tariffs less. Fifty-four states participated in the negotiations and 400,000 tariff headings were covered. The result was an average 35 percent reduction in duties levied on industrial products, a reduction that was phased in over a five-year period.

In addition to the negotiations on tariffs, the Kennedy Round dealt with the problems of nonreciprocity for developing states and with nontariff obstacles. The developing states parties successfully added a new part to the General Agreement entitled "Trade and Development," which called for stabilization, as far as possible, of raw material prices; reduction or elimination of customs duties and other restrictions that unreasonably differentiate between products in the primary (or raw) state and the same products in their finished form; and renunciation by the developed states of the principle of reciprocity in their relations with developing states. In the area of nontariff barriers to trade, the Kennedy Round produced an agreement on anti-dumping (popularly called the Anti-dumping Code).

Tokyo Round GATT MTNs held from 1973 to 1979 that produced six nontariff codes.

The next multilateral trade negotiations, known as the **Tokyo Round** (1973–1979), were characterized by an ambitious agenda and the participation of non-GATT states. In all, 102 states participated. As with the Kennedy Round, formulas for negotiating tariffs were again applied, but with less success. For a variety of political reasons, tariff rates for some items (e.g., agricultural products and exempt industrial products) were not cut at all, and the cuts on other items were larger or smaller than they would have been if the formulas had been applied. Nevertheless, the tariffs on industrial products were cut, again, an average of 35 percent, to an overall range of 5 to 8 percent among the developed states parties.

Also, following the example of the Kennedy Round, the Tokyo Round produced several special agreements (popularly known as *codes*) to regulate nontariff matters as well as several sectoral agreements to promote trade in particular commodities. These codes, which were sponsored but not administered by GATT, were multilateral treaties open to ratification by any state. Six codes were completed: (1) customs valuation, (2) subsidies and countervailing measures, (3) anti-dumping, (4) standards, (5) import licensing, and (6) government procurement. In addition, three sectoral agreements were concluded on trade in civil aircraft, dairy products, and bovine meat.

The Uruguay Round

Uruguay Round GATT MTNs held from 1986 to 1994 that resulted in the establishment of the World Trade Organization.

The **Uruguay Round** (1986–1994)[11] brought about a major change in the institutional structure of the GATT, replacing the informal GATT institution with a new institution: the *World Trade Organization*.[12] The round concluded on April 15, 1994, when representatives of 108 states

[11]Calls for a new round of MTNs were made soon after the Tokyo Round was completed. GATT set up a preparatory committee in 1982 to create an agenda for a new round, but it was not until 1986, after much debate, that the GATT members formally began negotiations.

[12]For a historical overview of the Uruguay Round, see "Understanding the WTO: The Uruguay Round" at www.wto.org/english/thewto_e/whatis_e/tif_e/fact5_e.htm. The introduction to this WTO Web page discussing the Uruguay Round begins, "It took seven and a half years, almost twice the original schedule. By the end, 123 countries were taking part. It covered almost all trade, from toothbrushes to pleasure boats, from banking to telecommunications, from the genes of wild rice to AIDS treatments. It was quite simply the largest trade negotiation ever, and most probably the largest negotiation of any kind in history."

signed its *Final Act*[13] at a ceremony in Marrakesh, Morocco, and committed their governments to ratify the results of the round.[14] Again, as it had with the ITO Charter, the world waited to see if the U.S. Congress would approve of the new institution. This time, after much delay, including time out for an election, Congress convened in an extraordinary session and ratified the Final Act on December 8, 1994. Moments after the vote was announced in Washington, the representatives of the old GATT convened an Implementation Conference in Geneva and agreed that its successor institution, the World Trade Organization, would officially come into existence on January 1, 1995.[15]

The Uruguay Round Final Act is made up of three parts that together form a single whole. The first part, the formal Final Act itself, is a one-page "umbrella" that introduces the other two parts. Most importantly, this first part provides that its signatories agree to (1) submit the Agreement Establishing the World Trade Organization (WTO Agreement) and its annexes (with the exception of four Plurilateral Trade Agreements) to their appropriate authorities for ratification and (2) adopt the Ministerial Declarations, Decisions, and Understandings agreed to during the course of the negotiations.

The second part of the Final Act is made up of the WTO Agreement and its annexes, of which there are two kinds: Multilateral Trade Agreements and Plurilateral Trade Agreements.

Multilateral Trade Agreements are "integral parts" of the WTO Agreement and are "binding on all members" of the WTO.[16] They consist of (1) 14 Agreements on Trade in Goods (including GATT 1994), (2) the General Agreement on Trade in Services (GATS), (3) the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), (4) the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), and (5) the Trade Policy Review Mechanism (TPRM). The four *Plurilateral Trade Agreements* are also part of the WTO Agreement, but they are only binding on those member states that have accepted them. They "do not create either obligations or rights for members that have not accepted them."[17]

The third and final part comprises the ministerial declarations, decisions, and understandings just mentioned.[18] See Figure 7.5.

B. The World Trade Organization

The **World Trade Organization (WTO)** is best described as an umbrella organization under which the agreements that came out of the Uruguay Round of MTNs are gathered.[19] As the WTO Agreement states, the WTO is meant to provide the "common institutional

World Trade Organization (WTO) Intergovernmental organization responsible for (1) implementing, administering, and carrying out the WTO Agreement and its annexes; (2) acting as a forum for ongoing MTNs; (3) serving as a tribunal for resolving disputes; and (4) reviewing the trade policies and practices of WTO member states.

---

[13]Its full title is the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations.

[14]The European Community (now the European Union) and 108 states signed the Final Act at Marrakesh. Bureau of National Affairs, *International Trade Reporter*, vol. 11, p. 610 (April 20, 1994). At the conclusion of the Uruguay Round, 125 states were participating in the negotiations. John Kraus, *The GATT Negotiations: A Business Guide to the Results of the Uruguay Round*, p. 6 (1994).

[15]GATT 1947 was itself to continue to function "in tandem" with the WTO until the end of 1995 so that the business then being carried on by GATT could gradually be turned over to the WTO. GATT state parties became free to withdraw from GATT 1947 at the end of 1995. Bureau of National Affairs, *International Trade Reporter*, vol. 11, p. 1925 (December 14, 1994).

[16]Agreement Establishing the World Trade Organization, Article II, para. 2 (1994).

The requirement that the member states of the WTO have to participate in the Multilateral Trade Agreements (which include updated versions of many of the Tokyo Round codes) "ends the free ride of many GATT members that benefited from, but refused to join, new agreements negotiated in the GATT since the 1970s." Many states, especially developing states, must now adopt trade rules to bring themselves into compliance. In this respect, the WTO Agreement requires a higher degree of commitment from its members than the old GATT, which had allowed its contracting states to decline participation in its ancillary agreements. Jeffrey J. Schott and Johanna W. Buurman, *The Uruguay Round: An Assessment*, p. 133 (1994), quoting Professor John H. Jackson.

[17]Agreement Establishing the World Trade Organization, Article II, para. 3 (1994).

[18]The Final Act, the WTO Agreement, and a selection of the annexes and ministerial decisions and declarations are reproduced in *International Legal Materials*, vol. 33, pp. 1–152 (1994). They are also available at www.wto.org/english/docs_e/legal_e/legal_e.htm#wtoagreement.

[19]The WTO home page is www.wto.org. For the WTO's own description of what it does, see "What Is the World Trade Organization?" at www.wto.org/english/thewto_e/whatis_e/whatis_e.htm#intro.

FIGURE 7.5

Outline of the Final Act Embodying the Results of the Uruguay Round of MTNs

I. FINAL ACT
II. AGREEMENT ESTABLISHING THE WORLD TRADE ORGANIZATION (WTO AGREEMENT)

Annex 1A: Agreements on Trade in Goods

1. General Agreement on Tariffs and Trade 1994
2. Uruguay Round Protocol to the General Agreement on Tariffs and Trade 1994
3. Agreement on Agriculture
4. Agreement on Sanitary and Phytosanitary Measures
5. Agreement on Textiles and Clothing
6. Agreement on Technical Barriers to Trade
7. Agreement on Trade-Related Investment Measures
8. Agreement on Implementation of Article VI [concerning anti-dumping]
9. Agreement on Implementation of Article VII [concerning customs valuation]
10. Agreement on Preshipment Inspection
11. Agreement on Rules of Origin
12. Agreement on Import Licensing Procedures
13. Agreement on Subsidies and Countervailing Measures
14. Agreement on Safeguards

Annex 1B: General Agreement on Trade in Services
Annex 1C: Agreement on Trade-Related Aspects of Intellectual Property Rights
Annex 2: Understanding on Rules and Procedures Governing the Settlement of Disputes
Annex 3: Trade Policy Review Mechanism
Annex 4: Plurilateral Trade Agreements

Annex 4(a): Agreement on Trade in Civil Aviation
Annex 4(b): Agreement on Government Procurement
Annex 4(c): International Dairy Agreement a
Annex 4(d): International Bovine Meat Agreement b

III. MINISTERIAL DECISIONS AND DECLARATIONS

framework" for the implementation of those agreements.[20] The WTO thus serves four basic functions:

1. To implement, administer, and carry out the WTO Agreement and its annexes,[21]
2. To act as a forum for ongoing multilateral trade negotiations,[22]
3. To serve as a tribunal for resolving disputes,[23] and
4. To review the trade policies and practices of member states.[24]

Additionally, the WTO is to cooperate with the IMF and the World Bank in order to achieve greater coherence in global economic policymaking.[25]

[20]Agreement Establishing the World Trade Organization, Article II, para. 1 (1994).
[21]*Id.*, Article III, para. 1.
[22]*Id.*, para. 2.
[23]*Id.*, para. 3.
[24]*Id.*, para. 4.
[25]*Id.*, para. 5.

The WTO's Web site is at
www.wto.org.

The WTO Agreement

The Agreement Establishing the World Trade Organization (WTO Agreement) has been described as a "mini-charter"[26] because it is much less complex than the ITO's Havana Charter. The Havana Charter, of course, was never ratified—GATT 1947 was adopted instead. What the WTO Agreement does is to transform GATT 1947, which was a trade accord serviced by a professional secretariat, into a membership organization.[27]

The WTO Agreement, to reiterate, is not a reenactment of the stillborn Havana Charter. Its provisions are exclusively institutional and procedural, unlike those of the Havana Charter, which contained substantive provisions of its own.[28] The WTO Agreement in essence establishes a legal framework to bring together the various trade pacts that were negotiated under GATT 1947. Thus, the WTO was created as a unified administrative organ to oversee all of the Uruguay Round Agreements. This unification solves two problems that hampered the old GATT. First, because GATT 1947 dealt with trade in goods, there was no obvious mechanism for handling agreements relating to trade in services and the protection of intellectual property rights. The WTO Agreement, which "separates the institutional concepts from the substantive rules,"[29] eliminates this difficulty. Second, because the ITO never came into existence, the old GATT had no formal institutional structure. The establishment of the WTO rectifies this.

The WTO Agreement, however, is not substantially different either in scope or function from the old GATT. It does not create a new supranational organization with the power to usurp the sovereignty of its members.[30] In fact, the WTO is to be guided by the procedures, customary practices, and decisions of the old GATT.[31] As Professor John Jackson, the author of an early draft of what was to become the WTO Agreement, told the U.S. Senate Finance Committee about the WTO, it "has no more real power than that which existed for the GATT under the previous agreements."[32]

Later in this chapter, GATT 1994 and the other multilateral agreements relating to trade in goods are examined in some detail. The General Agreement on Trade in Services (GATS) is discussed in Chapter 8 and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) is explored in Chapter 9.

Membership of the WTO

Cape Verde and the Ukraine joined the WTO in 2010, bringing its total membership to 153. During 2011, the WTO approved the membership of Montenegro, Russia, Samoa, and Vanuatu. Before they become members of the WTO, the deals have to be ratified by their respective parliaments—which is expected to happen during 2012. In addition, a further 26 countries are seeking to join the WTO. In order to join the WTO, a nation must complete an "accession agreement" which must be approved by all WTO members.[33] The negotiations with the many nations and various groupings within the WTO are lengthy and complex. Russia's accession to the WTO is discussed in more detail below.

[26]Jeffrey J. Schott and Johanna W. Buurman, *The Uruguay Round: An Assessment*, p. 133 (1994), quoting John H. Jackson.

[27]*Id*.

[28]Thomas J. Dillon, Jr., "The World Trade Organization: A New Legal Order for World Trade," *Michigan Journal of International Law*, vol. 16, p. 349 at p. 355 (1995).

[29]Uruguay Round Legislation, March 23, 1994, Hearings before the Senate Finance Committee, 103rd Congress, Second Session, p. 195 at p. 197 (testimony of John H. Jackson).

[30]Thomas J. Dillon, Jr., "The World Trade Organization: A New Legal Order for World Trade," *Michigan Journal of International Law*, vol. 16, p. 349 at pp. 355–356 (1995).

[31]Agreement Establishing the World Trade Organization, Article XVI, para. 1 (1994).

[32]Uruguay Round Legislation, March 23, 1994, Hearings Before the Senate Finance Committee, 103rd Congress, Second Session, p. 195 at p. 197 (testimony of John H. Jackson).

[33]See the WTO Web site for accession information at: http://www.wto.org/english/thewto_e/acc_e/cbt_course_e/signin_e.htm

The members of the WTO[34] comprise both states and customs territories that conduct their own trade policies.[35] States that were members of GATT 1947 on January 1, 1995,[36] along with the EU, were eligible to become "original members" of the WTO.[37] These members agreed to adhere to all of the Uruguay Round multilateral agreements and to submit their Schedules of Concessions and Commitments concerning industrial and agricultural goods and their Schedules of Specific Commitments concerning services within a year after joining.[38] Original members, however, that are recognized by the United Nations as being among the least developed states were required to undertake only commitments and concessions consistent with their individual development, financial, and trade needs and within their administrative and institutional capabilities.[39] They also were given an additional year in which to submit their schedules.[40]

A state that did not qualify for admission as an original member must negotiate entry into the WTO on terms to be agreed on between it and the WTO and approved by the WTO Ministerial Conference by a two-thirds majority of the member states of the WTO.[41] Negotiations for entry into the WTO are complicated, with each new entrant needing to make a lengthy series of commitments regarding its trade policies and practices. For example Ukraine applied for WTO membership in 1993 and negotiations have been conducted since then, finally leading to membership in 2010. Some of the "accession documents" signed by Ukraine as part of joining the WTO include the following:

- Ukraine's commitments on goods—a 890-page list (or "schedule") of tariffs, quotas, and ceilings on agricultural subsidies, and in some cases the timetable for phasing in the tariff cuts.
- Ukraine's commitments on services—a 40-page document (also a "schedule") outlining the services in which Ukraine is giving access to foreign service providers on a nondiscriminatory basis and any additional conditions, including limits on foreign ownership.
- The Working Party report—a 240-page document describing Ukraine's legal and institutional setup for trade, along with commitments it has made in many of the areas covered by the report.[42]

[34]For a current list of WTO members, see www.wto.org. As of December 1, 2011, there were 153 members, plus 30 countries or territories that had applied for admission and that had observer status, and one other country (the Vatican) with observer status. As is discussed in the text, the WTO offered membership in late 2011 to Russia, Vanuatu, Samoa, and Montenegro. Several formalities remained before admission was final, but by the time you read this page, the membership of these nations may have been completed and the WTO will have 157 members. The members at the end of 2011 were Albania, Angola, Antigua and Barbuda, Argentina, Armenia, Australia, Austria, Bahrain, Bangladesh, Barbados, Belgium, Belize, Benin, Bolivia, Botswana, Brazil, Brunei Darussalam, Bulgaria, Burkina Faso, Burundi, Cambodia, Cameroon, Canada, Cape Verde, the Central African Republic, Chad, Chile, China, Colombia, Congo, Costa Rica, Côte d'Ivoire, Croatia, Cuba, Cyprus, the Czech Republic, the Democratic Republic of the Congo, Denmark, Djibouti, Dominica, the Dominican Republic, Ecuador, Egypt, El Salvador, Estonia, the European Community, Fiji, Finland, the Former Yugoslav Republic of Macedonia, France, Gabon, Gambia, Georgia, Germany, Ghana, Greece, Grenada, Guatemala, Guinea, Guinea Bissau, Guyana, Haiti, Honduras, Hong Kong, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, Jamaica, Japan, Jordan, Kenya, Korea (Republic of), Kuwait, the Kyrgyz Republic, Latvia, Lesotho, Liechtenstein, Lithuania, Luxembourg, Macao, Madagascar, Malawi, Malaysia, the Maldives, Mali, Malta, Mauritania, Mauritius, Mexico, Moldova, Mongolia, Morocco, Mozambique, Myanmar, Namibia, Nepal, the Netherlands, New Zealand, Nicaragua, Niger, Nigeria, Norway, Oman, Pakistan, Panama, Papua New Guinea, Paraguay, Peru, the Philippines, Poland, Portugal, Qatar, Romania, Rwanda, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Saudi Arabia, Senegal, Sierra Leone, Singapore, Slovak Republic, Slovenia, the Solomon Islands, South Africa, Spain, Sri Lanka, Suriname, Swaziland, Sweden, Switzerland, Chinese Taipei, Tanzania, Thailand, Togo, Tonga, Trinidad and Tobago, Tunisia, Turkey, Uganda, Ukraine, the United Arab Emirates, the United Kingdom, the United States, Uruguay, Venezuela, Vietnam, Zambia, and Zimbabwe.

[35]Agreement Establishing the World Trade Organization, Article XII, para. 1 (1994).

[36]On December 8, 1994, Guinea became the 125th member of GATT 1947 and the last state to qualify for becoming an original member of the WTO. Bureau of National Affairs, *International Trade Reporter*, vol. 12, p. 36 (January 4, 1995).

[37]Agreement Establishing the World Trade Organization, Article XI, para. 1 (1994).

[38]*Id*., Article XIV, para. 1.

A state eligible for original membership that became or becomes a member after January 1, 1995 (when the WTO Agreement came into force), must "implement those concessions and obligations in the Multilateral Trade Agreements that are to be implemented over a period of time starting with the entry into force of this Agreement as if it had accepted this Agreement on the date of its entry into force." *Id*., Article XIV, para. 2.

[39]*Id*., Article XI, para. 2.

[40]Ministerial Decision on Measures in Favor of Least-Developed Countries, para. 1 (1994).

[41]Agreement Establishing the World Trade Organization, Article XII, paras. 1–2 (1994).

[42]www.wto.org/english/news_e/pres08_e/pr511_e.htm (accessed July 10, 2011).

At the time a state becomes a member of the WTO, but only then, it may take advantage of Article XIII of the WTO Agreement, entitled "Nonapplication of Multilateral Trade Agreements between Particular Members." This provision (which is analogous to GATT Article XXXV) allows one member state to ignore another member state's participation in the WTO Agreement or in the Multilateral Trade Agreements.

Finally, a member may withdraw from the WTO six months after notifying the director-general of its intention to do so.[43]

Eighth Ministerial Conference Approves Russia's WTO Membership (and Samoa and Montenegro) in December 2011

The WTO's eighth ministerial conference in Geneva came to a close on December 17, 2011, after three days of high-level meetings that saw the accession of Russia, Samoa, and Montenegro, along with the clinching of a 42-country deal that would liberalize billions of dollars in public contracts. Russia cleared the final hurdle to become a World Trade Organization member when WTO Ministers adopted Russia's WTO terms of entry. Russia must ratify the deal within 220 days and then will become a fully fledged WTO member 30 days after it notifies the ratification to the WTO, which is expected. The admission of Samoa and Montenegro (and Vanuatu earlier in 2011) was less controversial but must follow the same formalities before becoming official WTO members.

Russia was formally offered admission into the WTO 18 years after negotiations began. Russia was the world's last major economy, and the only BRIC nation (the rapidly developing powers Brazil, Russia, India, and China) remaining outside of the organization. It began negotiations to join the WTO in 1993 when Boris Yeltsin was in the Kremlin and, even by the WTO's normally slow standards, its progression has been painfully drawn out. Russia had cleared the last hurdle to membership in early November 2011 when it finally agreed to the terms of a compromise agreement with Georgia, the former Soviet republic that it went to war with in 2008. It had been the only remaining member of the 153-nation trade organization blocking Russia's accession.

The benefits of membership could be huge, with some analysts estimating it could bring the Russian economy a bounce of nearly 3 percent annually. Of course, membership works both ways and, just as Russia will gain greater access to overseas markets, Russia will have to grant other WTO members greatly improved access to the Russian market via binding cuts in tariffs and nontariff barriers; stronger intellectual property protection; rule of law; transparency; and accountability. With the admission of Russia, it is estimated that more than 97 percent of world trade will be between WTO members.

WTO Director-General Pascal Lamy said, "This is a historic moment for the Russian Federation and the rules-based multilateral trading system. After an 18-year marathon, the finish line has been crossed. This is a double win for Russia and the WTO. The package we have just adopted is the result of hard technical work, led by modernizing political leadership."

When the accession process is complete sometime in 2012, the three new members, along with Vanuatu, which was offered admission earlier in 2011, will bring the WTO membership to 158 nations.

Structure of the WTO

The WTO has five main organs: (1) a Ministerial Conference, (2) a General Council that also functions as the WTO's Dispute Settlement Body and Trade Policy Review Body, (3) a Council for Trade in Goods, (4) a Council for Trade in Services, and (5) a Council for Trade-Related Aspects of Intellectual Property Rights. In the tradition of GATT, the Ministerial Conference and the General Council are made up of representatives from all the member states.[44] In essence, they are each "committees of the whole." The General Council names the members of the other main organs.[45] See Figure 7.6.

The composition of the Ministerial Conference and especially the General Council has been criticized on the grounds that "[m]ass management does not lend itself to operational efficiency or serious policy discussion."[46] However, attempts at the Uruguay Round to establish a small executive body, similar to the executive boards of the IMF and the World Bank, were not successful. The smaller states opposed this type of structure, as it would undoubtedly be dominated by the larger trading states, as is the case for the IMF and the World Bank. In the absence of some such arrangement, however, it is likely that the major trading states will continue to resort, as they did under GATT

[43]*Id*., Article XV, para. 1.

[44]*Id*., Article IV, paras. 1–4.

[45]*Id*., Article IV, para. 5.

[46]Jeffrey J. Schott and Johanna W. Buurman, *The Uruguay Round: An Assessment*, p. 139 (1994).

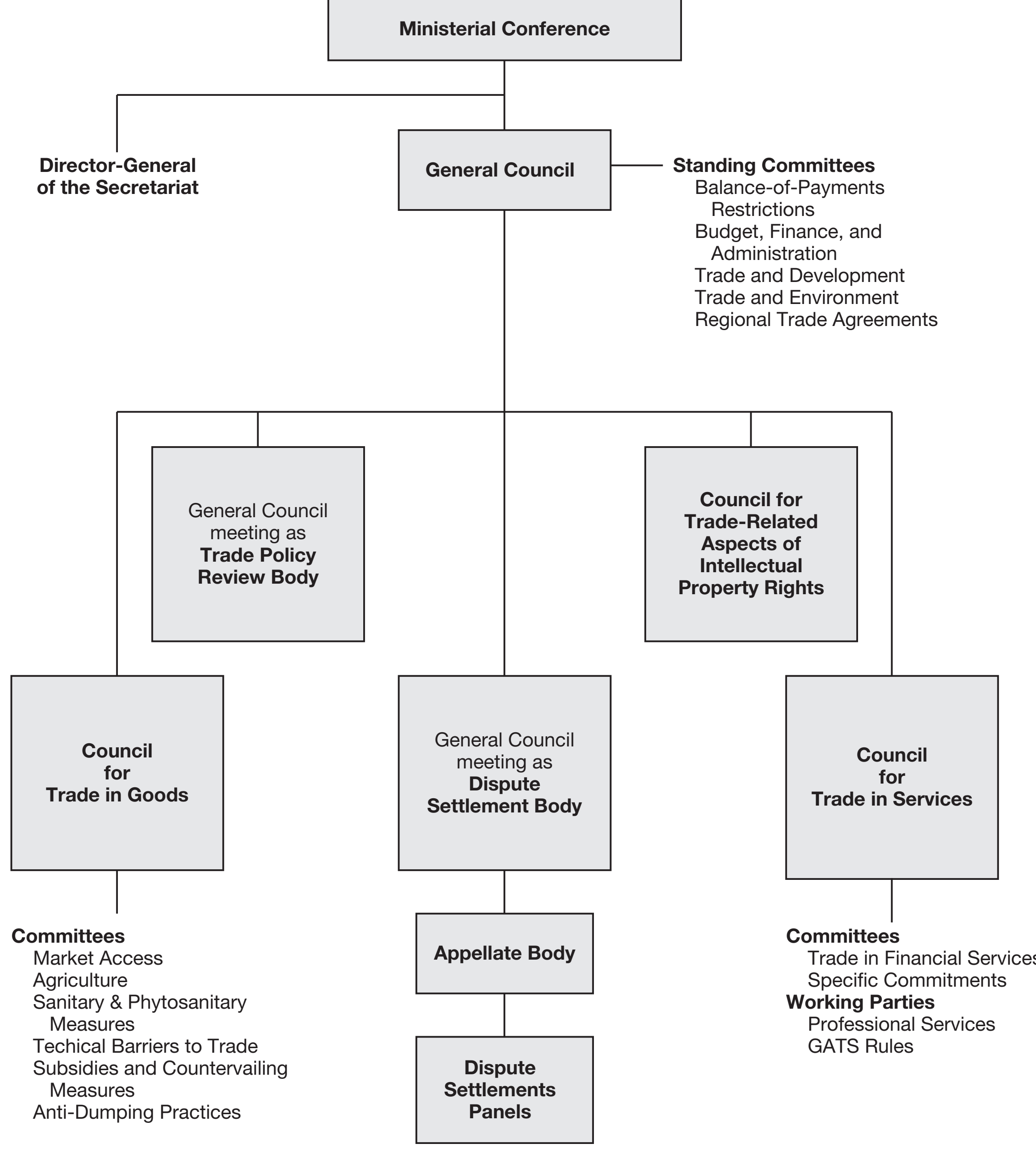


FIGURE 7.6

The WTO Structure

1947, to extralegal mechanisms like the Quad (an informal group made up of the United States, the EU, Canada, and Japan). Or, as was the case for the Uruguay Round negotiations on agriculture, the United States and the EU may simply "cut their own deal" and then insist that the other states accept it.[47] However, since the Doha Ministerial Conference in 2001, the developing and less-developed countries have formed their own subgroups and have tried to assert themselves.

In addition to the main organs of the WTO, there is also a secretariat headed by a director-general,[48] who is appointed by the Ministerial Conference.[49] The staff of the GATT 1947 secretariat

[47] *Id.*

[48] Renato Ruggiero of Italy became the first WTO director-general on May 1, 1995, succeeding Peter Sutherland, the GATT 1947 director-general, who had served as acting director-general since the WTO's inauguration on January 1, 1995. "WTO Formally Accepts Ruggiero as Its First Director-General," Bureau of National Affairs, *International Trade Reporter*, vol. 12, p. 567 (March 29, 1995).

[49] Agreement Establishing the World Trade Organization, Article VI, para 2 (1994).

became the staff of the WTO secretariat on the latter's inauguration. Traditionally, the role of the GATT secretariat was limited, and its small budget put tight restraints on its staff's ability to initiate studies or carry on programs on its own. The responsibility of the secretariat has grown because of its new role in assessing member state trade policies in support of the Trade Policy Review Body; nevertheless, it is likely that the staff will remain relatively small.

The director-general of the WTO is responsible for supervising the administrative functions of the WTO. Because WTO decisions are made by member states (through either a Ministerial Conference or the General Council), the director-general has little power over matters of policy, other than his or her ability to negotiate, mediate, and persuade. The role is largely managerial. The director-general is appointed by WTO members for a term of four years and supervises the WTO secretariat of about 700 staff.

The current director-general (since September 2005) is Pascal Lamy of France. Mr. Lamy has had a long career in international trade and political affairs, and served as trade commissioner for the EU prior to his appointment as director-general of the WTO.

Directors-General of the WTO

Director-General	Start of Term	End of Term	Country of Residence
1. Renato Ruggiero	May 1, 1995	September 1, 1999	Italy
2. Mike Moore	September 1, 1999	September 1, 2002	New Zealand
3. Supachai Panitchpakdi	September 1, 1999	September 1, 2002	Thailand
4. Pascal Lamy	September 1, 2005	—	France

Ministerial Conference The Ministerial Conference generally meets at least every other year to oversee the operation of the WTO. Five standing committees deal with (1) trade and development; (2) balance-of-payments restrictions; (3) budget, finance, and administration; (4) trade and the environment; and (5) regional agreements.[50] As is further explored in Reading 7-1, the Ministerial Conferences have become major events, with thousands of representatives of all member nations (now 153), activists from many nongovernmental organizations (NGOs) around the world, antiglobalization protesters, a significant security and police presence, press from around the globe, and many more attendees of various interests. Since the tumultuous Ministerial Conference in Seattle in 1999, Ministerials have been held in Doha, Qatar, in 2001; in Cancun, Mexico, in 2003; in Hong Kong in 2005; in Geneva in 2009; and another in Geneva in 2011.

General Council The General Council carries on the functions of the Ministerial Conference in the intervals between the meetings of the Conference. It also "convene[s] as appropriate" to function as the WTO Dispute Settlement Body and the WTO Trade Policy Review Body. Each of these bodies has its own chairman. In addition, the three subordinate councils—the Council for Trade in Goods, the Council for Trade in Services, and the Council for Trade-Related Aspects of Intellectual Property Rights—function under the guidance of the General Council to oversee the implementation and administration of the three main WTO agreements (GATT 94, GATS, and TRIPS).[51]

The General Council is also responsible for making arrangements for "effective cooperation" with other intergovernmental organizations (IGOs) whose responsibilities are related to the WTO and for "consultation and cooperation" with NGOs involved in matters of interest to the WTO.[52]

[50]The first three committees are specified in *id.*, Article IV, para. 7. The committee on trade and environment was added by the Ministerial Conference meeting at Marrakesh in April 1994—see www.wto.org/english/tratop_e/envir_e/envir_e.htm—and the committee on regional agreements by the Ministerial Conference meeting at Singapore in December 1996: see www.wto.org/english/tratop_e/region_e/region_e.htm. See also Jeffrey J. Schott and Johanna W. Buurman, *The Uruguay Round: An Assessment*, p. 137 (1994).

[51]Agreement Establishing the World Trade Organization, Article IV, paras. 2–5 (1994).

[52]*Id.*, Article V.

Decision Making within the WTO

consensus
The making of a decision by general agreement and in the absence of any voiced objection.

The WTO Agreement says that the WTO will "continue the practice of decision making by consensus followed under the GATT 1947."[53] **Consensus** is the making of a decision by general agreement and in the absence of any voiced objection.[54] The WTO, however, can make a decision by a vote if a consensus cannot be reached. At meetings of the Ministerial Conference and the General Council, each WTO member state has one vote, with the EU having a number of votes equal to (but not more than) the number of its member states that are members of the WTO. Should a vote be required, the decision will be made by a simple majority in most cases.[55]

The role of the WTO and the controversies surrounding it are analyzed from differing perspectives in Reading 7-1.

Reading 7-1 The WTO from Seattle to Doha to Hong Kong to Geneva (and beyond)

"The WTO is Not a World Government and No One Has Any Intention of Making it One, Moore Tells NGOs," Press Release 155 from The World Trade Organization, 29 November, 1999. Copyright © 1999 by the World Trade Organization. Reprinted with permission. And "Lamy urges members to start negotiating to put together a December package," from WTO News, 22 June, 2011. Copyright © 2011 by the World Trade Organization. Reprinted with permission.

When the WTO was established, the powers and duties of this new international organization based in Geneva, Switzerland, were known mainly to politicians and individuals and businesses involved with international trade. The general public knew little about the WTO. How things have changed in a few years! Today the WTO and the issues surrounding "globalization" are controversial topics, sparking heated discussions on the street, in national legislatures, and in all types of media. The WTO really became a major topic of public interest during the Ministerial Conference held in Seattle in December 1999.

The Ministerial Conference, the WTO's main decision making body, meets at least every two years. All the members of the world-wide organization, more than 140 nations at that time, send officials to the meeting. In addition, thousands of other members of non-governmental organizations (NGOs) and environmental and labor groups attend some WTO meetings and/or organize demonstrations outside the meetings. At the Seattle Conference, protesters campaigning for causes ranging from the environment to animal rights to various labor and employment issues took to the streets and, despite the tear gas and rubber bullets of the police, eventually brought the Conference to a standstill.

The Protestors' Arguments

Over 70,000 people and 500 global civil society organizations brought the attention of the world to the streets of Seattle where people of all ages, from many countries and all walks of life, demonstrated their concerns about the World Trade Organization. The demonstrators claimed that the WTO would lead to the "corporatization" of all areas of the global commons including food security, health care, public education, cultural integrity, water, air, forest conservation, labor standards, human rights, local development, intellectual property rights, and patents on plant, animal, and even human genetic material. The protestors claimed the Seattle events showed that the world was awakening to the realization that the scope of the WTO reached far beyond the closeted world of Geneva (WTO headquarters) and into the very roots of democratic values and the lives of individuals

The voices of 35,000 trade union representatives and the emerging international global citizens movement challenged the WTO's credo that globalization was natural and irreversible, that it benefited the developing countries, and that free trade is really free, despite the volumes of rules governing its form of highly regulated, corporate-managed trade.

At the same time as serious activists were trying to achieve mass education about the WTO and its agenda to the global media, unknown provocateurs began smashing windows downtown. Word was passed that a group of extremely violent individuals was roaming the streets. As the marchers—including those dressed as sea turtles—and other environmental representatives neared downtown, they were split and diverted away from the main demonstration already jamming the streets and were sidelined to a sit-down protest some blocks away.

By nightfall the curfew had been announced and the first scenes of excessive and indiscriminate use of force were starting to be reported and broadcast on television. Viewers saw protestors, largely engaged in peaceful acts of civil disobedience, being met by forces in fully equipped riot gear—true-life violence, capturing the attention of the world. While media coverage riveted viewers on the street action, the "Battle of Seattle" was also taking place within the Trade and Convention Center itself, and in a myriad of venues throughout the downtown core where discussions and debates flourished.

[53] *Id.*, Article IX, para. 1.

[54] See Understanding on Rules and Procedures Governing the Settlement of Disputes, para. 2.4, n. 1 (1994).

[55] Agreement Establishing the World Trade Organization, Article IX, para. 1 (1994).

Decisions that require a larger than simple majority vote include decisions to adopt interpretations of the WTO Agreement and the Multilateral Trade Agreements (*id.*, Article IX, para. 2); waivers of obligations imposed on members by the WTO Agreement and the Multilateral Trade Agreements (*id.*, Article IX, para. 3); amendments to the WTO Agreement or the Multilateral Trade Agreements (*Id.*, Article X); and decisions of the General Council when convened as the Dispute Settlement Body (Understanding on Rules and Procedures Governing the Settlement of Disputes, para. 2.4 [1994]).

Rumors were rife, action lines and curfew boundaries kept moving, buses to events were cancelled in largely unsuccessful attempts to thwart public mobility and access; ministers and delegates from developing nations within the WTO scrambled to find meetings scheduled in unknown locations (infamous "green rooms" only announced to select participants) and called the WTO's own internal process "the ultimate in nontransparency."

Many activists claimed that the chaos being reported from the streets was mirrored in much more subtle forms within the Convention Center itself. The much-touted NGO Symposium (a WTO first) was postponed by three hours to become an hour and a half lecture to the NGOs by the presiding table chaired by Charlene Barshevsky (U.S. Trade Representative) and Michael Moore (WTO Director General) on the benefits of trade. Finally, only a small number of NGO representatives were allowed to address the table and "in the interest of time for all," not permitted to ask questions.

The WTO Response

Mike Moore, then the Director General of the WTO argued that the WTO was getting a bad rap. "First let's be clear about what the WTO does not do," he said. "The WTO is not a world government, a global policeman, or an agent for corporate interests. It has no authority to tell countries what trade policies—or any other policies—they should adopt. It does not overrule national laws. It does not force countries to kill turtles or lower wages or employ children in factories. The WTO is not a supranational government, and no one has any intention of making it one."

Mr. Moore pointed out that WTO decisions must be made by the Member States, agreements ratified by Parliaments and every two years Ministers meet to supervise their work. "There's a bit of a contradiction with people outside saying we are not democratic, when inside over 120 Ministers all elected by the people or appointed by elected presidents, decide what we will do."

"The WTO is an international organization that mediates trade disputes, seeks to reduce barriers between countries, and embodies the agreements. Globalization is a fact today and is being driven above all by the power of technology—by faster and cheaper transportation, by new communications, by the increasing weightlessness of our economies—the financial services, telecommunications, entertainment, and e-commerce that make up a growing share of global trade. It's also driven by common values of freedom, democracy, and the desire to share what the world has to offer."

Mr. Moore stated, "The real question we should ask ourselves is whether globalization is best left unfettered—dominated by the strongest and most powerful, the rule of the jungle—or managed by an agreed system of international rules, ratified by sovereign governments. How will the global economy be made more stable by undermining its foundation of rules and cooperation? By returning to the same system of regional blocs and trade anarchy that helped plunge us into world war in the 1930s?"

Mr. Moore posed several questions regarding the role of the WTO. "How are developing countries helped by shutting our markets, restricting their exports, and worsening their marginalization? How is the global environment improved by retarding growth, distorting prices, or subsidizing the consumption of scarce resources? How will we find jobs for the unemployed—or homes for the dispossessed—by making our economies and societies poorer? Consider this: exports have accounted for more than a quarter of U.S. economic growth in the United States in the past six years. And almost 20 million new jobs. . . ."

"What are we fighting for in Seattle? We are fighting for a multilateral trading system that is an essential component of the architecture for international cooperation—a firm foothold in an uncertain world. The world would not be a safer place without the UN, IMF, World Bank, or WTO despite their imperfections. The GATT/WTO system is a force for international peace and order. A fortification against disorder. This is reason enough to insist on the rightness of what we are doing."

"We are also fighting to reduce poverty and to create a more inclusive world. We all want a fairer world, a world of opportunity accessible to all. Just ask the mother with a sick child who wants the best medical advice the world has to offer—whether it's from Boston or Oxford or Johannesburg. There is a strong argument that economic, social, and political freedom is a basic prerequisite for development."

"I began by asking what the world would be like without the multilateral trading system? Let me answer my own question. It would be a poorer world of competing blocs and power politics—a world of more conflict, uncertainty, and marginalization. Too much of this century was marked by force and coercion. Our dream must be a world managed by persuasion, the rule of law, the settlement of differences peacefully by the law and in cooperation. Seattle ought to be remembered then with confidence, in our case that economic and political freedom means higher living standards and a better lifestyle. Let's hope our vision of the new century matches that of our parents who lived through depression and war, then created us and our institutions. Let's honor them."

What Has Happened Since the Seattle Ministerial?

In the years since the Seattle conference, there have been WTO Ministerial Conferences in Doha, Qatar, in 2001, in Cancun, Mexico, in 2003, in Hong Kong in 2005, and Geneva in 2009 and 2011. At each conference (and at many other international economic and financial meetings) there have been protests against "globalization." More than 1,000 activists and protesters were arrested at the Hong Kong Conference. At the Doha conference, the members signed an agreement called the "Doha Development Agenda" by which they promised to negotiate over the next several years to improve conditions for developing countries, to reduce government subsidies for agriculture, to reduce barriers to trade on agricultural products, reduce tariffs on many other manufactured goods, to reconsider some anti-dumping provisions, and much more. The initial agenda comprised both further trade liberalization and new rule-making, underpinned by commitments to strengthen substantial assistance to developing countries. The negotiations since 2001 have been highly contentious and agreement has not yet been reached—as of summer 2012—despite the intense negotiations at several Ministerial Conferences and at other sessions.

The original agreement reached at Doha contemplated that negotiations on these matters would be completed in a few years, but as reaching any agreement on these complex issues has been elusive, the deadlines established at Doha have been extended several times, and talks are still going on in summer 2012. In July 2006, frustrated by the lack of progress toward agreement, Director General Pascal Lamy suspended negotiations on the Doha Agenda. Mr. Lamy reached his conclusion after talks among six major members—Australia, Brazil, the European Union, India, Japan, and the United States—broke down. The main blockage was in the two key agriculture legs of the triangle of issues, market access, and domestic support, Mr. Lamy said. The six did not even move on to the third leg, nonagricultural market access, he observed.

In 2007, citing an "increasing level of political engagement and clear signals of renewed commitment" by leaders of several nations to a successful conclusion of the Round, Mr. Lamy announced the resumption of full negotiations on the Doha Agenda. Intense talks began in early 2008 and

representatives from 35 member nations representing about 95 percent of world trade met in Geneva in July 2008, where it was hoped that an agreement could be reached. The U.S. and the EU had agreed to reduce food tariffs and agricultural subsidies (although not as much as developing nations wanted). However, negotiations broke down in July 2008 over a failure to reach an agreement on agricultural import rules between the United States, the European Union, India, Brazil, and China.[56] Chief among these differences was the disagreement regarding the special safeguard mechanism for developing countries, designed to allow countries to protect their farmers through the imposition of special tariffs during periods of falling prices or increasing imports, with the United States arguing that the threshold for allowing the use of this mechanism had previously been set too low. In addition, Brazil and India were unwilling to dismantle trade barriers that protected their industries from Western and Chinese competition. Brazil, for example, has a 35 percent tariff on imported cars, and offered to reduce it to 22 percent but not lower. Then in 2009, at the Geneva Ministerial, Director-General Lamy again urged the members to work toward completing the Doha round during 2010, noting that "impressive progress" had been made since the Hong Kong Ministerial conference. "But how" he asked, "do we translate this political will into concrete action? Isn't it time to take a deep breath and push for this last stretch?" But the Doha issues discussed at the Ministerial remained unresolved.

Then in 2011 another push toward the completion of the Doha Round began. Director-General Lamy asked the chairs of the various negotiating groups to provide "documents" that indicate what has been agreed on and what issues remain to be resolved. In June 2011, Mr. Lamy and various trade ministers proposed a "three-lane" approach to Doha negotiations, which some called "Doha Light."[57] The hope was that there could be agreement (an "early harvest") regarding certain issues of key importance to the least-developed countries (LDCs) by the end of 2011, while there would be a "middle lane" of additional issues that were near maturity. Difficult outstanding issues such as agriculture, services, and nonagricultural market access (NAMA) would be left on a "slow lane" for discussion after the December 2011 Ministerial Conference in Geneva.

However, despite the efforts, no significant new agreements were reached at the Geneva conference in December 2011. The concluding memorandum from the Geneva Ministerial made these remarks regarding the Doha Development Agenda:

1. Ministers deeply regret that, despite full engagement and intensified efforts to conclude the Doha Development Agenda single undertaking since the last Ministerial Conference, the negotiations are at an impasse.
2. Ministers acknowledge that there are significantly different perspectives on the possible results that Members can achieve in certain areas of the single undertaking. In this context, it is unlikely that all elements of the Doha Development Round could be concluded simultaneously in the near future.
3. Despite this situation, Ministers remain committed to work actively, in a transparent and inclusive manner, towards a successful multilateral conclusion of the Doha Development Agenda in accordance with its mandate.
4. In order to achieve this end and to facilitate swifter progress, Ministers recognize that Members need to more fully explore different negotiating approaches while respecting the principles of transparency and inclusiveness.
5. In this context, Ministers commit to advance negotiations, where progress can be achieved, including focusing on the elements of the Doha Declaration that allow Members to reach provisional or definitive agreements based on consensus earlier than the full conclusion of the single undertaking.[58]

Some of the more important Doha Development issues that have been troublesome to resolve and are still the subject of intense negotiation are set forth below.

- **Agriculture** Comprehensive negotiations, incorporating special and differential treatment for developing countries aimed at substantial improvements in market access; elimination of all forms of export subsidies, as well as establishing disciplines on all export measures with equivalent effect and substantial reductions in trade-distorting domestic support for farmers.
- **Services** Negotiations aimed at achieving progressively higher levels of liberalization through market-access commitments and rule-making, particularly in areas of export interest to developing countries.
- **Nonagricultural Market Access (NAMA) products** Negotiations aimed at reducing or, as appropriate, eliminating tariffs, including the reduction or elimination of tariff peaks, high tariffs, and tariff escalation, as well as nontariff barriers, in particular on products of export interest to developing countries.
- **Rules** Negotiations aimed at clarifying and improving disciplines dealing with anti-dumping, subsidies, countervailing, regional trade agreements, and fisheries subsidies, taking into account the importance of this sector to developing countries.
- **Trade facilitation** Negotiations aimed at clarifying and improving disciplines for expediting the movement, release, and clearance of goods, and at enhancing technical assistance and support for capacity-building, taking into account special and differential treatment for developing and least-developed countries.
- **Intellectual property** Negotiations aimed at creating a multilateral register for geographical indications for wines and spirits; negotiations aimed at amending the TRIPS Agreement by incorporating the temporary waiver that enables countries to export drugs made under compulsory license to countries that cannot manufacture them; discussions on whether to negotiate extending to other products the higher level of protection currently given to wines and spirits; review of the provisions dealing with patentability or nonpatentability of plant and animal inventions and the protection of plant varieties; examination of the relationship between the TRIPS Agreement and biodiversity, the protection of traditional knowledge, and folklore.
- **Dispute settlement procedures** Negotiations aimed at improving and clarifying the procedures for settling disputes.
- **Trade and environment** Negotiations aimed at clarifying the relationship between WTO rules and trade obligations set out in multilateral environmental agreements and at reducing or, as appropriate, eliminating tariff and nontariff barriers to environmental goods and services.

[56] John W. Miller, "Global Talks Fail as New Giants Flex Muscle," *Wall Street Journal*, July 30, 2008.

[57] "'Doha Light' Takes Shape as WTO Members Lower Ambitions," *Bridges Weekly Trade Digest*, vol. 15, no. 20, June 1, 2011.

[58] WTO Web site: Ministerial Conference: Geneva 2011, December 17, 2011, Day 3: *Samoa and Montenegro join Russia with membership agreed, as ministers wrap up conference:* http://www.wto.org/english/news_e/news11_e/mn11a_17dec11_e.htm#politicalguidance

WTO Web site, see
www.wto.org/english/thewto_e/whatis_e/tif_e/doha1_e.htm (accessed July 10, 2011); "'Doha Light' Takes Shape as WTO Members Lower Ambitions," *Bridges Weekly Trade News Digest*, June 1, 2011; "Pessimism Reigns as WTO Hits Easter Deadline," *Bridges Weekly Trade News Digest*, April 20, 2011; Global Exchange Web site (see information below); "Doha Trade Talks May Hinge on Tariff Cuts, Drug Patents," *Wall Street Journal*, at A5, July 18, 2008; Joseph Kahn and David Sanger, "Trade Obstacles Unmoved, Seattle Talks End in Failure," *New York Times*, Dec. 4, 1999; Keith Bradsher, "Trade Officials Agree to End Subsidies for Agricultural Exports," Dec. 19, 2005.

www.globalexchange.org is the Web site for Global Exchange, an international human rights organization working to promote social, economic, and environmental justice around the world. Global Exchange is quite critical of the WTO, arguing that it represents primarily the interests of powerful nations and corporations. This site also contains much detailed information about the issues presented in this chapter, although from an environmentalist and developing-nation perspective.

Waivers

GATT 1947 was sometimes characterized as a system of loopholes held together by **waivers**.[59] The WTO agreements dramatically changed this. First, with one exception,[60] the waivers of obligations in existence under GATT 1947 terminated no later than two years after the inauguration of the WTO.[61] Second, the procedures for obtaining new or continuing waivers are more rigorous. Thus, an applying member state must (1) describe the measures that it proposes to take, (2) specify the policy objectives it seeks to obtain, and (3) explain why it cannot achieve those objectives without violating its obligations under GATT 1994.[62] Third, waivers must be approved by the Ministerial Conference, which has up to 90 days to do so by consensus. If a consensus cannot be reached in that period, waivers must then be approved by a three-quarters majority of the members.[63] Waivers are reviewed annually thereafter.[64] Fourth, any dispute that arises in connection with a waiver, whether or not the waiver is being carried out in conformity with its terms and conditions, can be referred for settlement under the Dispute Settlement Understanding.[65]

waiver
The relinquishment of an obligation owed by another.

Dispute Settlement

The Understanding on Rules and Procedures Governing the Settlement of Disputes (the *Dispute Settlement Understanding*, or *DSU*) carries forward and improves on the dispute settlement procedures of GATT 1947.[66] Most importantly, the DSU establishes a unified system for settling disputes that arise under the WTO Agreement and its annexes (other than the annex establishing the Trade Policy Review Mechanism).[67] See Chapter 3 for a discussion of the WTO's dispute settlement procedures.

[59]John Kraus, *The GATT Negotiations: A Business Guide to the Results of the Uruguay Round*, p. 78 (1994).

[60]The exception allows the waiver that applies to the U.S. Jones Act (which restricts the use, sale, or lease of non-U.S. ships in the movement of goods between points in national waters or the waters of an exclusive economic zone) to continue in force, subject to a first review after five years, and then subsequent reviews every two years by the WTO Ministerial Conference. General Interpretive Note to Annex IA (GATT 1994), para. 1:e.

[61]Understanding in Respect of Waivers of Obligations under GATT 1994, para. 2.

A list of these waivers can be found in footnote 7 to the General Interpretive Note to Annex 1A (GATT 1994). Among these are waivers relating to German unification, the United Kingdom's dependent overseas territories, the U.S.–Canada Auto Pact, the U.S. Caribbean Basin Economic Recovery Act, and the U.S. Andean Trade Preference Act.

[62]Understanding in Respect of Waivers of Obligations under GATT 1994, para. 1.

[63]Agreement Establishing the World Trade Organization, Article IX, para. 3 (1994).

[64]*Id*., para. 4.

[65]Understanding in Respect of Waivers of Obligations under GATT 1994, para. 3.

[66]At the Uruguay Round, negotiators identified and worked to remedy three basic flaws in the old dispute settlement procedures: (1) the long times taken by panels in concluding their proceedings, (2) the ability of participating states to deny the consensus needed to approve the panel findings and to authorize retaliation, and (3) the difficulty of obtaining compliance with panel decisions.

[67]The Trade Policy Review Mechanism (1994) is meant to be a political rather than a legal process, and its exclusion from the DSU is therefore quite logical.

Trade Policy Review

Annex 3 of the WTO Agreement establishes a Trade Policy Review Mechanism. This mechanism is built around a *Trade Policy Review Board* (*TPRB*) that is meant to be the WTO's auditor or watchdog. It is responsible for promoting "improved adherence" by all WTO member states to the WTO Multilateral Trade Agreements and, for the member states that are signatories, the Plurilateral Trade Agreements. The TPRB, however, is meant neither to enforce the agreements nor to settle disputes between members.[68] To accomplish its goal, the TPRB (1) carries out periodic reviews of the trade policies and practices of all member states and (2) prepares an annual overview of the international trading environment.

C. The 1994 General Agreement on Tariffs and Trade

General Agreement on Tariffs and Trade (GATT 1994)
Annex to the Agreement Establishing the World Trade Organization that sets out the rules under which the member states of that organization are committed to negotiate reductions in customs tariffs and other impediments to international trade in goods.

The current **General Agreement on Tariffs and Trade (GATT 1994**) (see Figure 7.7) is made up essentially of the same set of rules as GATT 1947. The changes in the text of GATT 1994 amount mainly to changes in terminology (e.g., *member* replaces *contracting party* and references to the "contracting parties acting jointly" are taken to mean the WTO or its Ministerial Conference).[69] Even so, despite the similarity between GATT 1994 and GATT 1947, they are described by the WTO Agreement as "legally distinct" instruments.[70]

The significance of the two instruments being legally distinct is that (1) the WTO is not the "legal successor"[71] to the old GATT organization and (2) the member states of GATT 1994 owe no legal obligations to the contracting parties of GATT 1947. Thus, the WTO is not bound to service GATT 1947, nor is it bound by any obligations made by the previous GATT organization except to the extent that it expressly assumes those responsibilities.

In addition, states that become member states of GATT 1994 without withdrawing from GATT 1947 will be bound by two different sets of commitments involving two different lists of states. Similarly, states that withdraw from GATT 1947 after becoming members of GATT 1994 (which they may do any time after December 31, 1995) will only continue to have GATT obligations under GATT 1994.[72]

Although GATT 1994 is not the legal successor of GATT 1947, most of the past decisions of the GATT Council, the GATT contracting parties acting jointly, and the GATT Dispute Settlement Panels relating to the text of the General Agreement continue to have force.[73] Some decisions, however, were modified at the time GATT 1994 came into force by a series of "Understandings" annexed to the new General Agreement.

direct effect
The principle whereby a treaty may be invoked by a private person to challenge the actions of a state that is a party to the treaty.

Direct Effect

Some of the provisions of GATT 1994 are directly effective. That is, they may be relied upon by private persons (including both natural and juridical persons) to challenge the actions of a member state. In particular, those provisions that prohibit a state from taking action contrary to the General Agreement are directly effective. Those that require a contracting state to take some positive action may only be challenged by individuals if the state adopts implementing legislation authorizing such a challenge. This rule is set out in Case 7-1.

---

[68] Trade Policy Review Mechanism, para. A(i) (1994).

[69] See General Interpretive Note to Annex 1A, para. 1(d) (1994).

[70] Agreement Establishing the World Trade Organization, Article II, para. 4 (1994).

[71] Statement of GATT Director-General Peter Sutherland quoted in Amelia Porges, "Introductory Note, General Agreement on Tariffs and Trade—Multilateral Trade Negotiations (the Uruguay Round): Final Act Embodying the Results of the Uruguay Round of Trade Negotiations," *International Legal Materials*, vol. 33, p. 1 at p. 4 (1994).

[72] *Id.*

[73] Agreement Establishing the World Trade Organization, Article XVI, para. 1 (1994), provides: "Except as otherwise provided for under this Agreement or the Multilateral Trade Agreements, the WTO shall be guided by the decisions, procedures, and customary practices followed by the Contracting Parties of the GATT 1947 and the bodies established in the framework of the GATT 1947."

FIGURE 7.7

Selected Descriptive Contents of the General Agreement of Tariffs and Trade 1994

Article I: General Most-Favored-Nation Treatment

- To be applied by each member to the imports and exports of all other members.

Article II: Schedules of Concessions

- Individual country tariff concessions, as annexed to the Agreement, to be applied to all other members.

Article III: National Treatment on Internal Taxation and Regulation

- Products of one member imported into the territory of another must be accorded treatment no less favorable than that given like products of national origin in respect to their internal sale or distribution.

Article VI: Anti-dumping and Countervailing Duties

- Anti-dumping duties to be imposed only if goods are sold for export at a price below that which they are sold for domestic consumption.
- Anti-dumping duties may not be greater than the amount by which the domestic price exceeds the export.
- Countervailing duties may not be greater than the amount of the estimated "bounty" or subsidy.
- Anti-dumping and countervailing duties may be imposed only if there is a threat of material injury to an established industry in the importing country or if it materially retards the establishment of such an industry.

Article XI: General Elimination of Quantitative Restrictions

- Import and export quotas and licenses are prohibited, with certain exceptions for critical shortages, grading or marketing standards, and domestic marketing or production programs.

Article XII: Restrictions to Safeguard the Balance of Payments

- Permits nondiscriminatory quotas as necessary to forestall a serious decline in monetary reserves to increase such reserves from too low a level.
- Requires annual consultation procedures and progressive relaxation of the restrictions.
- Developing countries operate under the separate but similar provisions of Article XVIII, which requires consultations at two year intervals.

Article XIII: Nondiscriminatory Administration of Quantitative Restrictions

- Requires that export and import quotas be administered on a nondiscriminatory basis.
- Requires that import quotas be fairly allocated among suppliers.

Article XVI: Subsidies

- Seeks to avoid use of subsidies generally and prohibits use of export subsidies (other than on primary products).
- Requires reporting of subsidies, consultations with parties affected, and equitable sharing of markets for primary products.

Article XVIII: Government Assistance to Economic Development

- Permits developing countries to modify or withdraw tariff concessions by agreement with parties affected and after efforts to provide compensatory concessions.
- Recognizes persistent balance-of-payment pressures on developing countries and permits quantitative restrictions to deal with them.
- Specifies procedures whereby developing countries may use protective import quotas to promote infant industries.

Article XIX: Emergency Action on Imports of Particular Products

- The "escape clause" of the General Agreement.
- Authorizes importing country to suspend, withdraw, or modify tariff concessions if increased imports threaten serious injury to domestic producers.
- Requires notice and consultation with parties affected and permits exporting country to restore previous balance of concessions.

Article XXII: Consultation

- Provides for bilateral consultation and settlement of disputes.

FIGURE 7.7

(continued)

Article XXIII: Nullification or Impairment

- Establishes procedures for bilateral consultation and for referral of disputes to a plenary session of the members for a recommendation and a ruling, whether or not the issue in dispute constitutes a violation of the Agreement.

Article XXIV Territorial Application; Frontier Traffic; Customs Unions and Free Trade Areas

- Deals with the application of the General Agreement to colonial territories.
- States exceptions to the rule of nondiscrimination for customs unions and free trade areas.

Article XXVIII: Modification of Schedules

- Permits a member, at the beginning of each three-year period, or under "special circumstances," to modify or withdraw a concession after renegotiation with the members affected.

Article XXXV: Nonapplication of the Agreement between Particular Members

- Permits a member to withhold the application of its tariff concessions from another member with which it has not entered into tariff negotiations.

Article XXXVI: Trade and Development: Principles and Objectives

- Expresses the need and desire of the members to give special preferences to developing countries.

In Brief: CASE 7-1 Finance Ministry v. Manifattura Lane Marz Otto, SpA

Italy, Court of Cassation (Joint Session), 1973
Foro Italiano, vol. 1, p. 2443 (1973); *Italian Yearbook of International Law*, vol. 1976, p. 383 (1976); *International Law Reports*, vol. 77, p. 551 (1988).

MAP 7.1

Italy (1973)

Manifattura Lane Marzotto, SpA, an Italian manufacturer of woolen goods, sued the Italian Finance Ministry after being charged an "administrative services duty" (dirrito per servizi amministrativi) on wool it imported from Australia, claiming that this duty violated GATT. GATT 1947, Article III(1)(b), prohibits

member states from charging duties in excess of those set out in the Agreement's annexes and schedules, or from increasing its duties after the time the member state accedes to the General Agreement. Because the law that first imposed the administrative services duty was enacted after Italy acceded to the General Agreement, Marzotto claimed that it was illegal. The Finance Ministry asked the court to dismiss the case, contending that Article III(1)(b) was not directly effective because parliament had not adopted implementing legislation. The trial court in Milan dismissed the suit, but the Court of Appeal reversed, ruling that the duty was illegal. The Finance Ministry appealed to the Court of Cassation.

Judgment of the Court

***

Article III . . . of the General Agreement deals first with ordinary customs duties and provides that they are applicable to the products included in the schedules at a rate not higher than that indicated in those same lists. It then establishes that duties other than ordinary customs duties may not be higher than those in force on the date of the General Agreement. . . .

Law No. 295 of 5 April 1950, which implemented the GATT Agreement, provides in Article 2:

> The aforementioned Agreements, Annexes and Protocols are fully and entirely implemented as from the time limits established by the Protocol of Annecy. . . .

As Italy has fully integrated into its legal system the first part of the General Agreement—including the provision concerning customs duties—it remains to be seen whether this provision is merely a simple declaration of principle, deprived of any direct legal effect within the country. If that is so, the member states would only be obliged to each other to harmonize their laws, and there would be no immediate right for individuals to bring actionable claims. According to the Finance Ministry, parliament is the only entity that can properly determine when and to what extent the existing customs laws should be modified, and no other person or entity should be allowed to do so.

This Court cannot agree. It seems clear to us that the provision of the General Agreement that we are examining is directly effective, giving rights both to the member states of the GATT and to individuals within those states, without any need for additional legislative implementation. The provision—which is essentially a prohibition against increasing duties above those in effect on the date a member state accedes to the General Agreement—is clearly one which imposes on the acceding state an obligation not to act. There is, therefore, no need for the state to act. Accordingly, this prohibition is complete and directly effective not only between the member states but also between the member states and their nationals. . . .

Thus, in compliance with the law implementing the General Agreement, we hold that goods imported from one GATT member state to another are not subject to internal duties and charges of any kind which are higher than those that were in force on the date the General Agreement became effective. . . .

The judgment of the Court of Appeal was affirmed.

Casepoint

The court decided that the GATT provision that prohibits a GATT member from increasing duties on imported products above the level established when the member nation acceded to the agreement was directly effective. Thus, it was part of Italian law and an individual citizen or company could bring a lawsuit to enforce this provision.

Nondiscrimination

The most fundamental principle of GATT is that international trade should be conducted without discrimination. This principle is given concrete form in the *most-favored-nation* (MFN) and *national treatment* rules.

The MFN Rule Article I of GATT requires each member to apply its tariff rules equally to all other members. Paragraph 1 of that article provides:

> . . . [A]ny advantage, favor, privilege, or immunity granted by any member to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other members.

The MFN rule is not without exceptions, however. The rule does not apply to

1. The use of measures to counter dumping and subsidization.[74]
2. The creation of customs unions and free trade areas.[75]
3. Restrictions that protect public health, safety, welfare, and national security.[76]

In addition to these three exceptions[77] to the MFN rule and the principle of nondiscrimination, GATT provides for a special exception in the case of developing states. In order both to promote and protect the economies of developing states, GATT encourages the developed states not to demand reciprocity from them in trade negotiation, and it authorizes developed member states to adopt measures that give preferences to developing member states.[78]

The contracting parties to GATT 1947 approved two preferential treatment schemes that are carried forward into GATT 1994. One, the **Generalized System of Preferences (GSP)**, allows developing countries to export all (or nearly all) of their products to a participating developed country on a nonreciprocal basis. The hope is that the GSP will make developing countries more competitive in world markets and less dependent on the production of raw or primary goods.[79] The other, the **South-South Preferences** (so called because most developing nations are located in the Southern Hemisphere), lets developing countries exchange tariff preferences among themselves without extending the same preferences to developed states.[80]

Generalized System of Preferences (GSP)
A GATT scheme that allows a developing state to obtain tariff concessions from a developed state on a nonreciprocal basis.

South-South Preferences
A GATT scheme that allows developing states to grant tariff preferences to each other without having to grant them to developed states.

The National Treatment Rule The national treatment rule is the second manifestation of the principle of nondiscrimination that appears in GATT. In contrast to the MFN rule, which requires nondiscrimination at a country's border, the national treatment rule requires a country to treat products equally with its own domestic products *once they are inside its borders*.[81] Article III, paragraph 4, of GATT provides:

> The products of the territory of any member state imported into the territory of any other member state shall be accorded treatment no less favorable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution, or use. . . .

Article III, paragraph 2, sets out the same nondiscriminatory requirement with respect to internal taxes. In Case 7-2, a WTO Panel was asked to determine if Japan was taxing imported alcoholic beverages differently than a domestically produced beverage known as *shochu*.

national treatment rule
Once imported goods are within the territory of a state, that state must treat those goods no less favorably than it treats its own domestic goods.

---

[74]General Agreement on Tariffs and Trade 1994, Article VI.

[75]*Id.*, Article XXIV, para. 8.

[76]*Id.*, Articles XX and XXI.

[77]These three exceptions are discussed later in this chapter.

[78]*Id.*, Article XXXVI, para. 8, provides: "The developed members do not expect reciprocity for commitments made by them in trade negotiations to reduce or remove tariffs and other barriers to the trade of less-developed members."

[79]GATT, *Analytical Index: Guide to GATT Law and Practice*, pp. 49–50, 53–54 (6th ed., 1994).

Eight developed states, plus the EU (now 27 member nations), presently participate in the GSP. The states are Australia, Canada, Finland, Japan, New Zealand, Norway, Switzerland, and the United States. *Id.*, p. 50.

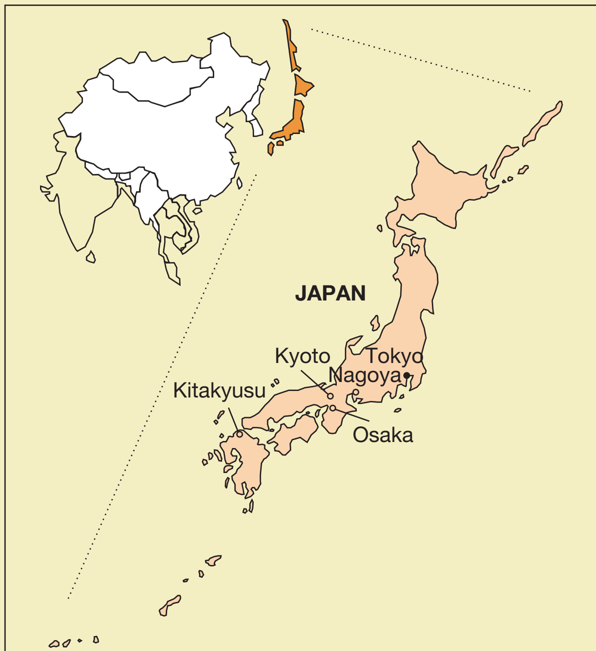
[80]*Id.*, pp. 50–51, 53–54.

[81]Section 801(a)(2) of the Restatement of Foreign Relations Law of the United States, Tentative Draft No. 4 (1983), states that " 'national treatment' by a state means according to the nationals of another state treatment equivalent to that which the state accords to its own nationals."

To ensure that member states comply with the national treatment standards, GATT requires them to promptly notify other members of any new trade regulations they may enact. See General Agreement on Tariffs and Trade 1994, Article X, para. 1.

CASE 7-2 Japan—Taxes on Alcoholic Beverages

World Trade Organization, Dispute Settlement Panel, 1998
Panel Reports WT/DS8/R, WT/DS10/R, WT/DS11/R[82]



MAP 7.2

Japan (1998)

Canada, the EU, and the United States complained that Japan imposed lower taxes on shochu, a locally produced alcoholic beverage, than it did on imported alcoholic beverages, including vodka, in violation of Article III, paragraph 2, of GATT 1994.

Report of the Panel

* * *

The Panel noted that the complainants are essentially claiming that the Japanese Liquor Tax Law is inconsistent with GATT Article III:2 (hereinafter "Article III:2"). Article III:2 reads:

> The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

GATT Article III:1 (hereinafter "Article III:1"), which is referred to in Article III:2, reads:

> The contracting parties recognize that internal taxes and other internal charges, and laws, regulations, and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution, or use of products, and internal quantitative regulations requiring the mixture, processing, or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.

* * *

[82]This Dispute Settlement Panel Report is posted on the WTO's Web site at www.wto.org/english/tratop_e/dispu_e/cases_e/ds8_e.htm.

Article III:2, First Sentence

a) Definition of "Like Products"

The Panel noted that the term "like product" appears in various GATT provisions. The Panel further noted that it did not necessarily follow that the term had to be interpreted in a uniform way. In this respect, the Panel noted the discrepancy between Article III:2, on the one hand, and Article III:4 on the other: while the former referred to Article III:1 and to like, as well as to directly competitive or substitutable products (see also Article XIX of GATT), the latter referred only to like products. This is precisely why, in the Panel's view, its conclusions reached in this dispute are relevant only for the interpretation of the term "like product" as it appears in Article III:2.

The Panel noted that previous panels had agreed that the term "like product" should be interpreted on a case-by-case basis, but had not established any particular test to be followed in defining likeness. Previous panels had used different criteria in order to establish likeness, such as the product's properties, nature and quality, and its end-uses; consumers' tastes and habits, which change from country to country; and the product's classification in tariff nomenclatures.

In the Panel's view, "like products" need not be identical in all respects. However, in the Panel's view, the term "like product" should be construed narrowly in the case of Article III:2, first sentence. This approach is dictated, in the Panel's view, by two independent reasons: (i) because Article III:2 distinguishes between like and directly competitive or substitutable products, the latter obviously being a much larger category of products than the former; and (ii) because of the Panel's conclusions reached with respect to the relationship between Articles III and II.

As to the first point, the distinction between "like" and "directly competitive or substitutable products" has already been discussed. As to the second point, as previous panels had noted, one of the main objectives of Article III:2 is to ensure that WTO Members do not frustrate the effect of tariff concessions granted under Article II through internal taxes and other internal charges, it follows that there should be a similar interpretation of the definition of products for purposes of Article II tariff concessions and the term "like product" as it appears in Article III:2. This is so in the Panel's view, because with respect to two products subject to the same tariff binding and therefore to the same maximum border tax, there is no justification, outside of those mentioned in GATT rules, to tax them in a differentiated way through internal taxation. . . .

. . . In the view of the Panel, the term "like products" suggests that for two products to fall under this category they must share essentially the same physical characteristics. Flexibility is required in order to conclude whether two products are directly competitive or substitutable. In the Panel's view, the suggested approach can guarantee the flexibility required, since it permits one to take into account specific characteristics in any single market; consequently, two products could be considered to be directly competitive or substitutable in market A, but the same two products would not necessarily be considered to be directly competitive or substitutable in market B. The Panel next turned to an examination of whether the products at issue in this case were "like products," starting first with vodka and shochu. The Panel noted that vodka and shochu shared most physical characteristics. In the Panel's view, except for filtration, there is virtual identity in the definition of the two products. The Panel noted that a difference in the physical characteristic of alcoholic strength of two products did not preclude a finding of likeness especially since alcoholic beverages are often drunk in diluted form. The Panel then noted that essentially the same conclusion had been reached in the 1987 Panel Report, which

> . . . agreed with the arguments submitted to it by the European Communities, Finland, and the United States that Japanese shochu (Group A) and vodka could be considered as "like" products in terms of Article III:2 because they were both white/clean spirits, made of similar raw materials, and the end-uses were virtually identical.

Following its independent consideration of the factors mentioned in the 1987 Panel Report, the Panel agreed with this statement. The Panel then recalled its conclusions concerning the relationship between Articles II and III. In this context, it noted that (i) vodka and shochu were currently classified in the same heading in the Japanese tariffs . . . and (ii) vodka and shochu were covered by the same Japanese tariff binding at the time of its negotiation. Of the products at issue in this case, only shochu and vodka have the same tariff applied to them in the Japanese tariff schedule.

Consequently, in light of the conclusion of the 1987 Panel Report and of its independent consideration of the issue, the Panel concluded that vodka and shochu are like products. In the Panel's view, only vodka could be considered as [a] like product to shochu since, apart from commonality of end-uses, it shared with shochu most physical characteristics. Definitionally, the only difference is in the media used for filtration. Substantial noticeable differences in physical characteristics exist between the rest of the alcoholic beverages at dispute and shochu that would disqualify them from being regarded as like products. More specifically, the use of additives would disqualify liqueurs, gin and genever; the use of ingredients would disqualify rum; lastly, appearance (arising from manufacturing processes) would disqualify whisky and brandy. . . .

b) Taxation in Excess of That Imposed on Like Domestic Products

The Panel then proceeded to examine whether vodka is taxed in excess of the tax imposed on shochu under the Japanese *Liquor Tax Law*. The Panel noted that what was contested in the Japanese legislation was a system of specific taxes imposed on various alcoholic drinks. In this respect, it noted that vodka was taxed at 377230 Yen per kiloliter—for an alcoholic strength below 38°—that is 9927 Yen per degree of alcohol, whereas shochu A was taxed at 155700 Yen per kiloliter—for an alcoholic strength between 25° and 26°—that is 6228 Yen per degree of alcohol (see Figure 7.8). The Japanese taxes on vodka and shochu are calculated on the basis of and vary according to the alcoholic content of the products and, on this basis, it is obvious that the taxes imposed on vodka are higher than those imposed on shochu. Accordingly, the Panel concluded that the tax imposed on vodka is in excess of the tax imposed on shochu.

The Panel then addressed the argument put forward by Japan that its legislation, by keeping the tax/price ratio "roughly constant," is trade neutral and consequently no protective aim and effect of the legislation can be detected. In this connection, the Panel recalled Japan's argument that its aim was to achieve neutrality and horizontal tax equity. To the extent that Japan's argument is that its *Liquor Tax Law* does not impose on foreign products (i.e., vodka) a tax in excess of the tax imposed on domestic like products (i.e., shochu), the Panel rejected the argument for the following reasons:

i. The benchmark in Article III:2, first sentence, is that internal taxes on foreign products shall not be imposed in excess of those imposed on like domestic products. Consequently, in the context of Article III:2, first sentence, it is irrelevant whether "roughly" the same treatment

FIGURE 7.8

The Variation in Taxes Between Shochu and Vodka

377,230
Yen per kiloliter

155,700
Yen per kiloliter

through, for example, a "roughly constant" tax/price ratio is afforded to domestic and foreign like products or whether neutrality and horizontal tax equity is achieved.

ii. Japan had argued that the comparison of tax/price ratios should be done on a category-by-category basis, but its statistics on which the tax/price ratios were based excluded domestically produced spirits from the calculation of tax/price ratios for spirits and whisky/brandy. Since the prices of the domestic spirits and whisky/brandy are much lower than the prices of the imported goods, this exclusion has the impact of reducing considerably the tax/price ratios cited by Japan for those products. In this connection, the Panel noted that one consequence of the Japanese tax system was to make it more difficult for cheaper imported brands of spirits and whisky/brandy to enter the Japanese market. Moreover, the Panel further noted that the Japanese statistics were based on suggested retail prices and there was evidence in the record that these products were often sold at a discount, at least in Tokyo. To the extent that the prices were unreliable, the resultant tax/price ratios would be unreliable as well.

iii. Nowhere in the contested legislation was it mentioned that its purpose was to maintain a "roughly constant" tax/price ratio. This was rather an *ex post facto*[83] rationalization by Japan and at any rate, there are no guarantees in the legislation that the tax/price ratio will always be maintained "roughly constant." Prices change over time and unless an adjustment process is incorporated in the legislation, the tax/price ratio will be affected. Japan admitted that no adjustment process exists in the legislation and that only *ex post facto* adjustments can occur. The Panel lastly noted that since the modification in 1989 of Japan's *Liquor Tax Law* there has been only one instance of adjustment.

***

Consequently, the Panel concluded that, by taxing vodka in excess of shochu, Japan is in violation of its obligation under Article III:2, first sentence.

***

[The Panel also found that "shochu, whisky, brandy, rum, gin, genever, and liqueurs are 'directly competitive or substitutable products' and Japan, by not taxing them similarly, is in violation of its obligation under Article III:2, second sentence, of the General Agreement on Tariffs and Trade 1994."]

***

The Panel recommends that the Dispute Settlement Body request Japan to bring the *Liquor Tax Law* into conformity with its obligations under the General Agreement on Tariffs and Trade 1994.

Casepoint

The WTO panel considered whether Japan's policy of taxing imported vodka (and whiskey, brandy, and other imported alcoholic beverages) at a higher rate than Japanese shochu was a violation of GATT Article III. This section of GATT requires that imported goods be accorded "national treatment"—that is, not subjected to higher internal taxes than similar domestic products. After comparing vodka and shochu, the panel decided that they were indeed "like" products. Since imported vodka was taxed at a higher rate, this practice constituted a violation of Japan's obligations under GATT-WTO rules.

As with the most-favored-nation rule, exceptions apply to the application of the national treatment rule. These include:

1. The maintenance of preferences existing at the time GATT 1947 came into effect.[84]
2. Discrimination in the procurement of goods by government agencies for governmental purposes only.[85]

[83] [From Latin: "After the fact."]

[84] General Agreement on Tariffs and Trade, 1994, Article III, para. 6.

[85] *Id.*, para. 8(a).

3. Discrimination in the payment of subsidies to domestic producers.[86]
4. Discrimination in the screening of domestically produced cinematographic films.[87]

Protection Only Through Tariffs

The second major principle of the GATT is that each member state may protect its domestic industries only through the use of **tariffs**. Quotas and other quantitative restrictions that block the function of the price mechanism are forbidden by Article XI of GATT.[88] Additionally, to ensure that internal taxes are not disguised as tariffs, Article II requires that tariffs be collected "at the time or point of importation."

tariffs
Governmental charges imposed on goods at the time they are imported into a state.

As with the other GATT principles, exceptions apply to the principle of protection through tariffs. The main exceptions include:

1. The imposition of temporary export prohibitions or restrictions to prevent or relieve critical shortages of foodstuffs or other essential products.[89]
2. The use of import and export restrictions related to the application of standards or regulations for classifying, grading, or marking commodities.[90]
3. The use of quantitative restrictions on imports of agricultural and fisheries products to stabilize national agricultural markets.[91]
4. The use of quantitative restrictions to safeguard a state's balance of payments.[92]
5. The use of quantitative restrictions by a developing state to further its economic development.[93]

GATT requires member states not only to use customs tariffs as the primary device for protecting their domestic trade, but also to work toward their "substantial reduction." Tariff reductions are negotiated among the member states and then recorded as Schedules of Concessions annexed to GATT. A **bound tariff rate** represents the highest rate that a member state may set on an item under the terms of GATT (tariffs are "bound" to this rate). Once such a rate is negotiated, the member state is required to extend it to all other GATT members by the MFN rule.[94]

bound tariff rates
The highest tariff rates a WTO member state may set on imports from another member state.

United States and the European Union Argue Over Tariff Classification

In 2008, the United States, Japan, and Taiwan filed a suit against the European Union at the World Trade Organization, arguing that the EU had violated the Information Technology Agreement by imposing tariffs ranging from 6 to 14 percent on imported electronics.[95] The Information Technology Agreement, signed in 1996, sets tariffs at 0

[86] *Id.*, para. 8(b).

[87] *Id.*, para. 10, and Article IV.

[88] *Id.*, Article XI, para. 1, states: "No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licenses, or other measures, shall be instituted or maintained by any member on the importation of any product of the territory of any other member or on the exportation or sale for export of any product destined for the territory of any other member."

The rationale underlying Article XI was provided in a statement by the U.S. delegate at the First Preparatory Session of GATT: "In the case of a tariff the total volume of imports can expand with the expansion of trade. There is flexibility in the volume of trade. Under a quota system the volume of trade is rigidly restricted, and no matter how much more people may wish to buy or consume, not one single more unit will be admitted than the controlling authority thinks fit.

"In the case of tariffs, the direction of trade and the source of import can shift with changes in quality and cost and price. Under a quota system the direction of trade and the sources of imports are rigidly fixed by public authority without regard to quality, cost or price. Under a tariff, equality of treatment of all other states can be assured. Under a quota system, no matter how detailed our rules, no matter how carefully we police them, there must almost inevitably be discrimination as amongst other states." UN Document EPCT/A/PV. 221 at pp. 16–17 (1947).

[89] General Agreement on Tariffs and Trade 1994, Article XI, para. 2(a).

[90] *Id.*, para. 2(b).

[91] *Id.*, para. 2(c).

[92] *Id.*, Article XII, para. 1, provides: ". . . [A]ny member, in order to safeguard its external financial position and its balance of payments, may restrict the quantity or value of merchandise permitted to be imported. . . ."

[93] *Id.*, Article XVIII, para. 4(a).

[94] *Id.*, Article XXVIII(bis).

[95] J. W. Miller, "WTO Orders EU To Lift Tech Tariffs," *Wall Street Journal*, August 17, 2010. http://online.wsj.com/article/SB10001424052748703908704575433493886779162.html (accessed July 6, 2011); see also Reuters, "W.T.O. Rules Against European Union on Tariffs for Electronics," *New York Times*, August 16, 2010. www.nytimes.com/2010/08/17/business/global/17wto.html (accessed July 6, 2011).

percent on a wide variety of high-tech electronic goods. The European Union had imposed tariffs on television cable converter boxes that also deliver Internet access, flat-panel computer screens, and printers with scanning, faxing, or copying functionality, arguing that these items involved old technology and accordingly did not constitute the type of "high-tech" items falling under the 0 percent provisions of the Information Technology Agreement. In August 2010, the World Trade Organization panel ruled in favor of the United States, Japan, and Taiwan, finding that European Union tariffs on electronic goods violated the WTO's Information Technology Agreement and requesting "the European Communities to bring the relevant measures into conformity with its obligations."

Transparency

transparency
Principle that governments must make their rules, regulations, and practices open and accessible to the public and other governments.

Essential to the operation of GATT is the principle of transparency. **Transparency**, as defined in Article X, is the requirement that governments disclose to the public and other governments the rules, regulations, and practices they follow in their domestic trade systems. Complementing this principle is the requirement, found in Article VIII, that member states must strive to simplify their import and export formalities. The operation of both of these principles can be seen in the way countries classify imports for the purpose of imposing duties.

While negotiations were underway in Geneva in 1947 to set up the original GATT, discussions were also being held in Western Europe to establish a customs union. For political reasons this early attempt failed, but the participants agreed to take advantage of the accords that had been reached to establish a standardized system (or *nomenclature*) for classifying goods for the purpose of imposing customs duties. In 1950, the Convention on Nomenclature for the Classification of Goods in Customs Tariffs was signed, and the Customs Cooperation Council (CCC), an international organization based in Brussels, was established to administer it.

Harmonized System (HS)
A system of classifying goods for customs purposes established by the Convention on Nomenclature for the Classification of Goods in Customs Tariffs.

Most countries have ratified this convention. On January 1, 1989, the United States—the last major holdout—brought its tariff schedules into line with the CCC or "Harmonized" system. The **Harmonized System (HS)** is made up of a schedule of about 900 tariff headings, which are interpreted through explanatory notes and classification opinions published and regularly updated by the CCC. Both the notes and opinions are commonly incorporated into the tariff interpretation rules used by states that have adopted the HS.

Regional Integration

free trade area
A group of states that have reduced or eliminated tariffs among themselves but that maintain their own individual tariffs in dealing with other states.

customs union
A group of states that have reduced or eliminated tariffs among themselves and have also established a common external tariff.

GATT seeks to promote international trade through regional economic integration. It accordingly encourages WTO member states to participate in free trade areas and customs unions. A **free trade area** consists of a group of states that have reduced or eliminated tariffs among themselves but that maintain their own individual tariffs in dealing with other states.[96] A **customs union** involves a group of states that have reduced or eliminated tariffs among themselves and have also established a common tariff for all other states.[97]

WTO member states may participate in these regional groups, however, only if the groups do not establish higher duties or more restrictive commercial regulations with respect to other WTO countries. The same prohibition also applies to interim agreements leading to the establishment of these groups.[98]

Any member state seeking to participate in a free trade area or customs union is required to "promptly notify" the WTO of its intentions. The proposed agreement and a transition schedule are then reviewed by WTO working parties to ensure that they comply with GATT Article XXIV. The results of this review are reported to the WTO Ministerial Conference, which in turn approves the proposal or makes recommendations for modification. *Recommendations* are actually demands to make changes. GATT Article XXIV, paragraph 7(b), says that "members shall not maintain or put into force . . . such [an] agreement if they are not prepared to modify it in accordance with these recommendations."

Once a free trade area or customs union is established, GATT rules apply to the area or union as a whole and not to its constituent states.

[96]General Agreement on Tariffs and Trade 1994, Article XXIV, para. 8(b).

[97]*Id.*, Article XXIV, para. 8(a). Free trade areas and customs unions can exist between *customs territories* (areas within states that are treated as separate territories for customs purposes) as well as between states. *Id.*, para. 8.

[98]*Id.*, Article XXIV, paras. 5(a) and 5(b).

In many respects, a customs union or free trade area operates as a regional GATT, with its own tariff and nontariff codes. The North American Free Trade Agreement (see Figure 7.9) illustrates this.

Commodity Arrangements

Commodity arrangements are trade regulations meant to stabilize the production and supply of basic or *primary* commodities through the intergovernmental regulation of supply and demand. **Primary commodities** are, generally speaking, those derived by extraction (fuels and ores) or harvest (foodstuffs and fish) and that require minimal industrial processing before being used or consumed. The list commonly includes bananas, bauxite, cocoa, coffee, copper, cotton and cotton yarns, hard fibers and their products, iron ore, jute and its products, manganese, meat, phosphates, rubber, sugar, tea, tropical timber, tin, and vegetable oils including olive oil and oil seeds.

GATT allows member states to participate in commodity agreements, provided that they involve both exporting and importing countries and are submitted to the WTO for approval.[99] In developing and overseeing commodity agreements in the past, the GATT 1947 organization cooperated with both the UN Economic and Social Council (ECOSOC) and the UN Conference on Trade and

commodity arrangements Intergovernmental agreements regulating the production and supply of primary commodities.

primary commodities Products obtained by extraction or harvest that require minimal processing before being used.

FIGURE 7.9

Principal Features of the North American Free Trade Agreement

Tariffs. The North American Free Trade Agreement (NAFTA) was scheduled to eliminate all tariffs on products traded between Canada, Mexico, and the United States by 2007. Almost all tariffs have been removed, with just a few difficult issues yet to be resolved.Tariffs between Canada and the United States were eliminated at the end of 1998 under a free trade agreement between those two states that was agreed to prior to the establishment of NAFTA.

Rules of Origin. Only those Canadian, Mexican, and U.S. products that meet NAFTA's rules of origin qualify for preferential tariff treatment. In other words, only products that are principally produced or manufactured in Canada, Mexico, or the United States will qualify for the special tariff rates.

Safeguards. Should imports from a NAFTA member state seriously injure or threaten to seriously injure another member state's businesses or workers, the affected state may temporarily impose quotas or tariffs on the goods causing the injury.

Investment. NAFTA removes investment barriers (in particular, government approval is no longer required for member state nationals to invest in a wide range of business activities); it removes investment distortions (by eliminating requirements concerning domestic content, the transfer of technology to local competitors, and minimum levels of exports and maximum levels of imports); and it protects investors (by guaranteeing the right to repatriate capital and profits, the right to obtain fair compensation in the event of expropriation, and the right to use international arbitration in the event of a dispute between an investor and a government).

Services. Virtually all service areas (except for air and maritime transport and basic telecommunications) are opened to service providers from the three member states.That is, firms in one member state do not have to relocate to another member state in order to provide services. The licensing of professionals, including accountants, doctors, and lawyers, will be based on competency rather than nationality or residency.

Border-Crossing Procedures. NAFTA streamlines border-crossing procedures for business visitors, professionals, traders and investors, and intracompany transferees and ensures that qualified persons will be permitted entry. The right of blue-collar workers to move across borders to take jobs, however, is not provided for.

Government Procurement. NAFTA authorizes firms in its member states to compete on an equal basis for a wide range of government contracts as well as contracts with government-controlled enterprises. Government procurement procedures are to be transparent and subject to independent review.

Standards. Standards (including both voluntary and mandatory technical specifications concerning the characteristics of a product, such as quality, performance, or labeling) have to be applied on a nondiscriminatory basis. The process of developing new standards has to be open and transparent, and nationals of the other member states are allowed to participate in this process.

Dispute Resolution. NAFTA creates a Trilateral Trade Commission to oversee trade relations and to appoint bilateral or trilateral panels to resolve disputes. Disputes must be resolved in no more than eight months. Member states must comply with panel recommendations or offer acceptable compensation. If they do not, then the affected state can retaliate by withdrawing *equivalent trade concessions.* Special provisions apply in certain areas, including investment and commercial disputes.These allow investors and merchants to go directly to international arbitration.

[99]*Id.*, Article XX(h), authorizes members to enforce measures "undertaken in pursuance of obligations under any intergovernmental commodity agreement which conforms to criteria submitted to the World Trade Organization and not disapproved by the WTO or which is itself so submitted and not so disapproved."

Development (UNCTAD). The most active of the three in promoting commodity agreements was UNCTAD. At a meeting in Nairobi in 1976, UNCTAD adopted (under pressure from its developing member states) an **Integrated Program for Commodities (IPC)**. The IPC called for the early conclusion of commodity agreements covering 10 *core* commodities—cocoa, coffee, copper, cotton, hard fibers, jute, rubber, sugar, tea, and tin—and for the establishment of a $6 billion internationally financed Common Fund to underwrite the costs of maintaining the buffer stocks commonly used in stabilizing the supply of the core commodities. To date, commodity arrangements have been set up for cocoa, coffee, rubber, sugar, and tin, but the money needed to establish the Common Fund has yet to be found.[100]

Integrated Program for Commodities (IPC) Proposal of developing countries that would establish a Common Fund to underwrite the costs of maintaining a buffer stock of primary commodities as a way to stabilize supplies.

Once established, the organizations created by commodity agreements operate independently of the WTO, ECOSOC, or UNCTAD. They typically come under the supervision of a council made up of representatives of all participating states and a permanent secretariat appointed by the council. To support both supplies and prices, the agreements set up one or more stabilization programs. Typically, these include contractual arrangements to buy and sell the goods at agreed-upon prices; export quotas to limit the quantities available to the world market during stressful times; and internationally financed buffer stocks, operated by a central body, which buys and sells from those stocks to stabilize market prices.[101]

Escape Clause

Article XIX of GATT 1994—entitled "Emergency Action on Imports of Particular Products"—is an **escape clause** or safety valve that allows a member state to avoid, temporarily, its GATT obligations when there is a surge in the number of imports coming from other member states. The injured state can impose emergency restrictive trade measures—known as **safeguards**—if it can demonstrate that there is an actual or seriously threatened injury to one of its domestic industries.[102]

escape clause Allows a WTO member state to escape temporarily from its GATT obligations when there is a surge in the number of imports coming from other member states.

A state making use of the escape clause must notify the WTO and consult with the affected exporting state to arrange for compensation.[103] If a notifying country fails to negotiate, the injured exporting countries are authorized to *retaliate*—that is, withhold "substantially equivalent concessions" in order to restore the previous balance of trade between the two states.[104] The procedures for engaging in consultations and for withholding concessions are incorporated in a Safeguards Agreement, discussed later in this chapter.

safeguards Emergency trade measures imposed to protect domestic industry from a surge of imports.

Exceptions

The drafters of GATT realized that states sometimes need to take certain measures as a matter of public policy that conflict with GATT's general goal of liberalizing trade. Article XX sets out "General Exceptions" and Article XXI "Security Exceptions."

The **general exceptions** excuse a member state from complying with its GATT obligations so long as this is not done as "a means of arbitrary or unjustifiable discrimination" or as "a disguised restriction on international trade." They allow a state to take measures contrary to GATT that

general exceptions Situations that excuse a WTO member state from complying with its GATT obligations in order for the state to protect certain essential public policy objectives.

1. are necessary to protect public morals;
2. are necessary to protect human, animal, or plant life or health;
3. relate to the importation or exportation of gold or silver;
4. are necessary to secure compliance with laws or regulations that are not inconsistent with GATT;
5. relate to the products of prison labor;
6. protect national treasures of artistic, historic, or archaeological value;
7. relate to the conservation of exhaustible natural resources;
8. are undertaken in accordance with an intergovernmental commodity agreement;

[100]Frank Stone, *Canada, the GATT, and the International Trade System*, pp. 120–124, 139–154 (1984).

Note that no commodity agreements were ever submitted to the GATT 1947 organization for its approval under Article XX(b). GATT, *Analytical Index: Guide to GATT Law and Practice*, p. 547 (6th ed., 1994).

[101]*Id*. at 144–145.

[102]General Agreement on Tariffs and Trade 1994, Article XIX, para. 1(a).

[103]*Id*., Article XIX, para. 2.

[104]*Id*., Article XIX, para. 3. See GATT, *Analytical Index: Guide to GATT Law and Practice*, pp. 488–489 (6th ed., 1994).

9. involve restrictions on exports of domestic materials needed by a domestic processing industry during periods when the domestic price of those materials is held below world prices as part of a governmental stabilization plan; or
10. are essential to acquiring products in short supply.

In Case 7-3, the WTO Appellate Body explains how these general exceptions are interpreted and applied.

The **security exceptions** set out in Article XXI allow member states to avoid any obligations they may have under GATT that are contrary to their "essential security interests" or that conflict with their duties "under the United Nations Charter for the maintenance of international peace and security."

security exceptions Situations that excuse a WTO member state from complying with its GATT obligations when those are in conflict with its essential security interests or its duties under the United Nations Charter.

Export Controls

Member states commonly employ GATT exceptions to limit certain kinds of exports. Noteworthy examples of export controls that fit under the general exceptions found in Article XX are several multilateral treaties that limit the removal of cultural artifacts from their countries of origin. Examples

CASE 7-3 United States—Import Prohibition of Certain Shrimp and Shrimp Products

World Trade Organization, Appellate Body, 1998
Appellate Body Report WT/DS58/AB/R[105]

MAP 7.3

United States (1998)

I. Introduction: Statement of the Appeal

This is an appeal by the United States from certain issues of law and legal interpretations in the Panel Report, *United States—Import Prohibition of Certain Shrimp and Shrimp Products*. . . .

* * *

[105]This report is posted at the WTO's Web site at www.wto.org/english/tratop_e/dispu_e/cases_e/ds58_e.htm.

The United States issued regulations in 1987 pursuant to the Endangered Species Act of 1973[106] requiring all United States shrimp trawl vessels to use approved Turtle Excluder Devices ("TEDs"; see Figure 7.10) or tow-time restrictions in specified areas where there was a significant mortality of sea turtles in shrimp harvesting.[107] These regulations, which became fully effective in 1990, were modified so as to require the use of approved TEDs at all times and in all areas where there is a likelihood that shrimp trawling will interact with sea turtles, with certain limited exceptions.

. . . Section 609(b)(1) imposed . . . an import ban on shrimp harvested with commercial fishing technology which may adversely affect sea turtles. Section 609(b)(2) provides that the import ban on shrimp will not apply to harvesting nations that are certified by the U.S. Department of State. To be certified a nation must either (a) not have any of the relevant species of turtles in its waters; (b) harvest shrimp exclusively by means that do not pose a threat to sea turtles, e.g., harvest shrimp exclusively by artisanal means; or (c) conduct its commercial shrimp trawling operations exclusively in waters subject to its jurisdiction in which sea turtles do not occur.

Second, certification shall be granted to harvesting nations that provide documentary evidence of the adoption of a regulatory program governing the incidental taking of sea turtles in the course of shrimp trawling that is comparable to the United States program and where the average rate of incidental taking of sea turtles by their vessels is comparable to that of United States vessels.[108] According to the 1996 [*Administrative*] *Guidelines* [*for Implementing the Endangered Species Act*] the Department of State assesses the regulatory program of the harvesting nation and certification shall be made if the program includes: (i) the required use of TEDs that are "comparable in effectiveness to those used in the United States. Any exceptions to this requirement must be comparable to those of the United States program . . ."; and (ii) "a credible enforcement effort that includes monitoring for compliance and appropriate sanctions." . . .

***

In the Panel Report, the WTO Panel reached the following conclusions:

> . . . [W]e conclude that the import ban on shrimp and shrimp products as applied by the United States on the basis of Section 609 of Public Law 101–162 is not consistent with article XI: 1 of GATT 1994, and cannot be justified under article XX of GATT 1994.

***

FIGURE 7.10

Example of a Turtle Excluder Device

Source: AFP/HO/Getty Images/ Newscom

[106]Public Law 93–205, *United States Code*, title 16, § 1531 et seq.

[107]United States Federal Regulation, title 52, para. 24244, June 29, 1987 (the "1987 Regulations"). Five species of sea turtles fell under the regulations: loggerhead (*Caretta caretta*), Kemp's ridley (*Lepidochelys kempi*), green (*Chelonia mydas*), leatherback (*Dermochelys coriacea*), and hawksbill (*Eretmochelys imbricata*).

[108]Section 609(b)(2)(A) and (B).

IV. Issues Raised in This Appeal

In this appeal the United States raises several issues, including: whether the Panel erred in finding that the measure at issue constitutes unjustifiable discrimination between countries where the same conditions prevail and thus is not within the scope of measures permitted under article XX of the GATT 1994 ("Exceptions.")

VI. Appraising Section 609 Under Article XX of the GATT 1994

***

A. [Introduction]

Article XX of the GATT 1994 reads, in its relevant parts:

> ARTICLE XX GENERAL EXCEPTIONS
>
> Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this agreement shall be construed to prevent the adoption or enforcement by any Member of measures:
>
> ***
>
> (g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption;
>
> ***

In *United States*—[*Standards for Reformulated and Conventional*] *Gasoline*,[109] we enunciated the appropriate method for applying article XX of the GATT 1994:

> In order that the justifying protection of article XX may be extended to it, the measure at issue must not only come under one or another of the particular exceptions—paragraphs (a) to (j)—listed under article XX; it must also satisfy the requirements imposed by the opening clauses of article XX. *The analysis is, in other words, two-tiered: first, provisional justification by reason of characterization of the measure under XX(g); second, further appraisal of the same measure under the introductory clauses of article XX*. (emphasis added)

***

B. Article XX(g): Provisional Justification of Section 609

In claiming justification for its measure, the United States primarily invokes article XX(g). . . .

1. **"Exhaustible Natural Resources"** We begin with the threshold question of whether Section 609 of the U.S. law is a measure concerned with the conservation of "exhaustible natural resources" within the meaning of article XX(g) . . . . The complainants' principal argument is rooted in the notion that "living" natural resources are "renewable" and therefore cannot be "exhaustible" natural resources. We do not believe that "exhaustible" natural resources and "renewable" natural resources are mutually exclusive. One lesson that modern biological sciences teach us is that living species, though in principle, capable of reproduction and, in that sense, "renewable," are in certain circumstances indeed susceptible of depletion, exhaustion and extinction, frequently because of human activities. Living resources are just as "finite" as petroleum, iron ore and other non-living resources.

[109]Appellate Body Report WT/DS2/AB/R, posted on the WTO's Web site at www.wto.org/english/tratop_e/envir_e/gas1_e.htm.

We believe it is too late in the day to suppose that article XX(g) of the GATT 1994 may be read as referring only to the conservation of exhaustible mineral or other non-living natural resources. Moreover, two adopted GATT 1947 panel reports previously found fish to be an "exhaustible natural resource" within the meaning of article XX(g).[110] We hold that . . . measures to conserve exhaustible natural resources, whether living or non-living, may fall within article XX(g). Further, since all seven recognized species of sea turtle are today listed in the Convention on International Trade as "endangered species" we conclude that the sea turtles involved here do constitute "exhaustible natural resources" for the purpose of article XX(g) of the GATT 1994.

C. The Introductory Clauses of Article XX: Characterizing Section 609 Under the Chapeau's Standards

Although provisionally justified under article XX(g), if it is ultimately to be justified as an exception under article XX, Section 609 must also satisfy the requirements of the introductory clauses—the "chapeau"[111]—of article XX, which state, as quoted earlier, that:

> such measures are not to be *applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade*. (emphasis added)

We turn, hence, to the task of appraising Section 609, and specifically the manner in which it is applied under the chapeau of article XX; that is, to the second part of the two-tier analysis required under article XX.

In the previous case, *United States—Gasoline*, we stated that "the purpose and object of the introductory clauses of article XX is generally the prevention of 'abuse of the exceptions of [article XX]."' We went on to say that:

> . . . The chapeau is animated by the principle that while the exceptions of article XX may be invoked as a matter of legal right, they should not be so applied as to frustrate or defeat the legal obligations of the holder of the right under the substantive rules of the General Agreement. In other words, the exceptions must be applied reasonably, with due regard both to the legal duties of the party claiming the exception and the legal rights of the other parties concerned.

In drafting the preamble of the WTO Agreement, the drafters followed much of the language of the former GATT preamble but specifically did not include as one objective the phrase "full use of the resources of the world," apparently believing that this was no longer appropriate to the world trading system of the 1990's. Instead, they decided to qualify the original objectives of the GATT 1947 with the following words:

> . . . while allowing for the optimal use of the world's resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development. . . .

[T]his language demonstrates a recognition by WTO negotiators that optimal use of the world's resources should be made in accordance with the objective of sustainable development. As this preambular language reflects the intentions of negotiators of the WTO Agreement, we believe it must add color, texture and shading to our interpretation of the agreements annexed to the WTO Agreement, in this case, the GATT 1994. . . .

In our view, the language of the chapeau makes clear that each of the exceptions in paragraphs (a) to (j) of article XX is a limited and conditional exception from the substantive obligations contained in the other provisions of the GATT 1994, that is to say, the ultimate availability of the exception is subject to the compliance by the invoking Member with the requirements of the chapeau. . . .

---

[110]United States—Prohibition of Imports of Tuna and Tuna Products from Canada, adopted 22 February 1982, BISD 29S/91, para. 4.9; Canada—Measures Affecting Exports of Unprocessed Herring and Salmon, adopted 22 March 1988, BISD 35S/98, para. 4.4.

[111]From French: "hat."

2. **"Unjustifiable Discrimination"** We scrutinize first whether the U.S. regulations have been applied in a manner constituting "unjustifiable discrimination between countries where the same conditions prevail." . . . Section 609, in its application, is, in effect, an economic embargo which requires *all other exporting Members*, if they wish to exercise their GATT rights, to adopt *essentially the same* policy . . . (together with an approved enforcement program) as that applied to, and enforced on, United States domestic shrimp trawlers. Viewed alone, Section 609(b)(2)(A) and (B) appears to permit a degree of discretion or flexibility in how the standards for determining comparability might be applied, in practice, to other countries. However, any flexibility that may have been intended by Congress when it enacted the statutory provision has been effectively eliminated in the implementation of that policy through the 1996 *Guidelines* promulgated by the Department of State and through the practice of the administrators in making certification determinations.

   According to the 1996 *Guidelines* . . . any exceptions to the requirement of the use of TEDs must be comparable to those of the United States program. . . . [And] in practice, the competent government officials only look to see whether there is a regulatory program requiring the use of TEDs or one that comes within one of the extremely limited exceptions available to United States shrimp trawl vessels.

   The actual *application* of the measure . . . *requires* other WTO Members to adopt a regulatory program that is not merely *comparable*, but rather *essentially the same*, as that applied to the United States shrimp trawl vessels. Thus, the effect of the application of Section 609 is to establish a rigid and unbending standard by which United States officials determine whether or not countries will be certified, thus granting or refusing other countries the right to export shrimp to the United States. Other specific policies and measures that an exporting country may have adopted for the protection and conservation of sea turtles are not taken into account, in practice, by the administrators making the comparability determination.

   . . . It may be quite acceptable for a government . . . to adopt a single standard applicable to all its citizens throughout that country. However, it is *not acceptable*, in international trade relations, for one WTO Member to use an economic embargo to *require* other Members to adopt essentially the same comprehensive regulatory program . . . *without* taking into consideration different conditions which may occur in the territories of those other Members.

   [Furthermore, the record shows that] *shrimp caught using methods identical to those employed in the United States* have been excluded from the United States market solely because they have been caught in waters of *countries that have not been certified by the United States*. . . . This suggests to us that this measure, in its application, is more concerned with effectively influencing WTO Members to adopt essentially the same comprehensive regulatory regime as that applied by the United States to its domestic shrimp trawlers, even though many of those Members may be differently situated. We believe that discrimination results not only when countries in which the same conditions prevail are differently treated, but also when the application of the measure at issue does not allow for any inquiry into the appropriateness of the regulatory program for the conditions prevailing in those exporting countries.

3. **"Arbitrary Discrimination"**—We next consider whether Section 609 has been applied in a manner constituting "arbitrary discrimination between countries where the same conditions prevail." We have already observed that Section 609, in its application, imposes a single, rigid and unbending requirement that countries applying for certification under Section 609(b)(2)(A) and (B) adopt a comprehensive regulatory program that is essentially the same as the U.S. program, without inquiring into the appropriateness of that program for the conditions prevailing in the exporting countries. Furthermore, there is little or no flexibility in how officials make the determination for certification pursuant to these provisions.[112] In our view, this rigidity and inflexibility also constitute "arbitrary discrimination" within the meaning of the chapeau.

[112]In the oral hearing, the United States stated that "as a policy matter, the United States government believes that all governments should require the use of turtle excluder devices on all shrimp trawler boats that operate in areas where there is a likelihood of intercepting sea turtles" and that "when it comes to shrimp trawling, we know of only one way of effectively protecting sea turtles, and that is through TEDs."

. . . The certification processes under Section 609 consist principally of administrative *ex parte*[113] inquiry or verification by staff of the Office of Marine Conservation in the Department of State with staff of the United States National Marine Fisheries Service. With respect to both types of certification, there is no formal opportunity for an applicant country to be heard, or to respond to any arguments that may be made against it, in the course of the certification process before a decision to grant or to deny certification is made. There is no formal written, reasoned decision, whether of acceptance or rejection, rendered on applications and countries are not even notified of denial of their applications, but must await the publication of a list of approvals in the Federal Register. No procedure for review of, or appeal from, a denial of an application is provided.

***

We find, accordingly, that the United States measure is applied in a manner which amounts to a means not just of "unjustifiable discrimination," but also of "arbitrary discrimination" between countries where the same conditions prevail, contrary to the requirements of the chapeau of article XX. The measure, therefore, is not entitled to the justifying protection of article XX of the GATT 1994. . . .

In reaching these conclusions, we wish to underscore what we have *not* decided in this appeal. We *have not decided* that the protection and preservation of the environment is of no significance to the Members of the WTO. Clearly, it is. We *have not decided* that the sovereign nations that are Members of the WTO cannot adopt effective measures to protect endangered species, such as sea turtles. Clearly, they can and should. And we *have not decided* that sovereign states should not act together bilaterally, plurilaterally or multilaterally, either within the WTO or in other international fora,[114] to protect endangered species or to otherwise protect the environment. Clearly, they should and do.

What we have decided in this appeal is simply this: although the measure of the United States in dispute in this appeal serves an environmental objective that is recognized as legitimate under paragraph (g) of article XX of the GATT 1994, this measure has been applied by the United States in a manner which constitutes arbitrary and unjustifiable discrimination between Members of the WTO, contrary to the requirements of the chapeau of article XX. . . .

***

The Appellate Body *recommends* that the DSB request the United States to bring its measure found to be inconsistent with article XI of the GATT 1994, and found in this Report to be not justified under article XX of the GATT 1994, into conformity with the obligations of the United States under that agreement.

Casepoint

The WTO Appellate Body considered whether the U.S. ban on imported shrimp that were harvested in a manner not meeting U.S. environmental requirements violated GATT rules. Generally, WTO members must treat imported goods the same way as domestic goods and not subject them to additional requirements. There are some exceptions to these rules, including one that allows a nation to take action to protect "exhaustible natural resources." The United States had imposed strict rules on shrimp harvesting, in an effort to protect endangered sea turtles, and then required all other nations to essentially adopt the same rules in order for shrimp to be imported into the United States.

The panel first concluded that the sea turtles involved here did indeed constitute "exhaustible natural resources" under Article XX(g) of the GATT, and thus the exception might apply. However, the WTO panel held that the U.S. rules were discriminatory under the *chapeau* (heading) of Article XX of the treaty in that they were applied in a rigid manner, without regard to any measures taken to protect turtles by other nations. In addition, the panel found that the U.S. procedure for determining whether other nations met the U.S standards constituted arbitrary discrimination, in that the decision was made without any opportunity for other nations to present evidence, or to have a hearing or consultation, and no review or appeal was allowed.

[113]From Latin: "from one party or side." An *ex parte* inquiry is one conducted without notice to the other party or parties adversely interested and without the latter being present or having the opportunity to contest the decision made there.

[114]Plural of "forum." A meeting place, such as a court or tribunal.

of export controls that relate to the security exceptions set out in Article XXI include export restrictions for national security reasons or in support of actions taken by the United Nations in maintaining the peace.

Protection of Cultural Property The United Nations Education, Scientific, and Cultural Organization (UNESCO), the Organization of American States (OAS), and the International Institute for the Unification of Private Law (Unidroit) have each sponsored conventions to control the international transfer of cultural artifacts.[115] The UNESCO-sponsored Convention for the Protection of Cultural Property in the Event of Armed Conflict, signed at The Hague in 1954, is the oldest of these agreements.[116] It is important in defining cultural property (i.e., "movable or immovable property of great importance to the cultural heritage of every people"); in prohibiting the theft, pillage, misappropriation, or exportation of cultural property during an armed conflict; and in establishing the principle that obligations under cultural property conventions are not retroactive.[117] The UNESCO-sponsored Convention on the Means of Prohibiting and Preventing the Illicit Import, Export, and Transfer of Ownership of Cultural Property, signed at Paris in 1970, establishes that the import, export, and transfer of ownership of cultural property are illegal if they are done contrary to laws adopted by states to protect their national heritage. The convention also requires member states to take all steps necessary to return stolen cultural properties to their state of origin.[118] An example of a contested artwork is shown in Figure 7.11.

The OAS's 1976 Convention on the Protection of the Archaeological, Historical, and Artistic Heritage of the American Nations copies most of the provisions of the 1970 UNESCO Convention, adding articles that make enforcement easier.[119]

FIGURE 7.11

One of the Elgin Marbles, Taken from the Greek Parthenon, now in the British Museum

Source: Mark R. Higgins/ Shutterstock

[115]UNESCO's Convention Concerning the Protection of the World Cultural and Natural Heritage (1972) is concerned principally with the identification and protection of cultural sites within the borders of member states. The Council of Europe's European Convention on the Protection of the Archaeological Heritage (Revised 1992) primarily regulates the exploration of archaeological sites; it only peripherally restricts the exportation of cultural property. The text of the Convention is posted on the Council of Europe's Web site at http://conventions.coe.int/treaty/en/treaties/html/143.htm.

[116]The text is in *The Protection of Cultural Property I: Compendium of Legislative Texts*, pp. 335–356 (UNESCO, 1984). It is also posted on UNESCO's Web site at http://portal.unesco.org/en/ev.php-URL_ID=13637&URL_DO=DO_TOPIC&URL_SECTION=201.html. Currently, 123 states are parties to this convention. See http://portal.unesco.org/la/convention.asp?KO=13637&language=E (accessed June 6, 2011).

[117]See *Autocephalous Greek-Orthodox Church of Cyprus v. Goldberg & Feldman Fine Arts, Inc.*, *Federal Supplement*, vol. 717, p. 1374 (1989), for an example of a case where the recipient of artifacts expropriated by an occupying military force was required to return them to their country of origin.

[118]The text is in *The Protection of Cultural Property I: Compendium of Legislative Texts*, pp. 357–364 (UNESCO, 1984). It is also posted on UNESCO's Web site at http://portal.unesco.org/en/ev.php-URL_ID=13039&URL_DO=DO_TOPIC&URL_SECTION=201.html. Currently, 120 states are parties to this convention. See http://portal.unesco.org/la/convention.asp?KO=13039&language=E (accessed June 6, 2011).

[119]The text is in *id.*, at pp. 370–374. It is also posted on the OAS's Web site at www.oas.org/juridico/english/treaties/c-16.html. The current member states are Argentina, Bolivia, Chile, Costa Rica, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Nicaragua, Panama, Paraguay, and Peru. See www.oas.org/juridico/english/sigs/c-16.html < (accessed June 6, 2011).

The 1995 Unidroit Convention on Stolen or Illegally Exported Cultural Objects requires member states to return stolen cultural objects. Claims must be made within three years after the owner learns of the location of such property and within 50 years of the time of the theft.[120]

Maintenance of National Security States have long imposed restrictions on strategically important exports as a matter of national security. Following World War II, export restrictions became a prominent feature of the West's Cold War with the East, and by 1949, the United States and its Western European allies had enacted legislation limiting exports to the Soviet Union and its Eastern European allies. The U.S. Export Control Act of 1949, for example, restricted American exports of strategic commodities to Communist countries for three reasons: (1) national security, (2) foreign policy, and (3) to preserve materials in short supply. In 1949, the United States and its allies formed the Coordinating Committee on Multilateral Export Controls (COCOM). COCOM maintained a list of commodities and technological information that each country agreed not to export to Communist and certain other states. In 1993, with the Cold War at an end, the COCOM member states agreed that its East–West focus was no longer an appropriate basis for establishing export controls, and they agreed to bring the committee to an end. The following year, at a meeting in Wassenaar, the Netherlands, the member states formally terminated COCOM and agreed to establish a new multilateral arrangement.

Wassenaar Arrangement Intergovernmental arrangement and organization to coordinate national policies so that transfers of conventional arms and dual-use goods and technologies do not contribute to the development or enhancement of military capabilities that undermine international and regional security and are not diverted to support such capabilities.

The Wassenaar Arrangement In July 1996, 33 countries[121]—including Canada, France, Great Britain, Japan, Russia, and the United States—approved the Wassenaar Arrangement on Export Controls for Conventional Arms and Dual-Use Goods and Technologies.[122] As of July 2011 there were 40 members of the Wassenaar Arrangement. Its goals are to promote transparency, the exchange of views and information, and greater responsibility in transfers of conventional arms and dual-use goods and technologies. Member countries, through their own national policies, seek to ensure that such transfers do not contribute to the development or enhancement of military capabilities that undermine international and regional security and are not diverted to support such capabilities. The Wassenaar Arrangement, however, is not meant to impede bona fide transactions and, unlike COCOM, is not directed against any state or group of states.[123]

Member countries are required to maintain export controls on a list of agreed-upon items (see Table 7.1).[124] They meet regularly in Vienna, where a small secretariat is located,[125] to update the list and to exchange information. Additionally, they make semi-annual reports on the transfer of arms and controlled dual-use items.

Membership is open to all countries on a nondiscriminatory basis. A member must be a producer of arms or an exporter of industrial equipment; maintain nonproliferation policies and appropriate national policies, including adherence to relevant nonproliferation regimes and treaties; and maintain fully effective export controls.[126]

Other Multilateral Export-Control Programs

Australia Group Multilateral group of states concerned with curbing the proliferation of chemical and biological weapons.

In addition to the Wassenaar Arrangement, there are four other multilateral export-control programs. The **Australia Group** is an informal multilateral group of states established in 1984 to address

[120]The convention is posted on the Unidroit Web site at www.unidroit.org/english/conventions/1995culturalproperty/main.htm. The convention entered into force on July 1, 1998. Currently, there are 31 member parties. See https://docs.google.com/viewer?url=http%3A%2F%2Fwww.unidroit.org%2Fenglish%2Fimplement%2Fi-95.pdf.

[121]Current members are Argentina, Australia, Austria, Belgium, Bulgaria, Canada, Croatia, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, New Zealand, Norway, Poland, Portugal, the Republic of Korea, Romania, Russia, Slovakia, Slovenia, South Africa, Spain, Sweden, Switzerland, Turkey, Ukraine, the United Kingdom, and the United States. The Wassenaar Secretariat Web site is at www.wassenaar.org (accessed March 29, 2012).

[122]The "Initial Elements" of the Wassenaar Arrangement are posted at http://www.wto.org/english/news_e/news11_e/mn11a_17dec11_e.htm#politicalguidance (accessed March 28, 2012).

[123]See "What Is the Wassenaar Arrangement?" at www.wassenaar.org/publicdocuments/whatis.html.

[124]The lists are posted at www.wassenaar.org/controllists/index.html.

[125]The secretariat maintains a Web site at www.wassenaar.org.

[126]Links to Web sites describing the export-control programs of all the Wassenaar Agreement member states are located on the secretariat's home page at www.wassenaar.org.

TABLE 7.1

Categories of excluded items

- Category 1 Special Materials and Related Equipment
- Category 2 Materials Processing
- Category 3 Electronics
- Category 4 Computers
- Category 5 - Part 1 Telecommunications
- Category 5 - Part 2 “Information Security”
- Category 6 Sensors and “Lasers”
- Category 7 Navigation and Avionics
- Category 8 Marine
- Category 9 Aerospace and Propulsion
- Sensitive List
- Very Sensitive List
- Munitions List

concerns about the proliferation of chemical and biological warfare capabilities.[127] Members[128] meet annually to share information about proliferation dangers and to harmonize their national export controls in an effort to curb the transfer of materials or equipment that could be used in the creation of chemical or biological weapons. The group maintains lists of items that should be controlled, as well as warning lists of items whose purchase may indicate proliferation activities.[129]

The **Zangger Committee** was set up the year after the Treaty on Non-Proliferation of Nuclear Weapons[130] came into force in 1970.[131] Also known as the Non-Proliferation Treaty Exporters' Committee,[132] it works to harmonize the member states' interpretations of the export-control provision of the treaty.[133] This provision calls for exporters to require International Atomic Energy Agency safeguards as a condition for the supply of nuclear material or items “especially designed or prepared for the processing, use, or production of special fissionable material.” The safeguards include peaceful end-use assurances and assurances that an item will not be reexported to a nontreaty non-nuclear weapon state unless the receiving state accepts safeguards on the item.[134]

Zangger Committee Exporting states parties to the Treaty on Non-Proliferation of Nuclear Weapons that seek to harmonize their interpretations of the treaty's export-control provision.

The **Nuclear Suppliers Group (NSG)** is a group of nuclear supplier countries—including members and nonmembers of the Treaty on Non-Proliferation of Nuclear Weapons—that seeks to contribute to the nonproliferationof nuclear weapons by maintaining control lists for

Nuclear Suppliers Group (NSG) Group of nuclear supplier states concerned with limiting the proliferation of nuclear weapons.

[127]The Australia Group Secretariat maintains a Web site at www.australiagroup.net.

[128]Currently there are 41 members: Argentina, Australia, Austria, Belgium, Bulgaria, Canada, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, the European Commission, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, New Zealand, Norway, Poland, Portugal, Romania, Slovakia, Slovenia, South Korea, Spain, Sweden, Switzerland, Turkey, Ukraine, the United Kingdom, and the United States. See the Australia Group Secretariat Web site at www.australiagroup.net/en/guidelines.html (accessed January 6, 2012).

[129]The lists are posted at www.australiagroup.net/en/controllists.html.

[130]The text of the treaty is posted on the U.S. Arms Control and Disarmament Agency's Web site at http://dosfan.lib.uic.edu/acda/treaties/npt1.htm.

[131]See National Nuclear Security Administration, “Treaties and Agreements” (June 6, 2011) at http://nnsa.energy.gov/aboutus/ourprograms/nonproliferation/treatiesagreements.

[132]The Zangger Committee was named in honor of Professor Claude Zangger of Switzerland, who chaired the committee from its inception in 1971 until 1989. U.S. Arms Control and Disarmament Agency, *Annual Report*, Chap. 6 (1997), posted at http://dosfan.lib.uic.edu/acda/reports/annual/chpt6.htm.

[133]There are now 38 member states of the Zangger Committee: Argentina, Australia, Austria, Belarus, Belgium, Bulgaria, Canada, China, Croatia, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Kazakhstan, Luxembourg, the Netherlands, Norway, Poland, Portugal, the Republic of Korea, Romania, Russia, Slovakia, Slovenia, South Africa, Spain, Sweden, Switzerland, Turkey, Ukraine, the United Kingdom, and the United States. The committee's Web site is at www.zanggercommittee.org (accessed January 11, 2012).

[134]U.S. Arms Control and Disarmament Agency, Annual Report, chap. 6 (1997), posted at http://dosfan.lib.uic.edu/acda/reports/annual/chpt6.htm.

nuclear exports and nuclear-related exports.[135] The NSG's lists aim to ensure that nuclear trade for peaceful purposes does not contribute to the proliferation of nuclear weapons or other nuclear explosive devices without hindering international trade and cooperation in the nuclear field.[136]

Missile Technology Control Regime
Group of states concerned with limiting the proliferation of missiles capable of delivering nuclear warheads.

The **Missile Technology Control Regime** was established in 1987 to limit the proliferation of missiles "capable of delivering nuclear weapons." This is an informal group with no permanent organization; each member administers its missile-related export controls independently. The members convene at regular meetings to exchange information and to agree on the goods and technologies that need to be controlled.[137]

United Nations Action to Maintain International Peace The United Nations Charter authorizes the UN Security Council to impose sanctions, including the adoption of bans on trade, on states whose actions threaten international peace,[138] and on several occasions it has imposed such sanctions. For example, in 1966, when Rhodesia's minority white government unilaterally declared independence from the United Kingdom in the hope of preserving white domination of the country, the Security Council ordered members of the United Nations to suspend trade in certain commodities with Rhodesia.[139] In 1977, in reaction to the use of apartheid laws, the Security Council imposed a mandatory ban on the sale of arms to South Africa.[140] And in recent years, following Iraq's invasion of Kuwait, the Security Council imposed an economic embargo on Iraq that is still in place.[141] And of course, there have been many other UN resolutions dealing with Iraq in recent years. Perhaps the best known is Resolution 1441, adopted by the Security Council in November 2002, finding that Iraq had violated a number of previous UN resolutions regarding weapons inspection and other matters and ordering compliance.[142]

D. Multilateral Trade Agreements

In addition to GATT 1994, there are 13 other Agreements on Trade in Goods annexed to the WTO Agreement: Nine of these deal with regulatory matters; two are *sectoral agreements* that extend GATT to certain types of goods not covered under GATT 1947; one is a program to devise a new agreement; and one is a protocol. The regulatory agreements deal with (1) customs valuation, (2) preshipment inspection, (3) technical barriers to trade, (4) sanitary and phytosanitary measures, (5) trade-related investment measures, (6) import-licensing procedures, (7) subsidies and countervailing measures,

[135]The 46 current members are Argentina, Australia, Austria, Belarus, Belgium, Brazil, Bulgaria, Canada, China, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Kazakhstan, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, New Zealand, Norway, Poland, Portugal, Romania, Russia, Slovakia, Slovenia, South Africa, South Korea, Spain, Sweden, Switzerland, Turkey, Ukraine, the United Kingdom, and the United States. The Web site of the Nuclear Suppliers Group Secretariat is at www.nuclearsuppliersgroup.org/Leng/03 (accessed January 11, 2012).

[136]See the Nuclear Suppliers Group Secretariat Web site at www.nuclearsuppliersgroup.org.

[137]Arms Control Association, "Fact Sheet: Missile Technology Control Regime," at www.armscontrol.org/factsheets/mtcr.asp. The 34 current members are Argentina, Australia, Austria, Belgium, Brazil, Bulgaria, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Portugal, Russia, South Africa, South Korea, Spain, Sweden, Switzerland, Turkey, Ukraine, the United Kingdom, and the United States.

[138]Article 41 of the United Nations Charter provides: "The Security Council may decide what measures not involving the use of armed force are to be employed to give effect to its decisions, and it may call upon members of the United Nations to apply such measures. These may include complete or partial interruption of economic relations and of rail, sea, air, postal, telegraphic, radio, and other means of communication, and the severance of diplomatic relations." The Charter is posted on the UN's Web site at www.un.org/aboutun/charter.

[139]The text of the UN Declaration is in *International Legal Materials*, vol. 5, p. 141 (1967).

[140]Security Council Resolution 418 (November 4, 1977), in *UN Monthly Chronicle*, p. 10 (December 1977) and posted on the UN Web site at http://daccess-ods.un.org/access.nsf/Get?Open&DS=S/RES/418%20(1977)&Lang=E&Area=RESOLUTION.

[141]Security Council Resolution 661 (August 6, 1990), posted on the UN Web site at http://daccess-ods.un.org/access.nsf/Get?Open&DS=S/RES/661%20(1990)&Lang=E&Area=RESOLUTION.

[142]www.un.org/Docs/journal/asp/ws.asp?m=S/RES/1441(2002).

(8) anti-dumping, and (9) safeguards.[143] The sectoral agreements cover (1) agriculture and (2) textiles and clothing. The program to devise a new agreement relates to rules of origin. The protocol describes how the Schedules of Commitments and Concessions of the member states were phased in following the adoption of the WTO Agreement.

The most significant aspect of these agreements is that they have to be acceded to by all WTO member states. Under GATT 1947, member states were not required to participate in its nontariff codes and many did not.[144] This change is intended to produce much greater international harmony in the way trade is conducted.

Another important harmonizing factor found in all of the new nontariff agreements is that disputes between member states over their application are now uniformly governed by the WTO Dispute Settlement Understanding. Previously, each agreement had its own dispute settlement provisions. Procedures to settle disputes between individuals and governments over the latter's compliance with the provisions of a particular agreement continue, however, to be specified in each agreement.

Customs Valuation

When goods cross an international frontier, they are charged a tariff that is based on a percentage of their value. The **Agreement on Implementation of Article VII of GATT 1994 (Customs Valuation Code)** is designed to harmonize the methods used by WTO member states to determine the value of those goods.[145] Its detailed rules are meant to provide for a fair, neutral, and uniform system of customs valuation. A primary method and fallback methods are established.

The primary method of customs valuation is to figure the **transaction value** of the imported item. This is based on "the price actually paid or payable for the goods when sold for export to the country of importation"[146] plus certain amounts reflecting packing costs, commissions paid by the buyer, any royalties or license fees paid by the buyer, and any resale, disposal, or use proceeds that accrue to the seller.[147]

If the transaction value of imported items cannot be fairly determined (which is the case, for example, when the seller and buyer are related), then fallback methods are used. The first such method involves determining the transaction value of identical goods sold for export to the same importing country at about the same time.[148] If this value cannot be established, then the second method is to determine the transaction value of similar items sold for export to the importing country at about the same time.[149] Third, if neither of these values can be ascertained, the **deductive value** method is used. In this case, the customs value is based on the price actually paid for the greatest number of units sold to unrelated persons in the importing country at about the same time.[150] Under the fourth method, the **computed value** is derived from the sum of (a) the cost or value of the materials, including the cost of fabrication or processing; (b) the profit and overhead that customarily apply to the particular goods in the exporting country; and (c) charges for handling, transportation, and insurance.[151] Finally, if none of these methods can be applied, a **derived value** is used. This is determined by applying whichever of the other methods best fits and adjusting it to the particular circumstances.[152]

Agreement on Implementation of Article VII of GATT 1994 (Customs Valuation Code)
Harmonizes the methods used by WTO member states for determining the value of goods for customs purposes.

transaction value
Customs value of imported goods that is based on the price actually paid or payable for goods at the time they were sold for export.

deductive value
Customs value of imported goods that is based on the price actually paid for similar goods by unrelated persons in the importing country at about the same time.

computed value
Customs value of goods that is based on their price calculated from the cost of manufacture, overhead, and handling.

derived value
Customs value of goods that is determined by using whichever of the other methods best fit and adjusting it to the particular circumstances.

---

[143]The Agreement on Government Procurement, adopted at the Tokyo Round, was carried forward as a Plurilateral Trade Agreement under the WTO rather than as a multilateral trade agreement.

[144]See the table setting out acceptances of the Tokyo Round agreements in GATT, *Analytical Index: Guide to GATT Law and Practice*, pp. 1056–1059 (6th ed., 1994).

[145]The Agreement on Implementation of Article VII of GATT 1994 reproduces the text of the 1979 Tokyo Round agreement. This is supplemented in Part III of the Final Act by a "Decision Regarding Cases Where Customs Administrations Have Reasons to Doubt the Truth or Accuracy of the Declared Value" and by "Texts Relating to Minimum Values and Imports by Sole Agents, Sole Distributors, and Sole Concessionaires." These supplements address concerns of developing countries relating to difficulties they commonly encounter in determining the value of goods for customs purposes.

[146]Agreement on Implementation of Article VII of GATT 1994, Article 1, para. 1.

[147]*Id.*, Article 8, para. 1.

[148]*Id.*, Article 2, para. 1(a).

[149]*Id.*, Article 3, para. 1(a).

[150]*Id.*, Article 5, para. 1(a).

[151]*Id.*, Article 6, para. 1(a).
At the request of the importer, the order of application of the deductive value and the computed value methods will be reversed. *Id.*, Article 4.

[152]*Id.*, Article 7, para. 1.

Preshipment Inspection

Developing states frequently engage private companies to verify price, quantity, quality, customs classifications, and other characteristics of goods before the goods are shipped from other states. This *preshipment inspection* (PSI) is meant to prevent over- and underinvoicing and fraud, and thus prevent the flight of capital and the evasion of customs duties.

Agreement on Preshipment Inspection
Allows WTO developing member states to use preshipment inspections, subject to certain criteria, to prevent over- and underinvoicing and fraud.

The **Agreement on Preshipment Inspection** authorizes developing states (other states are not mentioned) to make use of PSI, but it also tries to limit its harmful trade effects. Accordingly, WTO member states that use PSI must ensure that:

a. PSI activities are carried out in a nondiscriminatory manner;[153]
b. products subject to PSI activities and imported from other member states are accorded no less favorable treatment than national products;[154]
c. inspections are carried out either in the state of export or the state of manufacture;[155]
d. quantity and quality inspections are performed in accordance with the standards defined by the buyer and seller in their purchase agreement or, in the absence of those standards, according to relevant international standards;[156]
e. PSI activities are conducted in a transparent manner;
f. information, guidelines, and regulations relating to PSI must be readily available to exporters;
g. information received as part of the PSI is treated as business confidential;
h. conflicts of interest between entities engaged to carry out PSI activities and entities subject to those activities are avoided; and
i. unreasonable delays are avoided in carrying out PSI activities.

Central to the PSI process is the verification of prices. The PSI Agreement allows an entity engaged to carry out PSI activities to reject a contract price it believes wrong only if the entity follows certain guidelines. Most importantly, it may only compare the contract price of the goods being exported to "the price(s) of identical or similar goods offered for export from the same country of exportation at or about the same time, under competitive and comparable conditions of sale, in conformity with customary commercial practices and net of any applicable standards discounts."

In addition to the states making use of PSI, the states in which PSI activities are carried out also have certain obligations. These states must ensure that their laws and regulations relating to PSI activities are applied nondiscriminatorily and transparently. If requested, they also must offer to provide technical assistance to the states engaging in PSI activities within their territories.

Disputes between an exporter and an entity engaged to carry out PSI activities are to be resolved by mutual accord.[157] If not, either party may refer the matter for review to an independent review body[158] that will appoint a panel of three trade experts to decide the matter within eight working days. The decision of the panel will be binding on both the PSI entity and the exporter.

Agreement on Technical Barriers to Trade (TBT Agreement)
Establishes rules governing the way WTO member states draft, adopt, and apply technical regulations and standards.

Technical Barriers to Trade

The **Agreement on Technical Barriers to Trade (TBT Agreement)** establishes rules governing the way WTO member states draft, adopt, and apply technical regulations and standards to ensure that they (1) provide an appropriate level of protection for the life and health of humans, animals, and plants, as well as for the environment; (2) prevent deceptive practices; and (3) do not

[153] Agreement on Preshipment Inspection, Article 2, para. 1 (1994).

[154] *Id*., para. 2.

[155] *Id*., para. 3.

[156] *Id*., para. 4.

[157] The entity carrying out the PSI activities must designate officials to receive, consider, and promptly render decisions on grievances. *Id*., Article 2, para. 21(a).

[158] This body will be constituted jointly by an organization representing PSI entities and an organization representing exporters. *Id*., Article 4, para. (a).

create unnecessary obstacles to trade.[159] **Technical regulations** are mandatory laws and provisions specifying (1) the characteristics of products; (2) the processes and production methods for creating products; and (3) the terminology, symbols, packaging, marking, or labeling requirements for products, processes, or production methods.[160]

technical regulations
Mandatory laws and provisions that specify the characteristics of products; the processes and production methods for creating products; and the terminology, symbols, packaging, marking, or labeling requirements for products, processes, or production methods.

Recent International Developments

A. Newly Born IEC Technical Committee on Solar Thermal Electric Plants

In May 2011, a new IEC (International Electrotechnical Commission) Technical Committee (TC 117) was established to draft International Standards in the field of STE (solar thermal electric) Plants. Energy is becoming one of the most urgent and strategic issues of the policymaker's agendas. Renewable energies are expected to play an increasing role in the final energy consumption structure (2020 and beyond) in the whole world. Renewable energies are the only sustainable alternative to the increasing energy demand providing security of supply, avoiding CO2 emissions, and preventing from the uncontrolled impact of the fossil fuel price increases on the economies of developed and developing countries. Within the whole range of renewable energies, solar technologies show the largest potential. The need for standardization in the field of STE Plants arose in 2007 when new commercial plants in Spain and the United States were constructed and connected to the grid after a long period of stagnation from 1991. Many regulations at national and international levels already exist, which must be respected in manufacturing the components and erecting the plant, but standards for specific components and functionalities along with the univocal definition of performances and testing methods are missing. A global and systematic approach needs to involve experts at world level within the IEC and 20 countries have already committed to work within IEC TC 117. Spain will prepare international standards in the field of STE plants at system and component levels, including measurement standards for performance tests. Standardizing in the field of STE plants will be necessary for at least the next 10 years as the technology will evolve progressively. A fruitful production of standards is therefore foreseen as a result of the activities of this new IEC TC 117.[161]

Standards are voluntary guidelines that specify the same kind of requirements. **Conformity assessment procedures** include the sampling, testing, and inspecting of products; their evaluation, verification, and assurance of conformity; and their registration, accreditation, and approval.

standards
Voluntary guidelines that specify the same things that technical regulations mandatorily specify.

All products, including agricultural and industrial products, are covered by the TBT Agreement, but purchasing specifications related to the production or consumption requirements of governmental bodies (which are covered by the Agreement on Government Procurement) and sanitary and phytosanitary measures (which are covered by the Agreement on Sanitary and Phytosanitary Measures) are not. The TBT Agreement applies to local governments and NGOs, and central governments are required to take "reasonable measures" (in other words, to try their best) to see that these bodies do so. Ultimately, however, only the central governments are responsible for the observance of this agreement.

conformity assessment procedures
Any procedure used, directly or indirectly, to determine that relevant requirements in technical regulations or standards are fulfilled.

The main provisions of the TBT Agreement are as follows:

1. WTO member states must establish one or more offices where information and assistance about technical regulations, standards, and conformity assessment procedures can be obtained by other member states and any interested parties.[162]

---

[159]The 1994 TBT Agreement replaces the 1979 Tokyo Round Agreement on Technical Barriers to Trade (popularly known as the Standards Code).

[160]Agreement on Technical Barriers to Trade, Annex I, para. 1 (1994).

[161]WTO Committee on Technical Barriers to Trade, IEC activities in developing countries (March–June 2011), G/TBT/GEN/118.

[162]In the United States, the National Institute of Standards and Technology (NIST), part of the Department of Commerce, maintains a National Center for Standards and Certification Information. The NIST Web site describes its mission as follows. "Founded in 1901, NIST is a non-regulatory federal agency within the U.S. Commerce Department's Technology Administration. NIST's mission is to promote U.S. innovation and industrial competitiveness by advancing measurement science, standards, and technology in ways that enhance economic security and improve our quality of life." See www.nist.gov. The United States also monitors and provides information about the standards programs of other countries. See the Global Standards Program page on the NIST Web site at www.nist.gov.

2. Accepted international systems should be used in devising technical regulations, standards, and conformity assessment procedures wherever possible.[163]
3. With respect to the application of technical regulations, standards, and conformity assessment procedures, WTO member states shall ensure that products imported from other member states shall be accorded no less favorable treatment than like national products or like products originating in any other state.
4. Technical regulations, standards, and conformity assessment procedures are not to be prepared, adopted, or applied so as to create unnecessary obstacles to international trade.
5. Technical regulations, standards, and conformity assessment procedures are to be adopted or amended openly, unless international standards are used.
6. If requested, WTO member states are to provide technical assistance to other member states and especially to developing member states.

Sanitary and Phytosanitary Measures

Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement) Defines the measures that WTO member states may take to protect the life and health of humans, animals, and plants.

The **Agreement on the Application of Sanitary and Phytosanitary[164] Measures (SPS Agreement)** is meant to complement the Agreement on Technical Barriers to Trade by defining the measures that may be taken by WTO member states to *protect human, animal, and plant life and health*. Member states may protect the life and health of living things, but they may not do so as a disguised means for restricting international trade,[165] nor may they act arbitrarily to unjustifiably discriminate between states where identical or similar conditions exist. In addition, the measures taken must generally be justified by scientific evidence.

For much of the past 15 years the United States and several other countries have been at odds with the EU over the EU's ban on biotech foods and other genetically modified food products. This is a highly sensitive issue, with European governments such as those of France and Germany and several environmental groups claiming that genetically modified foods are unsafe for humans and the environment. In late 2006, the WTO officially adopted a panel decision finding that the 1998 EU ban on such foods lacked the necessary scientific proof to be justified under the SPS Agreement. The WTO ruling was 1,148 pages long—the longest ever issued by the WTO—and followed a three-year process of investigating the EU justification for banning biotech food.

The prevailing parties—Canada, Argentina, and the United States—hailed the decision as a win "for the principle of science-based policymaking over unjustified, anti-biotech policies." The U.S. Trade Representative called the ruling a rejection of "an unjustified trade barrier that has impeded both U.S. exports and the global use of technology that promises great benefit to farmers and consumers around the world." Surprisingly, the EU decided not to appeal the ruling. The top EU trade negotiator said that it had already removed the moratorium on modified sweet corn, and it had come into compliance on the other issues in the case, calling the WTO ruling "theoretical." Thus, the EU took the position that no new action was needed on its part, while the United States, Argentina, and Canada all called for the EU to immediately "remove its WTO-inconsistent measures."[166]

Case 7-4 illustrates how the SPS Agreement is applied.

Trade-Related Investment Measures

Agreement on Trade-Related Investment Measures (TRIMs Agreement) Forbids provisions commonly found in foreign investment laws that distort or reduce international trade, including provisions that discriminate against foreigners and that impose quantitative restrictions on the use of foreign products by foreign-owned local enterprises.

The **Agreement on Trade-Related Investment Measures (TRIMs Agreement)** is aimed at facilitating foreign investment and eliminating some of the provisions commonly found in foreign investment laws that distort or reduce international trade. In particular, the agreement forbids provisions in investment

[163] Agreement on Technical Barriers to Trade, Article 9 (1994). The International Organization for Standardization (ISO) is the principal IGO responsible for establishing international standards. It is a worldwide federation of national standards bodies from 130 countries. Its Web site is www.iso.org/iso/en/aboutiso/introduction/index.html.

[164] From Greek *phyto*, meaning "plant," and *sanitary*, meaning "of or pertaining to health or the conditions affecting health." Phytosanitary measures are measures taken to ensure the health of plants.

[165] Agreement on the Application of Sanitary and Phytosanitary Measures, Preamble and para. 20 (1994).

[166] "WTO Adopts Ruling That EU Illegally Blocked Biotech Food From U.S. and Others," *FindLaw.com*, Nov. 21, 2006.

CASE 7-4 Australia—Measures Affecting Importation of Salmon

Canada v. Australia
World Trade Organization, Appellate Body
Case AB-1998–5 (1998)

MAP 7.4

Australia and Canada

Introduction

Australia and Canada appeal from certain issues of law and legal interpretations in the Panel Report, *Australia—Measures Affecting Importation of Salmon*.[167] The Panel was established to consider a complaint by Canada regarding Australia's prohibition on the importation of fresh, chilled, or frozen salmon from Canada under Quarantine Proclamation 86A ("QP86A"), dated 19 February 1975 and any amendments or modifications thereto.

Before the promulgation of QP86A on 30 June 1975, Australia imposed no restrictions on the importation of salmonid products. QP86A "prohibit[s] the importation into Australia of dead fish of the sub-order Salmonidae, or any parts (other than semen or ova) of fish of that sub-order, in any form unless . . . prior to importation into Australia the fish or parts of fish have been subject to such treatment as in the opinion of the Director of Quarantine is likely to prevent the introduction of any infectious or contagious disease, or disease or pest affecting persons, animals, or plants." Pursuant to QP86A and in accordance with the authority delegated therein, the Director of Quarantine has permitted the entry of commercial imports of heat-treated salmon products for human consumption as well as non-commercial quantities of other salmon (primarily for scientific purposes) subject to prescribed conditions. Canada requested access to the Australian market for fresh, chilled or frozen, i.e., uncooked, salmon. Australia conducted an import risk analysis for uncooked, wild, adult, ocean-caught Pacific salmonid product ("ocean-caught Pacific salmon"). This category of salmon is to be distinguished from the other categories of salmon for which Canada seeks access to the Australian market ("other Canadian salmon"). The risk analysis on ocean-caught Pacific salmon was first set forth in the 1995 Draft Report, revised in May 1996 and finalized in December of 1996 (the "1996 Final Report").[168] The 1996 Final Report concluded that:

> . . . it is recommended that the present quarantine policies for uncooked salmon products remain in place.

[167] WT/DS18/R, 12 June 1998.

[168] Department of Primary Industries and Energy, Salmon Import Risk Analysis: An assessment by the Australian Government of quarantine controls on uncooked, wild, adult, ocean-caught Pacific salmonid product sourced from the United States of America and Canada, Final Report, December 1996.

The Director of Quarantine, on the basis of the 1996 Final Report, decided on 13 December 1996 that:

> . . . having regard to Australian Government policy on quarantine and after taking account of Australia's international obligations, importation of uncooked, wild, adult, ocean-caught Pacific salmonid product from the Pacific rim of North America should not be permitted on quarantine grounds.

***

. . . The Panel found that Australia has acted inconsistently with Articles 5.1, 5.5 and 5.6 and, by implication, Articles 2.2 and 2.3 of the *Agreement on the Application of Sanitary and Phytosanitary Measures* (the "*SPS Agreement*"). In paragraph 9.1 of its Report, the Panel reached the following [conclusion, among others]:

***

> (i) Australia, by adopting arbitrary or unjustifiable distinctions in the levels of sanitary protection it considers to be appropriate in different situations (on the one hand, the salmon products at issue from adult, wild, ocean-caught Pacific salmon and, on the other hand, whole, frozen herring for use as bait and live ornamental finfish), which result in discrimination or a disguised restriction on international trade, has acted inconsistently with the requirements contained in Article 5.5 of the Agreement on the Application of Sanitary and Phytosanitary Measures and, on that ground, has also acted inconsistently with the requirements contained in Article 2.3 of that Agreement. . . .

***

Article 5.5 of the SPS Agreement

The next issue we address is whether the Panel erred in law in finding that Australia has acted inconsistently with Article 5.5 of the *SPS Agreement*.

Following our Report in *European Communities—Hormones*,[169] the Panel considered:

> . . . that three elements are required in order for a Member to act inconsistently with Article 5.5:
>
> **1.** the Member concerned adopts different appropriate levels of sanitary protection in several "different situations";
>
> **2.** those levels of protection exhibit differences which are "arbitrary or unjustifiable"; and
>
> **3.** the measure embodying those differences results in "discrimination or a disguised restriction on international trade."
>
> The Panel found that all three conditions are fulfilled. . . .

***

Australia appeals from this finding of inconsistency with Article 5.5 and, by implication, Article 2.3 of the *SPS Agreement*. Without challenging the Panel's three-step legal test for inconsistency with Article 5.5 as such, Australia contends that the Panel has made a series of errors of law in the interpretation and application of the test. . . .

First Element of Article 5.5

With regard to the first element of Article 5.5, namely, the existence of distinctions in appropriate levels of protection in different situations, the Panel cited our Report in *European Communities—Hormones*, where we stated that "situations . . . cannot, of course, be compared, unless they

[169] Adopted February 13, 1998, WT/DS26/AB/R, WT/DS48/AB/R para. 214.

are comparable, that is, unless they present some common element or elements sufficient to render them comparable."[170] The Panel found that:

> . . . in the circumstances of this dispute, we can compare situations under Article 5.5 if these situations involve either a risk of "entry, establishment or spread" of the same or a similar disease *or* of the same or similar "associated biological and economic consequences" and this irrespective of whether they arise from the same product or other products. (emphasis added)

On this basis, the Panel determined that the import prohibition on fresh, chilled or frozen salmon for human consumption *and* the admission of imports of (i) uncooked Pacific herring, cod, haddock, Japanese eel and plaice for human consumption; (ii) uncooked Pacific herring, Atlantic and Pacific cod, haddock, European and Japanese eel and Dover sole for human consumption; (iii) herring in whole, frozen form used as bait ("herring used as bait"); and (iv) live ornamental finfish, are "different" situations which can be compared under Article 5.5 of the *SPS Agreement*.

***

Australia . . . contends that the Panel erred in determining that its examination on the comparability of different situations must be limited solely to those disease agents positively detected. According to Australia, the Panel diminished Australia's right to a cautious approach to determine its own appropriate level of protection. Australia argues that the Panel failed to interpret the provisions of Article 5.5 in their context and in the light of the object and purpose of the *SPS Agreement*. According to Australia, the terms "likelihood" and "potential" in regard to the definition of "risk assessment" contained in paragraph 4 of Annex A, and the terms "scientific principles" and "sufficient scientific evidence" contained in Article 2.2, make it clear that the basic SPS right set out in Article 2.1 to take SPS measures necessary for the protection of animal life or health, is not contingent on positive scientific evidence of disease detection.

We note that, contrary to what Australia argues, the Panel did not limit its examination under Article 5.5 to diseases positively detected in fresh, chilled or frozen ocean-caught Pacific salmon. On the contrary, it appears clearly from Annex 1 to the Panel Report, entitled "The Four Comparisons under Article 5.5," that the Panel examined diseases of concern which, according to Australia, may be carried by fresh, chilled or frozen ocean-caught Pacific salmon but which have not yet been positively detected in this type of salmon. We also note that the Panel stated explicitly that:

> . . . To the extent that both the other products and the salmon products further examined are known to be hosts to one of these disease agents or—for the salmon products—give rise to an alleged concern for that disease agent, they can be associated with the same kind of risk, namely a risk of entry, establishment or spread of that disease.

In addition, we believe that for situations to be comparable under Article 5.5, it is sufficient for these situations to have in common a risk of entry, establishment or spread of *one* disease of concern. There is no need for these situations to have in common a risk of entry, establishment or spread of *all* diseases of concern. Therefore, even if the Panel had excluded from its examination some diseases of concern not positively detected in fresh, chilled or frozen ocean-caught Pacific salmon, this would not invalidate its finding . . . on comparable situations under Article 5.5.

We, therefore, uphold the Panel's finding . . . that the import prohibition on fresh, chilled or frozen salmon for human consumption and the admission of imports of other fish and fish products are "different" situations which can be compared under Article 5.5 of the *SPS Agreement*.

[170]Adopted February 13, 1998, WT/DS26/AB/R, WT/DS48/AB/R para. 217.

Second Element of Article 5.5

With regard to the second element of Article 5.5, namely, the existence of arbitrary or unjustifiable distinctions in appropriate levels of protection in different situations, the Panel began its analysis by noting that in view of the difference in SPS measures and corresponding levels of protection for salmon products, on the one hand, and the four categories of other fish and fish products, on the other, one might expect some justification for this difference, such as a higher risk from imported salmon. However, as the Panel noted:

> . . . the arguments, reports, studies and expert opinions submitted to us in this respect—rather than pointing in the direction of a higher risk related to . . . [ocean-caught Pacific salmon], in order to justify the stricter sanitary measures imposed for these products—all provide evidence that the two categories of non-salmonids [herring used as bait and live ornamental finfish], for which more lenient sanitary measures apply, can be presumed to represent at least as high a risk—if not a higher risk—than the risk associated with . . . [ocean-caught Pacific salmon].

The Panel, therefore, found that, on the basis of the evidence before it, the distinctions in levels of sanitary protection reflected in Australia's treatment of, on the one hand, ocean-caught Pacific salmon and, on the other, herring used as bait and live ornamental finfish, are "arbitrary or unjustifiable" in the sense of the second element of Article 5.5.

Australia argues that the Panel erred in determining that its examination under Article 5.5, second element, must be limited solely to those disease agents positively detected in ocean-caught Pacific salmon. Australia raises the same objections to this limitation as it did in the context of the first element discussed above.

We do not agree with Australia that the Panel excluded diseases of concern which have not been positively detected in ocean-caught Pacific salmon from its examination under Article 5.5. The Panel explicitly took into account diseases which have not been positively detected in ocean-caught Pacific salmon but had been detected in herring used as bait and live ornamental finfish. . . .

Third Element of Article 5.5

With regard to the third element of Article 5.5, i.e., that the arbitrary or unjustifiable distinctions in levels of protection result in "discrimination or a disguised restriction on international trade," we note that the Panel identified three "warning signals" as well as three "other factors more substantial in nature." The Panel considered that each of these "warning signals" can be taken into account in its decision on the third element of Article 5.5. In . . . its Report, it concluded:

> On the basis of all "warning signals" and factors outlined above, considered cumulatively, . . . the distinctions in levels of protection imposed by Australia for, on the one hand, . . . [ocean-caught Pacific salmon] and, on the other hand, herring . . . use[d] as bait and live ornamental finfish, . . . result in "a disguised restriction on international trade," in the sense of the third element of Article 5.5.

Australia contends that the Panel made a number of substantive errors of law in using these "warning signals" to come to its conclusion on the third element of Article 5.5.

The first "warning signal" the Panel considered was the arbitrary or unjustifiable character of the differences in levels of protection. It noted what we stated in *European Communities—Hormones:*

> . . . the arbitrary or unjustifiable character of differences in levels of protection . . . may in practical effect operate as a "warning" signal that the implementing measure in its application might be a discriminatory measure or might be a restriction on international trade disguised as an SPS measure for the protection of human life or health.[171]

[171]Adopted February 13, 1998, WT/DS26/AB/R, WT/DS48/AB/R, para. 215.

The Panel, therefore, considered that:

> . . . In this dispute, . . . the arbitrary character of the differences in levels of protection is a "warning signal" that the measure at issue results in "a disguised restriction on international trade."

According to Australia, the Panel erred in according the first "warning signal," the status of evidence which demonstrates that the measure results in a disguised restriction on international trade. We note however, that it appears clearly from the Panel Report, and in particular, from the reference therein to our Report in *European Communities—Hormones*, that the Panel considered the arbitrary or unjustifiable character of differences in levels of protection as a "warning signal" for, and not as "evidence" of, a disguised restriction on international trade.

The second "warning signal" considered by the Panel was the *rather substantial difference* in levels of protection between an import prohibition on ocean-caught Pacific salmon, as opposed to tolerance for imports of herring used as bait and of live ornamental finfish. The Panel noted our statement in *European Communities—Hormones* that:

> . . . the degree of difference, or the extent of the discrepancy, in the levels of protection, is only one kind of factor which, along with others, may cumulatively lead to the conclusion that discrimination or a disguised restriction on international trade in fact results from the application of a measure.[172]

On that basis, the Panel stated:

> . . . we do consider that the rather substantial difference in levels of protection is one of the factors we should take into account in deciding whether the measure at issue results in "a disguised restriction on international trade," as argued by Canada.

Australia contends that this second "warning signal" is effectively no different in character from the first "warning signal" and should therefore be discounted. We note, however, that in this case the degree of difference in the levels of protection (prohibition *versus* tolerance) is indeed, as the Panel stated, "rather substantial." We, therefore, consider it legitimate to treat this difference as a separate warning signal.

The third "warning signal" the Panel considered was the inconsistency of the SPS measure at issue with Articles 5.1 and 2.2 of the *SPS Agreement*. The Panel considered that its earlier finding of inconsistency with Articles 5.1 and 2.2:

> . . . may, together with other factors, lead to the conclusion that the measure at issue results in a "disguised restriction on international trade." Indeed, considering these violations of Articles 5.1 and 2.2 it would seem that the measure at issue constitutes an import prohibition, i.e., a restriction on international trade, "disguised" as a sanitary measure. We do stress, however, that this additional "warning signal" as such cannot be sufficient to conclude that the measure results in a "disguised restriction on international trade."

Australia objects to the use of this inconsistency as a warning signal in the context of the third element of Article 5.5. It argues that inconsistency with Article 5.1 cannot "presume" or pre-empt a finding under Article 5.5. We note that a finding that an SPS measure is not based on an assessment of the risks to human, animal or plant life or health—either because there was no risk assessment at all or because there is an insufficient risk assessment—is a strong indication that this measure is not really concerned with the protection of human, animal or plant life or health but is instead a trade-restrictive measure taken in the guise of an SPS measure, i.e., a "disguised restriction on international trade." We, therefore, consider that the finding of inconsistency with Article 5.1 is an appropriate warning signal for a "disguised restriction on international trade.". . .

We, therefore, uphold the Panel's finding that, by maintaining the measure at issue, Australia has acted inconsistently with its obligations under Article 5.5, and, by implication, Article 2.3 of the *SPS Agreement*.

[172]Adopted February 13, 1998, WT/DS26/AB/R, WT/DS48/AB/R, para. 240.

Casepoint

Australia had banned the importation of fresh, chilled, or frozen salmon from North America under Quarantine Proclamation 86A, claiming that such protection was allowed by the GATT SPS regulations to protect against disease. Canada brought an action to the WTO challenging the ban and pointing out that Australia had not banned either herring or live ornamental fish. A WTO panel, and now the Appellate Body, ruled that Australia had violated the GATT by adopting arbitrary or unjustifiable distinctions in the levels of sanitary protection it considered to be appropriate in different situations. The Appellate Body found that the Australian action was not based on thorough scientific evidence or risk assessment and was, rather, a "disguised restriction on international trade."

Current International Issues

Trade Disputes Involving China

Since China joined the WTO in late 2001, it has become the world's leading exporter. In 2001, its share of world exports stood at 4.3 percent but by 2010 that share had soared to 10.6 percent. This rise in export strength has also spawned a rapidly growing list of trade quarrels. China was a party to only two of the 93 trade disputes that were taken to the WTO between its accession and the end of 2005. But in the five years from 2005 until 2010, it was involved in 26 of the 84 cases filed with the WTO and that number is increasing.

One recent case decided by the WTO concerned various practices by China, including double pricing, export taxes, and quotas, which served to restrict the export of certain industrial raw materials, including bauxite, magnesium, zinc, coke, fluorspar, and silica, of which China is a leading producer. The U.S., European Union, and Mexico argued that China's policies gave domestic firms that use these commodities an unfair competitive advantage, while also restricting world supply of these inputs and causing their prices to soar.

In addition, the European Union argued that China had violated a protocol to its 2001 WTO Accession Agreement that limited the circumstances in which export bans could be introduced. An annex to the protocol lists 87 products whose export could be limited by the Chinese authorities. In contrast, in 2009 a total of 373 items were subject to such restrictions. China argued that it was limiting the exports in order to conserve the world's limited supply of these materials and to protect the environment from the pollution caused by their extraction. However, the WTO panel noted, although China restricted the export of these commodities, it had done nothing to reduce their actual production. Thus China's policies were found in clear violation of its WTO commitments.

Sources: "The WTO and China: Hands slapped: A ruling with ramifications," The Economist, July 7, 2011; "Expected WTO ruling should strengthen EU position on export curbs," International Law Office, June 24, 2011.

laws that discriminate unfavorably against foreigners (i.e., that do not accord them "national treatment")[173] and that impose quantitative restrictions on the use of foreign products by foreign-owned local enterprises.[174] Examples include requirements that a foreign-owned enterprise must purchase or use a certain amount or proportion of domestic products ("local contents requirements") and requirements that restrict the volume or value of an enterprise's imports by linking them to the volume or value of its exports ("trade-balancing requirements") or by correlating an enterprise's access to foreign exchange to its foreign exchange earnings ("foreign exchange balancing restrictions").[175]

Import-Licensing Procedures

Agreement on Import-Licensing Procedures Requires that the import-licensing procedures of WTO member states be neutral in their application and that they be administered in a fair and equitable manner.

Because licensing requirements may restrict or distort trade, the **Agreement on Import-Licensing Procedures** seeks to ensure that import-licensing procedures are neutral in their application and administered in a fair and equitable manner.[176] Forms and procedures are to be as simple as possible

[173]Agreement on Trade-Related Investment Measures, Article 2, para. 1 (1994).

[174]*Id*., para. 2.

Developed member states were given until December 31, 1996, to eliminate any provisions inconsistent with the TRIMs Agreement. Developing states had until December 31, 1999, and ". . .[A] product is to be considered as being dumped, i.e., introduced into the commerce of another country at less than its normal value, if the export price of the product exported from least-developed member states had until December 31, 2001." *Id*., Article 5, para. 2. Further negotiations on these issues are still taking place in 2008 as one of the many items still on the Doha Agenda.

[175]*Id*., Annex, paras. 1–2.

[176]Agreement on Import Licensing Procedures, Article 1, para. 3 (1994).

and applicants should have to deal only with a single administrative body.[177] Import licenses are not to be denied because of minor errors in completing the application;[178] nor are imports to be barred because of minor deviations in the value, quantity, or weight designated on the license.[179]

Anti-dumping

The **Agreement on Implementation of Article VI of GATT 1994**, or the **Anti-dumping Code**, replaces codes negotiated during the Tokyo and Kennedy Rounds. The current code defines **dumping** in the following way:

> A product is to be considered dumped, i.e. introduced into the commerce of another country at less than its normal value, if the export price of the product exported from one country to another is less than the comparable price, in the ordinary course of trade, for the like product when destined for consumption in the exporting country.[180]
>
> For several years the United States and Canada have been involved in a dispute over the importation of softwood lumber into the U.S. After many hearings before WTO dispute settlement bodies, the WTO Appellate Body issued its final decision in 2006. The U.S. Department of Commerce (DOC) had placed anti-dumping duties on Canadian softwood lumber exporters, which were challenged by Canada, as violative of WTO rules. After a ruling in favor of Canada, the U.S. DOC had calculated new rates, but those were then challenged by Canadian authorities. After several hearings, the WTO Appellate Body found that the DOC calculations, which used a so-called "zeroing" method, violated the WTO anti-dumping rules and must be changed. The "zeroing" approach takes into account imports which enter the country at prices deemed to be below a "dumping" threshold, but ignores any shipments of the same product which come in at higher prices.[181]

Agreement on Implementation of Article VI of GATT 1994 (Anti-dumping Code)
Allows WTO member states to counter dumping through the application of anti-dumping duties.

dumping
Selling exported goods at prices below their normal value.

Significantly, the Anti-dumping Code does not prohibit dumping. It recognizes instead that the dumping of imports may be countered through the application of anti-dumping duties, but only if an investigation determines that the dumped imports cause or threaten to cause material injury to, or materially retard the establishment of, a domestic industry within the importing country.[182] A *domestic industry* is defined by the code as the domestic producers as a whole of like products or those domestic producers whose collective output of products makes up a major share of the total output of such products within their state.[183]

An investigation to determine the existence, degree, and effect of an alleged dumping may be initiated (1) "upon a written application by or on behalf of the [affected] domestic industry";[184] (2) "in special circumstances" by governmental authorities of the affected state;[185] or (3) by an application made by authorities of an affected third country.[186] In any of these cases, the application must disclose evidence showing (1) dumping; (2) material injury or threat of injury to, or material retardation to the establishment of, a domestic industry; and (3) a causal link between the dumped imports and the alleged injury.[187]

---

[177]*Id.*, paras. 5–6.

[178]*Id.*, para. 7.

[179]*Id.*, para. 8.

[180]Agreement on Implementation of Article VI of GATT 1994, Article 2, para. 1.

[181]See WTO Appellate Body Issues Compliance Report for US/Canada Lumber Dispute, *International Law Update*, Vol. 12, September 2006, p. 176 and also WTO Rules Outlaw "Zeroing" in Anti-dumping Cases, *Agra Europe* 2204 (April 21, 2006).

[182]*Id.*, Article 3, n. 9.

[183]*Id.*, Article 4, para. 1.

[184]Id., Article 5, para. 1.

[185]*Id.*, Article 5, para. 6.

[186]*Id.*, Article 14, para. 1.

[187]*Id.*, Article 5, paras. 2 and 6; and Article 14, para. 2.

The investigation will be terminated and no anti-dumping duties will be imposed if "the margin of dumping is *de minimis*, or [if] the volume of dumped imports, actual or potential, or the injury, is negligible. The margin of dumping shall be considered to be *de minimis* if this margin is less than 2 percent, expressed as a percentage of the export price. The volume of dumped imports shall normally be regarded as negligible if the volume of dumped imports from a particular country is found to account for less than 3 percent of imports of the like product in the importing country unless countries which individually account for less than 3 percent of the imports of the like product in the importing country collectively account for more than 7 percent of imports of the like product in the importing country." *Id.*, Article 5, para. 8.

The authorities carrying out an investigation must give all interested parties notice of the investigation, an opportunity to present written evidence, and the opportunity to examine and rebut adverse evidence.[188] Even so, the investigation is to be carried out expeditiously, and the procedures that allow interested parties to participate may not be used by the parties as a means of delaying the investigation, reaching a preliminary or final decision, or applying provisional or final anti-dumping measures.[189]

Provisional measures (i.e., the imposition of a provisional anti-dumping duty or the deposit of a security equal to a provisionally estimated anti-dumping duty) may be imposed after an investigation has been initiated, a preliminary determination has been made of dumping and consequential injury to a domestic industry, and the authorities concerned believe that such measures are necessary to prevent injury being caused during the course of the investigation.[190] Final anti-dumping duties may be imposed at the discretion of the authorities concerned upon the completion of an investigation and a final determination that dumping, injury, and a causal link between them exist.[191]

The monetary amount of an anti-dumping duty may not exceed the difference between a product's normal value (i.e., the price charged for the same or similar products exported to third countries, or their cost of production plus a reasonable amount for administrative and other costs and for profits) and the price at which it was actually exported.[192] Such a duty may remain in force as long as necessary to counteract dumping that is causing injury.[193]

Dumping investigations are lengthy, complex procedures that involve many hearings, much fact-finding, and actions by several different administrative agencies and courts. The procedure in the United States is explained in Case 7-5.

CASE 7-5 Nippon Steel Corporation v. United States

United States Court of Appeals for the Federal Circuit Decided: August 10, 2006

Opinion by Chief Judge Michel

The United States and Mittal Steel USA ISG Inc. ("Mittal") appeal the decision of the United States Court of International Trade ("trade court") instructing the United States International Trade Commission ("Commission") to issue a determination that the domestic industry was not materially injured by less-than-fair-value ("LTFV") imports of tin- and chromium-coated steel sheets ("TCCSS") from Japan. This anti-dumping case has a procedural history spanning six years, which now includes four determinations by the Commission, four opinions from the Court of International Trade, and one prior opinion from this court.

Appellants argue that the Court of International Trade erred in *Nippon IV* by reweighing the facts and substituting its own credibility determinations, in contravention of law and this court's remand instructions in *Nippon Steel Corp. v. Int'l Trade Comm'n*, 345 F.3d 1379, 1380 (Fed. Cir. 2003) ("*Nippon III*"). Appellants further argue that the Court of International Trade erred in holding in *Nippon IV*—that the Commission's affirmative material injury determination in its second remand determination was supported by less than substantial evidence.

[188] *Id.*, Article 6, paras. 1–2.

Interested parties include "(i) an exporter or foreign producer or the importer of a product subject to investigation, or a trade or business association a majority of the members of which are producers, exporters, or importers of such product; (ii) the government of the exporting country; and (iii) a producer of the like product in the importing country or a trade and business association a majority of the members of which produce the like product in the importing country." *Id.*, para 11.

[189] *Id.*, para. 14.

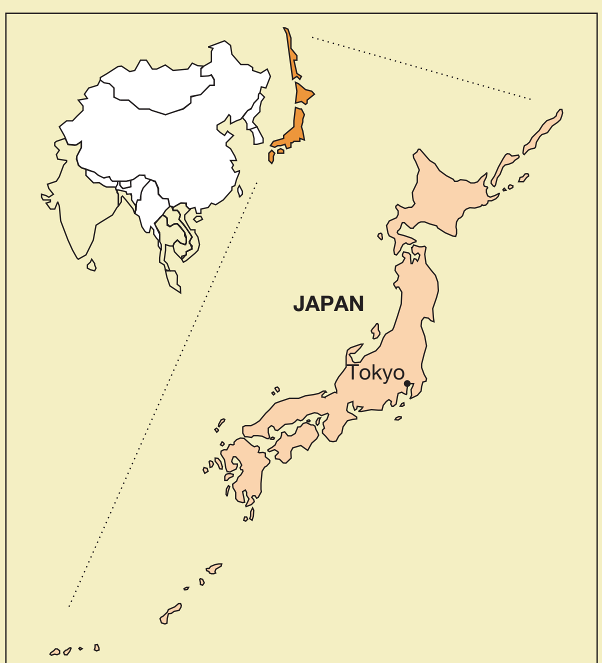
[190] *Id.*, Article 7, paras. 1–3.

[191] *Id.*, Article 9, para. 1.

[192] *Id.*, Article 9, para. 3; and Article 2.

[193] *Id.*, Article 11, para. 1.

Reviews must be held periodically and, if no review is conducted for a five-year period, the duty will automatically terminate. *Id.*, Article 11, paras. 2 and 3.



MAP 7.5

Japan (2006)

We agree. Accordingly, we reverse the Court of International Trade's decisions in *Nippon IV* and *Nippon V*, and instruct the trade court to vacate the Commission's negative material injury and negative threat of material injury determinations and reinstate the Commission's affirmative material injury determination.

I. A Brief History of this Case

In 2000, the Commission made a final determination that the domestic industry was materially injured by TCCSS dumping from Japan, which required consideration of import volume, price effects, impact on domestic producers, and causation. Nippon Steel Corporation, NKK Corporation, Kawasaki Steel Corporation, and Toyo Kohan Co., Ltd. (collectively, "Nippon") sought review in the Court of International Trade, which sustained the Commission's finding of a small but significant volume, but remanded for a reevaluation of price effects and causation. *Nippon Steel Corp. v. United States, 182 F. Supp. 2d 1330, 1340, 1356 (Ct. Int'l Trade 2001) ("Nippon I").*

On remand, the Commission again made an affirmative material injury determination. Nippon again appealed, and the Court of International Trade found lingering flaws in the Commission's analysis of price effects and causation *("Nippon II")* and directed the Commission to enter a negative material injury determination. The Commission then appealed to this court. We vacated the decision of the Court of International Trade in *Nippon II* and ordered a remand to the Commission for additional data gathering and analysis (*Nippon III*), 345 F.3d at 1380, stating that the Court of International Trade had exceeded its authority by engaging in refinding the facts (e.g., by determining witness credibility), and interposing its own determinations on causation and material injury. On the second remand, the Commission yet again made an affirmative material injury determination. And on appeal, the Court of International Trade remanded for a third time, again instructing the Commission to enter a negative material injury determination (*Nippon IV*), 350 F. Supp. 2d. at 1189. The Commission entered a negative material injury determination on the third remand, stating: "this outcome is dictated by the Court's findings in *Nippon IV;* it is not, however, the determination we would have made in the absence of those findings." In its decision the Commission expressed its concern about the actions of the Court of International Trade, stating its view that "the Court has again re-found facts by substituting its view of the record for that of the Commission . . . and has also rejected the Commission's witness credibility determinations, substituting the Court's own assessment of the accuracy of testimony."

II. The Role of Administrative Agencies and the Courts

Congress created a highly specialized system for resolving anti-dumping allegations, which recognizes and exploits each participant's area of expertise. An anti-dumping inquiry is divided into two sub-inquiries: (1) a determination of whether the subject imports were, or were likely to be, sold at Less Than Fair Value (LTFV), and (2) a material injury determination. Congress placed responsibility for the LTFV determination with industry experts at the Department of Commerce, and placed responsibility for the material injury determination with trade experts at the International Trade Commission.

Members of the International Trade Commission are appointed by the President, and confirmed by the Senate, because of their expertise in recognizing, and distinguishing between, fair and unfair trade practices. They presumably are selected to be Commissioners based on their expertise in, *inter alia*, foreign relations, trade negotiations, and economics. Because of this expertise, Commissioners are the factfinders in the material injury determination: "It is the Commission's task to evaluate the evidence it collects during its investigation. Certain decisions, such as the weight to be assigned a particular piece of evidence, lie at the core of that evaluative process." *U.S. Steel Group v. United States*, 96 F.3d 1352, 1357 (Fed. Cir. 1996).

In contrast, Article III judges have expertise primarily in law. Accordingly, Congress assigned the Court of International Trade, and, through our appellate authority, this court, the responsibility to review the legal sufficiency of a Commission determination. When the Commission has made a final determination of material injury or threat of material injury to a domestic industry, federal law provides that the Court of International Trade should reject any finding or conclusion which is "unsupported by substantial evidence on the record, or otherwise not in accordance with law." Judges of the Court of International Trade are experts in such cases, which form most of their docket.

Congress did not specify a standard of review for this court in reviewing judgments of the Court of International Trade. We have previously adopted the "substantial evidence" judicial review standard for the trade court as our appellate standard of review. Because the substantial evidence standard requires review of the entire administrative record, we consider both the trade court's prior decisions and the Commission determinations, including "the evidence presented to and the analysis by the Commission."

III. What Is "Substantial Evidence"?

A

"Substantial evidence" is difficult to define precisely. However, the Supreme Court, Congress, and prior panels of this court have provided some guidance. In *NLRB v. Columbian Enameling & Stamping Co.*, 306 U.S. 292, 300 (1939), the Court explained that "[s]ubstantial evidence is more than a scintilla, and must do more than create a suspicion of the existence of the fact to be established." A reviewing court must consider the record as a whole, including that which "fairly detracts from its weight," to determine whether there exists "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." A party challenging the Commission's determination under the substantial evidence standard "has chosen a course with a high barrier to reversal."

Accordingly, the question for the Court of International Trade was, and for this court is, "not whether we agree with the Commission's decision, nor whether we would have reached the same result as the Commission had the matter come before us for decision in the first instance." Rather, "we must affirm a Commission determination if it is reasonable and supported by the record as a whole, even if some evidence detracts from the Commission's conclusion." In short, we do not make the determination; we merely vet the determination.

In a material injury inquiry, the Commission is required by statute to evaluate the volume, price effects, and impact of the subject imports. When the Commission makes an affirmative material injury determination, it must decide *whether the material injury to the domestic industry is "by reason of" the subject imports. (emphasis added)*

The Commission engaged in substantial research and analysis prior to issuing its initial affirmative material injury determination. It created, distributed, and analyzed responses to detailed questionnaires sent to all seven domestic TCCSS producers, as well as the five largest domestic

purchasers of TCCSS. From producers, the Commission obtained and analyzed information on production, geographic scope of sales, pricing and discounting practices, capacity utilization, shipments, inventories, and employment. From purchasers, the Commission obtained and analyzed information on final bids of domestic and Japanese suppliers, negotiation tactics, and purchasing volume, and attempted to verify producers' lost sale allegations. Two Commission staff members visited complainant Weirton Steel's premises and interviewed several employees regarding the TCCSS manufacturing process, negotiations, pricing, and contracts. In addition, Commissioners heard a full day of testimony, including that of officers of four domestic purchasers, the CEO of Weirton Steel, and seven members of Congress, including Senator John D. Rockefeller IV.

In earlier proceedings the Commission had found there was a small but significant volume (sustained by the trade court) and that there was a significant impact (not questioned on appeal). Thus, as of *Nippon IV*, two of the three factors to be considered in a material injury determination had been established. The evidence rejected by the Court of International Trade in *Nippon IV* related to the remaining factor, price effects, and to causation.

We therefore state the issue before us as whether the Commission's findings that Japanese TCCSS *dumping could be linked to price effects* in, and causation of injury to, the domestic market so distorts or detracts from the evidence in favor of injury as to render the evidence supporting the Commission's ultimate affirmative material injury determination insubstantial on the record.

1. Price Effects U.S. law [Section 1677(7)(C)(ii)] provides that in evaluating price effects, the Commission shall consider whether:

- **I.** there has been significant price underselling by the imported merchandise as compared with the price of domestic like products of the United States, and
- **II.** the effect of imports of such merchandise otherwise depresses prices to a significant degree or prevents price increases, which otherwise would have occurred, to a significant degree.

The Commission evaluated the producers' financial data, noting that the domestic industry's overall cost of goods sold ("COGS") had increased in relation to net sales, from 96.4 percent of sales in 1997 to 97.8 percent in 1998 and 101.3 percent in 1999. The Commission attributed this change to a corresponding decline in unit prices "at a rate that outstripped the industry's unit costs" and noted that the industry's profitability levels also declined consistently during the relevant period, with operating losses increasing from 0.9 percent in 1997 to 3.0 percent in 1998 to 6.5 percent in 1999. The Commission acknowledged that the operating losses decreased to 1.9 percent in the interim year 2000, but attributed this change to the filing of the anti-dumping petition in October 1999. The Commission found that the subject imports caused the suppression of domestic prices, based on the Commission's underlying finding that the domestic industry was suffering from a cost-price squeeze.

The Court of International Trade agreed that "the domestic industry generally may have been experiencing a cost-price squeeze,"[194] but rejected the Commission's conclusion based on Nippon's assertion that the two domestic producers competing most directly with Japanese TCCSS importers reported positive operating margins during the period of investigation. Implicit in Nippon's assertion, and the Commission's rejection thereof, is the fact that other domestic producers showed negative operating margins. Thus, we are faced with a situation where some domestic producers, and the industry as a whole, were in a cost-price squeeze, while two major producers were not. Substantial evidence exists on both sides of the issue. The Commission opted for one inference, and the Court of International Trade for another. In such a situation, however, the statutory substantial evidence standard compels deference to the Commission.

2. Causation Section 1673d(b)(1) provides that, once the Commission has made an affirmative material injury determination, it must determine whether the injury arises "by reason of imports, or sales (or the likelihood of sales) for importation. . . . If the Commission determines that imports of the subject merchandise are negligible, the investigation shall be terminated." This causation requirement is met so long as the effects of dumping are not merely incidental, tangential, or trivial.

In rejecting the Commission's finding on causation, *we must conclude that the Court of International Trade again improperly substituted its own credibility determinations for those of*

[194]When the cost of goods sold ("COGS") exceeds the price, the producer is unable to sell the product for more than what it costs to produce the product; if the producer is unable to raise prices, the industry finds itself in what is referred to as a *cost-price squeeze*. See *Nippon IV*, 350 F. Supp. 2d at 1198.

the Commission. The Commission's finding of causation was based entirely on its interpretation of purchaser questionnaires, testimony, and purchasing history. Purchaser F's questionnaire response indicating that two domestic suppliers had been dropped because of price, and internal documents indicating that its sourcing decisions were driven primarily by price. Although quality and delivery issues were also mentioned, the Commission concluded that the evidence that import purchases were made because of price was more credible, and found that injury to the domestic industry was not caused solely by problems with domestic producers' quality and delivery. Under the substantial evidence standard, when adequate evidence exists on both sides of an issue, assigning evidentiary weight falls exclusively within the authority of the Commission.

C.

The Court of International Trade engaged in an extremely thorough, careful examination of the record—indeed it may well have conducted a better analysis than did the Commission. As explained *supra*, a party challenging the Commission's determination under the substantial evidence standard "has chosen a course with a high barrier to reversal." *Mitsubishi*, 275 F.3d at 1060. "[E]ven if it is possible to draw two inconsistent conclusions from evidence in the record, such a possibility does not prevent [the Commission's] determination from being supported by substantial evidence." Here, it is significant that the trade court already had accepted the Commission's findings on the first two factors supporting its affirmative material injury determination: volume and impact.

Ample evidence existed on both sides of the remaining factor, price effects, and on the question of causation. When the totality of the evidence does not illuminate a black-and-white answer to a disputed issue, it is the role of the expert factfinder—here the majority of the Presidentially-appointed, Senate-approved Commissioners—to decide which side's evidence to believe. So long as there is adequate basis in support of the Commission's choice of evidentiary weight, the Court of International Trade, and this court, reviewing under the substantial evidence standard, must defer to the Commission.

IV.

For the reasons articulated above, we hold that the Court of International Trade erred in assessing credibility and in reweighing the evidence before the Commission, and erred in concluding that the Commission's finding of material injury to the domestic injury was not supported by substantial evidence. Accordingly, we reverse the Court of International Trade's decisions in *Nippon IV* and *Nippon V*, set aside the Commission's negative material injury and negative threat of material injury determinations and direct that the trade court reinstate the Commission's affirmative material injury determination.

REVERSED.

Casepoint

This demonstrates the complex interaction between the various agencies involved in making a determination as to whether illegal dumping has occurred. The federal appellate court finally resolves a long-running dispute between the U.S. International Trade Commission and the Court of International Trade concerning the elements of proof necessary to prove dumping and which agency has the role of making which finding. In this case, the important findings of fact made by the commission were improperly disregarded by the Trade Court, and the federal circuit court therefore reverses the decision and reinstates the findings made by the commission that there was a material injury to a domestic industry.

subsidy
A financial contribution made by a government or other public body that confers a benefit on an enterprise, a group of enterprises, or an industry.

Subsidies and Countervailing Measures

A **subsidy** is a financial contribution made by a government (or other public body) that confers a benefit on an enterprise, a group of enterprises, or an industry. Examples of subsidies are (1) direct transfers of funds (e.g., grants, loans, and equity infusions), (2) potential direct transfers of funds (e.g., loan guarantees), (3) the foregoing of revenues (e.g., tax credits), (4) the providing of goods or services (other than general infrastructure), and (5) the conferring of any form of income or price

support.[195] Subsidies, moreover, may be made directly by a government or indirectly through funding mechanisms or private bodies.[196]

When improperly used by a government to promote its export trade to the detriment of another state, subsidies are forbidden by GATT 1994. If subsidies have an unreasonable impact on another country's internal market, that country can impose countervailing duties to offset their impact, but only if it follows certain conditions to ensure that its reaction is justified, appropriate, and not excessive.

The **Agreement on Subsidies and Countervailing Measures, or SCM Agreement**, replaces the 1979 Subsidies Code concluded at the Tokyo Round. The 1979 code was criticized because it failed to define a subsidy, to establish criteria for determining if harm had been or was about to be caused by a subsidy, and to calculate a subsidy's impact.[197] These deficiencies are all remedied in the new SCM Agreement.

The SCM Agreement clearly states that its "disciplines" (i.e., member state obligations) apply only to "specific" subsidies—that is, subsidies that target (1) a specific enterprise or industry, (2) specific groups of enterprises or industries, or (3) enterprises in a particular region.[198] The disciplines do not apply to (1) nonspecific subsidies, (2) certain specific subsidies defined in the agreement, and (3) agricultural subsidies (which are governed by the Agreement on Agriculture).

Agreement on Subsidies and Countervailing Measures (SCM Agreement)
Classifies subsidies as prohibited, actionable, and nonactionable; forbids the first class and allows affected WTO member states to request consultation, to obtain a remedy from the WTO, or to impose countervailing duties independently.

Categories of Specific Subsidies Specific subsidies (i.e., those regulated by the SCM Agreement) are divided into two categories: (1) prohibited subsidies (informally referred to as *red* subsidies), and (2) actionable subsidies (*yellow*). The agreement originally contained a third category: **nonactionable subsidies**. This category existed for five years, ending on December 31, 1999, and was not extended.

Prohibited subsidies (red subsidies) are subsidies that either (1) depend upon export performance (in other words, on a firm's or industry's success in exporting its products)[199] or (2) are contingent upon the use of domestic instead of imported goods (e.g., subsidies based on so-called domestic content rules).[200] Red subsidies are presumed to be trade distorting, and WTO member states are forbidden to grant or maintain them. [201]

Actionable subsidies (yellow subsidies) are subsidies that may or may not be trade distorting, depending on how they are applied (thus the reason for their designation as yellow). They are defined[202] as specific subsidies that, in the way they are used, (1) injure a domestic industry of another member state, (2) nullify or impair benefits due another member state under GATT 1994, or (3) cause or threaten to cause "serious prejudice" [203] to the interests of another member state. WTO member states are discouraged, but not forbidden, from using actionable subsidies. [204]

nonactionable subsidy
A subsidy that is permissible and nonchallengeable, such as government funding to underwrite research activities, to aid disadvantaged regions, or to help existing facilities adapt to new environmental requirements.

prohibited subsidy
A subsidy that is presumed to be trade distorting because it requires export performance or is contingent upon the use of domestic instead of imported goods.

actionable subsidy
A subsidy that may be challenged as trade distorting if it injures the domestic industry of another WTO member state, nullifies or impairs the benefits due another member state, or causes or threatens to cause serious prejudice to the interests of another member state.

[195]Agreement on Subsidies and Countervailing Measures, Article 1 (1994).

[196]*Id.*

[197]John Kraus, *The GATT Negotiations: A Business Guide to the Results of the Uruguay Round*, p. 33 (1994).

[198]Agreement on Subsidies and Countervailing Measures, Article 2 (1994).

[199]*Id.*, Article 3, para. 1(a).

An illustrative list of 12 examples is provided in Annex I of the SCM Agreement.

[200]*Id.*, para. 1(b).

[201]*Id.*, para. 2.

[202]*Id.*, Article 5.

[203]Serious prejudice "may arise in any case where one or several of the following apply: (a) the effect of the subsidy is to displace or impede the imports of like product into the market of the subsidizing member; (b) the effect of the subsidy is to displace or impede the exports of like product of another member from a third country market; (c) the effect of the subsidy is a significant price undercutting by the subsidized products as compared with the price of a like product of another member in the same market or significant price suppression, price depression, or lost sales in the same market; (d) the effect of the subsidy is an increase in the world market share of the subsidizing member in a particular subsidized primary product or commodity as compared to the average share it had during the previous period of three years and this increase must follow a consistent trend over a period when subsidies have been granted." *Id.*, Article 6, para. 3.

Serious prejudice is presumed to exist "in the case of: (a) the total *ad valorem* subsidization of a product exceeding 5 percent; (b) subsidies to cover operating losses sustained by an industry; (c) subsidies to cover operating losses sustained by an enterprise, other than one-time measures which are nonrecurrent and cannot be repeated for that enterprise and which are given merely to provide time for the development of long-term solutions and to avoid acute social problems; (d) direct forgiveness of debt, i.e., forgiveness of government-held debt, and grants to cover debt repayment." *Id.*, para. 1.

A subsidizing member state can nevertheless overcome these presumptions by showing that none of the effects first mentioned above (Article 6, para. 3) apply. *Id.*, para. 2.

[204]The SCM Agreement, Article 5, uses the permissive phrase "no member should" in describing the obligations of member states in connection with actionable subsidies.

Remedies and Countervailing Measures A WTO member state that believes that its domestic industries have been injured by either prohibited subsidies or actionable subsidies is given four options: (1) do nothing, (2) request consultations, (3) seek a remedy from the WTO, or (4) independently impose countervailing duties. If an injured member state chooses to do nothing, neither the WTO nor any other member state is entitled to intervene.[205]

To obtain a remedy from the WTO, a member state claiming an injury must first consult with the subsidizing member state.[206] If the two states are unable to find a mutually acceptable solution, either one may refer the matter to the WTO's Dispute Settlement Body (DSB) for the latter to set up a Panel.[207] If the Panel—which may seek the assistance of a Permanent Group of Experts (a body established by the SCM Agreement)—concludes that there is a prohibited subsidy, it will recommend the subsidy's withdrawal; if it concludes that there is an actionable subsidy, it will recommend that the subsidizing member state either remove the subsidy's adverse effects or withdraw the subsidy.[208] If neither party appeals to the DSB's Appellate Body, the DSB must promptly adopt the report (unless it rejects it by consensus).[209] If there is an appeal, the Appellate Body's decision must be unconditionally observed.[210]

One of the most contentious issues regarding subsidies and countervailing duties in recent years has involved the competition between the European-manufactured Airbus and the American-manufactured Boeing aircraft. Dating to 2005, the United States complaint against the European Union forms the first part of the most complex and voluminous case ever to have been brought before the global trade body. The original panel ruling in 2010 ran more than 1,000 pages, and the appellate body's report (summarized below) is more than 600 pages.

Case 7-6 represents the WTO Appellate Body ruling regarding complaints by the United States against the European Union.

CASE 7-6 United States—European Communities—Measures Affecting Trade in Large Civil Aircraft

Appellate Body Report WT/DS316/AB/R[211]

The United States complained that the European Union was providing illegal subsidies to Airbus companies in violation of Articles 3, 5, and 6 of the SCM Agreement and Articles III:4, XVI:1, and XXIII:1 of GATT 1994.

Measures at Issue

The measures at issue in this dispute are more than 300 separate instances of alleged subsidization, over a period of almost forty years, by the European Communities and four of its member States, France, Germany, Spain and the United Kingdom, with respect to large civil aircraft ("LCA") developed, produced and sold by the company known today as Airbus SAS. The measures that are the subject of the US complaint may be grouped into five general categories: (i) "Launch Aid" or "member State Financing" (LA/MSF); (ii) loans from the European Investment Bank; (iii) infrastructure and infrastructure-related grants; (iv) corporate

[205] Articles 4 and 7 of the SCM Agreement, which provide for the consultations and WTO remedies, and Articles 10 through 23, which authorize the imposition of countervailing duties, only allow a member state claiming an injury to one of its domestic industries to initiate these proceedings.

[206] Agreement on Subsidies and Countervailing Measures, Article 4, para. 1, and Article 7, para. 1 (1994).

[207] The referral may be made after 30 days in the case of prohibited subsidies, *id*., Article 4, para. 4; and after 60 days in the case of actionable subsidies, *Id*., Article 7, para. 4.

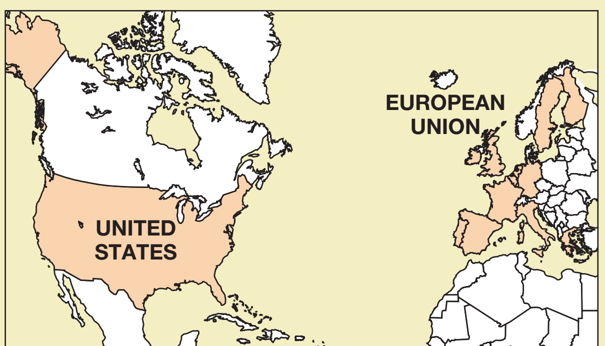
[208] The report must be submitted within 90 days for prohibited subsidies, *Id*., Article 4, para. 4; and 120 days for actionable subsidies, *Id*., Article 7, para. 4.

[209] This must be done within 30 days. *Id*., Article 4, para. 8; Article 7, para. 6.

[210] The Appellate Body must hand down its decision within 30 (in exceptional circumstances 60) days for prohibited subsidies, *Id*., Article 4, para. 9; and within 60 (in exceptional circumstances 90) days for actionable subsidies, Article 7, para. 7.

A prohibited subsidy must be withdrawn within a time period specified by the panel, *id*., Article 4, para. 7; and an actionable subsidy must be withdrawn within six months of the DSB or Appellate Body's decision, *Id*., Article 7, para. 9.

[211] This report is posted at the WTO's Web site at www.wto.org/english/tratop_e/dispu_e/cases_e/ds316_e.htm.



MAP 7.6

European Union and United States (2001)

restructuring measures; and (v) research and technological development funding. The United States claims that each of the challenged measures is a specific subsidy within the meaning of Articles 1 and 2 of the SCM Agreement, and that the European Communities and the four member States, through the use of these subsidies, cause adverse effects to the US interests within the meaning of Articles 5 and 6 of the SCM Agreement. In addition, the United States claims that seven of the challenged LA/MSF measures are prohibited export subsidies within the meaning of Article 3 of the SCM Agreement.

"Specific Subsidies" under SCM Agreement Articles 1 and 2

Turning to the allegations of subsidization, the panel found that each of the challenged LA/MSF measures constitutes a specific subsidy. However, the panel found that the United States had failed to establish the existence, as of July 2005, of a commitment of LA/MSF for the A350 constituting a specific subsidy, and that the United States had failed to demonstrate the existence of a "LA/MSF Programme" as a distinct measure, separate from the individual grants of LA/MSF. Finally, the panel concluded that the United States had established that the German, Spanish and UK A380 LA/MSF measures are subsidies contingent in fact upon anticipated export performance, and therefore prohibited export subsidies, but that the four other measures challenge in this respect are not prohibited export subsidies, either in law or in fact.

The panel found that each of the 12 challenged loans provided by the European Investment Bank ("EIB") to various Airbus entities between 1988 and 2002 is a subsidy, but that none of these subsidies was specific, and therefore dismissed the US claims in respect of the EIB loans from further consideration.

. . . The panel also concluded that the challenged grants provided by national and regional authorities in Germany and Spain for the construction of manufacturing and assembly facilities in several locations in Germany and Spain are specific subsidies. However, the panel found that road improvements by French authorities related to the ZAC Aéroconstellation industrial site were measures of general infrastructure, and thus not subsidies, and that GBP 19.5 million provided to Airbus UK in respect of its operations in Broughton, Wales, and a grant provided by the government of Andalusia to Airbus in Puerto Santa Maria, were not specific subsidies.

"Adverse Effect" under SCM Agreement Articles 5(a) and (c)

Having determined which of the measures challenged by the United States are specific subsidies, the panel proceeded to evaluate whether these subsidies to Airbus cause adverse effects to the US interests within the meaning of Articles 5(a) and (c) of the SCM Agreement. Specifically, the panel considered whether, through the use of these subsidies, the European Communities, France, Germany, Spain and the United Kingdom cause or threaten to cause: (i) "injury" to the US industry producing LCA (Article 5(a)); and (ii) "serious prejudice" to US interests (Article 5(c)), in that the effect of the subsidies is (a) to displace or impede imports of US LCA into the EC market, (b) to displace or impede exports of US LCA from third country markets, and (c) significant price undercutting by EC LCA as compared with the price of US LCA in the same market,

and significant price suppression, price depression and lost sales in the same market, within the meaning of Articles 6.3(a), (b) and (c) of the SCM Agreement.

The panel first concluded that it was appropriate to conduct the analysis of adverse effects on the basis of one subsidized product, all Airbus LCA, as proposed by the United States, and that there is a single US product that is "like" the subsidized product, namely all Boeing LCA. With respect to the appropriate "reference period" for the assessment of injury and serious prejudice, the panel rejected the US view that it was required to make the determination concerning adverse effects "as of" the date of establishment of the panel in July 2005. The panel concluded it is charged with making a determination of "present" adverse effects, taking into account all of the evidence before it, including the most recent information available, consistent with due process, that is relevant and reliable.

The panel addressed the claims with respect to serious prejudice following a "two-step" approach, considering first whether the evidence demonstrated that the particular market effects identified in Article 6.3(a), (b) and (c) of the SCM Agreement existed, and second whether any of the effects found to exist was caused by the specific subsidies it had found. The panel concluded that the United States had demonstrated the existence of displacement of imports and exports from the European and certain third country markets, as well as significant price depression, price suppression and lost sales, but had failed to demonstrate the existence of significant price undercutting.

With respect to causation, the panel concluded that LA/MSF shifts a significant portion of the risk of launching an aircraft from the manufacturer to the governments supplying funding, which was in all instances on non-commercial terms, and that Airbus' ability to launch, develop, and introduce to the market, each of its LCA models was dependent on subsidized LA/MSF. The panel found that all of the remaining specific subsidies at issue were sufficiently linked to the product and the particular market effects in question to make it appropriate to analyze the effects of the subsidies on an aggregated basis. The panel concluded that Airbus would have been unable to bring to the market the LCA that it launched as and when it did but for the specific subsidies it received from the European Communities and the governments of France, Germany, Spain and the United Kingdom. The panel did not conclude that Airbus necessarily would not exist at all but for the subsidies, but merely that it would, at a minimum, not have been able to launch and develop the LCA models it actually succeeded in bringing to the market. Thus, the panel considered that Airbus' market presence during the period 2001–2006, as reflected in its share of the EC and certain third country markets and the sales it won at Boeing's expense, was clearly an effect of the subsidies in this dispute. However, the panel rejected the US argument that the specific subsidies in this dispute provided Airbus with significant additional cash flow and other financial resources on non-market terms which allowed it to price its aircraft more aggressively than it would otherwise be able to without those subsidies, or that the effect of LA/MSF on cost of capital was such that it enabled Airbus to lower prices of LCA during the period 2001–2006. Therefore, the panel concluded that the United States had failed to demonstrate that an effect of the subsidies was the significant price depression or price suppression observed during that period.

Conclusions and Recommendations

Overall, the panel concluded that the United States had established that the effect of the specific subsidies found was (i) displacement of imports of US LCA into the European market; (ii) displacement of exports of US LCA from the markets of Australia, Brazil, China, Chinese Taipei, Korea, Mexico, and Singapore; (iii) likely displacement of exports of US LCA from the market of India; and (iv) significant lost sales in the same market, and that these effects constituted serious prejudice to the interests of the United States within the meaning of Article 5(c) of the SCM Agreement. However, the panel concluded that the United States had not established that the effect of the specific subsidies found was (i) significant price undercutting; (ii) significant price suppression; and (iii) significant price depression. In addition, the panel concluded that the United States had not established that, through the use of the subsidies, the European Communities and certain EC member States cause or threaten to cause injury to the US domestic industry.

Taking into account the nature of the prohibited subsidies it had found in this dispute, and in the light of Article 4.7 of the SCM Agreement, the panel recommended that the subsidizing Member granting each subsidy found to be prohibited withdraw it without delay, specifying that this be within 90 days. In light of its conclusions with respect to adverse effects, the panel recommended, pursuant to Article 7.8 of the SCM Agreement, that upon adoption of its report . . . the Member granting each subsidy found to have resulted in such adverse effects "take appropriate

steps to remove the adverse effects or . . . withdraw the subsidy." However, the panel declined to make any suggestions concerning steps that might be taken to implement its recommendations.

Casepoint

The WTO panel considered whether subsidies provided by members of the European Union to Airbus companies constituted prohibited subsidies under the SCM Agreement and GATT 1994. Ultimately, the panel found that some of the subsidies brought to issue by the United States constituted "serious prejudice to the interests of the United States" within the meaning of Article 5(c) of the SCM Agreement. However, the panel also concluded that the United States failed to provide sufficient evidence that a number of specific subsidies provided by the European Communities and EC member states caused or threatened to cause injury to the U.S. domestic industry. Accordingly, the panel recommended the immediate withdrawal of all subsidies found to be prohibited.

Commentary on this Case

Both sides claimed victory after the WTO appellate decision was announced. The ruling upheld a panel decision that *Boeing* lost market share to its European rival, *Airbus*, as a result of billions of dollars in low-cost government loans, according to European and American officials. But the decision rejected claims by the United States that state financing for the Airbus A380 superjumbo jet was automatically prohibited under global trade rules.

The appellate body concurred with the earlier WTO panel finding that loans extended to Airbus over the course of four decades did constitute unfair subsidies that had caused Boeing to lose aircraft sales. But the ruling also rejected the most crucial American argument: namely, that the loans—known as launch aid—that Airbus received from Germany, Spain, and Britain for the twin-deck A380 jets were expressly prohibited because governments expected a significant export market for the planes when they granted the support.

As we have discussed, the WTO defines two broad categories of subsidies: those that are "prohibited" and those that are "actionable"—that is, subject to legal challenge or to countervailing measures like punitive tariffs. Prohibited subsidies are those that are specifically designed to promote exports or to encourage production using domestically made components.

Under WTO rules, any "prohibited" subsidy must be withdrawn within 90 days of the adoption of a dispute panel's findings. "Actionable" subsidies are not prohibited automatically, but they can be challenged if the complaining country shows that the subsidy caused material injury—a loss of jobs, profit, or production capacity—or "adverse effects" to its industry, like a loss of export market share or sales.

The appellate ruling did not find European "launch aid" loans for the A380 to be prohibited. But it did find many of them to be actionable, which will require European governments to propose some form of remedy in the coming months to offset the benefit of any outstanding subsidies, trade lawyers said.

Other nations also gave their opinions on this blockbuster decision of the WTO.

China noted that the Appellate Body report made a significant contribution to the interpretation of subsidies, including systemic issues related to the life of a subsidy, the infrastructure measures, the export subsidies, and the determination of serious prejudice. China hoped that the EU would take appropriate steps to withdraw subsidies found inconsistent with the SCM Agreement, or remove the adverse effects caused by them to ensure that the industries of other WTO members would not suffer from such adverse effects any longer.

Brazil said that it continued to be concerned about distortive effects of subsidies of a particularly pernicious nature such as the launch aid measure that were at issue in this case. Brazil highlighted some of its concerns regarding the Appellate Body interpretation on export subsidies. Brazil believed that the panel and Appellate Body findings would help safeguard the disciplines of the SCM Agreement in a way that contributed to ensuring a level playing field, where manufacturers can develop products and compete with each other on the basis of their own strength, and not on the basis of the leverage provided by national treasuries.

Australia said that export subsidies were prohibited because of their potential to directly distort international trade. Australia added that it was therefore imperative that members, when designing public programs, were clearly aware of the rules that determined whether a particular program would amount to an export subsidy. Australia added that the Appellate Body developed that test for determining export contingency and thus the test for determining whether a particular subsidy amounted to a prohibited export subsidy.

EU Wins Similar WTO Case Against Boeing and the United States

In response to the United States case against the European Union challenging the Airbus subsidies, the EU countered in 2004 by filing a similar case with the WTO against U.S. airplane manufacturer Boeing.[212] In this suit, Boeing was alleged to have received billions of dollars in illegal subsidies from the U.S. government, just as Airbus was alleged to have received from the EU in the case filed by the United States, in the case summarized above. In 2011, following the WTO's ruling against Airbus for having received over $18 billion in illegal subsidies from the EU, the WTO also ruled against Boeing for having received at least $5.3 billion in illegal subsidies from the U.S. government. As of July 2011, the standoff has yet to be resolved, as United States officials are expected to appeal the WTO's ruling against Boeing. In the next few years, the EU and United States will undoubtedly be trying to reach a settlement of these two cases.

If a member state does not comply with a DSB-adopted report or Appellate Body decision, the DSB will authorize (unless it agrees by consensus not to do so) a complaining member state to adopt countervailing measures.[213] A **countervailing measure** is defined in the SCM Agreement simply as a duty specially levied to offset a subsidy. [214]

countervailing measure A duty specifically levied to offset a subsidy.

As an alternative to seeking a WTO-authorized remedy, a state may independently impose countervailing duties so long as it follows the procedures specified in the SCM Agreement[215] (which are the same as those used in the Anti-dumping Code for the adoption of anti-dumping measures). The reason a state may prefer to adopt countervailing duties independently instead of seeking a WTO-authorized remedy is that its administrative agencies will have greater control over the process. On the other hand, a state with limited resources will find the WTO-funded process more economical.

Developing States and States Transitioning to Market Economies Developing states are given special treatment in the SCM Agreement. The least developed states and developing states with a per capita income of less than U.S. $1,000 are allowed to use subsidies based on export performance and were

In the News: Recent International Developments

As has been mentioned earlier in this chapter, China is involved in an increasing number of cases before the WTO Dispute Settlement Body—winning some and losing some. One of the most recent cases arose when the U.S. imposed punitive tariffs of up to around 20 percent on Chinese steel pipes, tires, and laminated woven sacks in 2007. A year later, China complained to the WTO that the U.S. had acted illegally. In October 2010, a WTO panel rejected those claims.

China appealed, arguing the U.S. couldn't legally impose both classes of punitive duties—anti-dumping and anti-subsidy—on the same goods. As has been mentioned, anti-dumping duties punish the selling of goods below cost in a foreign country, while the countervailing duties compensate for government aid, such as grants and low-interest loans. Anti-dumping duties are usually levied on countries that are not designated as "market economies," because some subsidies are assumed in those countries. Instead, the WTO permits importers to calculate probable cost of the good using another country as a reference. For China, it is often another emerging economy such as Turkey or Mexico.

The U.S. and most other countries do not consider China a market economy, and therefore usually don't apply anti-subsidy duties. China has been campaigning hard for market-economy status from both the U.S. and EU because it would make it harder for those countries to levy anti-dumping duties. In its 232-page report, the WTO's appellate body said that the U.S. couldn't apply both kinds of duties to the same products. The U.S. must now remove some of the duties and change the method of computing punitive duties in future cases.

Source: John W. Miller, "Trade Body Rules in Beijing's Favor," Wall Street Journal, March 12, 2011.

[212]N. Clark, New York Times, March 31, 2011. www.nytimes.com/2011/03/31/business/global/01trade.html?_r=1 (accessed July 6, 2001); see also IBTimes Staff Reporter, "Boeing received illegal subsidies: WTO," *International Business Times*, January 31, 2011. www.ibtimes.com/articles/107115/20110131/boeing-received-illegal-subsidies-wto.htm (accessed July 5, 2011).

[213]*Id*., Article 4, para. 10; Article 7, para. 9.

[214]*Id*., Article 10, provides: "The term 'countervailing duty' shall be understood to mean a special duty levied for the purpose of offsetting any subsidy bestowed directly or indirectly upon the manufacture, production, or export of any merchandise, as provided for in Article VI:3 of the GATT 1994."

[215]*Id*., Articles 10–23.

given until the year 2003 to phase out subsidies based on domestic content.[216] Other developing states were required to phase out both kinds of subsidies by the end of 1999.[217] Less rigorous procedures were also applied to developing countries with respect to remedies and countervailing duties.[218]

States in the process of transforming themselves from centrally planned to market economies were allowed to adopt programs necessary to facilitate the transformation, and they were given time to phase out any existing prohibited and actionable subsidies.[219] How these developments are to be phased in is one of the many items under negotiation as part of the Doha round.

Safeguards

Safeguards are emergency actions that a WTO member state may take to protect its domestic industries from serious injury from a sudden increase in the quantity of an imported product. Until the **Agreement on Safeguards** was adopted with the inauguration of WTO, the provisions of Article XIX (entitled "Emergency Actions on Imports of Particular Products") of GATT 1947 governed safeguards. The problem with this was that Article XIX was simply ignored by the GATT 1947 contracting parties.[220] Instead of withdrawing concessions in the manner provided for by Article XIX, states found it easier to resort to alternative protectionist devices that limited exports instead of imports. Examples were *orderly marketing arrangements* (OMAs)[221] and *voluntary export restraints* (VERs).[222]

safeguard
An emergency action that a WTO member state may take in order to protect its domestic industry from serious injury due to a sudden increase in the quantity of an imported product.

Agreement on Safeguards
Establishes multilateral controls over the use of safeguards by WTO member states.

Even though OMAs, VERs, and other similar arrangements are restraints on exports, they nevertheless violate GATT,[223] and it is the purpose of the Agreement on Safeguards to establish multilateral control over them and over safeguards in general. Thus, safeguard measures in existence at the time the WTO was inaugurated[224] had to be phased out by the end of 1999,[225] and new safeguards can be instituted only in specific limited cases and only for limited time periods.

A WTO member state may apply safeguard measures against a product only after conducting an official investigation to determine that the product is being imported into its territory in such increased quantities and under such conditions as to cause or threaten to cause serious injury to the domestic industry that produces like or directly competitive products.[226] The measures must then be applied to a product (1) regardless of its origin (i.e., the GATT principle of nondiscrimination applies)[227] and (2) only for the time and to the extent necessary to prevent or remedy serious injury and to facilitate adjustment.[228]

To encourage domestic industries to make adjustments, any safeguard measure that is to last longer than one year must be progressively liberalized at regular intervals over its lifetime. If it is to

[216]Agreement on Subsidies and Countervailing Measures, Article 27, paras. 2 and 2 bis (1994).

[217]*Id*.

[218]*Id*., Article 27, paras. 6–14.

[219]*Id*., Article 29, paras. 1–2.

[220]John Kraus, *The GATT Negotiations: A Business Guide to the Results of the Uruguay Round*, p. 37 (1994).

[221]OMAs are formal agreements between importing and exporting states as to the quantity of a particular product that the exporting state will export to the importing state. OMAs that include industry participation are known as *voluntary restraint agreements* (VRAs). Organization for Economic Cooperation and Development, *Obstacles to Trade and Competition*, p. 17 (1993).

[222]VERs are government-sponsored arrangements among exporting firms that limit exports to a predetermined ceiling. *Id*.

[223]Although sometimes classed as being within a "gray area" under GATT because they involved exports (*Id*., p. 21), both VERs and OMAs, as well as other forms of export restraint agreements, clearly violate GATT. Article XI, para. 1, of GATT provides: "No prohibitions or restrictions other than duties, taxes, or other charges, whether made effective through quotas, import or *export* licenses, or other measures, shall be instituted or maintained by any member on the importation of any product of the territory of any other member or on the *exportation or sale for export* of any product destined for the territory of any other member" (emphasis added).

[224]See Kent A. Jones, *Export Restraint and the New Protectionism: The Political Economy of Discriminatory Trade Restrictions*, pp. 12–17 (1994), for a list of voluntary restraints and similar measures that were in existence as of mid-1990.

[225]Agreement on Safeguards, paras. 21 and 22(b) (1994).

An exception allowed each importing member state to maintain one existing OMA or VER until the end of 1999. *Id*., para. 23. One example is mentioned in the Annex to the Agreement on Safeguards. It involves an agreement between the EU and Japan on certain types of motor vehicles. According to the WTO, no other member took advantage of this exception. See "Understanding the WTO—Agreements: Anti-dumping, subsidies, safeguards, contingencies, etc.," posted at www.wto.org/english/thewto_e/whatis_e/tif_e/agrm8_e.htm.

[226]*Id*., para. 2.

[227]*Id*., para. 5.

[228]*Id*., para. 10.

last for more than three years, a review must be made by its midterm to determine if the measure should be withdrawn or liberalized more quickly.[229]

The WTO Safeguards Committee meets twice a year to review all safeguard actions and notifications by member nations. The most recent report covering the period from October 20, 2009–October 22, 2010, reviewed 21 notifications under Article 12.1(a) regarding the initiation of new investigations,[230] six notifications concerning the application of new provisional measures under Article 12.4, and 18 notifications of termination of safeguard investigation without measure. Furthermore, the Committee reviewed six notifications concerning decisions to apply new safeguard measures. [231] During the period under review, the Committee received six notifications concerning new decisions not to apply a safeguard measure to developing country members.

Figure 7.12 is a chart showing the total of all safeguard measures adopted by WTO member nations over the past 15 years, from the WTO Web site. The two nations that have initiated the most safeguard measures are India and Turkey.

Agriculture

Agriculture has always been one of the most difficult items on the WTO agenda. All nations want to protect and assist their farmers, and many governments provide them with substantial financial subsidies. This obviously distorts the free market for, and has a substantial effect on the prices of, agricultural goods around the world. The reduction and/or elimination of the subsidies is one of the central and most difficult matters that has prolonged the Doha negotiations. While the EU and the United States have attempted to obtain tariff reductions from other nations for their exports, other countries and regional groups have demanded that the EU and the United States substantially reduce their agricultural subsidies in return. The **Agreement on Agriculture** establishes guidelines for "initiating a process of reform of trade in agriculture." Its ultimate goal is the establishment of a market-oriented system for trade in agricultural products that is free of restrictions and distortions.

Agreement on Agriculture
Establishes guidelines for initiating a process of reform to progressively integrate international trade in agricultural products into the GATT system.

To begin the process of reform, the agreement (1) specifies the agricultural products it governs; (2) requires that nontariff barriers to agricultural imports be converted into customs tariffs; (3) defines permissible forms of domestic supports; (4) defines export subsidies; (5) phases in initial reductions in tariffs, impermissible domestic support measures, and export subsidies during a six-year implementation period (developing countries are given a 10-year period); and (6) progressively integrates international trade in agricultural products into the GATT system.

The agricultural products governed by the agreement include foodstuffs (except for fish and fish products), hides, skins, animal hairs, raw cotton, raw flax, raw hemp, raw silk, and certain related products.[232]

Upon becoming members of the WTO and parties to the Agreement on Agriculture, states agreed to convert their existing nontariff barriers upon agricultural imports (including quotas, levies, and licenses)[233] into equivalent customs tariffs. The process for doing this involved taking the difference in internal and external prices and making appropriate adjustments (for differences in quality or variety, for freight and other charges, and for other elements that provided protection to domestic producers). [234] These tariff rates were then incorporated into a Schedule of Concessions that each member state deposited with the GATT Secretariat to be appended to GATT 1994 along with its commitment to reduce its tariff rates during the implementation period. [235] On average,

[229] *Id.*, para. 13.

[230] Notifications concerning initiations of reviews to determine whether or not to extend existing measures are not included in this figure.

[231] This figure includes recommendations to impose measures where the final decisions have not yet been made.

[232] *Id.*, Article 2.

[233] *Id.*, Article 4, para. 2, n. 1.

[234] *Id.*, Attachment to Annex 5.

[235] Uruguay Round Protocol to the General Agreement on Tariffs and Trade 1994, para. 1.

Safeguard Measures by Reporting Member

Period: 29/03/1995 to 30/04/2012

Reporting Member	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total
Argentina	0	1	0	0	0	2	0	0	0	0	0	1	0	0	0	0	0	4
Brazil	0	1	0	0	0	0	1	0	0	0	0	0	0	0	0	0	0	2
Bulgaria*	0	0	0	0	0	0	2	0	0	0	0	0	0	0	0	0	0	2
Chile	0	0	0	0	2	1	2	0	0	1	1	0	0	0	0	0	0	7
China, P.R.	0	0	0	0	0	0	1	0	0	0	0	0	0	0	0	0	0	1
Croatia	0	0	0	0	0	0	0	0	0	0	0	0	0	1	0	0	0	1
Czech Republic*	0	0	0	1	0	1	1	2	0	0	0	0	0	0	0	0	0	5
Dominican Republic	0	0	0	0	0	0	0	0	0	0	0	0	0	0	2	0	0	2
Ecuador	0	0	0	0	0	1	0	1	1	0	0	0	0	0	1	0	0	4
Egypt	0	0	0	1	1	1	0	0	0	0	0	0	1	0	0	0	0	4
European Union*	0	0	0	0	0	0	1	0	1	1	0	0	0	0	0	0	0	3
Hungary*	0	0	0	0	0	0	0	3	0	0	0	0	0	0	0	0	0	3
India	0	0	4	1	1	0	2	0	0	1	0	0	0	3	0	1	1	14
Indonesia	0	0	0	0	0	0	0	0	0	0	1	0	0	2	0	7	3	13
Jordan	0	0	0	0	0	1	1	2	0	1	0	1	0	0	1	0	0	7
Korea, Rep. of	0	1	0	0	1	0	0	0	0	0	0	0	0	0	0	0	0	2
Kyrgyz Rep.	0	0	0	0	0	0	0	0	0	0	0	0	0	1	0	0	0	1
Latvia*	0	0	0	1	0	0	0	1	0	0	0	0	0	0	0	0	0	2
Lithuania*	0	0	0	0	0	0	1	0	0	0	0	0	0	0	0	0	0	1
Moldova	0	0	0	0	0	0	0	0	1	0	0	0	0	0	0	0	0	1
Morocco	0	0	0	0	0	1	0	0	0	0	1	0	0	0	0	0	0	2
Panama	0	0	0	0	0	0	0	0	0	0	0	1	0	0	0	0	0	1
Philippines	0	0	0	0	0	0	1	1	3	0	0	0	0	1	0	1	0	7
Poland*	0	0	0	0	0	0	0	4	0	0	0	0	0	0	0	0	0	4
Slovak Republic*	0	0	0	0	0	1	0	1	0	0	0	0	0	0	0	0	0	2
South Africa	0	0	0	0	0	0	0	0	0	0	0	1	0	0	0	0	0	1
Thailand	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1	0	1
Turkey	0	0	0	0	0	0	0	0	0	2	4	1	4	1	0	1	0	13
Ukraine	0	0	0	0	0	0	0	0	0	0	0	0	1	1	0	0	0	2
United States	1	0	1	1	2	0	1	0	0	0	0	0	0	0	0	0	0	6
Totals for 29/03/1995–30/04/2012	1	3	5	5	7	9	14	15	6	6	7	5	6	10	4	11	4	118

*The European Union enlarged its Members on 1 May 2004 and on 1 January 2007. The newly-acceded countries still appear on the tables in this database as individual WTO Members as their statistics prior to joining the European Union remain valid. All figures pertaining to the European Union are counted: (a) on a 15-Member basis for the period between 1 January 1995-30 April 2004, (b) on a 25-Member basis for the period between 1 May 2004-31 December 2006 and (c) on a 27-Member basis for the period after 1 January 2007.

Source: http://www.wto.org/english/tratop_e/safeg_e/safeg_stattab4_e.pdf.

FIGURE 7.12

Safeguard Measures Adopted by WTO Member Nations Through October 31, 2010

agricultural tariffs were reduced 36 percent for developed countries and 24 percent for developing countries. [236] With a few exceptions, all of these tariffs are "bound" (i.e., guaranteed against increase).[237]

As was mentioned, domestic agricultural support measures can sometimes restrict or distort trade. Developed states have agreed to reduce the monetary impact of measures that have this effect by 20 percent and developing countries by 13.3 percent (two-thirds of 20 percent) during the implementation period.[238] Not all support measures restrict or distort trade, however, and the Agreement on Agriculture defines those that are exempt. Exempt measures must satisfy two basic requirements: (1) they must be publicly funded government programs and (2) they must not have the effect of providing price supports to producers. Examples include support for research, pest and disease control, training services, extension and advisory services, inspection services, marketing and promotion services, and infrastructure services; food security and domestic food aid; direct payments to producers (including income support that is not linked to production); participation in social or crop disaster insurance; structural adjustment assistance; environmental protection; and regional assistance programs. [239]

Export subsidies for agricultural products can similarly restrict or distort trade. As with domestic support measures, the developed states have agreed to reduce export subsidies by 36 percent and developing states by 24 percent during the implementation period.[240] These measures are defined in the Agreement on Agriculture as subsidies that are contingent upon export performance. [241] Examples include direct government payments that are contingent upon export performance; the sale for export of governmental noncommercial stocks of agricultural products at less than their fair market value; government payments to exporters even when financed from levies on the exports; subsidies for marketing or transporting exports; and subsidies on farm products contingent on their incorporation in exported products. [242]

The Agreement on Agriculture provides for the gradual phasing-in of member state obligations. In addition to the six-year implementation period (10 years for developing states) for reducing tariffs, impermissible domestic support measures, and export subsidies, there was a nine-year transition period during which measures and supports maintained in conformity with the agreement would not be subject to actions otherwise available under the GATT and the SCM Agreement unless they cause or threaten to cause injury.[243] Even then, member states agree to exercise "due restraint" before initiating any countervailing duty investigations. [244]

Agreement on Textiles and Clothing
Establishes a process for the phasing-out of existing special arrangements governing international trade in textiles and clothing and the integration of those products into the GATT system.

Textiles and Clothing

The **Agreement on Textiles and Clothing** is designed to eliminate the current system of special arrangements governing international trade in these products. Prior to its adoption, a series of collateral arrangements had been entered into by the states principally involved in the clothing and textiles trade that created an exception to the GATT principle of protection through tariffs.

These arrangements came about because of the rapid growth in the 1950s of cotton textile imports into the United States from low-cost suppliers, most notably Japan. Under pressure from

[236]See "Understanding the WTO—Agreements: Agriculture," posted at www.wto.org/english/thewto_e/whatis_e/tif_e/agrm3_e. htm.

[237]Agreement on Agriculture, Article 4, p.

[238]See "Understanding the WTO—Agreements: Agriculture," posted at www.wto.org/english/thewto_e/whatis_e/tif_e/agrm3_e.htm.

The means for determining the value of these support measures is described in Agreement on Agriculture, Article 1(a), (d), and (h) (1994).

[239]*Id*., Annex 2.

[240]See "Understanding the WTO—Agreements: Agriculture," posted at www.wto.org/english/thewto_e/whatis_e/tif_e/agrm3_e.htm.

[241]Agreement on Agriculture, Article 1(e) (1994).

[242]*Id*., Article 9, para. 1.

[243]*Id*., Article 13, paras. 1 and 3.

[244]*Id*., paras. 2(a) and 3(a).

its own textile industry, the U.S. government negotiated concessions from Japan and other low-cost exporters to voluntarily limit their textile exports. Then, in 1961, the United States proposed that GATT agree to administer an "arrangement for the orderly development of the trade in such products . . . while at the same time avoiding disruptive conditions in import markets."[245] The European Community (which had a long-standing policy of restricting the importation of nearly all textiles) and other importing states supported the American initiative. The low-cost exporting states reluctantly agreed to the proposal, both in the hopes that it might improve access to the European market and to avoid the unilateral imposition of restrictions by the other importing states, especially the United States. A one-year Short-Term Arrangement Regarding Trade in Cotton Textiles, adopted in 1961, evolved into a Long-Term Arrangement Regarding Trade in Cotton Textiles, which was replaced in 1973 by the Arrangement Regarding International Trade in Textiles, commonly known as the Multi-Fiber Arrangement (MFA). [246]

The MFA was important because it applied to about half of the developed world's $100 billion worth of imports from developing countries. It allowed participating states to establish quantitative limits on imports of textiles through bilateral restraint agreements. Unlike the Generalized System of Preferences and the South-South Preferences (discussed earlier), the MFA was not designed to give preferences to developing states. Quite to the contrary, it overtly allowed developed states to discriminate against developing states. Although the MFA itself came to an end with the adoption of the Agreement on Textiles and Clothing, the quotas that it established and that were in existence on December 31, 1994, were carried forward under the new agreement.

The Agreement on Textiles and Clothing provided for the complete elimination of the MFA at the end of a 10-year transition period. Upon the agreement's adoption, WTO member states had to remove at least 16 percent of their textile and clothing imports from quota controls. An additional 17 percent was removed as of 1998, another 18 percent as of 2001, and the remaining quotas were removed at the beginning of 2005. The Agreement on Textiles and Clothing (ATC) and all restrictions thereunder terminated on January 1, 2005. The expiry of the 10-year transition period of ATC implementation means that trade in textile and clothing products is no longer subject to quotas under a special regime outside normal WTO/GATT rules but is now governed by the general rules and disciplines embodied in the multilateral trading system.[247] The ACT is the only WTO multilateral agreement that provides for its own termination. [248]

Rules of Origin

As the WTO itself says "Determining where a product comes from is no longer easy when raw materials and parts criss-cross the globe to be used as inputs in scattered manufacturing plants (see Figure 7.13). Rules of origin are important in implementing such trade policy instruments as anti-dumping and countervailing duties, origin marking, and safeguard measures."[249] The **Agreement on Rules of Origin** is essentially a program outlining procedures for bringing about an international system of harmonized rules of origin. **Rules of origin** are the laws, regulations, and administrative procedures used by states to determine the country of origin of goods. [250] The program for harmonization was instituted with the inauguration of the WTO and is being carried out in conjunction with the Customs Cooperation Council (CCC). [251] The agreement called for the program to be completed by mid-1998; however, "due to the complexity of [the] issues" involved, the WTO postponed the completion date to November 1999, which was subsequently postponed to 2005, and then again to 2007.

Agreement on Rules of Origin
Establishes a three-year program aimed at bringing about an international system of harmonized rules of origin.

rules of origin
Laws, regulations, and administrative procedures used by states for determining the country of origin of goods.

[245]Gardner Paterson, *Discrimination in International Trade: The Policy Issues, 1945–1965*, p. 309 (1966).

[246]See GATT Secretariat Study, *Textiles and Clothing in the World Economy* (1984).

[247]See WTO Web site at www.wto.org/english/tratop_e/texti_e/texti_e.htm.

[248]See "Understanding the WTO—Agreements: Textiles," posted at www.wto.org/english/thewto_e/whatis_e/tif_e/agrm5_e.htm.

[249]www.wto.org/english/tratop_e/roi_e/roi_e.htm.

[250]Agreement on Rules of Origin, Article 1, para. 1 (1994).

[251]*Id.*, Article 9, para. 1.

FIGURE 7.13

Even Something as Small as a Necklace Can Have Parts From Many Different Countries

Source: Sniegirova Mariia/ Shutterstock

In March 2010, the outgoing chair of the WTO Committee on Rules of Origin, Vera Thorstensen (Brazil), told the Committee that WTO members have to date reached consensus on country-of-origin rules for 1,528 products. She said this meant 55 percent of the work of the Committee had been completed. Thorstensen, who was chair for six years, said that "faced with the reality of globalization and increasing multi-country production of a good, our work requires reaching an agreement on specific rules of origin for 2,739 products."[252]

According to the guidelines set out in the Agreement on Rules of Origin, the resulting rules of origin are to be (1) coherent;[253] (2) objective, understandable, and predictable; (3) administered in a consistent, uniform, impartial, and reasonable manner; (4) applied equally to each member state's nonpreferential commercial policy instruments (e.g., most-favored-nation treatment, anti-dumping and countervailing duties, safeguard measures, origin marking requirements, quantitative restrictions, and tariff quotas); and (5) based on a positive standard (i.e., one that states what confers, rather than what does not confer, origin). Furthermore, the rules are not to be used as instruments of trade policy, nor should they restrict, distort, or disrupt trade. Finally, the *country of origin* is to be the one where a particular good was obtained or, when more than one country is involved in its production, the one in which the last substantial transformation is carried out.

During the transition period, these same principles are to govern the member states' existing rules. In addition, both during and after the transition, member states are required to observe the basic GATT principles of nondiscrimination and transparency.[254] Finally, the usual GATT 1994 procedures for review, consultation, and dispute settlement apply. [255]

[252]See the WTO "Rules of Origin" Web site at www.wto.org/english/news_e/news10_e/roi_25mar10_e.htm (accessed on July 13, 2011).

[253]Agreement on Rules of Origin, para. 1(f) (1994).

[254]*Id.*, Article 3(e).

A member state's laws, regulations, administrative actions, and court decisions establishing, implementing, or interpreting rules of origin must be promptly published. *Id.* Also, copies must be filed with the WTO Secretariat. *Id.*, Article 5.

[255]*Id.*, Articles 6, 7, and 8.

Chapter Questions

Customs Valuation

1. The Widget Company has just imported 10,000 widgets into State A. Describe how the Customs Service of State A, a signatory of the Customs Valuation Code, will go about determining the value of these goods in the process of collecting an import tariff.

WTO Import Restrictions

2. Several automobile manufacturers from State J are importing large numbers of cars to State K, taking over a large share of K's automobile market and putting K's own automobile manufacturers and workers out of business. State J's manufacturers are not subsidized by State J, nor are they dumping their cars at below-cost prices. Under GATT 1994, what can State K do? Discuss.
3. State D and State V are both members of the WTO. At the time of joining the WTO, State D prohibited the importation of foreign-grown rice. The prohibition has never been lifted. Presently, rice in State D sells for about four times the world price. State V, a large grower of rice, wants access to State D's market. Under GATT 1994, what can State V do? Discuss.
4. State R, a country with a centrally planned economy, uses prison labor to manufacture export goods at very low cost. When State S learns this, it imposes an import embargo on these goods. Both countries are members of the WTO, and State R complains to the WTO's Dispute Settlement Body. Assuming that a Dispute Settlement Panel is appointed to resolve this matter, how will the panel rule? Explain.

Sanitary and Phytosanitary Restriction Measures

5. Recently, State E, concerned that its nationals are being poisoned by chemical growth stimulants fed to livestock to make them grow faster and heavier, enacted legislation that forbids its livestock producers from using these stimulants and also forbids the sale of any meat from such animals within its territory. The law also forbids the importation of any animal fed a growth stimulant or any product from such an animal. Because it is impossible to detect the growth stimulant either in live animals or in their meat, the legislation requires importers to certify that the animals (or the animals from which an animal product is derived) have never been fed a growth stimulant.

   The livestock producers in State F have been using growth stimulants for many years to grow larger animals at lower cost, and they believe any possible health risk to consumers is insignificant. State F's Ministry of Health also agrees that growth stimulants pose little risk to consumers, and it encourages its livestock producers to use them. Because State F's livestock producers are no longer able to export their animals or the products from those animals to State E, they have asked their government to take action through the WTO on their behalf. Both State E and State F are members of the WTO. Consultation with State E proved unsuccessful, so State F asked the WTO's Dispute Settlement Body to appoint a Dispute Settlement Panel. This has been done. How should the panel rule on State F's request for a finding that State E's legislation violates the latter's obligations under GATT 1994? Discuss.

Countervailing Duties

6. State H provides general subsidies to all of its export manufacturers by means of low-cost loans, foreign currency exchange guarantees, and discounted prices for fuel and electricity purchased from the state's energy monopoly. HowdyDoo Company, a State H manufacturer of shampoos that has taken advantage of all of these subsidies, exports its goods to State I, where its products are in direct competition with those of several local manufacturers. State I's manufacturers have complained to their government, asking it to impose a countervailing duty on HowdyDoo. Both State H and State I are members of the WTO. Should the countervailing duty be imposed? Explain.
7. State C is a major exporter of lumber products (especially plywood) to State U. State C's lumber companies are able to manufacture and sell their products in State U inexpensively because (unlike State U) State C's government charges only a nominal fee for cutting lumber in its national forests. In State U, on the other hand, the cutting fee is substantial, adding 15–20 percent to the cost of the finished lumber product. One of State U's plywood lumber companies, Multi-Ply, Inc., has lost much of its market share in State U due to imports from State C. Multi-Ply has complained to State U's government, arguing that State C is unfairly subsidizing its lumber companies by charging such a low forest-cutting fee. Multi-Ply would like State U's government to impose a countervailing duty on imports of plywood from State C. May State U do so? Note that both State C and State U are members of the WTO. Discuss.

Anti-dumping Duties

8. The Snicker Company, the largest manufacturer of Snickerdoodles in State F, decided about two years ago to enter the cookie market in State G. Several small companies in State G manufacture Snickerdoodles, but the market has traditionally been very small. When Snicker entered State G's market, it undertook a widespread advertising campaign to promote Snickerdoodle consumption and to encourage consumers to try its product by publishing coupons in newspapers that allowed purchasers to buy Snicker's Snickerdoodles below their actual cost. As a consequence of this campaign, the sales of Snickerdoodles in State G have skyrocketed. In addition, the sales of Snickerdoodles manufactured by State G firms have more than tripled. State G's Snickerdoodle manufacturers are, nonetheless, displeased, because their market share has gone from 100 percent to 30 percent in two years. Concerned with this loss, they have asked State G to impose anti-dumping duties on Snicker, since its snickerdoodles are being sold below cost. Both State F and State G are members of the WTO. Should State G impose anti-dumping duties on Snicker? Explain.

National Product Standards

9. State Z's automobile manufacturing industry is one of the largest and most highly regarded in the world. The industry is concerned that it may lose some of its domestic market share to inexpensive,

low-quality cars manufactured in newly industrialized countries. To avoid this, the industry lobbies the State Z government until it enacts new standards for the sale of cars in the country. The standards are set in such a way that only cars manufactured in State Z can meet them. Assuming that State Z is a member of the WTO, can the governments of those newly industrialized countries (also members of the WTO) do anything to get State Z to rescind its new standards? Explain.

National Security and Public Morals

10. Eve, a national of State A, owns the technology for manufacturing a video game called "Porn-Man" that involves the use of the latest and most advanced computer technology to show lifelike images of Porn-Man doing truly obscene things. State A is a member of the WTO and of the Coordinating Committee on Multilateral Export Controls (COCOM). State A's government has issued an administrative order prohibiting Eve from (1) exporting the computer chips to State O (a country that is listed in State A's export-control legislation as being off limits for all high-technology exports), where the video games are supposed to be assembled, and (2) reimporting assembled and operational video games back into State A. Eve has brought suit in a State A court to obtain the appropriate order to lift the government's prohibition. What are the chances of her success? Discuss.

Relevant Internet Sites

www.wto.org is a huge site containing detailed information on all aspects of the WTO, including history, news, agreements, dispute settlement procedures and results, and much more information on all the issues discussed in this chapter.

http://globaledge.msu.edu/index.asp is a large site, sponsored by Michigan State University, that contains a great deal of information on legal issues involved in international trade and other topics of international and global interest.

http://library.lawschool.cornell.edu/WhatWeHave/Foreign/index.cfm is part of the extensive Cornell University online library, with resources on all legal topics; this is the URL for the index to available international online resources.

CHAPTER

8

Services and Labor

Chapter Outline

A. General Agreement on Trade in Services
  The Framework Agreement
  GATS Annexes
  GATS Schedules of Specific Commitments
B. Regional Intergovernmental Regulations on Trade in Services
  EU Law on Trade in Services
  Provisions Governing Trade in Services in the North American Free Trade Agreement (NAFTA)
C. International Labor Law
  International Labor Organization
  The Human Rights of Workers
D. Regional Intergovernmental Regulations on Labor
  Employment Laws in the EU
  Employment Standards of the Organization for Economic Cooperation and Development (OECD)
  Protection of Workers' Rights by the Council of Europe
  Transnational Organized Labor
E. Movement of Workers
  Visas
  Regulation of Foreign Workers
  Application of Home State Labor Laws Extraterritorially
Chapter Questions

Introduction

This chapter examines the international rules that govern services and labor. The rules on services are now found principally in the General Agreement on Trade in Services and in the agreements creating certain regional economic organizations such as the EU and the North American Free Trade Area. The rules governing labor—especially the movement of laborers—are to be found in the international labor standards promulgated by the International Labor Organization, in the agreements creating some regional organizations, and in national legislation.

A. General Agreement on Trade in Services

The **General Agreement on Trade in Services (GATS)** came into effect on January 1, 1995, as one of the three main multilateral annexes to the Agreement Establishing the World Trade Organization (the other two being the General Agreement on Tariffs and Trade [GATT] examined

General Agreement on Trade in Services (GATS)
Multilateral agreement in force from January 1, 1995, that contains rules and principles governing international trade in services and establishes guidelines for negotiating the future liberalization of such trade.

in Chapter 7 and the Agreement on Trade-Related Aspects of Intellectual Property Rights [TRIPS] examined in Chapter 9). The purpose of GATS is to give international trade in services a set of rules and principles and a basis for liberalization similar to those that GATT has applied to goods for the past five decades.

GATS is made up of three interrelated components: (1) the agreement itself (often called the *Framework Agreement*),[1] which contains the rules applicable to all member states of the World Trade Organization (which are automatically parties to the GATS); (2) the sectoral annexes that deal with issues unique to particular economic sectors (i.e., movement of natural persons, air transport services, financial services, maritime transport services, and telecommunications); and (3) the national Schedules of Specific Commitments each member state has agreed to undertake, which were agreed to mainly through negotiations undertaken as part of the Uruguay Round of Multilateral Trade Negotiations that produced the WTO Agreement (see Chapter 7) and the agreements made by nations when joining the WTO later through accession.

The Framework Agreement

The Framework Agreement lays out the basic parameters of GATS in six parts. These parts deal with (1) the scope and definition of GATS, (2) general obligations and disciplines of member states, (3) obligations and disciplines concerning specific commitments of member states, (4) a schedule for progressively liberalizing the world's trade in services, (5) the institutional structure for implementing GATS, and (6) miscellaneous provisions (including definitions of key terms).

Although much of GATS is based on the provisions in GATT and uses much of the same terminology, the "architecture" of GATS is significantly different. Unlike GATT, which provides for a single set of obligations that apply to all measures affecting trade in goods, GATS contains two sets of obligations: (1) a set of general principles and rules that apply to all measures affecting trade in services and (2) a set of principles and rules that apply only to the specific sectors and subsectors that are listed in a member state's schedule. The consequence of this division of obligations is that the principles and rules in GATS, as we shall see, are less binding than those in GATT.[2]

service
An act or action, such as work rendered or performed for another.

service sectors
Any parts of the economy involving the performance of a service.

Scope and Definition

The Framework Agreement covers all trade in services in any sector except those supplied in the exercise of governmental functions; however, the agreement does not define either service or service sector. In common usage, a **service** is an act or an action, such as work rendered or performed for another,[3] and this definition seems to fit with the use of the term in the agreement. The dictionary definition of a sector is a division or a part,[4] and the agreement and the GATS annexes provide several examples of service sectors, including banking, finance, insurance, telecommunications, and transportation. Thus, while not defined, the services referred to in the Framework Agreement seem to mean the work performed by one person for another, while **service sectors** are any parts of the economy related to the performance of such work. The Annex on Movement of Natural Persons makes it clear, however, that the GATS rules apply neither to laborers, except those temporarily involved in delivering a service, nor to member states' laws governing the permanent

---

[1]John Kraus, *The GATT Negotiations: A Business Guide to the Results of the Uruguay Round*, p. 40 (1994). The texts of GATS and other WTO agreements are available on the Internet at www.wto.org/english/docs_e/legal_e/legal_e.htm.

[2]Bernard Hoekman, "The General Agreement on Trade in Services," a paper presented to an OECD Workshop on the New World Trading System, Paris, April 25–26, 1994, reprinted in John H. Jackson, William J. Davey, and Alan O Sykes, Jr., *Legal Problems of International Economic Relations* (5th ed., 2008).

The reason for the difference in the architecture of GATS and GATT relates to the interests of the states involved in its negotiation. The United States, which saw trade liberalization as a means for enhancing its competitiveness, proposed that rules on most-favored-nation (MFN) treatment and national treatment be applied, as they are in GATT, equally to all member states as a general obligation. The EU and several of the major developing countries, which were reluctant to open their markets to foreign (especially U.S.) service suppliers, opposed this concept of *hard* obligations and offered a proposal of *soft* obligations meant to achieve comparable access to markets on a sector-by-sector basis for all participating states. Ultimately, this second proposal prevailed. Thus, MFN treatment was adopted subject to exemptions and national treatment (discussed *id*. below) and was made to apply only to the sectors the member states included in their Schedules of Commitments.

[3]See *Indiana Department of State Revenue, Sales Tax Division v. Cable Brazil, Inc., North Eastern Reporter, Second Series*, vol. 380, p. 555 at p. 561 (Indiana Ct. of Appeals, 1978).

[4]*The American Heritage Dictionary*, p. 1109 (2006 ed.).

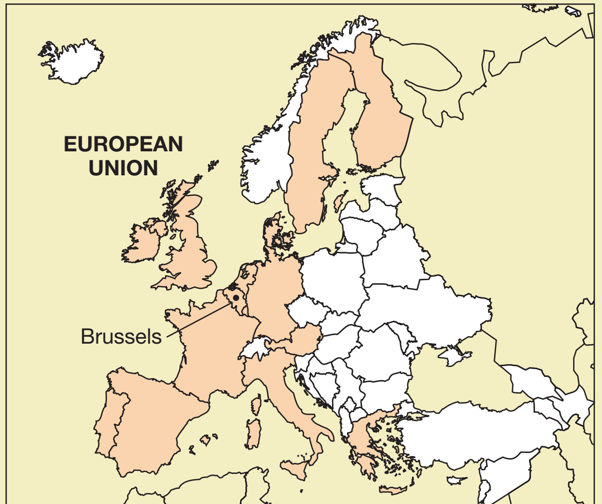
employment of natural persons.[5] Also, because GATS is but one of the three main annexes to the agreement creating the WTO, it is clear that GATS governs neither trade in goods (which is covered by GATT) nor the trade-related aspects of intellectual property rights (which are covered by TRIPS).

The Framework Agreement does define trade in services. It does so in terms of *modes of supply*. Four modes are described: (1) the cross-border supply of services that do not require the physical movement of either the supplier or the consumer (such as telecommunications), (2) the supply of services that require the consumer to go to the supplier (such as tourism), (3) services supplied by a service supplier[6] from one member state by means of a commercial presence[7] in another member's territory (such as banking), and (4) services supplied in the territory of a member state by a service supplier from another member state by means of the temporary presence of natural persons of another member state (such as construction or consulting work).[8] This four-sided definition is significant both because it broadly covers all forms of trade in services and because member states are allowed to exclude, for particular service sectors or subsectors, one or more of these modes of supply in their Schedules of Specific Commitments.[9]

In Case 8-1, the issue arose as to whether GATT and GATS could apply to the same factual situation or whether they were mutually exclusive.

CASE 8-1 European Communities—Regime for the Importation, Sale, and Distribution of Bananas

Ecuador, Guatemala, Honduras, Mexico, *United States v. European Communities*
Case WT/DS27/AB/R, AB-1997-3
World Trade Organization, Appellate Body (1997)



MAP 8.1

European Union (1997)

[5]Annex on Movement of Natural Persons Supplying Services under the Agreement, paras. 1–2.

[6]The Framework Agreement defines the term *service supplier* as "any person that supplies a service" (General Agreement on Trade in Services, Article XXVIII, para. g [1994]). It further defines a *person* as "either a natural person or a juridical person" (*id*., para. [j]).

[7]A *commercial presence* means any type of business or professional establishment, which may be in the form of a subsidiary, a branch, or a representative office. General Agreement on Trade in Services, Article XXVIII, para. (d).

[8]*Id*., Article I, §2.

[9]Although the right of member states to make exclusions as to modes of supply is not specifically stated in GATS, this may be inferred from Article XVI, §1, n. 9, and Article XVII, §1.

The European Communities [the name used by the WTO to refer to the EU] and Ecuador, Guatemala, Honduras, Mexico, and the United States (the "Complaining Parties") appeal from certain issues of law and legal interpretations in the Panel Reports, *European Communities—Regime for the Importation, Sale and Distribution of Bananas* (the "Panel Reports"). The Panel was established on 8 May 1996 to consider a complaint by the Complaining Parties against the European Communities concerning the regime for the importation, sale and distribution of bananas established by Council Regulation (EEC) No. 404/93 of 13 February 1993 on the common organization of the market in bananas ("Regulation 404/93"), and subsequent EC legislation, regulations and administrative measures, including those reflecting the provisions of the Framework Agreement on Bananas (the "BFA"), which implement, supplement, and amend that regime. [The EC legislation, regulations, and measures provided for preferential tariff treatment for former colonies of EC member states that were importing bananas to the EC. The WTO Panel held that the EC was in violation of the General Agreement on Tariffs and Trade of 1994 (GATT 1994) and the General Agreement on Trade in Services (GATS). The Panel recommended that the EC amend its banana tariff regulations to bring them into compliance with both GATT 1994 and GATS. In most respects, the Appellate Body affirmed the Panel's holding on the applicability of GATT 1994. The Appellate Body then considered the applicability of GATS.]

***

General Agreement on Trade in Services

1. Application of the GATS

There are two issues to consider in this context. The first is whether the GATS applies to the EC import licensing procedures. The second is whether the GATS overlaps with the GATT 1994, or whether the two agreements are mutually exclusive. With respect to the first issue, the Panel found that:

> . . . no measures are excluded *a priori* [beforehand] from the scope of the GATS as defined by its provisions. The scope of the GATS encompasses any measure of a Member to the extent [that] it affects the supply of a service regardless of whether such measure directly governs the supply of a service or whether it regulates other matters but nevertheless affects trade in services.

For these reasons, the Panel concluded:

> We therefore find that there is no legal basis for an *a priori* exclusion of measures within the EC banana import licensing regime from the scope of the GATS.

The European Communities argues that the GATS does not apply to the EC import licensing procedures because they are not measures "affecting trade in services" within the meaning of Article I:1 of the GATS. In the view of the European Communities, Regulation 404/93 and the other related regulations deal with the importation, sale, and distribution of bananas. As such, the European Communities asserts, these measures are subject to the GATT 1994, and not to the GATS.

In contrast, the Complaining Parties argue that the scope of the GATS, by its terms, is sufficiently broad to encompass Regulation 404/93 and the other related regulations as measures affecting the competitive relations between domestic and foreign services and service suppliers. This conclusion, they argue, is not affected by the fact that the same measures are also subject to scrutiny under the GATT 1994, as the two agreements are not mutually exclusive.

In addressing this issue, we note that Article I:1 of the GATS provides that "[t]his Agreement applies to measures by Members affecting trade in services." In our view, the use of the term "affecting" reflects the intent of the drafters to give a broad reach to the GATS. The ordinary meaning of the word "affecting" implies a measure that has "an effect on," which indicates a broad scope of application. This interpretation is further reinforced by the conclusions of previous panels that the term "affecting" in the context of Article III of the GATT is wider in scope than such terms as "regulating" or "governing."[10] We also note that Article I:3(b) of the GATS provides that "'services' includes *any service* in *any sector* except services supplied in the exercise

[10]See, for example, the panel report in *Italian Agricultural Machinery*, adopted 23 October 1958, BISD 7S/60, para. 12.

of governmental authority" (emphasis added), and that Article XXVIII(b) of the GATS provides that the "'supply of a service' includes the production, distribution, marketing, sale, and delivery of a service." There is nothing at all in these provisions to suggest a limited scope of application for the GATS. We also agree [with the Panel] that Article XXVIII(c) of the GATS does not narrow "the meaning of the term 'affecting' to 'in respect of."' For these reasons, we uphold the Panel's finding that there is no legal basis for an *a priori* exclusion of measures within the EC banana import licensing regime from the scope of the GATS.

The second issue is whether the GATS and the GATT 1994 are mutually exclusive agreements. The GATS was not intended to deal with the same subject matter as the GATT 1994. The GATS was intended to deal with a subject matter not covered by the GATT 1994, that is, with trade in services. Thus, the GATS applies to the supply of services. It provides, *inter alia*,[11], for both MFN treatment and national treatment for services and service suppliers. Given the respective scope of application of the two agreements, they may or may not overlap, depending on the nature of the measures at issue. Certain measures could be found to fall exclusively within the scope of the GATT 1994, when they affect trade in goods as goods. Certain measures could be found to fall exclusively within the scope of the GATS, when they affect the supply of services as services. There is yet a third category of measures that could be found to fall within the scope of both the GATT 1994 and the GATS. These are measures that involve a service relating to a particular good or a service supplied in conjunction with a particular good. In all such cases in this third category, the measure in question could be scrutinized under both the GATT 1994 and the GATS. However, while the same measure could be scrutinized under both agreements, the specific aspects of that measure examined under each agreement could be different. Under the GATT 1994, the focus is on how the measure affects the goods involved. Under the GATS, the focus is on how the measure affects the supply of the service or the service suppliers involved. Whether a certain measure affecting the supply of a service related to a particular good is scrutinized under the GATT 1994 or the GATS, or both, is a matter that can only be determined on a case-by-case basis. This was also our conclusion in the Appellate Body Report in *Canada—Periodicals*.[12]

For these reasons, we agree with the Panel that the EC banana import licensing procedures are subject to both the GATT 1994 and the GATS, and that the GATT 1994 and the GATS may overlap in application to a particular measure.

2. Whether Operators Are Service Suppliers Engaged in Wholesale Trade Services

The European Communities raises two issues concerning the definition of wholesale trade services and the application of that definition. Both these issues relate to the Panel's finding that:

> . . . operators in the meaning of Article 19 of Regulation 404/93 and operators performing the activities defined in Article 5 of Regulation 1442/93 are service suppliers in the meaning of Article I:2(c) of GATS provided that they are owned or controlled by natural persons or juridical persons of other Members and supply wholesale services. When operators provide wholesale services with respect to bananas which they have imported or acquired for marketing, cleared in customs or ripened, they are actual wholesale service suppliers. Where operators form part of vertically integrated companies, they have the capability and opportunity to enter the wholesale service market. They could at any time decide to re-sell bananas which they have imported or acquired from EC producers, or cleared in customs, or ripened instead of further transferring or processing bananas within an integrated company. Since Article XVII of GATS is concerned with conditions of competition, it is appropriate for us to consider these vertically integrated companies as service suppliers for the purposes of analyzing the claims made in this case.

First, the European Communities questions whether the operators within the meaning of the relevant EC regulations are, in fact, service suppliers in the sense of the GATS, in that what they

[11] From Latin: "among other things."

[12] Appellate Body Report, WT/DS31/AB/R, adopted July 30, 1997, p. 19.

actually do is buy and import bananas. The European Communities argues that "when buying or importing, a wholesale trade services supplier is a buyer or importer and not covered by the GATS at all, because he is not providing any reselling services." The European Communities also challenges the Panel's conclusion that "integrated companies," which may provide some of their services in-house in the production or distribution chain, are service suppliers within the meaning of the GATS.

On the first of these two issues, we agree with the Panel that the operators as defined under the relevant regulations of the European Communities are, indeed, suppliers of "wholesale trade services" within the definition set out in the Headnote to Section 6 of the [Central Product Classification, an international agreement classifying services activities, which is abbreviated as] CPC.[13] We note further that the European Communities has made a full commitment for wholesale trade services (CPC 622), with no conditions or qualifications, in its Schedule of Specific Commitments under the GATS.[14] Although these operators, as defined in the relevant EC regulations, are engaged in some activities that are not strictly within the definition of "distributive trade services" in the Headnote to Section 6 of the CPC, there is no question that they are also engaged in other activities involving the wholesale distribution of bananas that are within that definition.

The Headnote to Section 6 of the CPC defines "distributive trade services" in relevant part as follows:

> . . . the principal services rendered by wholesalers and retailers may be characterized as reselling merchandise, accompanied by a variety of related, subordinated services. . . .

We note that the CPC Headnote characterizes the "principal services" rendered by wholesalers as "reselling merchandise." This means that "reselling merchandise" is not necessarily the only service provided by wholesalers. The CPC Headnote also refers to "a variety of related, subordinated services" that may accompany the "principal service" of "reselling merchandise." It is difficult to conceive how a wholesaler could engage in the "principal service" of "reselling" a product if it could not also purchase or, in some cases, import the product. Obviously, a wholesaler must obtain the goods by some means in order to resell them.[15] In this case, for example, it would be difficult to resell bananas in the European Communities if one could not buy them or import them in the first place.

The second issue relates to "integrated companies." In our view, even if a company is vertically-integrated, and even if it performs other functions related to the production, importation, distribution, and processing of a product, to the extent that it is also engaged in providing "wholesale trade services" and is therefore affected in that capacity by a particular measure of a Member in its supply of those "wholesale trade services," that company is a service supplier within the scope of the GATS.

For these reasons, we uphold the Panel's findings on both these issues.

***

The Appellate Body recommends that the Dispute Settlement Body request the European Communities to bring the measures found in this Report and in the Panel Reports, as modified by this Report, to be inconsistent with the GATT 1994 and the GATS into conformity with the obligations of the European Communities under those agreements.

Casepoint

The Appellate Panel of the WTO considered whether a business operation could be subject to regulation under both GATT (goods) and GATS (services) and decided that this was indeed possible in certain cases. Then the panel held that the actions of banana wholesalers in purchasing, reselling, and conducting "a variety of related services" did constitute the provision of services under GATS.

[13]Provisional Central Product Classification, United Nations Statistical Papers, Series M, No. 77, 1991, p. 189.

[14]European Communities and their Member States' Schedule of Specific Commitments, GATS/SC/31, April 15, 1994, p. 52.

[15]After all, as the European Communities has pointed out, "goods cannot walk" or be resold by themselves (EC's appellant's submission, para. 236).

General Obligations and Disciplines Two general obligations in the Framework Agreement apply to all WTO member states: (1) most-favored-nation treatment and (2) transparency. The **most-favored-nation (MFN) treatment** provision provides that "each member shall accord immediately and unconditionally to services and service suppliers of any other member treatment no less favorable than that it accords to like services and service suppliers of any other country."[16] This means that a privilege a state grants to any country (including non-WTO members), such as allowing a foreign bank to operate within its territory, must be granted immediately and unconditionally to other WTO members.

most-favored-nation (MFN) treatment GATS requirement that its member states accord immediately and unconditionally to services and service suppliers of other members treatment that is no less favorable than that it accords to like services and service suppliers of any other state.

The MFN treatment rule in the Framework Agreement (unlike the rule in GATT) is not, it is important to note, a binding requirement that must be uniformly observed. During the Uruguay Round negotiations, the representatives of service industries in a number of industrialized nations opposed binding and unconditional MFN treatment on the ground that the level of market openness at that time varied too greatly among countries. They argued that unconditional MFN treatment would allow states with restrictive laws governing services to keep those laws in place while their own service suppliers would get a "free ride" into the markets of states with more open laws. To force states with closed markets to open them, the service industry representatives successfully advocated the use of MFN exemptions.[17] An annex was added to GATS that (1) allowed the original WTO member states to submit a list of MFN exemptions that became effective when GATS came into force and (2) provided that any later applications for exemptions will be considered using the ordinary WTO waiver procedures.[18] The MFN exemptions, furthermore, are to be limited in time (lasting no longer than 10 years) and subject to periodic review and to negotiation in future trade liberalization rounds.[19] Nevertheless, while this provision for exemptions does put pressure on states with restrictive laws to open up their markets, it clearly diminishes the effectiveness of GATS, making it (like the old GATT 1947) little more than a collection of loopholes held together by waivers.[20]

The **transparency provision** in GATS requires member states to publish, prior to their entry into force, all of their national measures and international agreements that affect their obligations under GATS.[21] Additionally, they have to notify the Council for Trade in Services of any relevant changes to those measures and agreements at least annually,[22] and they are obliged to respond promptly to another member state's requests for information and to establish points of inquiry to facilitate this.[23]

transparency provision GATS requirement that its member states publish their regulations affecting trade in services, that they notify the Council for Trade in Services of any relevant changes, and that they respond promptly to requests for information from other members.

In addition to its core obligations of MFN treatment and transparency, the Framework Agreement establishes other general criteria governing trade in services (most of which are analogous to similar provisions in GATT). To encourage the participation of developing countries, the agreement authorizes developed and developing member states to enter into negotiations (similar to those that produced GATT's General System of Preferences and South-South Preferences) targeted at improving the capacity, efficiency, and competitiveness of the developing members.[24]

GATS seeks to encourage regional economic integration both in trade in services and in the movement of labor with provisions comparable to those in GATT that deal with the establishment of common markets and free trade areas for goods. A service integration agreement among member states is required to have substantial sectoral coverage[25] and must provide for the elimination of all or substantially all discrimination among the parties in the sectors it covers.[26] A labor-market integration agreement has to exempt nationals of states parties from residency and work permit

---

[16]General Agreement on Trade Services, Article II, §1 (1994).

[17]Bernard Hoekman, "The General Agreement on Trade in Services," paper presented to an OECD Workshop on the New World Trading System, Paris, April 25–26, 1994, reprinted in John H. Jackson, William J. Davey, and Alan O Sykes Jr., *Legal Problems of International Economic Relations* (4th ed., 2002). See also *Legal Problems of International Economic Relations*, 2008 Documentary Supplement (American Casebooks) by the same authors.

[18]Annex on Article II Exemptions (1994).

[19]*Id.*, para. 6.

[20]See John Kraus, *The GATT Negotiations: A Business Guide to the Results of the Uruguay Round*, p. 78 (1994).

[21]General Agreement on Trade in Services (1994), Article III, §1.

[22]*Id.*, §3.

[23]*Id.*, §4.

[24]*Id.*, Article IV, §1(a).

[25]"This condition is [to be] understood in terms of number of sectors, volume of trade affected, and modes of supply." *Id.*, Article V, § 1(a), n. 1.

[26]*Id.*, Article V, §1(b).

requirements.[27] In either case, the participating states parties have to notify the Council for Trade in Services of their proposed agreement for the council's review and approval.[28]

GATS requires its member states to ensure that their domestic regulations affecting trade in services are administered in a reasonable, objective, and impartial manner. It forbids them from applying their existing licensing, qualification requirements,[29] and technical standards in a burdensome, restrictive, or nontransparent manner and, as soon as the Council on Trade in Services adopts harmonizing guidelines in these areas, it will require them to bring their practices into compliance with those guidelines.[30]

A member state may grant monopoly rights to a service supplier (such as granting an assigned frequency to a radio or television broadcaster), but in doing so, it must not allow the supplier to act inconsistently with the member's MFN treatment obligation or its specific commitments.[31] As for other business practices that restrain competition and therefore restrict international trade in services, GATS requires each member state, at the request of any other, to participate in consultations aimed at the eventual elimination of those practices.[32]

No restrictions may be applied by member states to international transfers and payments for current transactions[33] For the definition of *current transaction*, see Chapter 4. relating to a member state's specific commitments. Nevertheless, restrictions, including those just mentioned, may be adopted or maintained if a member state suffers serious balance-of-payments difficulties, especially if the member is developing or is in transition to a market economy.[34] When restrictions are imposed, they must not discriminate among member states or unnecessarily damage another member's economic interests; they must conform to the Articles of Agreement of the International Monetary Fund; they may not be excessive; and they must be temporary and progressively phased out as their purpose is achieved.[35]

In addition to the core requirements of MFN treatment and transparency, as well as the other obligations just discussed, other obligations and disciplines were being considered for inclusion in the Framework Agreement during the Uruguay Round but were not included before the round came to an end. The negotiating parties, nevertheless, agreed to continue multilateral negotiations on these items.[36] Negotiations to devise rules on emergency safeguard measures, government procurement of services, and trade-distorting subsidies began in January 1997 and are still ongoing.[37]

---

[27] *Id.*, Article V bis.

A footnote to Article V b notes that "[t]ypically, such integration provides citizens of the parties concerned with a right to free entry to the employment markets of the parties and includes measures concerning conditions of pay, other conditions of employment, and social benefits."

[28] While the Framework Agreement requires only that the council be notified, one can anticipate that the council will treat this notification process in the same way that the contracting parties under the old GATT 1947 treated a similar notification requirement—that is, that notification means submission, review, and approval. See Chapter 7.

[29] *Qualification requirements* are the training or experience requirements that a service provider must have before offering a service.

[30] General Agreement on Trade in Services (1994), Article VI, §§1, 4, and 5.

So that service suppliers are able to meet local criteria for operating, GATS encourages mutual recognition of education, experience, licenses, and certifications. Similarly, member states that are parties to existing bilateral or multilateral recognition agreements are encouraged to let other member states join or negotiate comparable new agreements. *Id.*, Article VII, §§ 1 and 2.

[31] *Id.*, Article VIII, §1.

[32] *Id.*, Article IX, §2.

[33] *Id.*, Article XI, §1.

[34] *Id.*, Article XII, §1.

[35] *Id.*, Article XII, §2.

[36] See *id.*, Articles X, XIII, and XV and the Ministerial Decision on Trade in Services and the Environment (1994).

[37] General Agreement on Trade in Services, Article X (1994), required the WTO to issue rules for emergency safeguard measures no later than January 1, 1998. The member states were unable to do so, and they extended the deadline to June 1999.

As of May 2012, however, the rules had not been issued and no notice of a new deadline had been agreed upon. In fact, WTO Director-General Pascal Lamy, in an address to the UNEP Global Ministerial Environment Forum in Nairobi on February 5, 2007, urged ministers to work hard toward completion of the Doha negotiations linking trade reform to environmental sustainability. Mr. Lamy warned that a failure of the Doha negotiations "would strengthen the hand of all those who argue that economic growth should proceed unchecked" without regard for the environment. He stressed that "trade, and indeed the WTO, must be made to deliver sustainable development." Mr. Lamy concluded, "As imperfect as the WTO may be, it continues to offer the only forum worldwide that is exclusively dedicated to discussing the relationship between trade and the environment. Through [the] Doha Round, decisions on that relationship can finally be made, influencing the way that the relationship is shaped. I call upon the environmental community to support the environmental chapter of the Doha Round, and to provide its much needed contribution." See www.wto.org/english/tratop_e/serv_e/state_of_play_e.htm (accessed on July 14, 2011).

At the Doha Ministerial Conference in November 2001 the services negotiations became part of the "single undertaking" under the Doha Development Agenda, whereby all subjects under the negotiations are to be concluded at the same time. At that time it was agreed by all that negotiations regarding safeguards, government procurement, and subsidies would be conducted along with the other Doha topics. Yet as of summer 2012, no firm agreements had been reached. The Council for Trade in Services (meeting in "special session") is the body responsible for overseeing the negotiations. In April 2011, the Chairman of the Council for Trade in Services submitted a report to the Trade Negotiations Committee called "State of Play" regarding the achievements and remaining gaps in all four areas of the services negotiations: market access; domestic regulation; GATS rules; and the implementation of LDC modalities.

The report noted that on:

- **Market access:** limited progress has been achieved since July 2008.
- **Domestic regulation:** recent intensification of negotiations has produced notable progress, even if disagreement persists on important and basic issues.
- **GATS rules:** while technical work continues, there does not seem to be any convergence regarding the expected outcome in any of the three negotiating subjects (safeguards, government procurement, and subsidies).
- **Implementation of LDC modalities:** members support a waiver permitting preferential treatment to least-developed countries (LDCs), but disagreements continue, mainly regarding the scope of the waiver and rules of origin for services and service suppliers.[38]

Negotiations to agree on rules concerning the links between the services trade and the environment began in January 1995, and they are still ongoing as part of the Doha Round negotiations.[39] The Framework Agreement provides for general exceptions[40] and security exceptions[41] that are analogous to those found in GATT. The GATS general exceptions include, additionally, a provision for a departure from the principle of national treatment (discussed later) to ensure that direct taxes may be effectively collected on services or from foreign service suppliers,[42] as well as a provision that authorizes an exception to the MFN treatment rule when the difference in treatment is the result of an agreement for the avoidance of double taxation.[43]

Specific Commitments GATS is designed to open up specific service sectors of the WTO member states' markets to international access on a sector-by-sector and a state-by-state basis. Following negotiations, or on its own initiative, a member is to submit a *Schedule of Specific Commitments* for annexation to GATS that *lists the sectors (or subsectors) it is opening to market access*.[44] The member may *also list limitations* that apply to these sectors, and it must do so as to six categories of limitations if it wants those six to apply. The categories of limitations that the member must either list or not apply are limitations on (1) the number of service suppliers allowed, (2) the total value of transactions or assets, (3) the total quantity of service output or the number of service operations, (4) the number of natural persons that may be employed in a particular service sector, (5) the type of legal entity or joint venture arrangement that a service supplier may use in supplying a service, and (6) the participation of foreign capital in terms of a maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment.[45]

For the sectors listed in a member state's Schedule of Specific Commitments, and subject to the limitations listed there, the member must observe two specific obligations: market access and national treatment. **Market access** is defined as giving services and service suppliers of other members

market access
GATS requirement that a WTO member state accord to services and service suppliers of other member states treatment no less favorable than that listed in its GATS Schedule of Specific Commitments.

[38]www.wto.org/english/tratop_e/serv_e/state_of_play_e.htm

[39]See "About Trade and the Environment in the WTO," posted at www.wto.org/english/tratop_e/envir_e/envir_e.htm.

[40]General Agreement on Trade in Services, Article XIV (1994).

[41]*Id.*, Article XIV bis.

[42]*Id.*, para. (d).

[43]*Id.*, para. (e).

[44]*Id.*, Article XX, §1.

[45]*Id.*, Article XVI, §2.

"treatment no less favorable" than that listed in the member's schedule.[46] **National treatment** is giving services and service suppliers of other members "treatment no less favorable" than what the member grants its own like services and service suppliers.[47]

national treatment GATS requirement that a WTO member state accord to services and service suppliers of other member states treatment no less favorable than what the member grants its own like services and service suppliers.

As mentioned earlier, the arrangement in GATS that separates obligations into two sets, general and specific, and that only requires a member state to observe its specific obligations to the extent that it opens its markets to international access, means that GATS is a much weaker agreement than GATT (Because GATT does not correlate the observance of any of its obligations to commitments on market access). Considering, however, that GATT was, at its outset, observed more often in the breach than in its performance, the decision to limit the extent to which members are required to subject themselves to the obligations and disciplines of GATS, at least in its initial version, was undoubtedly prudent.

Progressive Liberalization The long-term objective of GATS is to encourage its member states to open as many of their service sectors to market access as possible. Article XIX, Section 1, describes how this is to be done:

> In pursuance of the objectives of this Agreement, members shall enter into successive rounds of negotiations, beginning not later than five years from the date of entry into force of the WTO Agreement and periodically thereafter, with a view to achieving a progressively higher level of liberalization. Such negotiations shall be directed to the reduction or elimination of the adverse effects on trade in services of measures as a means of providing effective market access. This process shall take place with a view to promoting the interests of all participants on a mutually advantageous basis and to securing an overall balance of rights and obligations.

Although progressive liberalization is the goal of GATS, member states are not permanently bound to the commitments they make in their Schedules of Specific Commitments. After a period of three years from the entry into force of a commitment, a member may modify or withdraw it. Before doing so, however, the member must give the Council for Trade in Services at least three months' notice and, if a member state affected by the change asks, the notifying member must participate in negotiations to agree on appropriate compensatory adjustments.[48]

Council for Trade in Services A committee of representatives of all WTO member states that oversees the General Agreement on Trade in Services.

Institutional Structure The operation of GATS is overseen by a **Council for Trade in Services** made up of representatives of all WTO member states.[49] Subordinate to the council are several bodies, including sectoral committees responsible for the operation of the different sectoral annexes (e.g., the Committee on Trade in Financial Services; see Figure 8.1).[50]

FIGURE 8.1

The Structure of the Council for Trade in Services

Council for Trade in Services

- Business Services
- Communication Services
- Construction and Related Engineering Services
- Distribution Services
- Educational Services
- Environmental Services
- Financial Services
- Health Related and Social Services
- Tourism and Travel Related Services
- Recreational, Cultural and Sporting Services
- Transport Services
- Other Services

[46] *Id.*, §1.

[47] *Id.*, Article XVII, §1.

[48] *Id.*, Article XXI, §1(b), §2(a).

[49] *Id.*, Article XXIV.

[50] Decision on Institutional Arrangements for the General Agreement on Trade in Services (1994).

The Council for Trade in Services is meant to function within the WTO structure. Thus, the council is, in essence, the WTO Secretariat that provides technical assistance to developing countries on matters related to trade in services.[51] And both consultations and dispute settlements related to GATS are governed by the WTO's Understanding on Rules and Procedures Governing the Settlement of Disputes.[52]

GATS Annexes

As stated earlier, the annexes are the second component of GATS. Together with several supplementary instruments (Ministerial Decisions and Ministerial Understandings), they deal with special aspects of particular service sectors or issues. The provisions of these annexes are summarized in Table 8.1.

GATS Schedules of Specific Commitments

Each WTO member state is required to submit for annexation to GATS a Schedule of Specific Commitments regarding the service sectors that it has opened to international market access. For each such sector, its schedule must specify (as discussed earlier) (1) terms, limitations, and conditions on market access (2) conditions and qualifications on national treatment (3) undertakings relating to additional commitments (4) the time frame for implementing its commitments (if that applies) and (5) the date of entry into force of its commitments.[53]

An example of the list of Specific Commitments made by a country—in this case Chile's commitments relating to financial services at the time it joined the WTO in 1994—is given below.

TABLE 8.1

Annexes to the General Agreement on Trade in Services by Chile

Annex on movement of natural persons supplying services under the agreement
Provides that the entry into and temporary residence of natural persons within a WTO member state's territory may be regulated by that member state unless it makes a commitment to the contrary. More particularly, this Annex makes clear that GATS does not apply either to measures of WTO member states affecting natural persons seeking employment or to measures regarding citizenship, residence, or employment on a permanent basis.[a]

Annex on Air Transport Services
Makes clear that GATS does not replace the various bilateral and multilateral agreements on air traffic rights (i.e., rights to carry passengers, cargo, or mail for remuneration to, within, or across a country) and related services. In particular, GATS is to apply only to (a) aircraft repair and maintenance services, (b) the selling and marketing of air transport services, and (c) computer reservation system (CRS) services.

Annex on Financial Services
States that a WTO member state may adopt, in regulating financial services (i.e., insurance, banking, and their related services), prudential measures to protect investors, depositors, policyholders, and others, and it may take such other actions as are necessary to protect its financial system as a whole. Additionally, member states are free to maintain or adopt measures that protect the confidentiality of financial service customers.[b]

Annex on Negotiations on Maritime Transport Services
Provides that member states are not obliged to list in their Schedules of Commitments measures applicable to maritime transport services that are inconsistent with most-favored-nation treatment until the negotiations on such services (that began in 1994) are concluded.[c]

[51]General Agreement on Trade in Services, Article XXV, §2 (1994).

[52]Panelists for the dispute settlement panels in service matters, however, are taken from a special list of persons with special knowledge of GATS and/or trade in services, and panels for disputes regarding sectoral matters must be made up of persons with the necessary expertise relative to the sector concerned. Decision on Certain Dispute Settlement Procedures for the General Agreement on Trade in Services (1994).

[53]General Agreement on Trade in Services, Article XX, §1 (1994).

TABLE 8.1

(continued)

Annex on Telecommunications

Requires WTO member states that have granted market access to service suppliers of other members to ensure that those suppliers have access to the use of public telecommunications transport networks and services (other than cable and broadcast radio and television) on reasonable and nondiscriminatory terms within their territories and across their borders. Permits member states to place conditions on access to and use of these networks and services, but only to (a) ensure that they are available to the public generally, (b) protect their technical integrity, or (c) prevent suppliers from providing services that are not listed on the concerned member's Schedule of Specific Commitments.[d]

[a]This annex is supplemented by the Decision on Negotiations on Movement of Natural Persons (1994). The decision called for negotiations on liberalization of the movement of natural persons to begin in May 1994 and to conclude in June 1995.

[b]A Second Annex on Financial Services (1994) gave member states an extension of up to six months after the entry into force of the WTO Agreement in which to list, modify, or withdraw their specific commitments regarding financial services. In November 2001 the services negotiations were incorporated into the Doha Development Agenda, which gave more emphasis to bilateral—request and offer—negotiations. After the failure of the Ministerial Conference in Cancun (September 2003), new guidance was provided by members in July 2004. As a result, revised offers were to be submitted by May 2005.

The Hong Kong Ministerial Conference in December 2005 provided new momentum to the services negotiations. Clear objectives for services were established in Annex C of the Ministerial Declaration, with the submission of plurilateral requests being allowed by February 2006 and revised offers by mid-2006. A plurilateral request on financial services was prepared and sent. The main objectives of the request included the following: Commitments to provide rights to establish new companies and acquire existing companies; Commitments in a defined list of sub-sectors; the removal of key national treatment limitations; and others. Since negotiations were suspended in July 2006, no members have submitted a second revised offer. As of today, 71 offers (initial and revised) have been submitted, representing 95 members. Almost half of them contain improvements to financial services commitments. See WTO GATS Web site "Financial Services" at www.wto.org/english/tratop_e/serv_e/finance_e/finance_e.htm (accessed July 15, 2011).

[c]Maritime services is an area where negotiations were scheduled to improve on the commitments included in the initial Uruguay Round schedules of commitments. Negotiations were originally due to end in June 1996 but participants failed to agree on a package of commitments. Talks resumed when the new services round of negotiations started in 2000. Commitments already exist in some countries' schedules, covering the three main areas in this sector: access to and use of port facilities; auxiliary services; and ocean transport. See GATS: Maritime Transport, posted on the WTO Web site at www.wto.org/english/tratop_e/serv_e/transport_e/transport_maritime_e.htm.

The WTO Web site—accessed January 15, 2012—further describes the state of negotiations as follows: "Currently, maritime transport services, like all services, are included in the new services negotiations, which began in January 2000. In November 2005, WTO members collectively identified their sectoral and modal objectives for negotiations on maritime transport."

"Following the Hong Kong Ministerial Conference Declaration of December 2005, two separate plurilateral requests were prepared and addressed to targeted members. These requests recommend the use of the so-called '**maritime model schedule**.' They call notably for the elimination of cargo reservations, of restrictions on foreign equity participation and on the right to establish a commercial presence both for international freight transport and for maritime auxiliary services. They also call for additional commitments on access to/use of port services and multimodal transport services as well as for the elimination of most-favoured nation (MFN) exemptions." *Id*.

[d]In 1997, the WTO concluded negotiations on market access for basic telecommunications services. Sixty-nine governments agreed to offers that were annexed to the Fourth Protocol of the GATS. The one-page protocol and its annexed schedules and MFN exemption lists entered into force on February 5, 1998. See "GATS: Basic Telecommunications," posted at www.wto.org/english/tratop_e/serv_e/telecom_e/telecom_e.htm.

Chile—Schedule of Specific Commitments

Modes of supply: (1) cross-border supply, (2) consumption abroad, (3) commercial presence, and (4) presence of natural persons.

I. Horizontal Commitments

All sectors included in this Schedule

The commitments in this Schedule extend only to suppliers of services who operate in Chile through a commercial presence, when they establish themselves as a foreign investment and comply with the rules and legal procedures on direct foreign investment in force. The commercial presence covered by this Schedule is that effected solely through the Foreign Investment Statute and financed by external capital.

Authorization to deliver services through a commercial presence may take into account the following criteria:

Foreign investors may transfer abroad their capital following the elapse of three years from the date of entry.

a. The effect of the commercial presence on economic activity, including the effect on employment, on the use of parts, components, and services produced in Chile, and on exports of services;

As regards services that fall under the heading "professional services" at least 85 percent of the staff employed by a supplier of services established in Chile must be Chilean.

b. The effect of the commercial presence on productivity, industrial efficiency, technological development and product innovation in Chile;

As regards all other services listed in this Schedule, at least 85 percent of the staff employed by a supplier of services established in Chile must be Chilean, except in the case of enterprises with fewer than 15 employees.

c. The effect of commercial presence on competition in the sector and other sectors, on consumer protection, on the smooth functioning, integrity, and stability of the market, and on the national interest;

d. The contribution of the commercial presence to Chile's integration into world markets.

This schedule applies only to the following types of commercial presence for foreign investors: corporations, open or closed, private-limited companies, and subsidiaries (which under Chilean legislation are the equivalent of agencies of corporations).[54]

Of course, members are not required to open all of their service sectors, and developing countries have opened only about one-fifth of their service sectors and developed countries about two-thirds of theirs.[55] Nevertheless, GATS is but a first step. The Framework Agreement requires, and the member states have agreed, that negotiations continue to liberalize the international trade in services.

B. Regional Intergovernmental Regulations on Trade in Services

EU Law on Trade in Services

The EU is a common market not only for goods but also for services and (as discussed later in the chapter) labor. In comparison with GATS, the Treaty Establishing the European Community (EC Treaty), and the Lisbon Treaty of 2010 are the principal source of law in the EU, and create a much more open and liberal market for services (and business in general) between and among its member states. The EC Treaty provides that, within the EU, "restrictions on the freedom to provide services"[56] and "restrictions on the freedom of establishment"[57] are to be progressively abolished. In essence, service suppliers and entrepreneurs have consistently acquired (as the EU integrates and EU law evolves) greater rights to do business in all EU member states.

The **EU freedom to provide services** relates to economic activities carried out on a temporary or nonpermanent basis. It applies, for example, when a Danish firm of consultants advises businesses in Greece or an Italian construction company erects a building in Spain.

The **EU right of establishment** authorizes a natural person or a company to settle permanently in a member state and carry on a business.[58] It includes the right to set up and carry on a business both as an individual and as an employer.[59]

Concern has been expressed that some cases fall between the scope of both of these guarantees.[60] An example would be a British camera crew filming scenes in France and Germany. Because the

EU freedom to provide services
Right of member state nationals and firms to market their services on a temporary or nonpermanent basis throughout the EU.

EU right of establishment
Right of member state nationals and firms to settle permanently and carry on a business throughout the EU.

[54]Chile, Schedule of Specific Commitments, GATS/SC/18, http://docsonline.wto.org/imrd/gen_searchResult.asp?RN=0&searchtype=browse&q1=+%28%40mea%5FSymbol+GATS%FCSC%FC%2A%29+and+%28+%40meta%5FTitle+Chile+%29&language=1.

[55]Bernard Hoekman, "The General Agreement on Trade in Services," paper presented to an OECD Workshop on the New World Trading System, Paris, April 25–26, 1994, reprinted in John H. Jackson, William J. Davey, and Alan O Sykes Jr., *Legal Problems of International Economic Relations* (5th ed., 2008).

[56]Treaty establishing the European Community, Article 59.

[57]*Id.*, Article 52.

[58]Zoltan Horvath, *Handbook on the European Union*, p. 290 (3rd ed., 2009).

[59]Fearon, Case 182/83, *European Court Reports*, vol. 1984, p. 3677 (1984).

[60]Zoltan Horvath, *Handbook on the European Union*, p. 290 (2nd ed., 2005).

crew is neither establishing itself nor providing or receiving services, neither of the two guarantees fits exactly. However, in several cases, the European Court of Justice has read the two provisions together and hinted that it regards them as part of a general right of a self-employed person to pursue activities throughout the EU regardless of the location of his principal office or the kind of economic endeavor in which he is involved.[61]

To ensure that the right of establishment and the freedom to provide services are meaningful guarantees, the EC Treaty declares that the self-employed and the employees of service suppliers are entitled to travel freely within the member states of the EU and to carry on their activities free from discrimination.[62] In order to "create a real internal services market by 2010" the EU enacted the so-called Services Directive in 2006 (Directive 2006/123/EC). This legislation aims to "facilitate freedom of establishment for providers in other Member States and the freedom of provision of services between Member States." The directive (which was required to be implemented by all members by December 29, 2009) was intended to "increase the choice offered to recipients and improve the quality of services both for consumers and businesses using these services."

As often happens, all EU nations did not meet the deadline for enacting legislation implementing the directive. In June 2010, the EU Commission sent a message to all the EU nations that had not at that time passed appropriate legislation, warning them of further action if the law was not enacted soon.[63] Since that time several nations have enacted such legislation. However, in late October 2011, the EU Commission initiated legal proceedings in the EU Court of Justice against Germany, Austria, and Greece and asked the Court to impose significant monetary penalties on these Member States, on the ground that they have so far only partially "transposed" (implemented) the Services Directive (2006/123/EC). This is the first time that the EU has used the new powers created by the Lisbon Treaty to request the Court, as soon as a case is referred, to impose daily penalty payments on Member States that have not fully transposed the Directive within the appropriate time. The penalty payments requested of the Court are €44,876.16 for Austria, €141,362.55 for Germany, and €51,200.10 for Greece. These penalties have been set taking into account the different situations in the Member States and accordingly the seriousness of the infringements.[64]

The EU Commission stated that services constitute 70% of the European economy. But unjustified or disproportionate administrative requirements are still putting a major brake on the development of service activities. The 2006 Services Directive, which covers a large variety of economic activities—such as retail, construction services, tourism services, and the services of many regulated professions—applies to most, but not all, services provided for economic return,[65] and requires EU members to examine and simplify the procedures required to access and exercise a service activity and to provide a single point of contact where a provider can complete all necessary formalities, perhaps using online methods. The directive also requires members to remove legal and administrative barriers to the development of service activities to ensure nondiscrimination.

Each nation still maintains a large body of its own labor and employments laws and regulations, which are legal and enforceable as long as they do not discriminate against foreign workers. An example of certain French laws applying to employment is given below.

---

[61]See *Coenen v. Sociaal-Economische Raad*, Case 39/75, *European Court Reports*, vol. 1975, p. 1547 (1975); and *Koestler,* Case 15/78, *European Court Reports*, vol. 1978, p. 1971 (1978).

[62]Treaty Establishing the European Community, Articles 52 and 59.

[63]"The Commission has today sent a reasoned opinion to those Member States who have not yet notified to the Commission the adoption of all the regulatory changes required by the Directive—namely Austria, Belgium, Cyprus, France, Germany, Greece, Ireland, Luxemburg, Portugal, Romania, Slovenia and the United Kingdom." *Services Directive: good progress on implementation, but more needs to be done*, Europa Press Release IP/10/821, Brussels, June 24, 2010.

[64]EU Commission Press Release IP/11/1283, October 27, 2011, *Services Directive: the Commission refers Germany, Austria and Greece to the Court over incomplete transposition of the Directive*.

[65]Some exceptions are financial services, noneconomic services of general interest, electronic communication services covered by other directives, transport and port services, healthcare services, audiovisual services, gambling, services connected with the exercise of official authority, and private security services. Directive 2006/123/EC. The directive can be viewed at http://europa.eu/legislation_summaries/employment_and_social_policy/job_creation_measures/l33237_en.htm.

The Implications of Employing at Least 11, 20, and 50 Employees in France

In France, the headcount of a company is of crucial importance to determine the level of its labor-related obligations. When a company reaches the thresholds of 11 employees, 20 employees, and 50 employees that triggers specific obligations from a French employment perspective.

1. **Employment-related implications for companies reaching the threshold of 11 employees in France.** Companies that employ 11 or more employees are required to organise elections for the appointment of staff delegates. Staff delegates are generally responsible for presenting individual and collective grievances to management and ensuring the implementation of legislation and agreements.
2. **Employment-related implications for companies reaching the threshold of 20 employees in France.** All companies with at least 20 employees in France must implement company's internal rules dealing with matters of hygiene and safety, disciplinary sanctions, and moral and sexual harassment. It should also be noted that such company rules must be filed by the company with the relevant Labor authorities.

   French Courts have recently considered that to be able to notify a sanction validly, employers with at least 20 employees must have mentioned the relevant type of sanction in their internal rules. Consequently, all companies with at least 20 employees which did not implement internal rules, and/or whose internal rules do not mention the relevant sanctions (e.g., warning, disciplinary suspension, demotion etc.) would legally be at risk when notifying a sanction. Indeed, the sanction notified without the internal rules' support is illegal, and can be nullified—at the employee's request—by an industrial tribunal. This restriction does not however apply to dismissals.

   Disabled Employees. Companies with over 20 employees must have 6% of workforce registered as disabled. Otherwise, the company has to pay towards a fund to facilitate the training of disabled people. Newly created companies have 3 years from the point of having reached 20 employees to comply with this. Nonetheless they must complete a declaration to the relevant authority in the interim.
3. **Employment-related implications for companies reaching the threshold of 50 employees in France.** Companies that employ 50 or more employees are required to organize elections to set up a works council. More precisely, this obligation applies to companies, which employ an average of 50 employees or more for at least a 12-month period—not necessarily consecutive—over a 3 year period.

The works council receives information from the employer concerning the economic and social situation of the company. It also responds to formal consultations by the employer in areas which affect employees, such as redundancies, vocational training and changes to the legal structure of the company. It is also responsible for managing social and cultural activities, for which it has a budget at its disposal.

Source: InternationalLawOffice.com, May 31, 2011.

The EU laws allowing freedom of movement for workers are not absolute rights, however. Entry can be limited on the grounds of public policy, public security, and public health,[66] and contracts with the public service can be limited to nationals of the member state.[67] In general these limitations are narrowly construed.

It should be noted that in addition to these limitations, the accession agreements allow the "old" 15 EU member states to apply, for a few years, restrictive measures against workers from the 12 "new" member states that joined the EU in 2004 and 2006. These restrictions can be applied for a transitional period of "two plus three plus two" years (adding up to seven years at most). In the first two years after enlargement, the old member states were able to freely decide not to open their labor markets to workers from the new member states. After those two years, they could decide to continue their national transition arrangements for an additional three years. At the end of this three-year period, the old members could only prolong these restrictions for another two years if they could demonstrate that workers from the new member states posed a real threat of serious disturbance in the domestic labor market.

[66] *Id*., Articles 56 and 66.

[67] *Id*., Articles 55 and 66.

Germany, Austria Finally Remove Restrictions on Eastern European Workers

Under these provisions of EU law, Germany and Austria kept their doors closed for 7 years to workers from the eight former Soviet-bloc states which joined the European Union in 2004. Finally, on May 1, 2011, individuals from the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Slovakia and Slovenia were able to come and go and work freely in the last two EU states to maintain such restrictions.

Just three EU states—the UK, Ireland and Sweden—had fully opened their labor markets upon the EU's expansion in 2004, with other member countries steadily easing restrictions in the years that followed. However, Germany and Austria kept the door closed until the very last moment allowed within the transition period, which came to an end coincidentally on " international workers' day."

German politicians were still fearful of a wave of low-income immigrants. The government announced it would ramp up the number of checks in the construction and catering sectors to ensure employers were not using migrants to undercut wages. In contrast, a study released in the UK reported that migrants from eastern Europe had boosted the British economy by 0.38 percent from 2004 to 2009, equivalent to an injection of some £5 billion to the British economy. Some 700,000 workers from the east entered the UK over this period, the authors estimated, 500,000 of which came from Poland.

Meanwhile, workers from the last two eastern states to join the block, Romania and Bulgaria, who entered the Union in 2007, remain locked out until 1 January, 2013. Romanians and Bulgarians do however enjoy full rights to free movement in 15 member states.

Source: Leigh Phillips, "Germany, Austria Finally Open Doors to Eastern Workers," EU Observer.com., Feb. 5, 2011.

Provisions Governing Trade in Services in the North American Free Trade Agreement (NAFTA)

The trade-in-services provisions in NAFTA are very similar to those found in GATS. There are, nonetheless, some differences.

As is the case with GATS, each of the NAFTA countries (Canada, Mexico, and the United States) has to observe the basic rules of transparency,[68] MFN treatment,[69] and national treatment.[70] In addition, each NAFTA country is required to accord the better of national or MFN treatment to services and service suppliers of the other two countries.[71]

Also, as in GATS, service providers establishing a commercial presence in NAFTA countries, including providers from non-NAFTA states, are granted several important rights, including the right to be free from performance requirements,[72] the right to make inward and outward transfers,[73] the right to have the international standard of care doctrine applied to expropriations,[74] and the right to have investor–state disputes resolved by binding international arbitration.[75]

One important difference between GATS and NAFTA is that NAFTA does not deal with services generally, but rather by sectors. Its main service provisions, accordingly, are in three core service chapters (cross-border trade in services, telecommunications, and financial services), two associated chapters (investment and temporary entry of businesspeople), and three annexes (land transportation, professional services, and specific reservations and exceptions).[76] Because of this arrangement, rules such as transparency, MFN treatment, and national treatment are repeated (with minor variations) in different chapters.

Another difference is that NAFTA does not specifically define the four basic *modes of supply*, as GATS does, and instead deals with them piecemeal. NAFTA's chapter on cross-border trade in

[68]North American Free Trade Agreement, Articles 1306, 1411, and 1802 (1993).

[69]*Id.*, Articles 1103, 1203, and 1406.

[70]*Id.*, Articles 1102, 1202, and 1405.

[71]*Id.*, Articles 1104 and 1204.

[72]*Id.*, Article 1106.

[73]*Id.*, Article 1109.

[74]*Id.*, Article 1110.

[75]*Id.*, Article 1120.

[76]Harry G. Broadman, "International Trade and Investment in Services: A Comparative Analysis of the NAFTA," *International Lawyer*, vol. 27, p. 623 at pp. 637–644 (1993).

services covers that mode.[77] The chapter on investments generally covers the commercial presence mode of supply. Other chapters cover the movement of consumers and the temporary movement of natural persons.

A third difference between NAFTA and GATS is the manner in which NAFTA deals with sectoral coverage. Unlike GATS, which requires states to list the sectors covered (a *positive list*) and then list the limitations that apply to them (a *negative list*), NAFTA requires its countries to specify the sectors that are not covered by the agreement (a negative list) and the limitations that apply to them (a negative list). Thus, if a NAFTA country does not list a sector or a limitation, NAFTA's rules automatically apply.[78]

Finally, the NAFTA countries may modify their lists of sectors and limitations. However, they may not, unlike GATS member states, make the lists more restrictive.[79]

International Labor Organization (ILO)
A specialized agency of the United Nations responsible for promoting international efforts to improve working conditions, living standards, and the equitable treatment of workers worldwide.

C. International Labor Law

International law has been concerned with the rights of laborers from the beginning of the twentieth century. Following World War I, as part of the Treaty of Versailles, the international community agreed to establish the International Labor Organization (ILO), which has become the principal international advocate of workers. With the creation of the United Nations after World War II, the right of laborers to have reasonable working conditions became part of the basic human rights that were incorporated in the UN's Universal Declaration of Human Rights. In the materials that follow, we discuss both the ILO and those human rights rules that apply to workers.

General Conference
The legislative body of the ILO, made up of representatives from government, labor, and management from each member state.

International Labor Organization

The **International Labor Organization (ILO)** has as its primary goal the improvement of working conditions, living standards, and the fair and equitable treatment of workers in all countries. Created in 1919 by the Treaty of Versailles, it became a specialized agency of the United Nations in 1946. Headquartered in Geneva, the ILO carries out its objectives by issuing recommended labor standards, organizing conferences to draft international labor conventions,[80] monitoring compliance with its recommendations and conventions, and providing technical assistance to member states.

Governing Body
The governing body of the ILO, responsible for setting the ILO's agenda. It is made up of representatives from government, labor, and management from 28 member states.

The ILO's institutional structure is made up of a **General Conference** that acts as a legislative body, approving conventions and adopting recommendations; a **Governing Body** that serves as the executive; and an **International Labor Office** headed by a Director-General that functions as the organization's secretariat (see Figure 8.2). The membership of the General Conference comprises representatives from government, labor, and management. Each national delegation includes four representatives: two from government, one from labor, and one from employers. The same tripartite representation also exists in the Governing Body, which is composed of 56 members, half of whom are appointed by governments, a quarter by workers' groups, and a quarter by employers' organizations. Of the 28 seats reserved for government representatives, 10 are further reserved for delegates from the world's principal industrial powers.

International Labor Office
The secretariat of the ILO.

[77]Significantly, the agreement provides that NAFTA countries may not compel a cross-border service provider to establish an office or maintain a local presence. North American Free Trade Agreement, Article 1205 (1993).

[78]*Id*., Articles 1108, 1206, 1409.

NAFTA itself lists one service sector that is not covered by the agreement: the general civil aviation sector. *Id*., Article 1201, para. 2(b).

The principal exempted service sectors that the NAFTA countries have listed are (1) government-provided social services (exempted by all three countries), (2) basic telecommunications services (all three countries), (3) cultural industries (Canada), (4) sectors that are constitutionally reserved to nationals (Mexico), (5) legal services (Mexico and the United States), and (6) maritime transport services (all three countries). Harry G. Broadman, "International Trade and Investment in Services: A Comparative Analysis of the NAFTA," *International Lawyer*, vol. 27, p. 623 at p. 919 (1993).

[79]North American Free Trade Agreement, Article 1108, para. 1(c); Article 1206, para. 1(c); Article 1409, para. 1(c) (1993).

[80]The ILO has sponsored more than 180 conventions.

FIGURE 8.2

The Tripartite Organization of the ILO

The authors of the ILO's Constitution probably meant for the organization to involve itself primarily with manual, or blue-collar, labor and not with other forms of employment. This reflected the interests of the labor movement at the end of World War I, but it did not represent its concerns only a few years later. In the Employment of Women at Night Case, the Permanent Court of International Justice (PCIJ) considered whether the ILO could sponsor conventions that did not involve manual labor, in particular a 1919 Convention Concerning Employment of Women at Night. The PCIJ stated:

> It is certainly true that the amelioration of the lot of the manual laborer was the main preoccupation of the authors of Part XIII of the Treaty of Versailles of 1919; but the Court is not disposed to regard the sphere of activity of the International Labor Organization as circumscribed so closely, in respect of the persons with which it was to concern itself, as to raise any presumption that "Labor convention" must be interpreted as being restricted in its operation to manual workers, unless a contrary intention appears. . . .
>
> To justify the adoption of a rule for the interpretation of "Labor conventions" to the effect that words describing general categories of human beings such as "persons" or "women" must *prima facie*[81] be regarded as referring only to manual workers, it would be necessary to show that it was only with manual workers that the International Labor Organization was intended to concern itself. . . .
>
> The text . . . of Part XIII does not support the view that it is workers doing manual work—to the exclusion of other categories of workers—with whom the International Labor Organization was to concern itself. . . . [82]

The PCIJ's decision makes it clear that the scope of the ILO's concerns includes all forms of labor, whether it be blue-collar or white-collar, for hire or done gratuitously, and whether employed by the state or the private sector.

The ILO Web site is at
www.ilo.org.

International Labor Standards To pursue its goal of improving the lot of all working people, the ILO attempts to establish rules or *standards* that have international effect. Three reasons are sometimes given for why these standards need to have international effect. The *first*, and most practical one, is that individual states are not inclined to enact domestic labor laws because this would put them at a competitive disadvantage in the world market by increasing local labor costs. The adoption of an internationally effective agreement would, accordingly, keep multinational companies from practicing what is sometimes called *social dumping*.[83] *Second*, the establishment of fair and equitable

[81]From Latin: "at first sight." A fact presumed to be true until disproved by some contrary evidence.

[82]Advisory Opinion, *Permanent Court of International Justice Reports*, Series A/B, No. 50 (1932).

[83]Social dumping is the practice of directing services to the wealthy (e.g., developed countries) and letting the poor (e.g., underdeveloped countries) fend for themselves because of the high cost of providing services to them.

labor standards helps promote world peace. *Third*, the establishment of uniform labor standards is a matter of both justice and humanity.[84] Each of these justifications for international standards has become even stronger as globalization has increased.

Two instruments are used to create international standards: ILO conventions and ILO recommendations. **ILO Conventions** are sponsored by the ILO when there is substantial agreement in the international community about a particular labor practice. **ILO Recommendations** are issued by the International Labor Office staff when the situation is more amorphous—for example, when the subject at hand is complex, or when there is no consensus on how a problem should be solved, or sometimes as a supplement to a convention that covers a matter in more general terms.

ILO conventions Labor conventions sponsored by the ILO.

ILO recommendations International Labor Office opinions as to proper labor practices and as to how ILO conventions should be interpreted.

Over the years, ILO conventions and recommendations have dealt principally with three concerns. First, they have focused on the basic issues of labor protection, such as employment conditions (e.g., hours of work, weekly rest, holidays with pay, etc.) and the protection of women and children. (In general, these were also the issues the ILO addressed during its own earliest years.) Second, they have concentrated on setting up the basic machinery and institutions that are needed to make labor protection effective (e.g., labor inspection, employment service, labor statistics, and minimum wage–fixing machinery). Third (and this has been the focus of much of the ILO's work since the end of World War II), they have worked to promote and protect the human rights and fundamental freedoms of workers (e.g., freedom of association, freedom from forced labor, and freedom from discrimination in employment and occupation).

The ILO, among other things, studies and reports on a wide variety of employment and workplace issues of importance. For example, in May 2007, the ILO issued a report on workers with disabilities, from which Reading 8-1 is taken.

Reading 8-1 Equality at Work: Tackling the Challenges of Disability

Equality at Work: Tackling the Challenges, Global Report under the follow-up to the ILO Declaration on Fundamental Principles and Rights at Work, International Labour Conference, 96th Session 2007, International Labour Office, Geneva. ISBN 978-92-2-118130-9, ISSN 0074-6681. Used with the permission of the ILO.

The challenge for enhancing the employability of people with disabilities is significant. But according to a new ILO global report on discrimination in the world of work, there is growing evidence that people with disabilities are not only more productive, they may actually be more skilled in certain types of jobs than non-disabled people. Proof can be found in the cash management department of one of Sri Lanka's biggest banks, where millions of rupees are counted and sorted every day by people who can neither speak nor hear.

Ms. Jayamali Fernando is a pioneer. The 41 year old woman from Athurugiriya in Sri Lanka is one of the best employees in the cash counting department at the head office of Sampath Bank in Colombo. Ms. Fernando also cannot speak or hear. She is one of seven hearing and speech impaired people hired by Sampath Bank in a unique partnership set up by the bank, the country's employer's organization, and the ILO.

According to the ILO global report *Equality at work: Tackling the challenges*, some 650 million people, one out of every 10 people on the planet, live with a disability, either physical or mental. The new report, published in May 2007, provides a global report card on progress in addressing many forms of discrimination over the past four years.

"In a developing country like Sri Lanka, economic underdevelopment and massive unemployment mean that jobs are scarce, and the risk of discrimination is significant. Although there is a large body of labour laws and legal safeguards in place to prevent abuses in Sri Lanka's private sector, disabled people are particularly vulnerable," says Manuela Tomei, an ILO specialist on discrimination issues.

The Employer Network on Disability was created, with the help of the ILO, to give disabled people a chance to become productive workers. The Network's prime mover is the Employer's Federation of Ceylon (EFC), Sri Lanka's principal employers' organization, which represents 500 employers in sectors ranging from manufacturing to services, from banking to import/export firms to sales and marketing businesses.

Back in 1999, with assistance from the ILO, the EFC started the Network, which connects organizations that help disabled people with the business community, by enhancing employment opportunities as well as helping disabled people get access to vocational training. The EFC's Meghamali Aluvihare says it began with an awareness raising program to help dispel preconceptions about workers with disabilities. The EFC also created a database, matching disabled workers with the businesses that needed them, and later hosted a job fair connecting disabled people with local employers.

"Sampath Bank has a strong commitment to developing its people, and has made a major investment in training and human resources," says Ms. Aluvihare, making it an ideal company for hiring disabled people. The bank hired seven speech and hearing impaired people who attended the job fair set up by the EFC. The bank's managers thought they had just the right opportunity for the disabled workers.

The Central Cash Department at the bank's head office in Colombo is where all of the bank's cash is collected and categorized. Every day, millions of rupees are sorted, packed, counterfeit notes detected, and transported out. It is a job that involves minimal interaction with the rest of the bank's operations, but requires a high degree of honesty, integrity, and attention to detail.

[84]See *International Human Rights in Context: Law, Politics, Morals* by Henry W. Steiner and Philip Alston (2000). Section by Nicholas Valticos begins on p. 327.

For every banker, cash handling is a core skill, and the seven speech and hearing impaired people the bank hired had to be trained to do the job. The trainers had to learn sign language to communicate with the new workers, and even the bank officer in charge of the department was given special training to communicate with his new team of disabled workers.

The results have far exceeded expectations, especially of those who thought it could never work. All seven of the hearing and speech impaired workers have so successfully integrated into the department that they are no longer considered disabled.

According to the department's manager, the disabled workers' level of productivity and efficiency has been rated as much as three times as high as that of other people working in the same division, and what's more, the manager says they are not only punctual, but that none of the disabled workers has ever claimed a single day of sick leave . . . and, most importantly for the operation of the cash department, there has never been a single complaint of dishonest or suspicious conduct in all the years of this initiative.

One of the biggest surprises, according to the department's manager, was that the hearing and speech impaired workers showed a special, unexpected talent: because of their highly attuned vision and superior tactile skills, they are particularly good at detecting counterfeit notes.

Over the last years, the EFC has taken further steps to bring more of these special workers into productive jobs. Over the years, the EFC has held five job fairs, at which over 250 people with disabilities have gotten jobs in the private sector. Meanwhile, the EFC is codifying what it has learned, including launching a "Code for Managing Disability Issues in the Workplace" for employers.

Hiring people with disabilities makes good business sense as well. "The Sampath Bank story isn't an isolated case. People with disabilities are not only among the most productive of workers, hiring them makes good business sense as well," says Ms. Tomei.

The new global report cites research that reveals some provocative results. Two thirds of Australian employers surveyed who hired disabled people said the cost of accommodating the workplace for them was neutral, as only 4 per cent of disabled people of working age require additional adjustments in the workplace. Many companies actually reduced costs by hiring disabled workers. The Australian survey found that the average recruitment cost of an employee with a disability is 13 per cent below the cost of recruiting an employee without a disability.

The ILO global report also cites long term studies conducted by DuPont, showing that disabled employees perform equally or better compared to their non-disabled colleagues.

For Ms. Fernando, her disability is no longer an issue at work. She is not "deaf and dumb" but simply another valued, productive member of Sampath Bank's cash management team. And just like every other employee, Ms. Fernando benefits from the bank's strong culture of learning, taking advantage of training opportunities and building her skills in the job she loves, and excels at.

ILO Reports The member states of the ILO are obliged to provide annual reports to verify compliance with the conventions they have ratified,[85] as well as irregular reports (when solicited by the director-general) to provide information on both recommendations and unratified conventions.[86] The report format required for both recommendations and conventions is essentially the same. In general, it consists of four main parts, which require the submitting country to provide the following:

Part I Copies of the state's statutory legislation and administrative regulations dealing with the particular convention or recommendation and any documentary material (such as forms, booklets, handbooks, and reports) interpreting these.

Part II An interpretation of the materials provided in Part I, showing how they have given effect to the provisions of the particular convention or recommendation.

Part III (a) A description of the actions that need to be taken to modify existing legislation or practice to give effect to all or part of the provisions of the particular convention or recommendation; (b) reasons why those actions have not been taken; and (c) a statement as to whether or when those actions will be taken.

Part IV The names of employers and workers' organizations to which copies of the report were given, and the comments that those organizations made.

ILO Committee of Experts on the Application of Conventions and Recommendations A committee of the ILO's Governing Body that analyzes annual reports to determine the extent of member state compliance with ILO recommendations and conventions.

A summary of the information contained in the member states' reports is prepared annually by the International Labor Office for use by the General Conference. Since 1927, this has been the job of the **ILO Committee of Experts on the Application of Conventions and Recommendations**. The committee's members are appointed by the Governing Body as individuals and not as representatives of particular governments or groups. They must have a reputation for being impartial, independent, and knowledgeable of international labor law. Commonly they are drawn from the judiciary and academia.[87]

[85] The ILO Constitution, Article 22, states: "Each of the members agrees to make an annual report to the International Labor Office on the measures which it has taken to give effect to the provisions of conventions to which it is a party. These reports shall be made in such form and shall contain such particulars as the Governing Body may request."

[86] *Id*., Article 19.

[87] The Committee of Experts that prepared and issued the 2011 report included law professors and judges from the following countries: Argentina, Belize, Brazil, Kuwait, United States, South Africa, United Kingdom, Morocco, Sierra Leone, France, Russia, Thailand, Germany, Australia, India, Cameroon, Madagascar, and Japan. www.ilo.org/global/standards/applying-and-promoting-international-labour-standards/committee-of-experts-on-the-application-of-conventions-and-recommendations/WCMS_151570/lang--en/index.htm.

The Committee of Experts does more than merely prepare a summary of the aforementioned reports. It analyzes and evaluates the submissions, indicating, in the case of unratified treaties and ILO recommendations, how close international practice is to the standards set by the organization; and, in the case of ILO conventions, the extent to which the parties have complied with their obligations.[88]

A special **ILO Conference Committee on the Application of Conventions and Recommendations** reviews the summary at the General Conference. This Conference Committee, after hearing comments from governments, employers, and workers, compiles a **special list** of the governments that have defaulted on their obligations to the ILO. The list contains seven categories of deficiencies. Six deal with the failure of particular governments to submit reports, to respond to requests for information, or to participate in discussions concerning an alleged failure to comply with an ILO convention obligation. The seventh and most serious category alleges that certain governments have failed to implement fully one or more of the ILO conventions they have ratified.

ILO Conference Committee on the Application of Conventions and Recommendations
Committee of the ILO General Conference responsible for making a list of member states that have defaulted on their obligations to the ILO.

Each year the Conference Committee's special list is presented to the General Conference for review and adoption. This is often an awkward time for those states named on the list, especially those in Category 7. One especially memorable debate occurred in 1974, when the Soviet Union was named in Category 7. The U.S.S.R. was included for an alleged breach of the 1930 Convention Concerning Forced or Compulsory Labor because, among other things, its laws did not allow a collective farm laborer to quit work without the permission of the farm's management. After a lengthy and heated discussion, the General Conference was unable to obtain a quorum when a vote was called, so the special list was not adopted.[89]

special list
List of member states that have defaulted on their obligations to the ILO.

The failure of the General Conference to take action against the U.S.S.R., together with Soviet bloc and Third World nation interference with the independence of employee and employer groups and an increase in political debates at the General Conference, led the United States to withdraw from the ILO in 1977. The withdrawal had a dramatic impact on the ILO, in part because the United States was the major financial supporter of the organization. By 1980, when the United States rejoined, the ILO had adopted resolutions to strengthen the tripartite system of decision making; it also had censured the Soviet Union, adopted the use of secret ballots, defeated an anti-Israeli resolution, begun screening out resolutions that violated ILO procedures, and reduced the number of meetings dealing with political affairs.[90]

Settlement of Disputes Between ILO Member States If an ILO member state violates the ILO Constitution, an ILO convention that it has ratified, or the ILO Convention on the Freedom of Association (whether it is a party to it or not), there are several dispute-resolution procedures that can be invoked to reach a settlement. These include (1) the investigation of complaints of noncompliance with ratified conventions by commissions of inquiry, (2) the investigation of abuses by the Fact-Finding and Conciliation Commission on Freedom of Association, and (3) interpretations of the ILO Constitution and ILO conventions by the International Labor Office.

The Commission of Inquiry Article 26(1) of the ILO Constitution authorizes any member state to file a complaint with the ILO "if it is not satisfied that any other member is securing the effective observance of any convention which both have ratified." Upon receiving such a complaint, the "Governing Body may appoint a Commission of Inquiry to consider the complaint and to report thereon."[91]

Although this procedure has been available since the ILO was founded, the first Commission of Inquiry was appointed only in 1961, and only a few other commissions have been appointed since.[92]

[88]The 2011 Report of the Committee of Experts was issued in February 2011 and can be accessed at www.ilo.org/ilc/ILCSessions/100thSession/reports/reports-submitted/WCMS_151556/lang—en/index.htm.

[89]See "Proceedings Regarding Soviet Inclusion in the Special List," International Labor Conference, 59th Session, *Record of Proceedings*, pp. 733–760 (1974).

[90]Linda L. Moy, "The U.S. Legal Role in International Labor Organization Conventions and Recommendations," *International Lawyer*, vol. 22, pp. 768–769 (1988).

[91]International Labor Organization Constitution, Article 26(2).

[92]See Clarence Wilfred Jenks, *Social Justice in the Law of Nations: The ILO Impact after Fifty Years*, p. 48 (1970).

The Fact-Finding and Conciliation Commission on Freedom of Association The Preamble of the ILO Constitution establishes the "recognition of the principle of freedom of association" as one of the organization's primary purposes. To implement this principle, the General Conference adopted two labor conventions: the Convention Concerning Freedom of Association (ILO Convention No. 87) and the Convention Concerning the Application of the Principles of the Right to Organize and to Bargain Collectively (ILO Convention No. 98). The first grants workers the right to form and join trade unions free from governmental interference; the second protects workers from antiunion discrimination and protects unions from employer domination.

Although both conventions have been widely ratified,[93] it was feared at first that they would not be. Because the Commission of Inquiry procedure allowed by Article 26 of the ILO Constitution can be invoked only if both the complaining and offending states have ratified the convention involved, the expected delay in ratification of the two freedom of association conventions meant that Commissions of Inquiry could not be used. This was unacceptable to the Governing Body, which regarded the two conventions as especially important, so it established a special commission, modeled on the Article 26 Commission of Inquiry but not depending on the ratification of a convention to carry out its tasks.[94]

Together with the UN Economic and Social Council (ECOSOC), the Governing Body established in 1950 a nine-member **ILO Fact-Finding and Conciliation Commission** to consider complaints involving violations of the two freedom of association conventions. Under the guidelines established for the commission, it can hear complaints against a state that has ratified either of the conventions and, if the state against which a complaint has been made gives its consent, the commission can consider a complaint even though the state has not ratified either.[95]

ILO Fact-Finding and Conciliation Commission
Special ILO committee of inquiry that considers complaints that a state has violated the ILO's freedom of association conventions. If the state consents, the inquiry can proceed even though the state is not a member of the ILO.

Few states have consented to investigations by the Fact-Finding and Conciliation Commission; however, as the two conventions have become widely ratified in recent years, the requirement of consent has become of less concern. Most recent investigations have involved states that are parties to one or both of the freedom of association conventions. In these cases the Fact-Finding and Conciliation Commission is, except for its name and the focus of its investigation, nothing more than an Article 26 Commission of Inquiry.

The International Labor Office The ILO Constitution provides that "[a]ny questions or dispute relating to the interpretation . . . of any convention . . . shall be referred for decision to the International Court of Justice." Only one case, however, has ever been considered by the ICJ. As a practical matter, reference to the ICJ is cumbersome and expensive, so governments in doubt about the meaning of an ILO convention have taken to the practice of asking for the International Labor Office to express an opinion. As the office has stated:

> The Office has always considered it to be a duty to assist governments in this manner, though it has invariably pointed out that it has no special authority to interpret texts of Conventions; the opinions given by the Office have, when of sufficient general interest, been submitted to the Governing Body and published. Though not authoritative in the same final sense as an interpretation by the Court, these interpretations therefore enjoy such authority as derives from their having been formulated by the International Labor Office in its official capacity at the request of governments of members of the Organization.[96]

[93]According to the ILO site, accessed July 15, 2001, "By 31 December 2007 the total number of ratifications of Conventions Nos 87 and 98 stood at 148 and 158 member States respectively, out of the total ILO membership of 181 States." They have not, however, been ratified by the United States. Freedom of Association in Practice: Lessons Learned, ILO Conference report, International Labour Organization, Geneva, 2008.

[94]See James A. Nafziger, "The International Labor Organization and Social Change: The Fact-Finding and Conciliation Commission on Freedom of Association," *New York University Journal of International Law & Politics*, vol. 2, p. 1 at p. 11 (1969).

[95]The requirement that a state that has not ratified a convention must consent to an investigation by the Fact-Finding and Conciliation Commission was thought necessary because there is no provision in the ILO Constitution for setting up commissions other than the one in Article 26. Even with the addition of this requirement, the establishment of this commission was thought to be unconstitutional by Australia and South Africa. For a discussion of the debate on the establishment of the Commission, see Clarence Wilfred Jenks, *The International Protection of Trade Union Freedom*, pp. 190–193 (1957).

[96]International Labor Office, *The International Labor Code*, 1951, vol. 1, Preface, p. cix (1952).

Settlement of Disputes Between Intergovernmental Organizations and Their Employees The **ILO Administrative Tribunal** of the ILO[97] is a special court that hears complaints from employees in the secretariats of the ILO and 59 other intergovernmental organizations (IGOs) that have recognized the competence of the tribunal.[98] The tribunal's jurisdiction extends to disputes involving the "non-observance, in substance or in form, of the terms of appointment of officials" and to violations of the Staff Regulations of the ILO or other IGOs.[99]

ILO Administrative Tribunal
Special court that hears complaints from employees in the secretariats of the ILO and other IGOs.

The Tribunal is composed of seven judges, all of different nationalities, who are appointed for a renewable period of three years. The Tribunal's case law comprises nearly 3,000 judgments, available in English and in French,[100] and almost all of the decisions have been accepted and implemented by the officials and organizations involved.[101] The power of the tribunal to issue judgments, however, is limited. It has the power to "order the rescinding of the decision impugned or the performance of the obligation relied upon." It does not have the power to order an IGO to undertake an action it has not begun on its own, as Case 8-2 demonstrates.

The Human Rights of Workers

The basic principles underlying contemporary international labor law are found in the Universal Declaration of Human Rights and in the International Covenant on Economic, Social and Cultural Rights. Both the declaration, adopted by the United Nations General Assembly in 1948, and the covenant, adopted by the General Assembly in 1966 and in force from 1976, reflect the international community's aspiration and sensibilities following World War II.

---

[97]The tribunal maintains a home page at www.ilo.org/public/english/tribunal.

[98]As of June 19, 2011, the IGOs that have recognized the competence of the ILO's Administrative Tribunal are the International Labour Organization (ILO), including the International Training Centre, World Health Organization (WHO), including the Pan American Health Organization (PAHO), International Telecommunication Union (ITU), United Nations Educational, Scientific and Cultural Organization (UNESCO), World Meteorological Organization (WMO), Food and Agriculture Organization of the United Nations (FAO), including the World Food Programme (WFP), European Organization for Nuclear Research (CERN), World Trade Organization (WTO), International Atomic Energy Agency (IAEA), World Intellectual Property Organization (WIPO), European Organisation for the Safety of Air Navigation (Eurocontrol), Universal Postal Union (UPU), European Southern Observatory (ESO), Intergovernmental Council of Copper Exporting Countries (CIPEC) (until 1992), European Free Trade Association (EFTA), Inter-Parliamentary Union (IPU), European Molecular Biology Laboratory (EMBL), World Tourism Organization (UNWTO), European Patent Organisation (EPO), African Training and Research Centre in Administration for Development (CAFRAD), Intergovernmental Organisation for International Carriage by Rail (OTIF), International Center for the Registration of Serials (CIEPS), International Office of Epizootics (OIE), United Nations Industrial Development Organization (UNIDO), International Criminal Police Organization (Interpol), International Fund for Agricultural Development (IFAD), International Union for the Protection of New Varieties of Plants (UPOV), Customs Co-operation Council (CCC), Court of Justice of the European Free Trade Association (EFTA Court), Surveillance Authority of the European Free Trade Association (ESA), International Service for National Agricultural Research (ISNAR) (until July 14, 2004), International Organization for Migration (IOM), International Centre for Genetic Engineering and Biotechnology (ICGEB), Organisation for the Prohibition of Chemical Weapons (OPCW), International Hydrographic Organization (IHO), Energy Charter Conference, International Federation of Red Cross and Red Crescent Societies, Preparatory Commission for the Comprehensive Nuclear-Test-Ban Treaty Organization (CTBTO PrepCom), European and Mediterranean Plant Protection Organization (EPPO), International Plant Genetic Resources Institute (IPGRI), International Institute for Democracy and Electoral Assistance (International IDEA), International Criminal Court (ICC), International Olive Council (IOC), Advisory Centre on WTO Law, African, Caribbean and Pacific Group of States (ACP Group), Agency for International Trade Information and Cooperation (AITIC), European Telecommunications Satellite Organization (EUTELSAT), International Organization of Legal Metrology (OIML), International Organisation of Vine and Wine (OIV), Centre for the Development of Entreprise (CDE), Permanent Court of Arbitration (PCA), South Centre, International Organisation for the Development of Fisheries in Central and Eastern Europe (EUROFISH), Technical Centre for Agricultural and Rural Cooperation ACP-EU (CTA), The International Bureau of Weights and Measures (BIPM), ITER International Fusion Energy Organization (ITER Organization), Global Fund to Fight AIDS, Tuberculosis and Malaria, and the International Centre for the Study of the Preservation and Restoration of Cultural Property (ICCROM). See www.ilo.org/public/english/tribunal/membership/index.htm.

A UN Administrative Tribunal has a similar responsibility for the United Nations, the International Civil Aviation Organization (ICAO), and the International Maritime Organization.

[99]Statute of the International Labor Organization Administrative Tribunal, Article 2.

[100]The tribunal's Web site is www.ilo.org/public/english/tribunal and all of the tribunal's judgments are available online.

[101]The judgments of the Administrative Tribunal are "final and without appeal," except that challenges to the court's jurisdiction and claims of a "fundamental fault in the procedure followed" can be appealed to the ICJ. *Id*., Articles 7 and 12.

CASE 8-2 DUBERG v. UNESCO

Judgment No. 17, *International Labor Organization Official Bulletin*, vol. 38, no. 7, p. 251 (1955). Copyright © 1955 by the International Labour Organization. Reprinted with permission.

MAP 8.2

France (1995)

In 1949, Peter Duberg, an American citizen, began working for the United Nations Educational, Scientific and Cultural Organization (UNESCO) in Paris, France. In 1953, the U.S. government sent him a loyalty questionnaire that required him to swear that he was loyal to the United States and not sympathetic with any subversive organizations or ideas, including communism. When he did not return the questionnaire, the U.S. government asked him to appear before an International Employees Loyalty Board at its embassy in Paris. He refused as a matter of conscience. In 1954, the Director-General of UNESCO refused to renew his employment contract, citing Duberg's failure to appear before the Loyalty Board as the reason for doing so. The director-general's letter of dismissal stated, "In the light of what I believe to be your duty to the Organization, I have considered very carefully your reasons for not appearing before the International Employees Loyalty Board where you would have had an opportunity of dispelling suspicions and disproving allegations which may exist regarding you." Duberg requested the director-general to reconsider and, while his request was being reviewed, the chairman of the Loyalty Board wrote the director-general that "[it] has been determined on all of the evidence that there is a reasonable doubt as to the loyalty of Norwood Peter Duberg to the government of the United States" and that "this determination, together with the reasons therefore, in as much detail as security considerations permit, are submitted for your use in exercising your rights and duties with respect to the integrity of the personnel employed by the United Nations Educational, Scientific and Cultural Organization." The director-general refused to reconsider Duberg's employment. Duberg appealed to UNESCO's Appeals Board. The board issued an opinion that Duberg should be rehired, but the director-general informed the board that he would not comply with its recommendation. Duberg appealed to the ILO's Administrative Tribunal.

The Administrative Tribunal of the International Labor Organization . . .

A.

Considering that the defendant Organization holds that the renewal or nonrenewal of a fixed-term appointment depends entirely on the personal and sovereign discretion of the Director-General, who is not even required to give his reasons therefore; . . .

B.

Considering that if the Director-General is granted authority not to renew a fixed-term appointment and so to do without notice or indemnity, this is clearly subject to the implied condition that this authority must be exercised only for the good of the service and in the interest of the Organization;. . .

***

E.

Considering that . . . the ground for complaint of the Director-General is based solely on the refusal of the official to participate in measures of verbal or written inquiry to which his national government considers it necessary to subject him; That the Director-General of an international organization cannot associate himself with the execution of the policy of the government authorities of any state member without disregarding the obligations imposed on all international officials without distinction and, in consequence, without misusing the authority which has been conferred on him solely for the purpose of directing that organization towards the achievement of its own, exclusively international, objectives; That this duty of the Director-General is governed by Article VI, paragraph 5, of the Constitution of the defendant Organization, in the following terms:

> The responsibilities of the Director-General and of the staff shall be exclusively international in character. In the discharge of their duties they shall not seek or receive instructions from any government or from any authority external to the Organization. They shall refrain from any action which might prejudice their position as international officials. Each state member of the Organization undertakes to respect the international character of the responsibilities of the Director-General and the staff, and not to seek to influence them in the discharge of their duties;

Considering that the fact that in this case the matter involved is an accusation of disloyalty brought by a government which enjoys in all respects the highest prestige must be without any influence upon the consideration of the facts in the case and the determination of the principles whose respect the Tribunal must ensure;

That it will suffice to realize that if any of the 72 states and governments involved in the defendant Organization brought against an official, one of its citizens, an accusation of disloyalty and claimed to subject him to an inquiry in similar or analogous conditions, the attitude adopted by the Director-General would constitute a precedent obliging him to lend his assistance to such inquiry and, moreover, to invoke the same disciplinary or statutory consequences, the same withdrawal of confidence, on the basis of any opposal by the person concerned to the action of his national government; That if this were to be the case there would result for all international officials, in matters touching on conscience, a state of uncertainty and insecurity prejudicial to the performance of their duties and liable to provoke disturbances in the international administration such as cannot be imagined to have been in the intention of those who drew up the Constitution of the defendant Organization; Considering, therefore, that the only ground for complaint adduced by the Director-General to justify the application to the complainant of an exception to the general rule of renewal of appointments, that is to say his opposition to the investigations of his own government, is entirely unjustified;

***

Considering that it results therefrom that the decision taken must be rescinded; but that nevertheless the Tribunal does not have the power to order the renewal of a fixed-term appointment, which requires a positive act of the Director-General over whom the Tribunal has no hierarchical authority;

That in the absence of such a power, and unless the Director-General should consider himself in a position to reconsider his decision in this manner, the Tribunal is nonetheless competent to order equitable reparation of the damage suffered by the complainant by reason of the discriminatory treatment of which he was the object;. . .

That the decision not to renew the appointment is one which should not only be rescinded in the present case, but also constitutes a wrongful exercise of powers and an abuse of rights which consequently involves the obligation to make good the prejudice resulting therefrom; that this prejudice was aggravated by the publicity given to the withdrawal of confidence as being due to lack of integrity, this ground having been given in a press communiqué issued by the defendant Organization, without it being possible seriously to maintain the view that there could have existed the slightest doubt as to the identity of the persons to which the said communiqué referred; . . .

That redress will be ensured *ex aequo et bono* [102] by the granting to the complainant of the sum set forth below;

On the Grounds as Aforesaid—the Tribunal

***

Orders the decision taken to be rescinded and declares in law that it constitutes an abuse of rights causing prejudice to the complainant;

In consequence, should the defendant not reconsider the decision taken and renew the complainant's appointment, orders the said defendant to pay the complainant the sum of 15,500 dollars, plus children's allowance for two years, the whole together with interest at 4 per centum from 1 January 1955;

Orders the defendant Organization to pay to the complainant the sum of 300 dollars by way of participation in the costs of his defense.

Casepoint

The ILO Administrative Tribunal decided that Mr. Duberg's rights had been violated by the director-general of UNESCO, an agency of the United Nations. The director-general had bent to the pressure of one nation (the United States) rather than preserving the international character and independence of his organization, as its constitution requires. However, the tribunal did not have the power to give Mr. Duberg his job back, so it ordered that he be paid a sum of money by UNESCO if the director-general did not reconsider his decision to terminate Mr. Duberg.

The civilized world was shocked by the Nazis' attempt during the war to annihilate all the Jews of Europe and to enslave and destroy millions of others, including Poles, gypsies and Roma people, Soviet prisoners of war, homosexuals, and the mentally and physically handicapped. For many, the efforts of the Allied forces to defeat the Nazis and their allies became synonymous with a struggle for human rights.

The impetus for establishing the universal recognition of basic human rights came from U.S. President Franklin D. Roosevelt's "Four Freedoms" speech before the U.S. Congress in 1941. This speech asserted that there were four basic freedoms that could never be legitimately abridged: freedom of speech and expression, freedom of worship, freedom from want, and freedom from fear.[103] U.K. Prime Minister Winston Churchill likewise asserted that an Allied victory would bring about the "enthronement of human rights." In August 1941, Roosevelt and Churchill jointly issued the Atlantic Charter, announcing their goals in the war. The charter reiterated Roosevelt's four freedoms and proclaimed that the Allies sought "the object of securing for all improved labor standards, economic advancement, and social security."[104]

[102]From Latin: "according to what is just and good." Maxim that disputes shall be resolved amicably and by compromise and conciliation.

[103]The Four Freedoms Speech is available at www.fdrlibrary.marist.edu/fourfreedoms.

[104]The Atlantic Charter is posted on the U.S. State Department's Web site at www.usinfo.state.gov/usa/infousa/facts/democrac/53.htm.

Germany's defeat brought more news of Nazi atrocities, and this led to a determination to secure enduring respect for human rights. The cause was taken up at the Conference on International Organization, held in San Francisco in April 1946, to draft a charter for the United Nations. While many human rights advocates had hoped that the charter would contain a Bill of Rights, they were nevertheless pleased that the charter committed the international community to protect and preserve human rights.

The Preamble to the United Nations Charter declares that human rights are one of the four founding purposes of the United Nations. Article 1 declares that member states agree to work together "in promoting and encouraging respect for human rights." Article 55 states that the United Nations will promote "universal respect for, and observance of, human rights and fundamental freedoms," and Article 56 says that the members "pledge themselves to take joint and separate action" to achieve that respect.

Soon after the United Nations came into existence, its Economic and Social Council accepted the recommendation of a "nuclear commission," chaired by Eleanor Roosevelt (see Figure 8.3), and established a Commission on Human Rights. Among the commission's first acts was the creation of a subcommittee to draft an International Bill of Rights. At the suggestion of Eleanor Roosevelt, who was aware of the political difficulties of getting a human rights treaty adopted, the subcommittee began working on a declaration—the Universal Declaration of Human Rights—to be issued by the UN General Assembly, as well as two treaties, one dealing with civil and political rights, the other the International Covenant on Economic, Social, and Cultural Rights.

The Universal Declaration of Human Rights The Universal Declaration of Human Rights (UDHR) was promulgated by the General Assembly on December 10, 1946. It proclaims civil and political rights as well as economic, social, and cultural rights. The first of these—the civil and political rights—are based on the traditional Western civil liberties and political rights derived from the English Bill of Rights of 1689, the French Declaration of the Rights of Man and Citizen of 1789, the U.S. Bill of Rights of 1790, and similar instruments. The economic, social, and cultural rights were included at the insistence of the Soviet Union, its allies, and other non-Western countries.

Eleanor Roosevelt (1884–1962), the wife of President Franklin Roosevelt (1882–1945), was one of the world's great humanitarians. Born in New York City to a socially prominent family, she married Franklin Roosevelt in 1905 and over the next 11 years gave birth to six children. During World War I she was actively involved with the Red Cross and after the war she was active in the League of Women Voters, the Women's Trade Union League, and the women's division of the Democratic Party. In 1921, her husband was stricken with polio and she became his close adviser and political stand-in in his campaigns for governor of New York in 1928 and the presidency in 1932, 1936, 1940, and 1944. As First Lady she held weekly conferences with women reporters, had her own radio program, wrote her own newspaper column, and lectured widely. Traveling around the country, she was her husband's eyes and ears and a strong advocate for the underprivileged and racial minorities. Following the death of her husband and the end of World War II, President Harry Truman made her a member of the U.S. delegation to the United Nations. As chairman of the Commission on Human Rights she was instrumental in the drafting and adoption of the Universal Declaration of Human Rights. She resigned from the UN in 1952 only to be appointed again in 1961 by President John Kennedy.

FIGURE 8.3

Eleanor Roosevelt with a Copy of the Universal Declaration of Human Rights

Source: Eleanor Roosevelt with a copy of the Universal Declaration of Human Rights © 2006 European Parliament

The economic, social, and cultural rights listed in the Universal Declaration of Human Rights include many provisions dealing with the rights of laborers. These are expressed as follows:

Everyone has the right to:

- "freedom of peaceful assembly and association" (Article 20)

No one shall be

- "held in slavery" (Article 4)
- "subject to torture" (Article 5)
- "compelled to belong to an association" (Article 20)

Everyone has the right to:

- "social security" (Article 22)
- "work" (Article 23)
- "equal pay for equal work" (Article 23)
- "just and favorable remuneration" (Article 23)
- "form and . . . join trade unions" (Article 23)
- "rest and leisure" (Article 24)
- "a standard of living adequate for the health and well-being of himself and of his family" (Article 25)
- "education" (Article 26)

Legal Effect of the Universal Declaration of Human Rights The Universal Declaration is not a treaty—it is a "declaration" about the rights humans should enjoy. From its beginnings, however, commentators have argued at length about whether or not it constitutes "customary international law."[105] Eleanor Roosevelt campaigned in the United States for the declaration's adoption by arguing that it was not legally binding (see Figure 8.4). Some of the members in the General Assembly, however, were not so sure. South Africa and the Soviet Union, among others, expressed fears that the declaration would impose new legal obligations, and six states joined them in abstaining from the final vote of adoption.[106]

In the years since its adoption, more and more writers have made the case that the Universal Declaration is a statement of customary international law.[107] Several developments can be cited in support of this argument: (1) The United Nations consistently relies on the Universal Declaration when it applies the human rights provisions of the UN Charter.[108] (2) The General Assembly has said that the rights delineated in the Universal Declaration "constitute basic principles of international law."[109] (3) International conferences attended by large numbers of states have adopted resolutions stating that the Universal Declaration "constitutes an obligation for the members of the international community."[110] (4) More than 70 states have incorporated the Universal Declaration in their constitutions or main laws.[111] (5) Court decisions have held that the Universal Declaration is customary international law.[112]

---

[105]See Michael J. Dennis, "Human Rights in 2002: The Annual Sessions of the UN Commission on Human Rights and the Economic and Social Council," *American Journal of International Law*, vol. 97, no. 2, pp. 364–386 (April 2003); Henry J. Steiner, Philip Alston, Ryan Goodman, *International Human Rights in Context: Law, Politics, Morals* (3rd ed., 2008).

[106]Howard Tolley, Jr., *The UN Commission on Human Rights*, pp. 23–24 (1987).

[107]"The Declaration . . . though not a treaty, is increasingly regarded as imposing some legal obligations upon members of the U.N. Charter." Valerie Neal, "Slings and Arrows of Outrageous Fortune: The Deportation of 'Aggravated Felons,'" *Journal of Transnational Law*, vol. 36, p. 1619 at p. 1636 (2003).

[108]See ILO Fundamental Principles and Rights at Work, at www.ilo.org/declaration/lang--en/index.htm and; Humphrey Waldock, "Human Rights in Contemporary International Law and the Significance of the European Convention," *European Convention of Human Rights*, p. 1 at p. 14 (*International & Comparative Law, Supplementary Publication No. 11*, 1965).

[109]General Assembly Resolution 2625 (XXV) (October 24, 1970).

[110]United Nations International Conference on Human Rights at Teheran, 1968, *American Journal of International Law*, vol. 62, p. 674 (1969).

[111]The adoption of the Universal Declaration in a state's constitution has sometimes been advised by the UN Commission on Human Rights in the reports it has made following its investigation of human rights violations. Such was the case for Equatorial Guinea. Commission on Human Rights Resolution 32 (XXXVII), 1981; United Nations Doc. E/CN.4/1494 (1981).

[112]See Case 1-9, *De Sanchez v. Banco Central de Nicaragua*, 770 F. 2d 1385 (5th Cir., 1985) for a list of cases looking to the Universal Declaration as a source of human rights law.

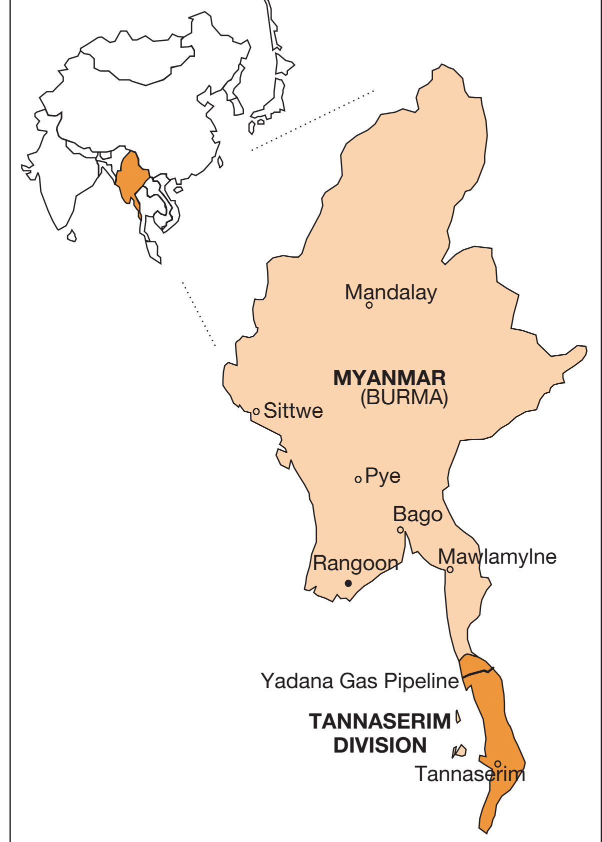
Among the most influential case decisions supporting the idea that the Universal Declaration is a statement of customary international law is the U.S. Second Circuit Court of Appeals case of *Filartiga v. Pena-Irala*.[113] That case, which dealt with the issue of whether torture is a violation of international law, held that the prohibition against a state's torturing its citizens "has become part of customary international law, as evidenced by the Universal Declaration of Human Rights . . . which states in the plainest terms, 'no one shall be subject to torture.'"

One interesting legal issue in the United States is whether a violation of the protections of the UDHR can serve as evidence that the "law of nations" has been violated in order to provide jurisdiction in U.S. federal courts under the Alien Tort Claims Act (ATCA). This law was enacted more than 200 years ago as part of the Judiciary Act of 1789. The ATCA, which is codified in United States Code, title 28, §1350, states:

> 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.

The ATCA provides both subject-matter jurisdiction and a cause of action.[114] To state a claim under the ATCA, a plaintiff must allege (1) a claim by an alien, (2) alleging a tort, and (3) a violation of the "law of nations" (international law).

One case that generated much interest in the United States a few years ago involved a claim by several citizens of Myanmar (formerly known as Burma) that they had been subject to physical harm and rape and forced into laboring on the construction of a pipeline for Unocal Corp. by the national army of Myanmar. The parties did not dispute that the first two elements of the ATCA were satisfied. The issue facing the federal court in 2000 was whether the conduct of the Myanmar military violated international law and, if so, whether Unocal is liable for these violations.



MAP 8.3

Myanmar (2000)

[113]*Federal Reporter, Second Series*, vol. 630, p. 876 (1980).

[114]In re Estate of Ferdinand Marcos, Human Rights Litigation, *Federal Reporter, Third Series*, vol. 25, p. 1467 at pp. 1474–75 (9th Circuit Ct. of Appeals, 1994).

The federal district court that heard the case stated that "Actionable violations of international law must be of a norm that is specific, universal, and obligatory."[115] When ascertaining the content of the law of nations, the Court must interpret international law not as it was in 1789 (the year the ATCA was enacted), but as it has evolved and exists among the nations of the world today.[116] The norms of the law of nations are found by consulting juridical writings on public law, considering the general practice of nations, and referring to judicial decisions recognizing and enforcing international law.[117]

The *Filartiga* [*v. Pena-Irala*] decision was the first Circuit decision interpreting the ATCA. "Construing this rarely-invoked provision, the Court held that deliberate torture perpetrated under color of official authority violates universally accepted norms of international law of human rights."[118]

. . . A few years later the 2nd Circuit's decision in *Kadic* [*v. Karadzic*] provided a further analysis of the scope of the private individual's liability for violations of international law. There, the court disagreed with the proposition "that the law of nations, as understood in the modern era, confines its reach to state action. Instead, [the court held] that certain forms of conduct violate the law of nations whether undertaken by those acting under the auspices of a state or only as private individuals."[119] While crimes such as torture and summary execution are proscribed by international law only when committed by state officials or under color of law, the law of nations has historically been applied to private actors for the crimes of piracy and slave trading, and for certain war crimes.[120]

"The 'color of law' jurisprudence of *United States Code*, title 42, §1983, is often used as a relevant guide to whether a defendant has engaged in official action for purposes of jurisdiction under the Alien Tort Claims Act."[121] A private individual acts under "color of law" within the meaning of section 1983 when he acts together with state officials or with significant state aid. In the *Unocal* case the plaintiffs argued that the joint venture between Unocal and the Myanmar government constituted sufficient "color of law" to create liability.

To answer the liability question, the court examined whether state officials and private parties had acted in concert in effecting a particular deprivation of constitutional rights.[122] The *Unocal* Plaintiffs presented evidence demonstrating that before joining the Project, Unocal knew that the military had a record of committing human rights abuses; that the Project hired the military to provide security for the Project; that the military, while forcing villagers to work and relocate, committed numerous acts of violence; and that Unocal knew or should have known that the military was committing, and would continue to commit, these tortious acts. However, there was no evidence that Unocal "participated in or influenced" the military's unlawful conduct; nor that Unocal "conspired" with the military to commit the challenged conduct.

Individual liability under the ATCA may be established for acts rising to the level of slavery or slave trading. The *Unocal* plaintiffs contended that forced labor was "modern slavery" and was therefore one of the "handful of crimes" to which individual liability under the ATCA may attach.

Over the past 40 years, the ILO has repeatedly condemned Burma's record of imposing forced labor on its people. In 1996, the ILO established a Commission of Inquiry to investigate allegations concerning Burma's noncompliance and, in 1998, the Commission issued its report, which acknowledged that the definition of slavery has historically been a narrow one, but that the term "slavery" now encompasses forced labor.

---

[115]*Id*. at p. 1475, citing *Filartiga v. Pena-Irala*, *Federal Reporter, Second Series*, vol. 630, p. 876 at p. 881 (2nd Circuit Ct. of Appeals, 1980); *Tel-Oren v. Libyan Arab Republic*, *id*., vol. 726, p. 774 at p. 781 (District of Columbia Circuit Ct. of Appeals, 1984).

[116]*Kadic v. Karadzic*, *Federal Reporter, Third Series*, vol. 70, p. 232 at p. 238 (2nd Circuit Ct. of Appeals, 1995).

[117]*Id*. at p. 241.

[118]*Federal Reporter, Second Series*, vol. 630, at p. 878.

[119]*Federal Reporter, Third Series*, vol. 70, at p. 239.

[120]*Id*. at p. 239.

[121]*Id*. at p. 245.

[122]*Gallagher v. Neil Young Freedom Concert, Federal Reporter, Third Series*, vol. 49, p. 1442 at p. 1453 (10th Cir., 1995).

The court found ample evidence in the record linking the Myanmar government's use of forced labor to human rights abuses. . .and there was an issue of fact as to whether the forced labor was used to benefit the Project, but in order to prevail on their ATCA claim against Unocal, however, the plaintiffs needed to establish that Unocal was legally responsible for the Myanmar military's forced labor practices.

The court found that there were no facts suggesting that Unocal sought to employ forced or slave labor. In fact, Unocal expressed concern that the Myanmar government was utilizing forced labor in connection with the Project and the military made efforts to conceal its use of forced labor. Because such a showing was insufficient to establish liability under international law, the court found there was no valid claim against Unocal for forced labor under the ATCA.

Later Developments Regarding the *Unocal* Case and Other Recent Alien Tort Claims Act Cases The Unocal case was appealed to the Ninth Circuit Court, where the lower court's dismissal of Unocal was reversed and the case remanded for a full trial. The appellate court issued a strong decision, finding that if the plaintiff's allegations were proved, Unocal could be held liable under the ACTA both for its own actions and for "aiding and abetting" violations by the Myanmar military and government. Furthermore, the court held that many of the alleged "torture, rape, forced labor, and murder" actions would violate the ACTA's prohibition of "specific, universal, and obligatory" international norms and the law of nations.

In addition, whereas the lower court found that Unocal had not engaged in "state action," the appellate court held that although "acts of rape, torture, and summary execution," like most crimes, "are proscribed by international law only when committed by state officials or under color of law," to the extent that they were committed *in isolation*, these crimes "are actionable under the Alien Tort [Claims] Act, without regard to state action, to the extent that they were committed *in pursuit of genocide or war crimes*." Thus, even crimes like rape, torture, and summary execution, which by themselves require state action for ATCA liability to attach, would *not* require state action when committed in furtherance of other crimes like slave trading, genocide, or war crimes, which by themselves do not require state action for ATCA liability to attach.

However, Unocal asked for, and was granted, a rehearing before the Ninth Circuit Court *en banc* (all judges participating). One day before that hearing, the case was settled by the parties and the prior Ninth Circuit opinion was "vacated." Unocal reportedly paid millions of dollars (the settlement terms were not publicly disclosed) as part of the settlement, but the vacating of the prior Ninth Circuit opinion means that this opinion is no longer publicly available, and is no longer available as a legal precedent-establishing opinion.

The U.S. Supreme Court finally did accept a case involving the ACTA and issued its long-awaited opinion in *Sosa v. Alvarez Machain* in June 2004.[123] This case arose after Mr. Alvarez Machain (Alvarez) was indicted in California for complicity in the kidnapping and murder of a U.S. Drug Enforcement Administration (DEA) agent. Several U.S. DEA officials organized a plan to hire a group of Mexican men (including Mr. Sosa) to arrest Mr. Alvarez in Mexico. The operation was successful and Mr. Alvarez was captured in April 1990, then transported to Los Angeles, where he remained in custody until his trial in late 1992. However, after the government had presented its case at trial, the district judge granted Mr. Alvarez's motion for acquittal, finding that the evidence was insufficient to support a guilty verdict. The judge stated that the case was based on "suspicion and hunches" but no proof, and the government's theory was "of whole cloth, the wildest speculation."[124]

The next year Mr. Alvarez brought a civil lawsuit against Mr. Sosa, the United States, and several other defendants alleging numerous constitutional and tort claims arising from his abduction, detention, and trial. The lower court entered judgment for Mr. Alvarez for $25,000 on the basis that the ATCA provided the basis for claims of arbitrary abduction and detention and that the state-sponsored transborder detention violated "specific, universal, and obligatory" norms of international law. The Ninth Circuit Court of Appeals affirmed Sosa's liability, although using slightly different grounds. The appellate court did not find that the transborder abduction was a violation of customary international law, but did hold that there was a specific, universal, and obligatory norm enforceable under the ATCA concerning arbitrary arrest and detention.[125]

---

[123]542 U.S. 692 (2004).

[124]*Alvarez-Machain v. United States*, 331 F.3d 604, 610 (9th Cir., 2003).

[125]*Id*. at 620–623.

The U.S. Supreme Court unanimously reversed the Ninth Circuit in 2004, and held that Mr. Alvarez was not entitled to a remedy under the ATCA. The Court's opinion, delivered by Justice Souter, however, did not totally prohibit individual claims for human rights abuse under the statute—the door was left slightly open.[126] The Court's opinion traced the history of the ATCA, and particularly noted the lack of legislative history regarding the passage of the law. The Court took the view that Congress must have intended the act to provide a remedy for torts in violation of the law of nations as it existed when the law was passed (1789). The conclusion was that Congress intended the law to confer jurisdiction on federal courts "for a relatively modest set of actions including piracy, violations of safe conduct, and infringement of the rights of ambassadors."[127]

The Court noted, however, that Congress had taken no action to curb the developments regarding interpretation of the ATCA in the next 191 years, culminating in the more expansive view taken in the *Filartiga* case (discussed earlier). Still, Justice Souter refused to adopt a broad view of the possible causes of action under the ATCA, and said that such claims must "rest on a norm of international character accepted by the civilized world and defined with specificity comparable" to the causes of action accepted in the eighteenth century. The Court stated that "judicial power should be exercised on the understanding that the door is still ajar subject to vigilant doorkeeping, and thus open to a narrow class of international norms today."[128]

Justice Souter's opinion stated that Congress was in the best position to decide on the creation of new private rights of action, especially because there were many considerations regarding U.S. foreign relations; thus, the courts should proceed with great caution. International law norms would not be recognized unless they had the type of acceptance among civilized nations as those three types of claims accepted when the law was enacted. The Court did note that piracy and torture were two of a "handful of heinous actions" having such acceptance and thus would be actionable under the ATCA.[129]

The Supreme Court concluded that Mr. Alvarez's claims of arbitrary detention were not covered by any obligatory international norms. The Court stated that the Universal Declaration of Human Rights was only a statement of aspirations and did not impose binding obligations upon nations. Furthermore, the International Covenant on Civil and Political Rights was ratified in the United States on the express understanding that it was not self-executing and thus did not establish a binding international norm.[130] Although the *Sosa* case did not directly involve any transnational corporations, the rationale and holding of this case will no doubt be most important in all future cases against such business entities concerning human rights abuses. It would appear that the judiciary should proceed slowly and carefully in recognizing any specific obligatory international norms, which may give rise to private actions under the ACTA. As Justice Souter wrote, "the door is still ajar, but subject to diligent doorkeeping."

In the years since the *Sosa* decision, several courts have dealt with these issues. In early proceedings in the *Talisman Energy* case, Judge Schwartz held that "corporations may also be held liable under international law, at least for gross human rights violations."[131] In *Sarei v. Rio Tinto*, the Ninth Circuit similarly concluded that corporations could be held vicariously liable for violations of *jus cogens* norms.[132] Similarly, the Eleventh Circuit has noted that corporations may be liable for aiding and abetting violations of international law.[133]

---

[126]One scholar found the court opinion lacking in clarity. "Justice Souter's majority opinion in *Sosa v. Alvarez-Machain* has become something of a Rorschach blot, in which each of the contending sides . . . sees what it was predisposed to see anyway" (Ernest A. Young, "Sosa and the Retail Incorporation of International Law," *Harvard Law Review*, vol. 120, p. 28 (2007).

[127]*Sosa v. Alvarez-Machain*, 542 U.S. 692, 714.

[128]*Id*. at 729.

[129]*Id*. at 732.

[130]*Id*. at 735.

[131]Presbyterian Church, 244 F. Supp. 2d at 319 (adding that a "private corporation is a juridical person and has no per se immunity under U.S. domestic or international law").

[132]*Sarei v. Rio Tinto*, PLC., 487 F.3d 1193, 1202–03 (9th Cir., 2007).

[133]See, e.g., *Sinaltrainal v. Coca-Cola Co*., 578 F.3d 1252 (11th Cir., 2009); *Romero v. Drummond Co., Inc*., 552 F.3d 1303 (11th Cir., 2008).

However, a contrary ruling came from the Second Circuit in 2010, when it held, in *Kiobel v. Royal Dutch Petroleum*, "that corporate liability is not a discernable—much less universally recognized—norm of customary international law."[134] The plaintiffs, families of seven Nigerians who were executed by a former military government for protesting Shell's exploration and development, had sought to recover from the oil giant under the Alien Tort Statute. This decision has been harshly criticized by some commentators.[135]

In early 2011, in a divided vote that prompted a bitter debate among some of its judges, the full Second Circuit, in a 5–5 *en banc* ruling, left intact the lower court ruling in the *Shell* case that companies cannot be liable in U.S. courts for violations of international human rights law. "The 2nd Circuit is alone among federal circuit courts in concluding that corporations cannot be responsible under U.S. law for human rights violations," said Ralph Steinhardt, an international law professor at George Washington University.[136] Given the controversy over this decision, and the split among the circuits (three circuits have ruled that corporations can be sued under the ATCA and now the Seventh Circuit has ruled otherwise), the U.S. Supreme Court decided to grant *certiorari* and will hear the appeal of this case in early 2012, with a decision expected by summer 2012.

In 2011 the United Nations Human Rights Council endorsed a new set of "Guiding Principles for Business and Human Rights." The principles are the first of their kind and consist of 30 recommendations designed to spell out the responsibilities of corporations and other business associations (see Figure 8.4). The United States joined 46 other nations in the UN Human Rights Council in Geneva in endorsing the first global standards detailing government duties to regulate business activities and corporate responsibilities to respect human rights—the establishment of an authoritative global reference point for the way businesses should handle human rights.[137]

The Guiding Principles are the product of six years of research, led by Professor John Ruggie of Harvard University. His team conducted 47 consultations and site visits in 20 countries, an online consultation that received thousands of responses from 120 countries, and voluminous research with experts from governments, business associations, companies, civil society, and investors and individuals around the world. The new standards outline how states and businesses should implement the UN's "Protect, Respect and Remedy" framework in order to better manage and remedy human rights challenges.[138]

FIGURE 8.4

The Three Pillars of the Guiding Principles for Business and Human Rights

[134]*Kiobel v. Royal Dutch Petroleum*, Nos. 06-4800-cv, 06-4876-cv, slip op. at 2 (2d Cir., Sept. 17, 2010).

[135]"The Second Circuit's decision in Kiobel betrays a profound ignorance about the nature and historical development of international law. It stands athwart precedent, evidence, and logic" (Andrei Mamolea, "The Future of Corporate Aiding and Abetting Liability under the Alien Tort Statute: A Roadmap," *Santa Clara Law Review*, vol. 51, p. 79 (2011).

[136]"U.S. court upholds key Shell ruling in Nigeria case," Reuters. www.reuters.com/article/2011/02/04/shell-nigeria-idUSN0424468420110204 .

[137]"United Nations Spells Out Human Rights Guidelines for International Businesses," Law.com, *International News,* June 24, 2011.

[138]"New Guiding Principles on Business and Human Rights Endorsed by the UN Human Rights Council," News release, UN Commission on Human Rights, www.ohchr.org, June 16, 2011.

International Covenant on Economic, Social, and Cultural Rights The International Covenant on Economic, Social, and Cultural Rights was adopted by the UN General Assembly on December 18, 1966. It entered into force on January 3, 1976. As of April 2012, there were 193 parties to the Covenant,[139] including the EU, Brazil, China, India, Japan, and Russia; the United States (under President Jimmy Carter) signed the treaty in 1977, but the Senate has so far failed to ratify it.[140]

The covenant implements the rights set out in the Universal Declaration of Human Rights and gives them the binding force of treaty law. The extent to which the provisions apply, however, varies from country to county. Article 2(1) provides:

> Each State Party to the present Covenant undertakes to take steps, individually and through international assistance and cooperation, especially economic and technical, to the maximum of its available resources, with a view to achieving progressively the full realization of the rights recognized in the present Covenant by all appropriate means, including in particular the adoption of legislative measures.

In other words, countries that ratify the covenant do not undertake to give immediate effect to its provisions. Rather, a country only commits itself to taking steps "to the maximum of its available resources" to achieve "progressively the full realization" of those provisions.

D. Regional Intergovernmental Regulations on Labor

Workers' rights are protected by a variety of regional intergovernmental organizations. Among those that are most active in advancing the interests of labor are the EU, the Organization for Economic Cooperation and Development, and the Council of Europe.

EU freedom of movement for workers Right of member state nationals to seek and accept employment throughout the EU.

Employment Laws in the EU

The **freedom of movement of workers** between the now 27 member states of the EU is a basic tenet in the treaties that constitute the fundamental instruments creating the Union.[141] The European Atomic Energy Community forbids any restrictions based on nationality in the employment of qualified

[139]As of April 1, 2012, the parties to the covenant were Afghanistan, Albania, Algeria, Angola, Argentina, Armenia, Australia, Austria, Azerbaijan, Bahamas, Bahrain, Bangladesh, Barbados, Belarus, Belgium, Belize, Benin, Bolivia, Bosnia and Herzegovina, Brazil, Bulgaria, Burkina Faso, Burundi, Cambodia, Cameroon, Canada, Cape Verde, Central African Republic, Chad, Chile, China, Colombia, Comoros, Congo, Costa Rica, Côte d'Ivoire, Croatia, Cuba, Cyprus, Czech Republic, Democratic People's Republic of Korea, Democratic Republic of the Congo, Denmark, Djibouti, Dominica, Dominican Republic, Ecuador, Egypt, El Salvador, Equatorial Guinea, Eritrea, Estonia, Ethiopia, Finland, France, Gabon, Gambia, Georgia, Germany, Ghana, Greece, Grenada, Guatemala, Guinea, Guinea-Bissau, Guyana, Honduras, Hungary, Iceland, India, Indonesia, Iran (Islamic Republic of), Iraq, Ireland, Israel, Italy, Jamaica, Japan, Jordan, Kazakhstan, Kenya, Kuwait, Kyrgyzstan, Lao People's Democratic Republic, Latvia, Lebanon, Lesotho, Liberia, Libyan Arab Jamahiriya, Liechtenstein, Lithuania, Luxembourg, Madagascar, Malawi, Maldives, Mali, Malta, Mauritania, Mauritius, Mexico, Monaco, Mongolia, Montenegro, Morocco, Namibia, Nepal, Netherlands, New Zealand, Nicaragua, Niger, Nigeria, Norway, Pakistan, Palau, Panama, Papua New Guinea, Paraguay, Peru, Philippines, Poland, Portugal, Republic of Korea, Republic of Moldova, Romania, Russian Federation, Rwanda, San Marino, Sao Tome and Principe, Senegal, Serbia, Seychelles, Sierra Leone, Slovakia, Slovenia, Solomon Islands, Somalia, South Africa, Spain, Sri Lanka, St. Vincent and the Grenadines, Sudan, Suriname, Swaziland, Sweden, Switzerland, Syrian Arab Republic, Tajikistan, Thailand, The former Yugoslav Republic of Macedonia, Timor-Leste, Togo, Trinidad and Tobago, Tunisia, Turkey, Turkmenistan, Uganda, Ukraine, United Kingdom of Great Britain and Northern Ireland, United Republic of Tanzania, United States, Uruguay, Uzbekistan, Venezuela (Bolivarian Republic of), Vietnam, Yemen, the Zambia, and Zimbabwe; posted at http://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=IV-3&chapter=4&lang=en.

[140]Conservatives in the U.S. government have opposed the covenant for a variety of reasons. Originally, segregationists saw it as a device for ending segregation. Later, economic conservatives looked upon the covenant as an assault on capitalism. During the administration of Ronald Reagan (1981–1989), Secretary of State Alexander Haig approved a memorandum that denied that economic, social, and cultural rights were "rights." The memorandum stated that U.S. foreign policy regarded human rights as "meaning political rights and civil liberties" only, and it directed members of the administration to "move away from 'human rights' as a term, and [to] begin to speak of 'individual rights,' 'political rights,' and 'civil liberties.'" Memorandum quoted in Hurst Hannum and Dana D. Fischer, eds., *U.S. Ratification of the International Covenants on Human Rights*, p. 15 (1993).

[141]For current information on the status of the movement of workers in the EU, see the European Parliament's Fact Sheet on the Freedom of Movement of Workers on the Parliament's Web site at www.europarl.europa.eu.

workers in the atomic energy industry.[142] The Treaty Establishing the European Community (EC Treaty), which is meant to promote the comprehensive economic integration of EU member states, provides that "freedom of movement for workers shall be secured" within the EU.[143] Article 39 of the EC Treaty allows workers, no matter what their occupations, to accept offers of employment and to remain in any member state to carry out that employment.[144] Article 40 authorizes the EU Council to remove and harmonize administrative procedures that obstruct the free movement of workers and to set up the machinery necessary to match job hunters in one state with job offers in another. Article 42 grants the EU Council the power to "adopt such measures in the field of social security as are necessary to provide freedom of movement for workers."[145]

In 1968, the Council of Ministers enacted Directive 68/360 to implement the EC Treaty provisions on the free movement of workers. The directive guarantees workers (and their families)[146] the right to leave their own country and to enter any other member state both to take up and to search for a job.[147] Workers must produce an identity card or passport, but no exit or entry visa can be required. And workers who secure employment are entitled to an automatically renewable residence permit allowing them to remain within a member state for at least five years, subject only to the requirement that they do not voluntarily quit their job or absent themselves from the country for a prolonged period.[148] Article 39(2) of the EC Treaty states that workers who are citizens of a member state cannot be treated differently because of their nationality.[149] This guarantee is implemented by Regulation 1612/68, which declares that national laws and administrative rules are void to the extent that they explicitly or implicitly limit the right of a worker to take up and pursue employment. Examples of improper requirements that relate to the finding of a job include those that

1. prescribe a special recruitment procedure for foreign nationals;
2. limit or restrict the advertising of vacancies in the press or through any other medium or subject it to conditions other than those applicable in respect of employers pursuing their activities in the territory of that member state; and
3. subject eligibility for employment to conditions of registration with employment offices or impede recruitment of individual workers where persons who do not reside in the territory of that state are concerned.[150]

---

[142]European Atomic Energy Community Treaty, Article 48.

[143]Treaty Establishing the European Community, Article 39 (formerly Article 48).

[144]*Id*., Article 39, provides:

1. Freedom of movement for workers shall be secured within the [Union]. . . .
2. Such freedom of movement shall entail the abolition of any discrimination based on nationality between workers of the member states as regards employment, remuneration and other conditions of work and employment.
3. It shall entail the right, subject to limitations justified on grounds of public policy, public security, or public health: (a) to accept offers of employment actually made; (b) to move freely within the territory of member states for this purpose; (c) to stay in a member state for the purposes of employment in accordance with the provisions governing the employment of nationals of that state laid down by law, regulation or administrative action; (d) to remain in the territory of a member state after having been employed in that state, subject to conditions which shall be embodied in implementing regulations to be drawn up by the Commission.
4. The provisions of this Article shall not apply to employment in the public service.

[145]Articles 40 and 42 were previously numbered 49 and 51 prior to renumbering of the Treaty Establishing the European Community agreed to by the Treaty of Amsterdam. For further information on the provisions regarding employment that were added by the Treaty of Amsterdam, see http://europa.eu/legislation_summaries/institutional_affairs/treaties/amsterdam_treaty/a13000_en.htm.

[146]A worker's family is defined by Regulation 1612/68 as "(a) his spouse and their descendants who are under the age of 21 years or are dependents; (b) dependent relatives in the ascending line of the worker and his spouse."

[147]The right to search for a job is not expressly contained in either Article 39 of the EC Treaty or in Directive 68/360. However, in construing both the treaty and the directive, the European Court of Justice, in *Procurer du Roi v. Royer*, Case 48/75, *European Court Reports*, vol. 1976, p. 496 (1976), stated that a worker had the right to enter the territory of any member state to "look for" employment.

[148]Workers looking for employment are allowed three months to find a job.

[149]Treaty Establishing the European Community, Article 39(2).

[150]European Union, Regulation 1612/68, Article 3.

Once a worker has found employment, discrimination in the amount of "remuneration" is improper. Thus, a foreign worker is entitled to "enjoy the same social and tax advantages as national workers"[151] and to "enjoy all the rights and benefits accorded to national workers in matters of housing, including the ownership of the housing he needs."[152] Finally, foreign workers may not be treated differently in the manner in which they are dismissed or in their "reinstatement or reemployment" if they have become unemployed.[153]

The right of workers to move freely across the borders of EU member states is subject to three broad limitations: Travel can be denied on the grounds of public policy, public security, and public health.[154] However, these limitations apply only to the right to enter or leave a member state, not to the right of equal treatment once a worker has been admitted to a state.[155]

The scope of these limitations was narrowed gradually in the 1970s and 1980s in a series of cases decided by the European Court of Justice. In 1974 in the case of *Van Duyn v. Home Office*, the court recognized that a member state had the right to restrict the entry of a foreign national for public policy reasons.[156] The next year, in *Rutili v. French Minister of the Interior*, the court stated that "restrictions cannot be imposed on the right of a national of any member state to enter the territory of another member state, to stay there [or] to move within it unless his presence or conduct constitutes a *genuine and sufficiently serious threat* to public policy."[157] Then in 1977, the court added that the genuine and serious threat had to affect "one of the fundamental interests of society."[158] Finally, in 1981 in *Adoni*, the court defined the fundamental interests of society as those listed in the European Convention on Human Rights, which, it pointed out, has been ratified by all the member states.[159]

As we have mentioned earlier, the EU expansions in 2004 and 2007 from 15 to 27 members, including many Eastern European nations, caused considerable concern in the "older" Western European EU members about a "flood of workers" that might disrupt their labor markets. The 15 EU members as of 2003 were given a period of years when they could restrict the entry of workers from the 10 "new" EU members admitted in 2004, and most of the "older" EU members did impose some restrictions, which were gradually removed between 2006 and 2010.

Germany and Austria, however, kept the restrictions in place until the last date allowed—May 1, 2011. Meanwhile, workers from the last two eastern states to join the block, Romania and Bulgaria, who entered the Union in 2007, still remain locked out until January, 1, 2013. Romanians and Bulgarians do, however, enjoy full rights to free movement in 15 member states.[160]

A recent study showed that, contrary to the worries expressed by politicians, migrants from Eastern Europe had boosted the British economy by 0.38 percent from 2004 to 2009, equivalent to an injection of some £5 billion into the economy. An estimated 700,000 workers from the east entered the UK over this period, 500,000 of which came from Poland.[161]

The issue is given greater sensitivity as the "free movement of persons" is one of the fundamental freedoms guaranteed under European law. In fact, it is enshrined in the 1957 Treaty of Rome. Article 39 lays down the right to look for a job in another member, the right to work, the right to reside, and the right to equal access to employment and equal working conditions. Those planning to work abroad will be hoping for this to be applied by all EU members as soon as possible.

---

[151] *Id.*, Article 9. Some of the social advantages that foreign workers are entitled to include a guaranteed minimum subsistence allowance (*Hoeckx,* Case 249/83, *European Court Reports*, vol. 1985, p. 973 [1985]); old-age benefits for individuals without a pension entitlement under the national social security system (*Frascogna,* Case 157/84, judgment of June 6, 1985); and a guaranteed minimum income for the elderly (*Castelli,* Case 261/83, *European Court Reports*, vol. 1984, p. 3199 [1984]).

[152] European Union, Regulation 1612/68, Article 9(1).

[153] *Id.*, Article 7.

[154] Treaty Establishing the European Community, Article 39(3).

[155] "On the grounds of public policy or public security a foreigner may not be permitted to enter a country and take up employment there, but those considerations have no bearing on conditions of work once employment has been taken up in an authorized manner." *Advocate General Gand in Ugioli,* Case 15/69, *European Court Reports*, vol. 1969, p. 369 (1969).

[156] Case 41/74, *European Court Reports*, vol. 1974, p. 1337 (1974).

[157] Case 36/75, *id.*, vol. 1975, p. 1219 (1975) (emphasis added).

[158] *Regina v. Bouchereau*, Case 30/77, *id.*, vol. 1977, p. 1999 (1977).

[159] Cases 115 and 116/81, *id.*, vol. 1982, p. 1665 (1982).

[160] Leigh Phillips, "Germany, Austria Finally Open Doors To Eastern Workers," *EU Observer*, May 2, 2011.

[161] *Id*.

The EU Web site for information on the rights of EU nationals to work in another EU nation is http://ec.europa.eu/social/main.jsp?langId=en&catId=25.

A final limitation to the free movement of workers is found in a clause in Article 39 of the EC Treaty stating that the "provisions of this Article shall not apply to employment in the public service." This does not mean that foreign nationals are forbidden from working in any job in the public service, nor does it allow discrimination in the terms and conditions of employment once a worker has been hired.

The official Web site for the European Union Commission states as follows.

Employment in the Public Sector in the European Union

Posts Reserved for Nationals

EU countries are allowed to reserve certain public-sector positions for their own nationals. This is an exception to the general rule of free movement of workers and must therefore be interpreted restrictively.

- Only posts involving direct or indirect participation in the exercise of public authority and duties designed to safeguard the general interest of the state may be restricted to nationals.
- These criteria must be assessed on a case-by-case basis, taking into account the tasks and responsibilities covered by the post.[162]

The public service limitation applies only to jobs that are related to the activity of governing. In *Commission v. Belgium* (*No. 1*), the Court of Justice said: "Such posts in fact presume on the part of those occupying them the existence of a special relationship of allegiance to the state and reciprocity of rights and duties which form the foundation of the bond of nationality."[163] In *Commission v. Belgium* (*No. 2*), the court gave examples of public service and nonpublic service jobs. Head technical office supervisor, principal supervisor, works supervisor, and stock controller for the municipalities of Brussels and Auderghem fell within the first group, while railway shunters, drivers, platelayers, signalmen and nightwatchmen, nurses, electricians, joiners, and plumbers employed by the same municipalities fell in the second group.[164]

Employment Standards of the Organization for Economic Cooperation and Development (OECD)

The Organization for Economic Cooperation and Development (OECD) began in 1960, when 18 European countries plus the United States and Canada joined forces to create an organization dedicated to global development. Today, the 34 member countries span the globe, from North and South America to Europe and the Asia-Pacific region.[165] The mission of the OECD is to promote policies that will improve the economic and social well-being of people around the world. The OECD[166] has worked to better the working standards of laborers. In order "to encourage the positive contributions" of multinational enterprises, "to minimize and resolve the difficulties" that can arise out of their operations, and "to contribute to improving the foreign investment climate," the **OECD's Guidelines for Multinational Enterprises** are far-reaching recommendations for responsible business conduct that 42 adhering governments—representing all regions of the world and accounting for 85 percent of foreign direct investment—encourage their enterprises to observe wherever they operate. The Guidelines are recommendations by governments covering all major areas of business ethics,

OECD Guidelines for Multinational Enterprises
Norms suggested by the OECD for the operation of multinational firms both in home and host states.

[162]The EU Commission Web page regarding the right to work in another EU country is http://ec.europa.eu/social/main.jsp?langId=en&catId=25.

[163]Case 149/79, no. 1, *id.*, vol. 1980, p. 3881 (1980).

[164]Case 149/79, no. 2, *id.*, vol. 1982, p. 1845 (1982).

[165]See www.oecd.org/pages/0,3417,en_36734052_36734103_1_1_1_1_1,00.html.

[166]The OECD's Web site is at www.oecd.org

including corporate steps to obey the law, observe internationally recognized standards, and respond to other societal expectations. The Guidelines were updated in 2011 for the fourth time since they were first adopted in 1976.

The Guidelines contain one section called "Employment and Industrial Relations," which establishes norms for the employment of workers in both home and host countries. The Guidelines state, among other recommendations, that multinational employers should, while complying with applicable law and regulations, employment practices, and applicable international standards, do the following:

1. Respect the right of workers to establish or join trade unions and engage in collective bargaining;
2. Contribute to the effective abolition of child labor;
3. Contribute to the elimination of all forms of forced or compulsory labor;
4. Conduct operations under the principle of equality of opportunity and treatment in employment and not discriminate against their workers on such grounds as race, color, sex, religion, political opinion, national extraction, or social origin;
5. Observe standards of employment and industrial relations not less favorable than those observed by comparable employers in the host country.
6. Take adequate steps to ensure occupational health and safety in their operations; and
7. Employ local workers to the greatest extent practicable, and provide training with a view to improving skill levels.[167]

Although the guidelines are only voluntary, they have had some influence because they establish, in essence, minimum international standards. Companies that fall below these standards are put in an awkward position when dealing with local governments, local unions, and the local and international media.

Protection of Workers' Rights by the Council of Europe

European Convention on Human Rights of 1950
Establishes and guarantees civil and political rights for the nationals of the member states of the Council of Europe.

The Council of Europe is responsible for enforcing the **European Convention on Human Rights of 1950**[168] and the European Social Charter of 1961.[169] The Human Rights Convention is concerned mainly with civil and political rights, whereas the Social Charter deals primarily with economic, social, and cultural rights. Despite the division in emphasis, there is some overlap between the two treaties.

In particular, the Human Rights Convention includes, as part of its guarantee of freedom of assembly, the right to join a trade union. Article 11 of the Convention provides as follows:

1. Everyone has the right to freedom of peaceful assembly and to freedom of association with others, including the right to join trade unions for the protection of his interests.
2. No restrictions shall be placed on the exercise of these rights other than such as are prescribed by law and are necessary in a democratic society in the interests of national security or public safety, for the prevention of disorder or crime, for the protection of health or morals, or for the protection of the rights and freedoms of others. This Article shall not prevent the imposition of lawful restrictions on the exercise of these rights by members of the armed forces, of the police or of the administration of the State.

[167]The 2011 Guidelines can be found at www.oecd.org/dataoecd/43/29/48004323.pdf. The guidelines represent the amendments to the *OECD Guidelines for Multinational Enterprises* and related Council Decision adopted by the 42 governments adhering to the *Declaration on International Investment and Multinational Enterprises* on May 25, 2011, on the occasion of the 2011 OECD Ministerial Meeting.

[168]*European Treaty Series*, No. 5 (1950). Forty-seven states were parties as of 2011. See Council of Europe, Chart of Signatures and Ratifications, Convention for the Protection of Human Rights and Fundamental Freedoms, posted on the Council of Europe Web site at www.conventions.coe.int/treaty/Commun/ChercheSig.asp?NT=005&CM=&DF=&CL=ENG.

[169]*United Nations Treaty Series*, vol. 529, p. 90. As of April 2012, 47 nations had signed the treaty and 43 had ratified it. See Council of Europe, Chart of Signatures and Ratifications, European Social Charter, posted at www.coe.int/t/dghl/monitoring/socialcharter/Presentation/SignatureRatificationIndex_en.asp.

Much broader provisions protecting the rights of workers are found in the **European Social Charter**.[170] Part I lays out, in general terms, the "rights and principles" that the charter aims to protect:

European Social Charter
Establishes and guarantees economic, social, and cultural rights for the nationals of the member states of the Council of Europe.

1. Everyone shall have the opportunity to earn his living in an occupation freely entered upon.
2. All workers have the right to just conditions of work.
3. All workers have the right to safe and healthy working conditions.
4. All workers have the right to a fair remuneration sufficient for a decent standard of living for themselves and their families.
5. All workers and employees have the right to freedom of association in national or international organizations for the protection of their economic and social interests.
6. All workers and employers have the right to bargain collectively.
7. Children and young persons have the right to a special protection against the physical and moral hazards to which they are exposed.
8. Employed women, in case of maternity, and other employed women as appropriate, have the right to a special protection in their work.
9. Everyone has the right to appropriate facilities for vocational guidance with a view to helping him choose an occupation suited to his personal aptitude and interests.
10. Everyone has the right to appropriate facilities for vocational training.
11. Everyone has the right to benefit from any measures enabling him to enjoy the highest possible standard of health attainable.
12. All workers and their dependents have the right to social security.
13. Anyone without adequate resources has the right to social and medical assistance.
14. Everyone has the right to benefit from social welfare services.
15. Disabled persons have the right to vocational training, rehabilitation, and resettlement, whatever the origin and nature of their disability.
16. The family as a fundamental unit of society has the right to appropriate social, legal, and economic protection to ensure its full development.
17. Mothers and children, irrespective of marital status and family relations, have the right to appropriate social and economic protection.
18. The nationals of any one of the contracting parties have the right to engage in any gainful occupation in the territory of any one of the others on a footing of equality with the nationals of the latter, subject to restrictions based on cogent economic or social reasons.
19. Migrant workers who are nationals of a contracting party and their families have the right to protection and assistance in the territory of any other contracting party.

Part II contains articles describing in detail these rights and principles. For example, Article 4 describes the "Right to a Fair Remuneration" as follows:

> With a view to ensuring the effective exercise of the right to a fair remuneration the contracting parties undertake:
>
> 1. to recognize the right of workers to a remuneration such as will give them and their families a decent standard of living;
> 2. to recognize the right of workers to an increased rate of remuneration for overtime work, subject to exceptions in particular cases;
> 3. to recognize the right of men and women workers to equal pay for work of equal value;
> 4. to recognize the right of all workers to a reasonable period of notice for termination of employment;
> 5. to permit deductions from wages only under conditions and to the extent prescribed by national laws or regulations or fixed by collective agreements or arbitration awards.

[170]It is reproduced in *United Nations Treaty Series*, vol. 529, p. 90 (1965). The charter, signed on October 18, 1961, came into force on February 26, 1965.

The exercise of these rights shall be achieved by freely concluded collective agreements, by statutory wage-fixing machinery, or by other means appropriate to national conditions.

Part III of the European Social Charter sets out the specific obligations that the contracting parties must undertake after ratifying the charter. They are not required to adhere to all 19 "rights and principles" described in Parts I and II. Rather, they must adhere to "at least" 10 articles or 45 numbered paragraphs.[171] This formulation has created a bizarre maze of adoptions.

For example, paragraph 3 of Article 4 (which establishes the right to equal pay for equal work) has been adopted in about half of the contracting states and ignored in the other half. Articles 1, 3, 5, 6, 13, 14, 15, 16, and 17, on the other hand, have been adopted in their entirety by nearly all the parties.

Transnational Organized Labor

Transnational labor unions, with the ability to represent employees across international boundaries, can exist only where IGOs have the power to sanction them. Both the EU and the Council of Europe have such power. Although the EU has yet to authorize the establishment of any transnational labor unions, the Council of Europe's European Social Charter specifically provides for them. Article 5 declares that the "right to organize" includes "the freedom of workers and employers to form local, national or international organizations for the protection of their economic and social conditions and to join such organizations." As noted earlier, Article 5 has been adopted by nearly all of the states that have ratified the Social Charter.

Several transnational labor organizations have been set up as coordinating bodies by municipal labor unions. They are designed to encourage cooperative action, to support national organizations, and to advocate the rights of workers before regional IGOs. Two reasonably successful examples are the International Secretariat of the World Auto Council and the European Confederation of Trade Unions. In addition to exchanging information about labor conditions and advocating labor issues, transnational labor organizations have been actively involved in collecting and disbursing *solidarity funds* to support national labor actions.

E. Movement of Workers

passport
A warrant of protection and authority to travel between nations.

The Universal Declaration of Human Rights, mentioned earlier in this chapter, was promulgated by the United Nations in 1948. It states that "everyone has the right to leave any country, including his own, and to return to his country."[172] This is not, however, the generally accepted rule in international law today. Many countries require that their citizens have a **passport** and permission from the government before traveling abroad (see Figure 8.5). The U.S. government, for example, has repeatedly held that American citizens do *not* have a right to have a passport or a right to leave the country.[173] In the case of *Haig v. Agee*,[174] the U.S. Supreme Court observed:

[171]Much interesting information on the Charter, including videos and charts, is available on the Charter Web site at www.coe.int/T/DGHL/Monitoring/SocialCharter/. The European Social Charter, Article 20(1), states: "Each of the contracting parties undertakes: (a) to consider Part I of this Charter as a declaration of aims to which it will pursue by all appropriate means, as stated in the introductory paragraph of that Part; (b) to consider itself bound by at least five of the following Articles of Part II of the Charter: Articles 1, 5, 6, 12, 13, 16, and 19; (c) in addition to the Articles selected by it in accordance with the preceding subparagraph, to consider itself bound by such a number of Articles or numbered paragraphs of Part II of the Charter as it may select, provided that the total number of Articles or numbered paragraphs by which it is bound is not less than 10 Articles or 45 numbered paragraphs."

[172]Universal Declaration of Human Rights, Article 13(2) (1948). A more detailed provision is contained in the International Covenant on Civil and Political Rights (1966). Article 12 provides:

1. Everyone lawfully within the territory of a State shall, within that territory, have the right to liberty of movement and freedom to choose his residence.
2. Everyone shall be free to leave any country, including his own.
3. The above-mentioned rights shall not be subject to any restrictions except those which are provided by law, are necessary to protect national security, public order, public health or morals, or the rights and freedoms of others, and are consistent with the other rights recognized in the present Covenant.

No one shall be arbitrarily deprived of the right to enter his own country.

[173]American citizens, however, can hold passports from other countries, as can the nationals of most states.

[174]*United States Reports*, vol. 453, p. 280 (Supreme Ct., 1981).

FIGURE 8.5

Each Country Issues a Different Passport

Source: Carolgaranda/ Shutterstock

> A passport is, in a sense, a letter of introduction in which the issuing sovereign vouches for the bearer and requests other sovereigns to aid the bearer. . . .
>
> With the enactment of travel control legislation making a passport generally a requirement for travel abroad, a passport took on certain added characteristics. Most important for present purposes, the only means by which an American can lawfully leave the country or return to it—absent a Presidentially granted exception—is with a passport. . . . As a travel control document, a passport is both proof of identity and proof of allegiance to the United States. Even under a travel control statute, however, a passport remains in a sense a document by which the government vouches for the bearer and for his conduct. . . .
>
> Revocation of a passport undeniably curtails travel, but the freedom to travel abroad with a "letter of introduction" in the form of a passport issued by the sovereign is subordinate to national security and foreign policy considerations; as such, it is subject to reasonable governmental regulations. The Court has made it plain that the freedom to travel outside the United States must be distinguished from the right to travel within the United States.[175]

A similar rule was applied in the United Kingdom before it joined the European Community (now the EU) on January 1, 1973. Until that time, passports could not be obtained as a matter of right, and a passport, once granted, could be impounded or canceled at any time. The EU requires its member states to issue and renew passports valid for travel throughout the EU, and it forbids member states from requiring exit visas or equivalent documents for travel to other EU member states. [176] To the extent that the EU rules do not apply (i.e., to travel outside the Union), U.K. law still regards the issuance of a passport as a matter of "royal prerogative."[177]

Case 8-3 illustrates how one country justifies its restrictions on issuing passports.

Visas

Visas are a host state's counterpart of the passport. They grant permission for an alien to enter a country. As with passports, issuance is discretionary with the host state, and both the length of time that an alien may stay in a country and the activities the alien may carry on while there can be limited. With respect to their duration, visas are classified as either temporary or permanent. An alien who receives a temporary visa is expected to leave the country after a stated time period. An alien who receives a permanent visa is allowed to stay indefinitely, and often an alien who seeks a permanent visa is expecting to apply for nationalization.

visa
Formal authorization to enter a country.

Commonly, an alien who wishes to obtain a visa must go to a state's overseas embassies or consulates and make an application before traveling to the state. An alien who is already inside a host state and has questions about his or her visa or wants to change from one kind of visa to another

[175] *Id.*, at pp. 293–306.

[176] EC Directive 68/360 (October 15, 1968), *Official Journal*, p. L257/13 (1968).

[177] See David E. Williams, "British Passports and the Right to Travel," *International Comparative Law Quarterly*, vol. 23, p. 642, at pp. 647–648, 652–653 (1974).

CASE 8-3 State v. Nagami

Japan, Nagasaki District Court, 1968
Criminal Case 267, *Hanreijiho*, No. 599, p. 8 (1968);
Japanese Annual of International Law, No. 16, p. 103 (1972)

MAP 8.4

Japan (1968)

Akie Nagami, a Japanese national, sought to obtain a Japanese passport that would allow her to visit China with her husband, Earle L. Reynolds, a U.S. national. Nagami and Reynolds were activists in the world peace movement, and they hoped to visit the People's Republic of China to promote understanding between China, Japan, and the United States. Japan did not recognize China at this time, and its Passport Law required nationals who wanted to visit an unrecognized country to obtain and attach to their passport applications an entrance permit from the particular country. Nagami was unable to obtain an entrance permit from China; and Japan, accordingly, refused to grant her a passport endorsed for entrance into China. Undaunted, Nagami and Reynolds sailed for China on Reynolds's yacht anyway. The Nagasaki harbor police, having been notified that this might happen, arrested both Nagami and Reynolds, charging her with leaving the country without a valid passport and him with being an accessory to her crime. At their trial, the accused argued that denying a person a passport is a breach of a fundamental human right as well as a breach of the Japanese constitutional provision establishing the right to travel.

Judgment of the Court

Article 3 of the Passport Law specifies the papers that an applicant must submit to the Foreign Minister in order to obtain a passport. . . .

The Court will now consider whether this provision [i.e., Article 3] gives too much discretion to the Foreign Minister to restrict the freedom of travel to foreign countries. . . .

Because this provision imposes a substantial restriction on a fundamental human right—the right of an individual to travel freely to foreign countries—it has to be narrowly interpreted. Because a passport serves not only to identify an individual and establish his nationality, but also as a letter from a government asking another government to ensure the care and safety of a traveler, it is appropriate to conclude that procedures established by the Passport Law are meant

to ensure that the bearer will be safe and secure in the country being visited. In this respect, Article 19(1)(4) of the Passport Law specifically provides that the Foreign Minister or a consular official may demand that an individual return a passport in circumstances where the Minister or official believes that the individual's life, person, or property are at risk. It seems appropriate, accordingly, that if an individual is subject to these same risks at the time that he applies for a passport, that the passport need not be given him.

The government's evidence establishes that it has long followed the practice of requiring nationals who want to visit a country with which Japan has no diplomatic relations to obtain and attach to their passport applications an entrance permit from that country. Several reasons are given for this practice. First, entrance into a country with which Japan does not have diplomatic relations may prove difficult for an individual who has not made advance arrangement. Second, after a person enters an unrecognized foreign state, it is not possible for the government to protect them or provide them with any assistance.

Considering that the practice of requiring applicants seeking to enter an unrecognized country to obtain an entrance permit is long standing, that the procedure is consistent with the general purpose of the Passport Law, and that there are good reasons for imposing this requirement, one cannot conclude that the discretionary authority given to the Foreign Minister in Article 3(1)(7) is overly broad or that it has been misused.

The Court will now consider whether the regulations of the Foreign Minister implementing Article 3(1)(7) of the Passport Law violate the guarantee set out in Article 22(2) of the Constitution, which establishes that freedom of travel is a fundamental right, or whether those regulations are an exception to that guarantee permitted by the Constitution's public welfare clause. We must begin by observing that the freedom of movement is not an unlimited or unrestricted right. We also observe that a restriction on a fundamental right in the interest of public welfare is allowed if it is based on substantial and rational reasons, and is not unduly burdensome.

The Foreign Minister's regulations, we note, are clear cut and succinct: they forbid travel to the People's Republic of China by anyone who cannot obtain an entrance permit from that country's government. While it may be difficult to obtain this authorization, it is not impossible. The government's evidence established that more than 3,000 Japanese visited China in 1968, having first received entrance permits. Consequently, it cannot be said that the procedure established by the Foreign Minister's regulations is unduly burdensome. Also, because the purpose of the regulations is to insure that travelers are safe in their person and property, it is obvious that they are based on substantial reasons and reasons rationally related to objectives of the Passport Law.

. . . The accused contend that it is irrational to punish individuals who do not wish to have the protection of their government, especially when that protection is realistically unavailable. In this regard, it has to be noted that Japan, which is a signatory of a Security Treaty with the United States, follows the U.S. lead in international relations, and, as a consequence, is opposed internationally to China. . . . It is also a fact, as established by the government's evidence, that the People's Republic of China has not given adequate protection to the Japanese who reside there. As a consequence, the probability that Japanese visitors will be in danger in China is very high.

The contention that protection should not be forced on persons who do not want it is untenable for the following reasons. First, the government has the responsibility—which it cannot relinquish—of ensuring the safety and security of Japanese who are abroad, and it was quite proper in this case that it took an interest in the accused and attempted to protect them from the dangers which they were very likely to face in the People's Republic of China. . . . Second, an important reason why the government is concerned with the safety of persons traveling overseas. . .is that foreign travel has, by its nature, a close connection with international relations and national security. In this regard, we cannot ignore the historical fact that the persecution or injury of nationals in foreign countries has often produced international tension. In sum, the government, in restricting the foreign travel of nationals, is acting both out of concern for the safety of the individual and also for the country's national security.

For these reasons, we hold that the Foreign Minister, acting out of concern for the public welfare, acted properly in restricting the travel of [Akie Nagami]. . . .

Akie Nagami was fined 50,000 yen. Her husband, Earle L. Reynolds, having been an accessory, was fined 30,000 yen.

Casepoint

The court held that the granting of a passport is not a fundamental human right, and a government can lawfully establish rules and regulations governing the issuance of passports. The court pointed out that there was a strong basis, both for the safety of its citizens and for international diplomatic and security reasons, for the Japanese government to enact and enforce restrictions on travel to China.

needs to contact the state's immigration service. For example, in the United States this was formerly known as the Immigration and Naturalization Service, but it is now called the Citizenship and Immigration Services; in Canada it is called Citizenship and Immigration Canada; and in the United Kingdom it is called the Immigration and Nationality Directorate.[178]

Some countries, especially developing countries, allow aliens to obtain a visa upon their arrival in the country. When this is the case, aliens have a duty to contact the immigration service within a reasonable period of time to obtain a visa.

Temporary Visas Most countries' immigration laws establish many categories of temporary visas, reflecting the many different activities that aliens may carry on while temporarily residing in a host country. The U.S. Immigration and Nationality Act, for instance, establishes the following categories of nonimmigrant aliens who are allowed to enter the United States for limited periods of time:

a. Foreign government officials
b. Visitors
c. Transits
d. Crewmen
e. Traders and investors
f. Students in colleges, universities, seminaries, conservatories, academic high schools, other academic institutions, and language training programs
g. Representatives of international organizations
h. Temporary employees
i. Representatives of information media
j. Exchange aliens
k. Fiancées and fiancés of U.S. citizens
l. Intracompany transferees
m. Students in established vocational or other recognized nonacademic institutions other than language training programs
n. Parents and children of certain special immigrants
o. Aliens of extraordinary ability
p. Artists, athletes, and entertainers
q. International cultural exchange visitors
r. Religious workers
s. NATO nonimmigrant aliens
t. Alien witnesses and informants[179]

[178]For information about U.S. immigration laws and policies, visit the U.S. Citizenship and Immigration Services' home page at www.uscis.gov/portal/site/uscis. The United Kingdom's Immigration and Nationality Directorate home page is at www.ind.homeoffice.gov.uk. Canada's Citizenship and Immigration Canada's home page is at www.cic.gc.ca. Information on other countries' immigration laws and policies can be obtained from their embassies. For a list of embassy home pages, see the Yahoo! listing at http://dir.yahoo.com/Government/Embassies_and_Consulates/?skw=embassies+and+consulates.

[179]*United States Code*, Title 8, §§1101, 1103, 1182, 1184, 1186a, 1187, 1221, 1281, and 1282.

The most common temporary visas are visitor visas for tourists.[180] Tourists ordinarily have to apply for a visa at an overseas embassy or consulate of the country they intend to visit. Many countries, however, have a Visa Waiver Program (VWP) that allows tourists from designated countries (usually countries with a reciprocal arrangement) to enter without a visa. The United States VWP, for example, as of 2012, does not require visas for tourists to enter the United States, for up to 90 days, from 35 countries, including Andorra, Australia, Austria, Belgium, Brunei, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Latvia, Liechtenstein, Luxembourg, Malta, Monaco, the Netherlands, New Zealand, Norway, Portugal, San Marino, Singapore, Slovakia, Slovenia, South Korea, Spain, Sweden, Switzerland, and the United Kingdom.[181]

In 2010, the United States enacted a "modernization" of the VWP that requires electronic registration of VWP travelers, as well as more data-sharing and better reporting of lost and stolen passports. According to the Department of Homeland Security, the Electronic System for Travel Authorization (ESTA) is an automated system that assists in determining eligibility to travel to the United States under the VWP and whether such travel poses any law enforcement or security risk.

Upon completion of an ESTA application, a traveler is notified of his or her eligibility to travel to the United States under the VWP. ESTA is required pursuant to Section 217 of the Immigration and Nationality Act, as amended by Section 711 of the Implementing Recommendations of the 9/11 Commission Act of 2007. Information posted by the DHS states that this legislation required DHS to develop and implement an automated system to determine, in advance of travel, the eligibility of visitors to travel to the United States and whether such travel poses a law enforcement or security risk. These new measures are intended to enhance security at U.S. borders.

EU member nations whose citizens can now travel to the United States without visas are carefully watching the developments. Currently, U.S. citizens and those of 38 other nations do not need a visa to visit the EU for three months or less.[182]

Another common temporary visa is given to business visitors.[183] Most countries allow business visitors to enter for short-term visits (typically for no more than six months) to contact customers, attend trade shows and conventions, show samples, take orders, and engage in other business activities. They must be acting on behalf of a foreign firm, however, and not working for a local employer.[184]

One important category of visas in the United States is the H-1B program, which allocates 65,000 visas per year to highly skilled professionals, engineers, and software experts to work with U.S. companies. In some recent years the entire quota for H-1B visas has been given out in a few days from April 1, when applications are first accepted. The 65,000 visas were snapped up in one day in 2009, but it took 265 days in 2010 and 300 days in 2011 to exhaust the supply, as companies cut back on hiring foreign workers.

Still there were controversies. In summer 2011 the State Department initiated an investigation of Bangalore-based Infosys Technologies to determine if the firm had repeatedly used B-1 visas to place its employees at temporary jobs in large U.S. companies. The B-1 visa is easy to obtain and intended to cover short-term visits by foreign nationals to attend business conferences or consult with business associates. B-1 visas can often be obtained in a few days at a cost of about $140, whereas the harder-to-get H-1B visa can take months to obtain and cost upwards of $3,000 each. Holders of H-1B visas can work in the United States for up to 3 years and be paid by their American employers. The State Department probe was sparked by a lawsuit filed in Alabama by an Infosys consultant who claimed that Infosys, frustrated by the limits on H-1B visas in 2009, began to prepare fraudulent documents to get B-1 visas for workers who were actually going to be employed in the United States.[185]

[180]In the United States, these are known as B-1 visas.

[181]http://travel.state.gov/visa/temp/without/without_1990.html\#vwp ; *United States Code of Federal Regulations*, Title 8, part 217.2 (January 1, 2002). U.S. immigration laws and regulations are available on the U.S. Citizenship and Immigration Service's Web site at www.uscis.gov/portal/site/uscis.

[182]http://europa.eu/travel/doc/index_en.htm.

[183]In the United States, these are called B-2 visas.

[184]The United States allows business visitors to "be admitted for not more than one year" and they "may be granted extensions of temporary stay in increments of not more than six months." *United States Code of Federal Regulations*, Title 8, § 214.2(b).

[185]*See,* "U.S. Probes Infosys on Visas", *Wall Street Journal,* May 25, 2011; James Lamont, India Lashes Out At US Visa Regime, *Financial Times*, August 10 2010; and Slump Sinks Visa Program, *Wall Street Journal*, October 29, 2009.

Following the terrorist attacks on the United States on September 11, 2001, the United States reorganized its administrative structure regarding entry into this country. The former Immigration and Naturalization Service has been replaced by the U.S. Citizenship and Immigration Service (USCIS), a division of the Department of Homeland Security. It has become considerably more difficult to enter the United States today than it was before September 11. U.S. citizens as well as foreign citizens now need a passport to enter the United States when arriving by plane from outside the United States and a passport is now required to enter Canada, which was not required until recent years.

For example, one of the opening pages of the USCIS Web site gives some initial information about visitors to the United States as set forth in Reading 8-2.

Most developed countries have a special category of visa for students.[186] To qualify, students typically must obtain a statement in advance from the educational institution showing that they have been admitted to a course of study.[187] They also need to prove that they have sufficient resources to cover their course of study and to return home upon its completion.[188] Some countries allow students to work on campus,[189] but many do not.[190]

Reading 8-2 United States Visa Regulations

U.S. Visa Laws for Business or Pleasure Visitors

Generally, a citizen of a foreign country who wishes to enter the United States must first obtain a visa, either a nonimmigrant visa for temporary stay or an immigrant visa for permanent residence. The visitor visa is a nonimmigrant visa for persons desiring to enter the United States temporarily for business (B-1) or for pleasure or medical treatment (B-2). Persons planning to travel to the U.S. for a different purpose, such as students, temporary workers, crewmen, journalists, etc., must apply for a different visa in the appropriate category. Travelers from certain eligible countries may also be able to visit the U.S. without a visa, through the Visa Waiver Program (as described above). Read more about how to participate in the Visa Waiver Program on the U.S. Customs and Border Protection (CBP) website. More helpful information on the Visa Waiver program is found on the State Department Visa Services website.

Also, you may want to find out more about "How Do I Get Legally Admitted to the U.S." (or "How Will I be Inspected When I Come to a U.S. Port of Entry") on the CBP website.

Qualifying for a Visa

Applicants for visitor visas must show that they qualify under provisions of the Immigration and Nationality Act. The presumption in the law is that every visitor visa applicant is an intending immigrant. Therefore, applicants for visitor visas must overcome this presumption by demonstrating that:

- The purpose of their trip is to enter the U.S. for business, pleasure, or medical treatment;
- They plan to remain for a specific, limited period; and
- They have a residence outside the U.S. as well as other binding ties which will insure their return abroad at the end of the visit.

Alien truck drivers may qualify for admission as B-1 visitors for business to pick up or deliver cargo traveling in the stream of international commerce. Please see "How Do I Enter the United States as a Commercial Truck Driver" for more information.

Passing through a U.S. Port of Entry

Applicants should be aware that a visa does not guarantee entry into the United States. Immigration authorities have the authority to deny admission and determine the period for which the bearer of a visitor visa is authorized to remain in the United States.

The USCIS Web site is
http://www.uscis.gov.

[186]In the United States, these are F-1 visas for students in academic institutions and M-1 visas for students in vocational programs.

[187]A student seeking to study in the United States must have the U.S. institution complete form I-20 A-B/I-20 ID, "Certificate of Eligibility for Nonimmigrant (F-1) Student Status," or form I-20M-N, "Certificate of Eligibility for Nonimmigrant (M-1) Student Status." *Id.*, §§ 214.2(f)(1)(I)(A) and 214.2(m)(1)(i)(A).

[188]*Id.*, §§ 214.2(f)(1)(i)(B) and 214.2(m)(1)(i)(A). Students enrolled at academic institutions are allowed to leave and return on the same visa for annual vacations. *Id.*, §214.2(f)(5)(iii).

[189]*Id.*, §214.2(f)(9). Students in U.S. vocational programs may only work in practical training programs after completing their course of study. *Id.*, §214.2(m)(i)(13) and (14).

[190]United Kingdom, *Immigration Rules* (HC 395), para. 57(vii).

Other important temporary visas are those given to temporary employees[191] and the intracompany transferees of multinational enterprises.[192] Typically, these visas are granted only on the petition of an employer,[193] and an alien who has such a visa and changes jobs must get the new employer to apply for a new visa.[194]

Permanent Visas All states limit the number of permanent visas that they grant to immigrants. This is because they want to ensure that the persons who are granted permanent visas will contribute to the state's society and will not be a burden on it. States typically establish a scheme that gives certain classes of persons a priority claim to visas with permanent immigrant status and that limits the total number of aliens who may enter from particular foreign countries.

For example, the U.S. Immigration and Nationality Act[195] establishes two categories of aliens with priority claims to permanent visas: (1) aliens who are family members of American citizens or of aliens who are already permanent residents of the United States[196] and (2) aliens with special skills.[197] Among this second category are aliens with extraordinary ability (such as well-known writers and philosophers), outstanding professors and researchers, and highly qualified multinational executives and managers.[198]

Recent International Developments

U.S. Increases Visa Fees

On August 13, 2010, United States President Barack Obama signed a fee hike on U.S. professional visas into law. The increased fees, made in connection with border protection legislation, increased fees to approximately $2,000 per application for H-1B and L-1 visas. This fee hike had immediate impacts on Indian foreign technology firms, many of which retain a significant portion of employees working in the United States on affected visas. Accordingly, Indian officials have issued a warning to the United States, declaring the fee hike "WTO-incompatible." As of June 21, 2011, the United States has yet to respond to India's communications. India is now set to issue another warning on the fee hike's violation of global trade rules, and has begun communication with WTO lawyers in preparation for filing a case.

Once all of the aliens with priority claims to permanent visas have been granted them, then persons who do not have such a claim are given visas, usually on a first-to-apply basis. There is ordinarily a limit on the number of visas that will be granted to aliens from any particular country

---

[191]In the United States, these are known as H-1 visas.

[192]These are called L-1 visas in the United States.

[193]For example, *United States Code*, Title 8, §1101(a)(15)(H), provides that an alien may be authorized to come to the United States temporarily to perform services or labor for, or to receive training from, an employer if petitioned for by that employer. The alien must be a registered nurse, a fashion model, a temporary or seasonal agricultural worker, a professional athlete, a trainee, a participant in a special education exchange visitor program, or an individual who will perform services in a specialty occupation, or services relating to a Department of Defense cooperative research and development project or coproduction project, or who is of distinguished merit and ability. See *United States Code of Federal Regulations*, Title 8, §214.2(h)(1)(i).

United States Code, Title 8, §1101(a)(15)(L), provides that an alien who within the preceding three years has been employed abroad for one continuous year by a qualifying organization may be admitted temporarily to the United States to be employed by a parent, branch, affiliate, or subsidiary of that employer in a managerial or executive capacity, or in a position requiring specialized knowledge.

[194]See *United States Code of Federal Regulations*, Title 8, §214.2(h)(2)(i)(c).

[195]*United States Code*, Title 8, §1101 *et seq*.

[196]These are known as *family-sponsored immigrants*, and they have priority in the following order: first, unmarried sons and daughters of citizens; second, spouses and unmarried sons and daughters of permanent resident aliens; third, married sons and daughters of citizens; and, fourth, brothers and sisters of citizens. *Id*., §1153.

[197]*Id*.

[198]Other aliens with priority claims to permanent residency visas based on special skills are (in order of preference) aliens who are members of the professions and who hold advanced degrees or who have exceptional ability; skilled workers whose skill requires two or more years of training or experience; professionals; other workers who have qualifications that are not available in the United States; and persons who have or will establish a business in the United States. *Id*.

and on the number of visas that will be granted in any one year. For example, the total number of visas that the United States grants annually is approximately 675,000.[199]

Most immigration schemes also provide for special cases, especially refugees and aliens seeking political asylum. Ordinarily, these applicants are not considered in determining the total number of visas that are granted on an annual basis.[200]

Compliance with Visa Obligations Aliens are obliged to comply with the terms of their visas and to leave a country when their visa expires or when it is withdrawn. Moreover, the issuance or denial of a visa, the extension or the refusal to extend an existing visa, and the revocation of a visa are all matters of executive discretion. As a consequence, such decisions are noncontestable in the courts of most countries, as Case 8-4 illustrates.

CASE 8-4 England and Another v. Attorney-General of St. Lucia

MAP 8.5

Saint Lucia (1987)

Court of Appeal of the Eastern Caribbean States, Civil Division, 1985
West Indian Reports, vol. 35, p. 171 (1987)

The appellants, David and Jean England, who were British subjects, moved to St. Lucia with their family in 1968 and became residents (but not citizens). On August 9, 1983, David England was informed by the prime minister of St. Lucia that the government had information indicating that he was helping political extremists in their efforts to recruit St. Lucians for terrorist training in Libya. The prime minister did not indicate the source of this information. He did, however, tell David England that the government regarded him as a threat to the security of the state and that he was no longer welcome.

David England, through his solicitor, denied these allegations, and he asked to present his side of the matter before the government took any action. The government did not give him the opportunity. On September 2, two orders concerning David and Jean England were made by the governor-general in council under Section 4(3)(b) of St. Lucia's Immigration Ordinance. The orders declared the Englands to be prohibited immigrants and authorized the chief immigration officer to remove them from the country on or before September 4. On September 5, the solicitor for the Englands filed motions challenging the procedure taken by the government and the validity of its two orders.

[199] *Id.*, §1151.

[200] For example, see *id.*, §1157 (for refugees).

Judgment of the court

On 1st September 1983 the Immigration Ordinance (Amendment) Act became law in St. Lucia. As a result, the Immigration Ordinance and Deportation (British Subjects) Ordinance were significantly affected. For the purposes of the instant case, in the former Ordinance there was no longer the section that created a class of persons who were "deemed to belong" to St. Lucia and the immigration of persons or of any person specified in an Order made by the Governor-General in Council was prohibited, unless there was some statutory barrier to such prohibition. Put another way, Section 2(2) and that part of Section 5 to which I alluded earlier were both deleted. The whole of the Deportation (British Subjects) Ordinance was repealed. The result was that the England family were without the description or classification of persons who were deemed to belong to St. Lucia for immigration and for deportation purposes. Further, they could be deemed prohibited immigrants under the Immigration Ordinance, as amended.

In my view, from the date when St. Lucia became an independent sovereign country, there were those persons who became citizens without more, there were persons who became citizens upon registration, and there were those persons who were not citizens, some of whom could apply for citizenship. It is clear and undisputed that, on 22nd February 1979 and after, the Englands were not registered as citizens and were not citizens. It does not arise for determination in this appeal whether the Englands could or should be registered as citizens on making application in the proper form. If and when application is made, that decision or a declaration from this court may become necessary. For the moment it is sufficient, in my opinion, to say that there was no application made for registration as citizens. The Englands did not have a right, in law, to reside in St. Lucia. They did not have a right, in law, not to be deported from St. Lucia. They did not have a right, in law, not to be declared prohibited immigrants.

On 2nd September 1983, around 3:30 p.m, two Orders (the David England (Prohibited Immigrant) Order and the Jean England (Prohibited Immigrant) Order) were served on the parties therein named. They were similar in substance and in their terms, the sole difference being the names, and so I shall quote only one of them.

> WHEREAS by Paragraph (b) of Subsection (3) of Section 4 of the Immigration Ordinance, Chapter 76, it is provided that where the Governor-General in Council is satisfied on information or advice that any person is undesirable as an inhabitant of, or a visitor to St. Lucia, he may by Order declare such a person to be a prohibited immigrant and direct that such person be removed from St. Lucia forthwith or by such time as shall be stipulated,
>
> AND WHEREAS the Governor-General in Council is satisfied on information received that David England is undesirable as an inhabitant of, or a visitor to St. Lucia,
>
> NOW THEREFORE the Governor-General in Council in pursuance to the power conferred upon him as aforesaid orders and declares and it is hereby ordered and declared as follows:
>
> 1. *Short Title.* This Order may be cited as the David England (Prohibited Immigrant) Order 1983.
> 2. *Declaration of Prohibited Immigrant.* David England is declared to be a prohibited immigrant as an inhabitant of, or a visitor to St. Lucia.
> 3. *Removal of Prohibited Immigrant.* The Chief Immigration Officer is hereby authorized to remove David England from St. Lucia by Sunday 4th September 1983.
>
> Made by the Cabinet under the authority of Subsection (3) of Section 4 of the Immigration Ordinance, Chapter 76, 2nd September 1983.

On 3rd September 1983, David and Jean England, through their solicitor, prepared and signed notices of motions and supporting affidavits, as a direct consequence of the service of the above Orders. These notices were filed on 5th September 1983 after the Englands had been

removed from St. Lucia. Upon completion of the hearing of the motion the trial judge reserved his decision for delivery on 23rd November 1983 and, as I have already indicated, he refused all the relief and prayers sought by the Englands in their motions.

. . . It was submitted by counsel for the Englands that the Governor-General in Council acting under Section 4(3) of the Immigration Ordinance, as amended, was an authority prescribed by law for the determination of the existence or extent of the civil right of persons falling in the category created by Section 102(1)(b) of the Constitution of St. Lucia and that, if that were so, the rules of natural justice ought to have been observed in arriving at the decision to remove the Englands from St. Lucia as the Governor-General in Council was made a *quasi*-judicial body.

Counsel for the Attorney-General submitted that the Governor-General in Council was not a tribunal nor was any exercise of a judicial or *quasi*-judicial function required under Section 4(3) of the Immigration Ordinance. He submitted, further, that it could not be reasonable, when the Governor-General in Council was satisfied that a person should be removed, to expect that that person should then be called and told of the information or advice given, as well as its source, so that that person could be afforded an opportunity to be heard. According to counsel, there were certain areas in government which were reserved for the state (for example, security and deportation) and "the courts could not substitute themselves for the state." . . .

In my opinion the Governor-General in Council was not acting as judicial tribunal nor was the function required by the Section one of a *quasi*-judicial nature. When it is borne in mind that the Governor-General is Her Majesty the Queen's representative in St. Lucia (Section 19 of the St. Lucia Constitution) and when the Immigration Ordinance (as amended in 1983) is considered, it becomes clear that under Section 4(3)(b) the Governor-General in Council, in September 1983, acted solely under executive powers and in no sense as a court.[201] As I perceive it, the Governor-General in Council was not called upon or empowered by the Section to adjudicate in any matter of contention between parties, nor was any procedure laid down or any provision made for anyone to be heard or for the person who would be affected by an Order to make any representation, oral or written. The Section did not state, either expressly or by implication, that the Governor-General in Council should conduct an inquiry. If Parliament had so intended or wished it would have been simple to state in the Section that the Governor-General in Council should be satisfied "after holding due inquiry," and not "on information or advice." So that there was no statutory requirement that there be evidence or that the source of information or advice on which the Governor-General in Council acted be disclosed or be controlled in accordance with any law. Indeed, it must be obvious that disclosure of the source, or of the information or advice, to the person who may be affected by the Order of the Governor-General in Council, would not only be highly understandable but could involve disclosure of confidential national matters, including defense policy, security and the internal safety of the public. Again, as was indicated by the Chief Justice, the Earl of Reading, in *R. v Leman Street Police Station Inspector, ex parte Venicoff*:[202]

> It might well be that a person against whom it was proposed to make such an order would take care, if he had notice of such an inquiry, not to present himself, and, as soon as he knew that an inquiry would be held, would take steps to prevent his apprehension.

There was no claim that the Governor-General in Council acted other than in good faith. Of course, had there been any assertion of bad faith, it would have had to be specifically alleged, with particulars, and the burden of proof would have been on the Englands. Nor could it have been asserted that the Governor-General in Council was not satisfied on information received that David England and Jean England were undesirable as inhabitants of, or visitors to St. Lucia.

***

[201] *Eshugbayi Eleko v. Officer Administering the Government of Nigeria*, *Law Reports, Appeal Cases*, vol. 1931, p. 662 (1931).

[202] *All England Law Reports*, vol. 1920, p. 157 (1920).

. . . I have found no cause to disturb the decision of the trial judge and would therefore dismiss the appeal.

***

The appeal was dismissed.

Casepoint

The court decided that the laws of St. Lucia had recently been amended to allow for the summary deportation procedure that was followed by the government. The governor-general was empowered to act in an executive capacity by the law, and his decision was not reviewable in the court system in the absence of bad faith, which was not alleged.

Regulation of Foreign Workers

Aliens who enter a country to work must obtain an appropriate entry visa (i.e., one that allows them to be gainfully employed), and they must comply with the host state's employment laws. Commonly, the same labor laws that apply to nationals govern foreign workers once they are allowed to enter a country. This is often so even when a foreign worker and a foreign employer agree to abide by the labor laws of their home state.

Many states impose special rules on foreign workers. Some use **percentile legislation** to ensure that a certain percentage of the local workforce is made up of nationals.[203] Others limit the benefits that foreign employees can be given. Singapore, for example, requires that alien employees be paid at the same rate as nationals. Singapore employers, furthermore, are responsible for ensuring that their alien employees get adequate housing and that a physician examines them before they enter the country; the employers additionally must make social security contributions and assume the cost of the employees' repatriation.[204]

percentile legislation A law requiring a certain percentage of employees to be local nationals.

Sometimes the rules governing foreign workers seem to grant them special privileges. This seems especially to be the case when the rules are set out in a treaty. For example, treaties called "Friendship, Commerce, and Navigation" commonly establish a reciprocal right for the national businesses of either signatory state to employ certain categories of their national workers within the territory of the other state. An example is the 1953 Japanese–United States Friendship, Commerce, and Navigation Treaty:[205]

> 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. Moreover, such nationals and companies shall be permitted to engage accountants and other technical experts regardless of the extent to which they may have qualified for the practice of a profession within the territories of such other party, for the particular purpose of making examinations, audits and technical investigations exclusively for, and rendering reports to, such nationals and companies in connection with the planning and operation of their enterprises, and enterprises in which they have a financial interest, within such territories.

[203] Oman's Ministry of Social Affairs and Labor has issued regulations that are a variant of percentile legislation. Ministerial Decision No. 51, effective August 17, 1993, provides that foreign workers may be employed only when Omani labor is inadequate. In addition, no more than 15 non-Omanis may be employed in Oman Chamber of Commerce and Industry category four companies, 30 in category three companies, and 60 in category two companies. Also, some industries, such as fishing, are forbidden to employ non-Omani workers, whereas others, such as tailoring, are not. Adrian Creed, "Oman Issues New Rules for Non-Omani Workers," *Middle East Executive Reports*, vol. 16, no. 12, p. 17 (December 1993).

[204] International Labor Organization, "Protecting the Most Vulnerable of Today's Workers," Chap. 4 (1997), posted at www.worldcat.org/title/protecting-the-most-vulnerable-of-todays-workers/oclc/36514742.

[205] Article VIII, paras. 1–2, *United States Treaties and Other International Agreements*, vol. 4, pt. 2, p. 2063 at p. 2070 (1953).

> Nationals of either party shall not be barred from practicing the professions within the territories of the other party merely by reason of their alienage . . .

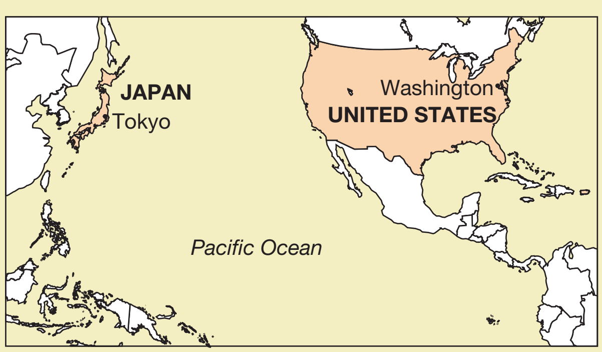
On its face, this provision allows a foreign business to discriminate in favor of its national employees by assigning its nationals to senior executive positions and by denying promotions to employees in the host state. This was not, however, the intent of the treaty's drafters. As Case 8-5 points outs, foreign employers and foreign workers are both subject to the employment laws of the host state unless a treaty or domestic law clearly and specifically provides otherwise.

CASE 8-5 Spiess et al. v. C. Itoh & Co. (America), Inc.

United States, District Court, Southern District of Texas, 1979
Federal Supplement, vol. 469, p. 1 (1979)

MAP 8.6

Japan and United States (1979)



District Judge Carl O. Bue, Jr.

Plaintiffs, non-Japanese employees of the defendant, have filed suit against defendant pursuant to Title VII of the Civil Rights Act of 1964, . . . alleging racially discriminatory employment practices. C. Itoh & Co. (America), hereinafter "Itoh-America," is a domestic corporation incorporated under the laws of New York and a wholly-owned subsidiary of C. Itoh & Co., Ltd., of Japan, hereinafter "Itoh-Japan," a Japanese corporation which is not a party to the instant suit. Presently before the Court for consideration is Itoh-America's . . . motion to dismiss for failure to state a claim upon which relief may be granted. The issue presented is a novel question of first impression: Does the 1953 Treaty of Friendship, Commerce and Navigation between the United States and Japan provide American subsidiaries of Japanese corporations with the absolute right to hire managerial, professional and other specialized personnel of their choice, irrespective of American law proscribing racial discrimination in employment? . . .

. . . Itoh-America asserts that the Treaty gives it three absolute rights, the combined effect of which "is to create an absolute right on the part of United States and Japanese nationals and companies to send their own nationals to the other country to hold managerial and specialized positions within their respective affiliates and subsidiaries." The rights claimed are:

1. The absolute right to establish, maintain, control, and manage a wide variety of commercial enterprises by nationals and companies of one country in the other country (Article VII, paragraph 1).
2. The absolute right of nationals of the two countries to enter the other country for the purpose of carrying on trade and engaging in related commercial activities between the two countries (Article I, paragraph 1).
3. The absolute right of nationals and companies of either country to engage, within the other country, managerial, professional, and other specialized personnel "of their choice," including their own nationals (Article VIII, paragraph 1).

. . . The crucial section of the Treaty relied upon by Itoh-America is Article VIII(1) which by its terms provides that "nationals and companies of either party shall be permitted to engage within the territories of the other party [personnel] of their choice." Stated otherwise in terms of the instant inquiry, a company of Japan is entitled to engage within the territory of the United States personnel of its choice. Thus, the pivotal issue becomes the nationality of Itoh-America. Plaintiffs urge that the Treaty's own definitional section provides the unequivocal answer to this question: Article XXII(3) provides that "[c]ompanies constituted under the applicable laws and regulations within the territories of either party shall be deemed companies thereof. . . ." Under this definition Itoh-America is a company of the United States because it is incorporated under the laws of the State of New York. Its business operations in the United States are, therefore, those of a United States company in the United States, not the activities of a company of one party within the territory of the other party. Accordingly, plaintiffs argue any immunity from United States discrimination laws conveyed by Article VIII(1) does not apply to Itoh-America.

. . . This analysis is supported by the case of *United States v. R. P. Oldham*,[206] wherein the court used a similar standard for determining corporate nationality for purposes of the 1953 Japanese-American Treaty. Kinoshita & Co., Ltd., U.S.A. ("Kinoshita-America"), an American subsidiary of Kinoshita & Co., Ltd., Tokyo, was indicted along with others for conspiracy in restraint of commerce in Japanese wire nails. Kinoshita-America argued that Article XVIII of the Treaty dealing with antitrust violations provided the exclusive remedy available to the government in dealing with antitrust violations by American corporations which are wholly owned by Japanese corporations. The District Court held that Article XVIII was not intended as an exclusive remedy; rather than replace American antitrust laws, Article XVIII was intended to supplement them. This conclusion was based on the fact that "[t]he tenor of the entire Treaty is equal treatment to nationals of the other party, not better treatment."[207] . . . The Court further held that even if Article XVIII were held to provide an exclusive remedy for antitrust violations, Kinoshita-America lacked standing to invoke its protection.

The Court engaged in a two-step process to arrive at the conclusion that Kinoshita-America was not shielded from United States antitrust laws by Article XVIII. The first step was the determination of the nationality of Kinoshita-America. In order to resolve this question the Court looked to Article XXII, the only definitional section of the Treaty, and pursuant to paragraph three of that Article determined that:

> [B]y the terms of the Treaty itself, as well as by established principles of law, a corporation organized under the laws of a given jurisdiction is a creature of that jurisdiction, with no greater rights, privileges or immunities than any other corporation of that jurisdiction.[208]

Once the question of the nationality of Kinoshita-America was determined, the Court completed the two-step inquiry by concluding that an American corporation has no standing to invoke Article XVIII as a defense to the United States antitrust laws. Any protection against application of United States law would extend only to Japanese corporations, concluded the Court:

> If . . . conspirator Kinoshita & Co., Ltd., Tokyo had wished to retain its status as a Japanese corporation while doing business in this country, it could easily have operated through a branch. Having chosen instead to gain privileges accorded American corporations by operating through an American subsidiary, it has for the most purposes surrendered its Japanese identity with respect to the activities of this subsidiary.[209]

***

[206]*Federal Supplement*, vol. 152, p. 818 (District Ct., N. Dist. of Calif., 1957).

[207]*Id*.

[208]*Id*., at p. 823.

[209]*Id*.

Despite the fact that the Treaty's own definitional section provides that the place of incorporation determines the nationality of a company for purposes of the Treaty and the fact that the Court in *Oldham* determined that an entity identically situated to Itoh-America was an American corporation for purposes of the Treaty, Itoh-America urges this Court to reach a different result.

As support for its argument that it should be considered a Japanese corporation, Itoh-America refers to guidelines promulgated by the Department of State for use by consular officials in determining whether a foreigner seeking admission to the United States qualifies as a "treaty-trader." Article I, paragraph 1 of the Japanese-American Treaty authorizes Japanese nationals to enter the United States as so-called treaty-traders "for the purpose of carrying on trade between the territories of the two parties and engaging in related commercial activities . . . ." In order to qualify as a treaty-trader an alien must satisfy Department of State regulations which require, among other things, that the alien "be employed by an individual employer having the nationality of the treaty company, or by an organization which is principally owned by a person or persons having the nationality of the treaty country."[210] Department of State guidelines provide further that:

> [t]he nationality of the employing firm is determined by those persons who own more than 50 percent of the stock of the employing corporation "regardless of the place of incorporation."

. . . Since it is wholly owned by Japanese interests, and thus is a Japanese corporation for treaty-trader purposes, Itoh-America urges that it should be considered a Japanese corporation for purposes of Article VIII(3). Any other conclusion, it argues, requires the absurd result that once a Japanese corporation exercises the right given to it by Article VII(1) to incorporate an American subsidiary, that subsidiary loses all other rights under the Treaty.

The Court finds that resort to the treaty-trader guidelines to determine corporate nationality for purposes of interpretation of the Treaty provisions is unwarranted in the face of the clear definitional provisions included in Article XXII(3) of the Treaty itself. Article XXII(3) unequivocally states that for the purpose of the Treaty the nationality of a corporation is determined by the place of incorporation. The fact that nationality is determined by a different standard for other purposes cannot alter the clearly stated test of the Treaty itself.

. . . Given the Treaty's own definitional terms, Itoh-America is a company of the United States for purposes of the interpretation of Articles VIII(1). Thus, it can claim no direct protection under Article VIII(1), which applies only to companies of one party within the territories of the other party. Furthermore, even assuming that Article VIII(1) provides absolute immunity from Title VII to Itoh-Japan and that Itoh-America has standing to assert Itoh-America's Treaty rights in this action, questions the Court need not resolve, the motion to dismiss must be denied. Any absolute rights granted to Itoh-Japan apply only to its own hiring decisions; the practices challenged in the present litigation are those of Itoh-America. Itoh-America is a United States company for purposes of Title VII and, like other United States companies, is subject to suit on the grounds that its employment practices are racially discriminatory. Accordingly, Itoh-America's motion to dismiss for failure to state a claim upon which relief may be granted is hereby denied.

Casepoint

The court needed to decide whether the employer here was subject to the civil rights laws of the United States, which prohibit employment discrimination. After finding that the employer-defendant in this case, although a wholly owned subsidiary of a Japanese company, was incorporated as a separate company under the laws of New York, the court ruled that the company was subject to U.S. law. The 1953 Treaty of Friendship, Commerce and Navigation between the United States and Japan did not provide American subsidiaries of Japanese corporations with the absolute right to hire managerial or professional personnel of their choice, irrespective of American law prohibiting racial and national origin discrimination in employment, where the subsidiaries are incorporated in the United States.

[210] *Code of Federal Regulations*, Title 22, §41.40 (1977).

Application of Home State Labor Laws Extraterritorially

Traditionally, countries have refused to apply their labor laws extraterritorially. This principle is based on the concept of *sovereignty*, by which each nation is independent, and not subject to the laws of other nations. For example, as long ago as 1804, the U.S. Supreme Court ruled that the laws of the United States will not be interpreted to violate the laws of other nations unless no other interpretation is possible.[211] In keeping with this, the Supreme Court has denied a Danish seaman's petition to have American tort law apply to an injury he suffered on a Danish ship in Havana harbor;[212] it has refused to give the National Labor Relations Board the authority to regulate collective bargaining among crewmen serving on foreign ships;[213] and it has held that the Equal Pay Act does not apply outside the territorial jurisdiction of the United States.[214]

However, even though the U.S. Supreme Court ordinarily assumes that the U.S. Congress does not intend for its legislation to apply extraterritorially, it does recognize that Congress "has the authority, in certain cases, to enforce its laws beyond the territorial boundaries of the United States."[215] And Congress—contrary to the practice in most other countries—has enacted labor-related laws that expressly apply extraterritorially, including the antidiscrimination provisions of Title VII of the Civil Rights Act of 1964[216] and the Americans with Disabilities Act of 1990, which apply to American citizens working for American employers overseas.[217]

In Case 8-6, a U.S. federal court was asked to determine if Congress intended the Age Discrimination Employment Act of 1967 to apply to employees of a foreign-based company who were working for that company in the United States.

CASE 8-6 Morelli v. Cedel

United States, Second Circuit Court of Appeals
Federal Reporter, Third Series, vol. 141, p. 39 (1998)

Richard D. Cudahy, Circuit Judge

This appeal requires us to decide whether the domestic employees of certain foreign corporations are protected under the Age Discrimination and Employment Act of 1967 (the ADEA), and, if so, whether a foreign corporation's foreign employees are counted for the purpose of determining whether the corporation has enough employees to be subject to the ADEA. We answer both questions in the affirmative.

Background

After the defendant fired the plaintiff, the plaintiff sued the defendant. The plaintiff's amended complaint asserted that the defendant violated the ADEA. . . . The district court dismissed the complaint on the grounds that the defendant was not subject to the ADEA. . . . The plaintiff appeals. . . .

---

[211] The Charming Betsy, *United States Reports*, vol. 6, p. 64 (Supreme Ct., 1804).

[212] *Lauritzen v. Larsen*, *id*., vol. 345, p. 571 (Supreme Ct., 1953).

[213] *Benz v. Compañia Naviera Hidalgo*, SA, *id*., vol. 353, p. 138 (1957).

[214] *Windward Shipping (London), Ltd. v. American Radio Assn*., AFL-CIO, *id*., vol. 415, p. 104 (Supreme Ct., 1974).

[215] *Equal Employment Opportunity Commission v. Arabian American Oil Co., id*., vol. 499, p. 244 at p. 248 (1991).

[216] *United States Code*, Title 42, §2000e(f), as amended by Public Law 102-166 of 1991. This amendment was adopted after the Supreme Court held in *Equal Employment Opportunity Commission v. Arabian American Oil Co*., *United States Reports*, vol. 499, p. 244 (1991), that the Civil Rights Act did not apply to American employees working for American employers overseas.

[217] *Id*., Title 42, §12111(4), Public Law 101–336, §2 of 1990.

While Congress may adopt regulations that apply extraterritorially, the states of the United States may not do so, as these regulations can conflict with the power of the federal government to regulate international commerce. *Crosby, Secretary of Administration and Finance of Massachusetts v. National Foreign Trade Council*, *United States Reports*, vol. 530, p. 363 (U.S. Supreme Ct., 2000).

MAP 8.7

Luxembourg (1998)

As alleged in the complaint, the facts relevant to this appeal are as follows. The plaintiff, Ida Morelli, was born on April 11, 1939. The defendant is a Luxembourg bank. On or about June 29, 1984, the defendant hired the plaintiff to work in its New York office. On or about February 26, 1993, the plaintiff became an assistant to Dennis Sabourin, a manager in the defendant's New York office. About one year later, Mr. Sabourin summoned the then 54-year-old plaintiff to his office, handed her a separation agreement, and insisted that she sign it.

Under the terms of the separation agreement, a copy of which was attached to the complaint, the plaintiff would resign, effective April 30, 1994. She would continue to receive her salary and benefits until the effective date of her resignation, but she would be relieved of her duties as an employee, effective immediately. Both the defendant and the employee would renounce all claims arising out of "their past working relationship." Mr. Sabourin told the plaintiff that she would receive the three months' severance pay, medical coverage for three months, and her pension only on the condition that she sign the agreement on the spot. The plaintiff had never seen the separation agreement before and had no warning that she was going to be asked to resign. But in the face of Mr. Sabourin's ultimatum, she did sign the agreement immediately and returned it to him. The defendant, however, never provided her with a pension distribution.

Discussion

1. Age Discrimination

(a) Does the ADEA Cover a U.S.-Based Branch of a Foreign Employer?

The ADEA was enacted in 1967 to prevent arbitrary discrimination by employers on the basis of age—it protects workers 40 years of age and older. In order to determine whether the defendant is subject to the ADEA, we must first determine whether the ADEA generally protects the employees of a branch of a foreign employer located in the United States.

It is undisputed that Cedel is a foreign employer with fewer than 20 employees in its sole U.S. branch. . . .

Section 4(h)(2) of the ADEA provides that "the prohibitions of [the ADEA] shall not apply where the employer is a foreign person not controlled by an American employer." At a minimum, this provision means that the ADEA does not apply to the foreign operations of foreign employers—unless there is an American employer behind the scenes. An absolutely literal reading of §4(h)(2) might suggest that the ADEA also does not apply to the domestic operations of foreign employers. But the plain language of §4(h)(2) is not necessarily decisive if it is inconsistent with Congress' clearly expressed legislative purpose.

Section 4(h)(2) was not part of the original ADEA. It was added in 1984. The context in which it was added reveals that Congress' purpose was not to exempt the domestic workplaces of foreign employers from the ADEA's prohibition of age discrimination. Instead, the purpose of adding this exclusion was to limit the reach of an extraterritorial amendment adopted as part of the same legislation.

In 1984, before §4(h)(2) was added, several courts of appeals had concluded that the ADEA did not apply to "Americans employed outside the United States by American employers."[218] . . . Within a few months of the 1984 court decisions, Congress amended the ADEA in a way that superseded the holding of these cases by "providing for limited extraterritorial application" of the ADEA.

The 1984 amendments amplified the definition of "employee" in §11(f) of the ADEA, which had previously embraced any "individual employed by any employer," except for certain elected public officials and political appointees. One of the 1984 amendments specified that "the term 'employee' includes any individual who is a citizen of the United States employed by an employer in a workplace in a foreign country."

Companion amendments dealt with the cases of foreign persons not controlled by an American employer—now § 4(h)(2) of the ADEA—and foreign corporations controlled by American employers—now §4(h)(1). . . .

The 1984 revision to the definition of "employee" in § 11(f) was intended "to assure that the provisions of the ADEA would be applicable to any citizen of the United States who is employed by an American employer in a workplace outside the United States."[219] The other 1984 amendments, to §4 of ADEA, conform the ADEA's reach to "the well-established principle of *sovereignty*, that no nation has the right to impose its labor standards on another country."[220] Thus §4(h)(2) of the ADEA merely limits the scope of the amended definition of employee, so that an employee at a workplace in a foreign country is not protected under the ADEA if the employer is a foreign person not controlled by an American employer.[221] There is no evidence in the legislative history that these amendments were intended to restrict the application of the ADEA with respect to the domestic operations of foreign employers.

***

If §4(h)(2) does not exempt the domestic operations of foreign companies from the ADEA, there is no other basis for such an exemption. . . . International comity does not require such an exemption; the 1984 amendments anticipate that American corporations operating abroad will be subject to foreign labor laws, and Congress presumably contemplated that the operations of foreign corporations here will be subject to U.S. labor laws.

We have previously concluded that even when a foreign employer operating in the United States can invoke a Friendship, Commerce and Navigation treaty to justify employing its own

[218] *Cleary v. United States Lines, Inc.*, *Federal Reporter, Second Series*, vol. 728, p. 610 (3d Circuit Ct. of Appeals, 1984). . . .

[219] Senate Report 98–467, at p. 27 (1984) . . . ; see *EEOC v. Arabian American Oil Co.*, *United States Reports*, vol. 499, p. 244 at pp. 258–59 (Supreme Ct., 1991).

[220] Senate Report at p. 27.

[221] See *id.* at pp. 27–28 ("The amendment . . . *does not* apply to foreign companies which are not controlled by U.S. firms.") (emphasis added).

nationals, this "does not give [the employer] license to violate American laws prohibiting discrimination in employment."[222]. . .

We therefore agree with the E.E.O.C., the agency charged with the enforcement of the ADEA, that the law generally applies "to foreign firms operating on U.S. soil."[223] For the reasons we have discussed, we are confident that Congress has never clearly expressed a contrary intent.

(b) Are Employees Based Abroad Counted in Determining Whether a U.S.-Based Branch of a Foreign Employer Is Subject to the ADEA?

Cedel will still not be subject to the ADEA by virtue of its U.S. operations unless Cedel is an "employer" under the ADEA. A business must have at least twenty "employees" to be an "employer."[224] Cedel maintains that, in the case of foreign employers, only domestic employees should be counted. The district court agreed, and, since Cedel had fewer than 20 employees in its U.S. branch, the court granted Cedel's motion to dismiss for lack of subject matter jurisdiction without considering the number of Cedel's overseas employees.

***

The district court reasoned that the overseas employees of foreign employers should not be counted because they are not protected by the ADEA. But there is no requirement that an employee be protected by the ADEA to be counted; an enumeration, for the purpose of ADEA coverage of an employer, includes employees under age 40, who are also unprotected, see 29 U.S.C. §631(a). The nose count of employees relates to the scale of the employer rather than to the extent of protection.

***

. . . Cedel contends that because it has fewer than 20 employees in the United States, it is the equivalent of a small U.S. employer. This is implausible with respect to compliance and litigation costs; their impact on Cedel is better gauged by its worldwide employment. Cedel would not appear to be any more a boutique operation in the United States than would a business with ten employees each in offices in, say, Alaska and Florida, which would be subject to the ADEA. Further, a U.S. corporation with many foreign employees but fewer than 20 domestic ones would certainly be subject to the ADEA.

Accordingly, in determining whether Cedel satisfies the ADEA's 20-employee threshold, employees cannot be ignored merely because they work overseas. We therefore vacate the judgment on the plaintiff's ADEA count.

***

Conclusion

The judgment is vacated . . . and the case is remanded for further proceedings not inconsistent with this opinion.

Casepoint

The Second Circuit Court of Appeals (the second highest court level in the United States) held that (1) the federal Age Discrimination in Employment Act (ADEA) did indeed protect U.S. employees of foreign corporations that have operations in the United States and that (2) all employees of the company (within and outside the United States) will be counted in determining whether the company has 20 or more employees and is thus subject to the ADEA.

[222]*Avigliano v. Sumitomo Shoji America, Inc.*, *Federal Reporter, Second Series*, vol. 638, p. 552 at p. 558 (2d Circuit Ct. of Appeals, 1981), vacated on other grounds, *United States Reports*, vol. 457, p. 176 (Supreme Ct., 1982).

[223]E.E.O.C. Policy Guidance, N-915.039, Empl. Prac. Guide (CCH) paras. 5183, 6531 (March 3, 1989).

[224]*United States Code*, Title 29, §630(b).

Chapter Questions

Allowable WTO Restrictions

1. Mari and Juana are both members of the WTO. Mari supplies special herbs to Juana, which processes and sells them as medicinal herbs. However, it was discovered that Mari entered into an agreement with its two ex-colonies, Maricoke and Marispliff, whereby special herbs were supplied at a lower price.

   Juana has approached the WTO, arguing that Mari's discriminatory pricing violates both the GATT and the GATS; the latter is invoked because companies in Juana include "medicinal processing departments" which provide the service of treating special herbs prior to their sale. Do you think Juana has a valid claim under the GATS?

GATS and NAFTA Commitments

2. State C is a WTO member state and a party to NAFTA. It has made no specific agreements under either GATS or NAFTA as to its road transport sector. Now, two freight companies, one from State D (a WTO member state) and one from State E (a party to both the WTO and NAFTA), wish to provide overland freight transportation services in State C using trucks operating out of terminals in their states of establishment. May they do so? If so, to what extent? Explain.

Role and Power of the ILO Fact-Finding and Conciliation Commission

3. State A has not ratified either the ILO Convention Concerning Freedom of Association or the ILO Convention Concerning the Application of the Principles of the Right to Organize and Bargain Collectively. Several workers within State A have lodged complaints with the ILO about their right to associate and bargain collectively. Can the ILO's Fact-Finding and Conciliation Commission consider their complaints?

Power of the ILO Administrative Tribunal

4. Armstrong worked for a United Nations specialized agency in Geneva for seven years. As part of his job, he tracked the civil rights activities of the agency's member states. One state did not appreciate his listing of certain civil rights abuses that he alleged that country was perpetrating against its nationals. The country refused to pay its dues to the agency unless he was fired. The secretary-general of the agency then fired him. Armstrong appealed this decision to the ILO's Administrative Tribunal, which has jurisdiction over these kinds of disputes. Armstrong asked the tribunal to order the agency to rehire him or, if it could not, then to order the agency to pay him compensation for the loss of his job. How should the tribunal rule? Discuss.

Freedom of Speech and Press in the EU

5. Barton works as a freelance reporter covering stories in State F, a member state of the EU. Her revealing stories, which she sells to a variety of progressive independent newspapers throughout the EU, have caused a great deal of embarrassment to a certain minister in the State F government, and the minister has asked the State F parliament to pass a law forbidding foreign news reporters from working in State F without the permission of that minister's office. Parliament has asked State F's attorney general for an opinion on the legality of the minister's request in light of State F's membership in the EU. What advice should the attorney general give Parliament? Discuss.

Right of an Attorney to Employment in Another EU Country

6. Caruso, a national of State G, is licensed as a lawyer in that state. Caruso, however, wants to work as a courtroom advocate in State H. May Caruso do so, despite the fact that under State H law, only citizens may be courtroom advocates in State H? (Both State G and State H are members of the EU.) Discuss.

U.S. Passport Rules

7. Dickens is a dual national of the United States and Ireland. The United States has a prohibition on travel and employment of U.S. nationals in Cuba. If Dickens goes to work in Cuba using his Irish passport to enter and leave Cuba, may the United States take any action against Dickens? Discuss.

National Government Power over Visas

8. The faculty of Public University (PU), located in State I, has invited Karl Engels, a "revolutionary Marxist" from State J, and Bishop Biggott, an advocate of apartheid from State K, to participate in a symposium at PU. Both individuals have agreed to attend, but both have been denied visas to enter State I by that state's Foreign Ministry. The ministry acted according to State I law, which grants the ministry authority to deny visas for reasons of public policy, public safety, or public health. The PU faculty petitioned the ministry for a waiver, but the foreign minister refused to grant it. The faculty members have now brought a suit claiming (1) that their rights under State I's Constitution (which guarantees both freedom of speech

and freedom of assembly) to hear the viewpoints of Mr. Engels and Bishop Biggott have been denied and (2) that the government has no basis on which to deny either applicant admission to State I. Will the faculty succeed on either of these grounds? Discuss.

Treaties of Friendship, Commerce, and Navigation

9. Americana, Inc., a large multinational corporation with its headquarters in the United States, has a subsidiary in Tokyo. It refuses to appoint any Japanese nationals to the senior executive posts of the subsidiary, claiming that it is specifically allowed to do so by the 1953 Japanese-United States Friendship, Commerce, and Navigation Treaty. Is this true? Explain.

Extraterritorial Application of U.S. Law

10. Edison, an employee of Big Corporation, works for Big at its subsidiary in State Y. Edison is an American citizen and Big is an American corporation. Big fires Edison because he is a member of a racial group that is generally despised in State Y. Edison now brings a suit in the United States claiming that his American civil rights have been violated. Have they? Explain.

CHAPTER

9

Intellectual Property

Chapter Outline

A. The Creation of Intellectual Property Rights
- Copyrights
- Patents
- Trademarks
- Know-How (Trade Secrets)

B. International Intellectual Property Organizations
- World Intellectual Property Organization
- Council for Trade-Related Aspects of Intellectual Property Rights

C. Intellectual Property Treaties
- Comprehensive Agreements
- Artistic Property Agreements
- Industrial Property Agreements

D. The International Transfer of Intellectual Property

E. Licensing Regulations
- Territorial Restrictions
- Export Restrictions
- Cartels
- Exclusive Licenses
- Sales and Distribution Arrangements
- Price-Fixing
- Noncompetition Clauses
- Challenges to Validity
- Tying Clauses
- Quantity and Field-of-Use Restrictions
- Restrictions on Research and Development
- Quality Controls
- Grant-Back Provisions
- Restrictions That Apply After the Expiration of Intellectual Property Rights
- Restrictions That Apply After the Expiration of the Licensing Agreement

F. Compulsory Licenses
- Patents
- Copyrights

Chapter Questions

Introduction

intellectual property Useful artistic and industrial information and knowledge.

artistic property Artistic, literary, and musical works.

industrial property Inventions and trademarks.

Intellectual property is, in essence, useful information or knowledge. It is divided, for the purposes of study (and for establishing legal rights), into two principal branches: artistic property and industrial property. **Artistic property** encompasses artistic, literary, and musical works. These are protected, in most countries, by copyrights and neighboring rights.

Industrial property is itself divided into two categories: inventions and trademarks. Inventions include both useful products and useful manufacturing processes. They are protected in a variety of ways, the most common protection being in the form of patents, petty patents, and inventors' certificates. Trademarks include "true" trademarks, trade names, service marks, collective marks, and certification marks. All of these are markings that identify the ownership rights of manufacturers, merchants, and service establishments. They are protected by trademark laws.

Regardless of its form, intellectual property is a creature of national law. International law does not create it. International law does, however, set down guidelines for its uniform definition and protection, and it sets up ways that make it easier for owners to acquire rights in different countries.

National law—and sometimes regional law—is also important in establishing the rules for assigning and licensing intellectual property. Recently, the international community has worked to establish international norms for the transfer of intellectual property, but so far the effort has not been fully successful.

These aspects of intellectual property law—its creation, protection, and transfer—form the subject matter of this chapter. Each is discussed in turn.

A. The Creation of Intellectual Property Rights

The realm of information that can be owned, assigned, and licensed is as broad as human inventiveness and imagination. Such information can involve either statutory or nonstatutory rights. The former include copyrights, patents, and trademarks. The latter include *know-how* (a term of American origin that has now been adopted as a term of art in many languages).[1] "Know how" is also often termed *trade secrets*. Today, many multinational companies have more of their total value tied to intellectual property than to hard assets. For example, Apple, Inc., with most of its value tied to intellectual property as embodied in consumer products, surpassed Exxon Mobil Corp. as the company with the highest market value in the world for a time in 2011, shortly before the untimely death of founder Steve Jobs. The creation, development, and protection of patents, copyrights, trademarks, and trade secrets is obviously a matter of the highest importance for firms in high-tech industries. But these types of intellectual property also have critical implications for businesses engaged in manufacturing, agriculture, and service operations, as we will see in this chapter.

Copyrights

copyright An incorporeal statutory right that gives the author of an artistic work, for a limited period, the exclusive privilege of making copies of the work and publishing and selling the copies.

A **copyright** is title to certain *pecuniary rights* and, in most countries, certain *moral rights* for a specified period of time. These rights belong to the authors of any work that can be fixed in a tangible medium for the purpose of communication, such as literary, dramatic, musical, or artistic works; sound recordings; films; radio and television broadcasts; and (at least in some countries) computer programs. Unlike a patent, a copyright does not give its owner the right to prevent others from using the *idea* or the *knowledge* contained in the copyrighted work; it only restricts the use of the work itself. That is, anyone can use the information in the work to make, use, or sell a product, but they will be limited in the way they may use a particular copy of the original work.

The duke of Milan issued the first known copyright—a grant of the exclusive right to print a work—in 1481 to the printer of a local history. Similar grants were given to other printers in Germany, France, Italy, and Spain at about the same time. The first true copyright act, which protected authors without requiring them to obtain an individual grant from their sovereign, was enacted in England in 1709. Similar statutes appeared in Spain in 1764, in the United States in 1790, in revolutionary France in 1791, and in the German Confederation in 1837. Comprehensive acts, granting

[1] Paul H. Vishny, *Guide to International Commerce Law*, vol. 1, §3.09 (1994).

both pecuniary and moral rights to authors with minimal formality, appeared on the European Continent in the 1880s—the Belgian Copyright Law of 1886 being the first of several. Also, in 1886, 10 countries, including Belgium, Britain, France, Germany, Italy, Spain, and Switzerland, signed the Berne Convention[2]—still by far the most influential international copyright convention—at Berne, Switzerland. This convention followed the Continental European model, requiring signatory states to impose minimal formalities and to protect both pecuniary and moral rights. Today, most of the nations of the world have ratified the Berne Convention, including, finally—in March 1989—the United States, thereby giving substantial (but certainly not complete) uniformity to the world's copyright laws.

Pecuniary Rights Economic or **pecuniary rights** are legislative or judicial grants of authority that entitle an author to exploit a work for economic gain. Historically, there were only two channels for doing so. One was through the printed medium (i.e., a work was printed and then distributed through book shops, music stores, poster shops, etc.), and the other was through an entertainment establishment (i.e., a work was performed or shown at theaters, music halls, galleries, etc.). Today, as a consequence, most of the nearly 100 countries that grant copyrights protect two kinds of pecuniary rights: the *right of reproduction* (which, in many jurisdictions, also includes the rights to exhibit and disseminate a work) and the *right of public performance*. An example of the pecuniary protection granted in a typical statute is found in Section 15 of the German Copyright Law:

pecuniary right
The right of an author to exploit a copyrighted work for economic gain.

I. The author shall have the exclusive right to exploit his work in material form; the right shall comprise in particular:
   1. the right of reproduction;
   2. the right of distribution;
   3. the right of exhibition.

II. The author shall further have the exclusive right to publicly communicate his work in nonmaterial form (right of publicly communicating); the right shall comprise in particular:
   1. the right of recitation, representation and performance;
   2. the right of broadcasting;
   3. the right of communicating the work by means of sound or visual records;
   4. the right of connecting broadcast transmissions.

Right of Reproduction, the oldest and most common of the copyright rights, is consistently defined in the market countries of the West. For example, the German statute defines it as the "right to make copies of a work, irrespective of the method or number"[3]; the British Copyright Act refers to "reproducing the work in any material form"[4]; the French Copyright Law defines a work reproduction as "the material fixation of a work by any method that permits indirect communication to the public"[5]; and the U.S. Copyright Act refers merely to the making of "copies."[6]

right of reproduction
The exclusive right of an author to make multiple copies of a copyrighted work.

In socialist countries, although a copyright does include the right of reproduction, the right can be exercised effectively only by state agencies. As a consequence, copyright holders have to assign their rights to an agency—commonly their employer—and hope that the agency will promote their copyrighted work. But as China moves to the forefront of international trade (and is a full member of the WTO), its laws are being revised to include "western" notions of copyright ownership and legal rights. Enforcement of these rights, however, has lagged behind the enactment of the laws.

Of course, the development of the Internet and the World Wide Web in the past 20–30 years has totally changed the ease with which copyrighted works may be reproduced. It is now possible—though not necessarily legal—to instantly send a perfect copy of a work of art, music, literature, or software to millions of people around the world with the click of a mouse. The rapid developments in

---

[2]Berne Convention for the Protection of Literary and Artistic Works (Paris, 1886, revised in Paris, 1896; Berlin, 1908; Berne, 1914; Rome, 1928; Brussels, 1948; Stockholm, 1967; and Paris, 1971).

[3]Germany, Copyright Law, §16 (September 9, 1965, as amended).

[4]United Kingdom, Copyright Act, §2(5) (1956 as amended).

[5]France, Law No. 57–298, Article 28 (March 11, 1957, as amended). Similar language appears in the Russian Civil Code, Article 479.

[6]United States, Copyright Act, §106(1) (1976).

technology have made enforcement of copyright law much more difficult, and business firms around the world have been struggling to protect their intellectual property in this new age.

Piracy, the unauthorized reproduction and sale of copyrighted works, has been a serious problem for the owners of copyrighted works in recent years. The music, movie, and software industry in developed nations have complained bitterly about the proliferation of counterfeit copies of their copyrighted works around the world. An OECD study titled *The Economic Impact of Counterfeiting and Piracy* attempted to determine the extent of such trade. The OECD study concluded that international trade in counterfeit and pirated goods could have accounted for up to U.S. $200 billion in 2005. The OECD then updated its estimates, based on the growth and changing composition of trade between 2005 and 2007, which suggest that counterfeit and pirated goods in international trade grew steadily over the period 2000–2007 and could have amounted to as much as U.S. $250 billion in 2007, and the number is much larger today. The share of counterfeit and pirated goods in world trade is also estimated to have increased from 1.85 percent in 2000 to 1.95 percent in 2007 and is likely higher now.

Figure 9.1 depicts a typical scene on a street in Shanghai, China, in 2008, where unauthorized copies of many current DVDs—including very recent major American movies and television shows—were on sale for approximately $1 each. One of the authors of this textbook took the photo, and has personally observed kiosks like this on many commercial streets, not only in China but in several other nations as well in recent years.

distribution rights
The right of an author to place a copy of a copyrighted work into circulation for the first time.

Distribution rights, unlike reproduction rights, are neither consistently defined nor consistently granted by one country to another. To understand distribution rights, one has to consider two questions: (1) What is meant by distribution? and (2) When are distribution rights *exhausted*?

The German Copyright Law defines distribution as "the right to offer to the public,[7] or to place in circulation, the original work or copies of the work."[8] Similar provisions are found in the American, Austrian, British, Scandinavian, and Swiss statutes.[9] Most countries do not directly grant such a right. For example, while the French Copyright Law does not directly grant a right of distribution, it does provide for essentially the same thing in the form of a limitation on a transferee's rights. Thus, a transferee only acquires those rights "specifically mentioned in the transfer agreement,"[10] and any attempt to assume greater rights is considered a crime. A French transferee who attempts "the sale, exportation or importation of unlawful copies of [copyrighted] works" is subject to penal sanctions.[11]

first sale doctrine or doctrine of exhaustion
Once a copy of a copyrighted work is in circulation, the author has no further right to control its distribution.

In most countries, once a particular copy of a work has been sold to a public transferee, the author's right to control any subsequent transfers of that particular copy ends. This is known as the "**first sale doctrine,**" or sometimes as the "**doctrine of exhaustion.**"[12] Practically, this doctrine is a necessary corollary to the right of distribution; otherwise, the copyright owner would be able to control every transfer of every copyrighted work.

There are three important limitations to the doctrine of exhaustion. The first is that the right only applies to sales. An author who transfers an original or a copy by lending, leasing, or as part of an

---

[7]While the statutory provisions do not define *public*, commentators generally agree that the circulation of one or two copies to members of one's family or to close friends is not a public distribution. See Stig Strömholm, "Copyright—Comparison of Laws," *International Encyclopedia of Comparative Law*, vol. 14, chap. 3, p. 52.

[8]Germany, Copyright Law, §17(1) (September 9, 1965, as amended).

[9]United States, Copyright Act, §106(1) (1976); Austria, Copyright Law, §16; United Kingdom, Copyright Act, §2(5) (1956 as amended); Switzerland, Federal Copyright Law, Article 12(1) (December 7, 1922, as amended). An example of the Scandinavian provisions is Sweden's Law No. 729 on Copyrights, §2(3) (1960 as amended).

[10]France, Law No. 57–298, Article 31(3) (March 11, 1957, as amended).

[11]France, Penal Code, Article 425(3).

[12]The doctrine of exhaustion was first introduced in the nineteenth century by Josef Kohler, a German law professor, and his ideas are now incorporated in the German Copyright Law, §17(2), and in the other copyright laws that provide for an express grant of the right of distribution.

The U.S. first sale or exhaustion-of-rights rule is set out in §27 of the U.S. Copyright Act, which states that "nothing in this title shall be deemed to forbid, prevent, or restrict the transfer of any copy of a copyrighted work the possession of which has been lawfully obtained." The EU's exhaustion-of-rights rule is a court-made rule. It was first applied by the European Court of Justice in a copyright dispute in the case *of Deutsche Gramophone v. Metro*, Case 78/70, *European Community Reports*, vol. 1971, p. 487 (1971) and then fully set out in Musik-Vetrieb Membran v. GEMA, joined Cases 55/80 and 57/80, *European Community Reports*, vol. 1981, p. 147 (1981).

FIGURE 9.1

Pirated DVDs Are Commonly Sold on the Street in China

Source: Courtesy of Michael Bixby

exhibition retains his or her distribution right as to any subsequent transfer. The second limitation is that the doctrine only applies to the right of distribution of that copy. The right to reproduce the original work, as well as other rights (such as performance rights and moral rights), is not affected. For example, making photocopies of a book purchased by a transferee is still an infringement of the copyright holder's right of reproduction. The third limitation has to do with the author's right to limit rentals of distributed original works and copies. By a widely subscribed-to international agreement, authors are entitled (at least with regard to computer programs and motion pictures) to prohibit commercial rentals of their copyrighted works.[13]

In addition to reproduction and distribution rights, copyright owners have a pecuniary **right of performance.** There are basically two approaches to the granting of this right. One, set out in the British, French, and U.S. laws, among others, is to grant a *general* right of performance (*droit de représentation*). The French law, which was extensively amended in 1985, provides a good example of this method. The right of performance is the right "to communicate the work to the public by any means whatsoever, including public recitation, lyrical performance, public presentation, public projection, and telecommunication."[14]

right of performance The right of an author to communicate a copyrighted work to the public.

This same general prohibition was incorporated into the Agreement on Trade-Related Aspects of Intellectual Property Rights Article 14 (1994). This agreement is discussed later in this chapter.

The second approach, followed in various countries but most fully utilized in Germany, is to create several *subsidiary* rights—in particular, the right to recite a literary work, the right to perform a musical work, the right to make a remote presentation over loudspeakers or similar devices, the right to make a projected image, the right to communicate by visual or sound records, and the right to make radio and television broadcasts.[15]

Regardless of the approach, the right of performance applies only to public performances. Private performances—that is, performances limited to a small group of people "inter-connected personally by mutual relations or by a relationship to the organizer"[16]—do not infringe the copyright. Examples of public performances from U.K. case law (all of which will infringe the copyright holder's performance right) include the performance of a play by members of a ladies' club to other members of the same club and playing music in the lobby of a hotel, in a television showroom, in a record

[13] The Agreement on Trade-Related Aspects of Intellectual Property Rights, Article 11 (1994), provides: "In respect of at least computer programs and cinematographic works, a [World Trade Organization] member shall provide authors and their successors in title the right to authorize or to prohibit the commercial rental to the public of originals or copies of their copyright works. A member shall be excepted from this obligation in respect of cinematographic works unless such rental has led to widespread copying of such works which is materially impairing the exclusive right of reproduction conferred in that member or authors and their successors in title. In respect of computer programs, this obligation does not apply to rentals where the program itself is not the essential object of the rental."

[14] France, Law No. 57–298, Article 27 (March 11, 1957, as amended). Similar provisions are found in the United Kingdom Copyright Act, §§2(5) and 3 (1956 as amended), and the United States Copyright Act, §§ 101 and 106(4) (1976).

This same general prohibition was incorporated into the Agreement on Trade-Related Aspects of Intellectual Property Rights Article 14 (1994). This agreement is discussed later in this chapter.

[15] Germany, Copyright Law, §§15(2), 19 (September 9, 1965, as amended).

[16] *Id.*, §15(3).

shop, over loudspeakers to workers in a factory, and to members of a dance club.[17] A private performance would be a reading of a book to one's family or to a small group of close friends. The difference between public and private performances is examined in Case 9-1.

CASE 9-1 Performing Right Society, Limited v. Hickey

Zambia, High Court at Lusaka, 1978
Zambia Law Reports, vol. 1979, p. 66 (1979)

MAP 9.1

Zambia (1978)

Opinion of the Court—Judge Sakala

The plaintiff's claim is for an injunction to restrain the defendant—whether by himself or by his servants or agents—from authorizing or procuring communication to the public of the musical works "Kung Fu Fighting," "House of Exile," and "Money Won't Save You," or any other musical works the copyright of which vests in the plaintiff. The plaintiff also claims for damages.

In support of the claim, Ronald Clarence Chipumza, an accountant with Lightfoot Advertising, told the Court that he is also the Zambian Agent for the Performing Right Society, Limited, the plaintiff in this case. He testified that the objective of the plaintiff is to protect the copyright of musical writers, artists, and composers. The Society represents them and collects fees on behalf of its members, which in the end [are] distributed to the members. In Zambia, the position of the plaintiff is to represent the copyright of the affiliated societies throughout the world. He testified that in early 1975 a search was conducted at the defendant's premises to determine the extent to which the copyright of the society members was being violated. He told the Court that in September a letter was sent to the defendant advising him that the plaintiff's copyright was being infringed. Another letter was sent in October 1975 reminding the defendant of the consequence of performing copyrighted music without the consent of the copyright owner.

[17] See Stig Strömholm, "Copyright—Comparison of Laws," *International Encyclopedia of Comparative Law*, vol. 14, chap. 3, p. 57.

The witness further testified that he also wrote the defendant suggesting to him to take out the society's license. But there was no reply to any of these letters. Further, the defendant made no attempt to arrange for a meeting. In the end the matter was referred to the plaintiff's solicitors. The witness further testified that he physically, on several occasions, made searches at the defendant's premises. First of these occasions was on the 4th of April 1975. He discovered that the Society's copyright was being infringed. The inspections were carried out after the defendant failed to reply to the correspondence. At the time of the inspections, the songs that were being performed were "Kung Fu Fighting," "House of Exile," and "Money Won't Save You." These last two songs were composed by Jimmy Cliff, while "Kung Fu Fighting" was by Carl Douglas. He testified that copyright in these works subsists in the plaintiff. The witness also told the Court that after the institution of the present proceedings, he carried out another search at the defendant's premises on the 11th of July 1978. It was again established that the copyright of the Society was still being violated. He said about five searches in all were carried out by him personally. He said that other works of the plaintiff are still being infringed, in addition to those specifically mentioned in the pleadings. . . .

In defense, Francis Anthony Hickey testified that he is one of the proprietors of Bar-B-Que Drive-in Restaurant. He agreed that on the 26th of April, 1976, he caused to be heard in public three records, namely, "Kung Fu Fighting," "House of Exile," and "Money Won't Save You." He said that it is not his intention to carry on breaking the copyright. He said, before then, he received several letters from the plaintiff's solicitors asking him to stop playing copyrighted music, but he did not know what they were asking him. He has never in his life heard that there is a copyright in music. He testified that he has bought records and played them. The letters he received did not mention any specific records and the pamphlet he received did not specify the music. He said he only realized that the letters referred to "Kung Fu Fighting," "House of Exile," and "Money Won't Save You" when he approached his lawyer, who explained [the letters] to him. Otherwise, before then, he had no idea. He said he does not intend to play these records until he obtains a license from the rightful owner. He told the Court that nobody approached him at his restaurant asking him to stop playing the records. He said he holds about one dance a week depending on the license allocated to him by the police.

In cross-examination, he said [that] on receipt of the various letters from the plaintiff, he asked his various friends who run discos and in their case, they did not know anything of copyright and as he was a beginner himself, he thought that these letters were some sort of a money making racket. He said he does not remember whether he read the pamphlet sent to him. He said he understood the word copyright to mean that you cannot manufacture the item in question.

. . . The contention by the plaintiff is that they have lost royalty fees by reason of the defendant's refusal and/or negligence to take out the plaintiff's license. As a result, they are claiming for an injunction to restrain the defendant by himself, or by his servants or agents, from causing to be heard, in public at the defendant's premises, the said musical works or any other such work the copyright of which vests in the plaintiff or from authorizing performance without a license from the plaintiff. They also ask for damages for infringement of the copyright.

. . . The defense is that the performance was done innocently and under mistake. The submission on behalf of the defendant was that, in matters of copyright infringement it is a good defense that at the time of the infringement that the defendant was not aware and had no reasonable grounds for suspecting that copyright subsisted. A further submission on behalf of the defendant is that if the plaintiff suffered any damages, the damages should only relate to the one day as pleaded. In the circumstances, counsel for the defendant urged that the damages should either be nominal or nil. It is conceded on behalf of the defendant in the submissions that the granting of an injunction cannot be opposed and was never at any stage objected to. The plaintiff's contention is that with regard to all the correspondence sent to the defendant, the defense of innocence must be rejected. The law governing copyright of musical works and other works in Zambia is contained in the *Copyright Act*, Chapter 701. I must confess that, in my research, I have not come across any Zambian authority based on the *Copyright Act*. Even in the submissions, I was not referred to any local decided cases. Musical works under the Act are eligible for copyright. Infringement of copyright is specifically provided for in §13 of the Act. Section 13 reads as follows:

> Copyright shall be infringed by any person who does, or causes any other person to do, an act falling within the copyright without the license of the person in whom is

> vested either the whole of the copyright or, where there has been a partial assignment or partial testamentary disposition, the relevant portion of the copyright.

In the instant case, the defendant admits that on the 26th of April, 1976, he did perform or cause the performance of the three musical works without a license.

***

. . . Section 13(3) provides a defense to infringements of copyright. The subsection reads as follows:

> Where in an action for infringement of copyright it is proved or admitted—(a) that an infringement was committed; but (b) that at the time of the infringement the defendant was not aware, and had no reasonable grounds for suspecting, that copyright subsisted in the work or other subject matter to which the Section relates; the plaintiff shall not be entitled under this Section to any damages against the defendant in respect of the infringement, but shall be entitled to an account of profits in respect of the infringement whether any other relief is granted under this Section or not.

As already mentioned, the defense raised is one of innocence. Quite clearly, §13(3) of Chapter 701 provides a good defense of innocence of infringements of copyright. Although there is no decided authority in Zambia, . . . English decisions based on the English *Copyright Act* of 1956 . . . have very strong persuasive value . . . bearing in mind that the wording of §13(3) of Chapter 701 is the same as §17(2) of the English *Copyright Act* of 1956. . . . Innocence as a defense under this Section has been considered in a number of English cases, reference to which will be found in *Halsbury's Laws of England*.[18] Part of that paragraph reads as follows:

> In general, any invasion of a right of property gives a cause of action to the owner against the person responsible for the invasion, whether it is intentional or not. Consequently, innocence is no defense to an action for infringement of copyright or for the conversion or detention of any infringing copy or a plate.
>
> Where, however, it is proved or admitted in an action for infringement that an infringement was committed, but that at the time of the infringement the defendant was not aware and had no reasonable grounds for suspecting that copyright subsisted in the work or other subject matter to which the action relates, the plaintiff is not entitled to damages, but is entitled to an account of profits whether any other relief is granted or not.

On the evidence before me, I am satisfied and find as a fact that at the time of the defendant's admitted infringement, he was not aware and had no reasonable grounds for suspecting that copyright subsisted in the plaintiff's three musical works. This being the case, I hold that the plaintiff is not entitled to any damages against the defendant in respect of the infringement. The Section, on the other hand, provides an alternative to damages in that the plaintiff is entitled to an amount of profits in respect of the infringement whether any other relief is granted or not. On the defendant's admission of the infringement of the plaintiff's copyright of the three musical works on April 26th, 1976, I hold that the plaintiff is entitled to the profits made on that day. As to quantum, I grant the parties liberty to apply in chambers. The defendant, at least from the evidence, does not appear to object to the injunction being granted. In the circumstances, I grant the injunction in respect of the three works pleaded.

Casepoint

The defendant admitted that he played records of copyrighted music during a public disco at his establishment in Zambia. Thus, a *performance* was done, without permission of the copyright owner, which constituted an infringement of the song composer's rights. The judge decided that the defendant did not fully understand copyright at that time, so did not award damages but did hold him liable for the profits made that day at the disco. In addition, the court entered an injunction prohibiting any further such infringement by the defendant.

[18] 4th ed., vol. 9 at paragraph 938, p. 602.

Moral Rights The personal rights of authors to prohibit others from tampering with their works are called **moral rights.** These rights are independent of the author's pecuniary rights, and in most states that grant moral rights, they continue to exist in the author even after the pecuniary rights have been transferred—that is, when someone else owns the copyright to the work. In France, for example, they are inalienable.[19]

moral rights
The right of an author to prohibit others from tampering with a copyrighted work.

The concept of moral rights is a product of nineteenth-century German legal philosophy. Starting in the period of the natural law thinkers (such as Locke, Montesquieu, and Pufendorf), a belief gained currency that there existed in nature certain legal rights (called *Persönlichkeitsrecht* or personal rights) that were inherent in the persons of individuals. Later, the Positivists, including Hegel, Jellinek, and Triepel, accepted that such rights ought to exist, even if they did not exist in nature. For example, Immanuel Kant, the eminent eighteenth-century German philosopher, looked upon the *Persönlichkeitsrecht* as a grant of freedom essential to the existence of an ethical society.[20]

The principal nineteenth-century German legal commentators—the Pandectists—were generally opposed to the notion of *Persönlichkeitsrecht*; it did not fit into the patterns of Roman law, which they regarded as conclusive and unimprovable. Nonetheless, a small group of writers, who studied German rather than Roman laws, were adamant defenders of the idea. These *personalists*, led by Otto von Gierke, took the view that a copyright was a single unified privilege that included both economic rights (i.e., reproduction and distribution) and moral rights. For these writers, a copyright was essentially personal; it could not be transferred, seized, or banned.[21]

Although the unitary view of von Gierke and the other personalists may have been philosophically and logically sound, it did not reflect actual practice. Copyright laws in every country allowed authors to transfer, at a minimum, their pecuniary rights. Josef Kohler proposed, about 1880, a *dualist* theory of copyright law. This divided copyrights into economic and moral rights—the latter being those rights that reflected the creative interests and concerns of the author. Kohler's theory was based on extensive studies of British and French case law (German case materials were generally unavailable at that time), and his ideas were especially influential in France.

Judicial decisions in France in the 1870s—under the influence of German scholarship—came to recognize moral rights as separate and distinct from economic rights. The French decisions, and Kohler's dualist theory, were incorporated in statutory form for the first time in the Belgian Copyright Law of 1886.

The 1886 Belgian Copyright Law recognized what today are considered the three basic moral rights: (1) the right to object to distortion, mutilation, or modification (*droit de respect*); (2) the right to be recognized as the author (*droit à la paternité*); and (3) the right to control public access to the work (*droit de divulgation*). These same rights were recognized in French and German copyright laws at the beginning of the twentieth century and, in 1928, the Berne Convention (which provides for the international recognition of national copyright laws) was amended to specifically recognize these three moral rights. France and Germany have subsequently added a fourth moral right—the right to correct or retract a work (*droit de repentir, Rückrufsrecht*)—but it is not as universally recognized as the other three.

Moral rights are not recognized in the copyright laws of the United Kingdom, the United States, and most countries that have inherited their law from England. The United Kingdom, which is a signatory of the Berne Convention and therefore obliged to protect the moral rights of authors, complies with its international obligations, at least arguably, by claiming that an author can bring an action for libel to complain of distortion, mutilation, or modification and an action for passing off to protect the author's rights of paternity. It also has argued that the right to control public access is inseparable from the economic right of reproduction and therefore is similarly protected.

[19]The Berne Convention for the Protection of Literary and Artistic Works defines an artist's moral rights as "the right to claim authorship of the work and to object to any distortion, mutilation, or other modification of, or other derogatory action in relation to, the said work, which would be prejudicial to his honor or reputation." See Berne Convention for the Protection of Literary and Artistic Works, July 24, 1971, 24 U.S.T. 1749, art. 6 bis, available at www.law.cornell.edu/treaties/berne/6bis.html.

[20]In "Von der Unrechtmässihkeit des Büchernachdruckes," *Berlinische Monatsschrift*, p. 416 (1785), Kant described a copyright as "not a right in the thing . . . but an innate right, inherent in the author's person, which implies the faculty to protest against another making him speak unwillingly to the public."

[21]*Deutsches Privatrecht*, vol. 1, pp. 756–766 (1895).

American courts and legal writers have often denied the existence of moral rights in the United States.[22] It was long suggested that the principal reason that the United States refused to become a signatory of the Berne Convention was the treaty's requirement that member states recognize moral rights (Article 6bis). With U.S. ratification of the Berne Convention in 1989, however, this explanation was no longer viable.[23] In ratifying the Berne Convention, the U.S. Congress carefully avoided accepting the moral rights portion, arguing that "existing state and federal law in the United States satisfied Article 6bis." This claim, that "there is a composite of laws in this country that provides the kind of protection envisioned by Article 6bis," was always seriously doubted.[24] A few American writers have suggested—in the fashion of British commentators—that moral rights are protected by tort and contract law.[25] These suggestions, however, have been halfhearted at best and, with the adoption of the Agreement on Trade-Related Aspects of Intellectual Property Rights (discussed below), probably no longer necessary.

Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement)
Annex to the Agreement Establishing the World Trade Organization; it creates a multilateral and comprehensive set of rights and obligations governing the international trade in intellectual property.

The **Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement),** which is an annex to the Agreement Establishing the World Trade Organization, requires WTO member states to comply with provisions of the Berne Convention (whether or not they are parties to that convention) with one significant exception: Member states are not required to grant moral rights to authors.[26] It seems likely as a consequence, at least for now, that authors in the United Kingdom, the United States, and other countries that follow the English tradition will continue to do without moral rights, despite the provisions in the Berne Convention and the practice in most of the rest of the world.[27] However, as Case 9.2 demonstrates, moral rights are recognized in India, which generally follows the English legal tradition.

work
An artistic, literary, musical, or scientific creation.

Works Covered The object of copyright protection is a **work,** that is, an intellectual creation in the field of art, literature, music, or science. Particular examples of works covered are provided in many copyright laws.[28] For example, the 1976 U.S. Copyright Act lists seven categories of works that are eligible for copyright protection:

1. Literary works
2. Musical works, including any accompanying words
3. Dramatic works, including any accompanying music
4. Pantomimes and choreographic works
5. Pictorial, graphic, and sculptural works
6. Motion pictures and other audiovisual works
7. Sound recordings

[22]See Kimberly Y. W. Holst, "A Case of Bad Credit?: The United States and the Protection of Moral Rights in Intellectual Property Law," *Buffalo Intellectual Property Law Journal*, vol. 3, p. 105 (2006).

[23]See Clint A. Carpenter, "Mother May I?: Moral Rights, Dastar, and the False Advertising Prong of Lanham Act Section 43(A)," *Washington and Lee Law Review*, vol. 63, p. 1601 (Fall 2006).

[24]Melville B. Nimmer and David Nimmer, Nimmer on Copyright, §8D.02[D][1] (2005) (stating that Congress's determination that current U.S. law met the Article 6bis requirements "flies in the face of numerous judicial and scholarly pronouncements on the subject").

[25]See William Patry, "The United States and International Copyright Law: From Berne to Eldred," *Houston Law Review*, vol. 40, pp. 749, 751–752 (2003).

[26]Agreement on Trade-Related Aspects of Intellectual Property Rights, Article 9, para. 1 (1994).
The Agreement specifies that WTO member states are to comply with the Berne Convention as revised in Paris in 1971.

[27]One commentator urged a few years ago that there was a strong need for more uniformity of protection for moral rights. "In light of new technologies that are present and those that will be developed, legislation is not keeping up with the rate at which technological advances are developing, which makes a multilateral agreement strictly enforcing the moral rights of an artist that much more imperative. Moral rights protection must be strictly imposed and enforced under a multilateral treaty with proper guidelines such as the French regime which would prohibit the waiver of these rights. To achieve such a treaty, given the many differences among the nations on the scope of moral rights, compromise will be needed. One possible compromise is to limit the term of moral rights protection to the term of copyright protection. When the copyright term of protection expires, therefore, the moral rights protection will expire as well. This compromise will further the objective of copyright protection which is to encourage artistic creation by economically protecting those creations for a limited period, while respecting the artistic integrity of the work." Patry, "The United States and International Copyright Law: From Berne to Eldred," *Houston Law Review*, vol. 40, p. 749 (2003).

[28]A similar list of examples can be found in the United Kingdom Copyright Act, the German Copyright Law, and French Law.

CASE 9-2 Amar Nath Sehgal v. Union of India

"Copyright in the Courts: How Moral Rights Won the Battle of the Mural," WIPO Magazine, April 2007. Copyright © 2007 by the World Intellectual Property Organization. Reprinted with permission.

MAP 9.2

India (2005)

In 1959, the Ministry of Works, Housing and Supplies of the Government of India commissioned a talented sculptor, Amar Nath Sehgal, to design a mural. The work was to adorn the walls around a central arch of the Vigyan Bhawan, a venue for important government functions in New Delhi, the capital city. The design was approved by the first Prime Minster of India, Pandit Jawahar Lal Nehru, and the mural was completed in 1962. In its final shape, it measured a mammoth 40 feet high and 140 feet long.

The mural won widespread acclaim, and gave the world a glimpse of the "real" India—its farmers, artisans, women and children, their daily chores and celebrations, frozen in time, and molded from tons of solid bronze. For nearly 20 years the mural attracted dignitaries and art connoisseurs from all over the world. It became a landmark in the cultural life of the capital. Then the Vigyan Bhawan buildings were renovated. In the process, the mural was ripped off the walls and the remnants put into storage.

Distressed by the destruction of his artistic work, and after petitioning the authorities for years without a response, Mr. Sehgal brought a lawsuit against the government for violation of his moral rights. Specifically, he claimed that:

- the dismemberment of the homogeneous blend of the pieces of each tile in the mosaic constituted an act of mutilation;
- the Ministry's action was prejudicial to his honor and reputation as an artist, because, by reducing the mural to junk, it dealt a body blow to the esteem and celebrity bestowed on the work at its inception;
- the obliteration of his name on the work violated his right to claim authorship.

Though too late to rescue the mural by the time his grievance came to court in May 1992, Mr. Sehgal was nonetheless granted an interim injunction restraining the defendants from causing further damage to the work. It turned out, fortunately for Mr. Sehgal, that the presiding

Judge was himself an art aficionado with, literally, a flair for poetic justice. The restraining order handed down by Justice Jaspal Singh came across as an acutely empathetic one:

> Sometime in the year 1962, the barren walls of Vigyan Bhawan were blessed with a mural . . . created by the magic hands of eminent sculptor Amar Nath Sehgal, approved by connoisseurs of all that is beautiful. . . . For years, it was dance to the discerning eye, and song to the ears who could hear. However, in 1979, it was pulled down and dumped in a storehouse. It is said that improper handling caused immense damage, and that bits and pieces have altogether disappeared, including the name of its creator. . . . In a country rightly proud of its creativity and ingenuity, men who can hardly distinguish the heads of Venus from those of Mars cannot be allowed to decide the fate of artists who create our history and heritage. Section 57 of the Copyright Act provides the light. . . .

The defense objected at the outset to the power of the court to intervene in the matter. Confident that the ministry was within its legal rights, the government argued that:

- the plaintiff (Mr. Sehgal) had assigned his copyright to the defendant (the government) in an agreement dated 31st October 1960;
- the defendant had purchased all rights from the plaintiff, and was consequently free to do as it pleased with the mural;
- the mural had already been damaged in a fire in the Vigyan Bhawan;
- according to the terms of the 1960 agreement, any grievance should be referred to an arbitrator appointed by the defendant.

The case was then set to go to trial, though not before further months were spent in unsuccessful efforts to find a mutually acceptable solution which Mr. Sehgal felt would vindicate his honor and reputation.

At the outset, the odds appeared to be stacked heavily against the artist. Not only had he created the work on commission, but he had also explicitly assigned his copyright—and so all economic rights—to the commissioning ministry. He faced a powerful opponent in the Indian government.

The success of Mr. Sehgal's legal action rested upon the "moral rights" established by the single statutory provision in Section 57 of the Indian Copyright Act (1957) on "author's special rights." Based on the Berne Convention Article 6bis, this section codifies the concept of moral rights, by protecting an author's right, independent of his copyright, to claim to authorship of his work, and to restrain any distortion, mutilation or modification of the work which could be prejudicial to his honor or reputation.

The court noted that if the mural [had] been completely destroyed, it was unlikely that Mr. Sehgal could have obtained the same relief, particularly given the long gap between the removal of the mural and the institution of the legal proceedings. However, since the stored remnants were still redeemable, upon viewing them, the court could visualize the magnitude of the work.

The fact that the defendant was the government was also significant. One of the arguments that the court adopted was that, unlike a private owner of an artwork, the Indian government had an obligation, enshrined in the national 5-year plan, to protect, preserve and respect cultural rights and the country's artistic and cultural heritage. Extracts from UNESCO's non-copyright cultural conventions also helped create a link between the facts of this case and governmental obligations.

When the matter came up for final hearing, Justice Pradeep Nandrajog of the Delhi High Court ruled that: "All rights of the mural shall henceforth vest with Mr. Sehgal." The court ordered the return of the remains of the mural to the sculptor, and also slapped damages of Rs.500,000 (some U.S. $12,000) on the defendant.

But the fight was still not quite over. The decree was not fulfilled, and Mr. Sehgal again took recourse to the court in execution proceedings, while the defendant appealed against the decree to a division bench of the court. Ultimately, the matter was amicably resolved. After the hard fought and emotional battle, Mr. Sehgal, grateful for his victory, waived the claim of damages against the government in exchange for the return of the mural.

Casepoint

The case involving Mr. Sehgal's mural shows the importance of the moral rights section of the Berne Convention, as adopted in the Indian Copyright Act, and the weight it has been given by courts in India and Europe. The law

is based on the principle that there should be a law to protect the soul and essence of artistic expression as much as the physical or tangible form of that expression, separate and distinct from the economic rights of the artist or author.

Source: Binny Kalra, "Copyright in the Courts: How Moral Rights Won the Battle of the Mural," *WIPO Magazine*, April 2007. This article was originally provided by the World Intellectual Property Organization (WIPO), the owner of the copyright. The WIPO Secretariat assumes no liability or responsibility with regard to the transformation of this data.

Not every work that falls within these categories qualifies for copyright protection, however. A work must also be **original;** that is, an author must infuse creativity into it. As Lord Atkinson once stated in a famous Privy Council case: "To secure [a] copyright . . . it is necessary that labor, skill and capital should be expended sufficiently to impart to the product some quality or character which the raw material did not possess, and which differentiates the product from the raw material."[29] Originality, however, should not be confused with the patent law requirements of novelty or merit. Two painters, for example, may paint the same still life. Each painting is an original, since it reflects the creativity of the maker. Accordingly, even though neither is novel, and even if they both lack any artistic merit whatsoever, both painters are entitled to a copyright for their works, as long as one did not "copy" the other's work.

originality
Creative effort invested by an author in raw materials that gives them a new quality or character.

What is protected is not the idea or knowledge contained in the work, but the **expression** of the work. That is, copyrights do not apply to "ideas, procedures, methods of operations, or mathematical concepts as such."[30] Anyone may use the information or knowledge in the work; they are limited only in the way they may use the original or a particular copy.[31]

expression
The exact manner in which a particular work of authorship is set down in a tangible way.

Of course, before there can be a copy, there must be an original. The original must be such that it is capable of being "fixed in any tangible medium of expression, now known or later developed."[32] A story written down on paper with pen and ink is the classic example of an original work that has been fixed in a tangible medium. So, too, is a picture painted with oils on a canvas, an image sculpted in marble, and music recorded on a record, tape, or compact disc.

Most copies (other than performances) must also be fixed in a tangible medium. That being so, is a copy made when the data stored on a computer disk are placed in the computer's central memory? The court in *MAI Systems v. Peak Computer*[33] was faced with this question some 20 years ago. In that case, MAI Systems, a computer programming company, wrote unique operating system programs for its customers' computers, which were stored on the computers' hard disks. MAI also serviced those computers whenever they needed it. Peak Computer, a rival programming company, contracted to service many of MAI's customers' computers for substantially less money than MAI Systems charged. MAI was not happy about this, and it sought to stop Peak by suing for copyright infringement. MAI, which had licensed only its customers to use the operating system programs installed on their computers, claimed that Peak had made unauthorized copies whenever it turned on the computers. The court agreed. Peak was able to view the error log generated by MAI's operating system program when a computer with the program was turned on. This meant that a perceivable copy of the program was taken from the hard disk and placed in the computer's operating memory. Although the copy was removed when the computer was shut down, it still existed for "more than a transitory period." That is all that is required. The court, therefore, enjoined Peak from infringing MAI's copyrights. (Because this meant that Peak could not turn on the computers with MAI's programs, Peak was effectively stopped from competing against MAI.)

Neighboring Rights Copyright laws generally apply to most works of an artistic, literary, musical, or scientific nature. Technology, however, has a habit of producing new kinds of works that fall outside of existing definitions. Today we have iPads, Nooks and Kindles. In earlier years, new technology

[29]*MacMillan & Co., Ltd. v. Cooper*, *Times Law Reports*, vol. 40, p. 188 (Privy Council, 1923).

[30]Agreement on Trade-Related Aspects of Intellectual Property Rights, Article 9, para. 2 (1994).

[31]This principle is formally stated in many copyright laws. For example, Colombia, Law No. 23 on Copyright, Article 6(2), provides: "The ideas or conceptual content of literary, artistic and scientific works may not be the subject of appropriation."

[32]United States, Copyright Act, §102 (1976). Similar provisions are found in Argentina, Law No. 11,723 on Copyright, Article 1; Colombia, Law No. 23 on Copyright, Article 2; Ghana, Copyright Law, §2(2); Kenya, Copyright Law, §3(2); Malaysia, Copyright Act, §7(3)(b); Nigeria, Law No. 61 on Copyright, §1(2)(b); and Uganda, Copyright Act, §2.

[33]*Federal Reporter, Second Series*, vol. 991, p. 511 (9th Circuit Ct. of Appeals, 1993).

included such examples as computer programs and semiconductor chips. Legislatures respond to such changes in different ways. Sometimes they make amendments to existing copyright laws to incorporate these new works. Copyright laws in most developed countries were amended in the mid-1980s to include protection for computer programs.[34] Sometimes, however, new laws, parallel to but separate from the existing copyright statutes, are enacted. The rights created by such laws are often called **neighboring rights** (from the French *droits voison*) because they are neighbors to, but not part of, an author's copyright. For example, in 1989, two new international treaties governing rights similar to, but different from, the traditional copyright were adopted: the Treaty on the International Registration of Audiovisual Works and the Treaty on Intellectual Property in Respect of Integrated Circuits.[35]

neighboring rights Rights similar to copyrights that are protected by different statutes.

Downloading and Copying of Music and Movies in Cyberspace

Listening to music and watching movies are favorite activities for millions of people. The manufacturers of electronic equipment have developed various means of capturing the exact sounds and images of songs and movies. Certainly one of the most publicized copyright issues in recent years has been the massive "downloading" of music and movies, without the permission of the owners of the copyrights. Since motion picures and music are now produced digitally and are available for purchase on compact discs, the owner of the disc has the right to listen to it as often as he/she wants.

Furthermore, the Internet and computers have made it quite possible for the owner of a DVD or CD to load an exact copy of the work onto his/her computer, and then "share" the recorded (and copyrighted) work with any number of other persons (thousands perhaps) who log onto a "peer-to-peer" (P2P) network on the Web and "download" the song. These same digital images and sounds can also be transferred to various types of portable players so the movies and music can be enjoyed whenever and wherever the user chooses. Millions of people can thus acquire the exact same movies and musical performance for free—and enjoy them over and over. Perhaps even some of the students reading this text have downloaded a few songs or movies over the Internet.

SOCIAL/ETHICAL ISSUE

But what about the copyright? Someone wrote the lyrics, and composed the tunes, and owns the copyright in that work of art (and there is likely another copyright on the particular musical performance by this artist on this disc) and someone wrote the script and produced the movie—so any reproduction or exact copying of the "expression" is copyright infringement. The recording and motion picture industries have argued vigorously that this massive "infringement" is causing great harm to their industries, and denying musicians, artists, actors, studios, and composers billions of dollars in royalties, which would have been earned if consumers had purchased the CDs and DVDs containing the recorded songs and movies, rather than downloading them for free.

While members of the authors' generation grew up buying records and cassettes of songs and albums they wanted to hear, and paid to view movies, millions of college students (like most of you reading this book) and many other consumers have become quite accustomed in recent years to being able to acquire, for free, any recorded songs they want.

The recording and movie industries have insisted that copyright law still exists, despite the ease of circumventing it, and should be enforced. The industries have pressed their copyright claims, and have filed suit against several hundred individual consumers who have been identified as large-scale abusers. Apparently these lawsuits have had some effect, and the number of downloaded songs has decreased, while some "pay for use" sites, like iTunes have developed thriving businesses. Yet, many millions of consumers continue to download for free, ignoring copyright law, or believing that whatever can be accessed on the Internet should be free.

Clearly the act of making a perfect copy of an entire copyrighted sound recording or motion picture is, in effect, the direct copying of the "expression" of the copyrighted work, without the permission of the copyright owner. Such actions do undoubtedly detract from the sales of videotapes, DVDs, audiotapes, and CDs by the producers and copyright holders. Yet it is so easy to do, should it be unlawful?

[34]For example, the German Copyright Law, §2(1) (September 9, 1965, as amended in 1985), now includes computer programs among the examples it provides of "literary writings"; the U.K. Copyright (Computer Software) Amendments Act (1985) amends the U.K. Copyright Act (1956) to grant protection to computer programs; and the U.S. Computer Software Protection Act (1980) amends §117 of the U.S. Copyright Act (1976) to make computer programs copyrightable.

This change was also incorporated in the Agreement on Trade-Related Aspects of Intellectual Property Rights, Article 10, para. 1 (1994) (which applies to all WTO member states). It provides: "Computer programs, whether in source or object code, shall be protected as literary works under the Berne Convention ([as amended in Paris in] 1971)."

[35]The substantive provisions of the Treaty on Intellectual Property in Respect of Integrated Circuits have been made applicable to WTO member states by the Agreement on Trade-Related Aspects of Intellectual Property Rights, Article 35 (1994).

What do you think? Should the copyright law be changed? Is it still relevant to the digital electronic world of today? Should we care about the rights of authors, composers, movie producers, and actors? Would you feel differently if you had spent 100 hours writing a software program for your own business firm and then someone got hold of it and put it on the Internet for anyone to use for free? Should manufacturers be allowed to sell products that enable and encourage others to violate copyright laws? What about regulation of the Internet? Can or should anything be done?

Several nations have now enacted laws that allow copyright holders to assert their rights when an infringing copy of a copyrighted work is posted on the internet through an Internet service provider (ISP). For example, New Zealand recently enacted the Copyright (Infringing File Sharing) Amendment Act of 2011, which states that a copyright owner whose work has been posted on the Internet to notify the ISP and ask that an infringement notice be sent to the account holder, called a "detection" notice. If a second instance occurs a "warning" notice can be sent at the copyright holder's request. A third infringement by the same account will lead to a final "enforcement" notice, after which the rights holder can apply to the Copyright Tribunal for damages of up to NZ$15,000. The rights holder may also apply to the district court for an order to suspend the account holder's Internet account, although this controversial provision will not come into force for two years—while it is determined whether the damage awards are a sufficient penalty.

Formalities The Berne Convention, as amended in Berlin in 1908, established that the title granted by copyright laws is subject to no formalities. When the United States became a member of the Berne Convention in March 1989, this became the rule throughout the world.[36]

Prior to March 1989, the United States was the only country that required authors to observe certain formalities to obtain a copyright. In particular, all publicly distributed copies of a work had to include a copyright notice consisting of the symbol © or the word "Copyright" or the abbreviation "Copr."; the year the work was first published; and the name of the copyright owner. In addition, two copies of certain kinds of works (e.g., books and phonographs) had to be deposited with the Copyright Office of the U.S. Library of Congress.[37] This is no longer the case in the United States as now a copyright exists at the moment a copyrightable work is produced in a "tangible medium of expression."

Scope A copyright applies only within the territory of the state granting it. A state will not prevent the making of copies of copyrighted material outside its territory. However, most states will keep unauthorized copies of copyrighted works from being imported into their territory.[38]

Recent International Developments

UNAUTHORIZED IMPORTATION OF COPYRIGHTED GOODS

One interesting recent example of the previously mentioned principle involved the importation of copyrighted goods that were lawfully manufactured outside the United States but were imported into the United States without the permission of the copyright holder. Textbooks published outside the United States are often less expensive than the same books produced domestically. In *John Wiley & Sons, Inc. v. Supap Kirtsaeng* (2nd Cir., 2011), the defendant Kirtsaeng had purchased foreign copies of eight Wiley textbooks and brought them into the United States for resale at a profit. Wiley sued under copyright law to block the importation. The Second Circuit Court of Appeals had to balance the "first sale doctrine" or "exhaustion" rule allowing the owner of a lawfully made copy to resell that article against the rights of the copyright owner to keep unauthorized copies out of the United States. Finding that the phrase "lawfully made under this title" (which allows the owner to resell copies of copyrighted books) did not apply to articles made outside the United States, the Court upheld a lower court judgment for $600,000 against Kirtsaeng and blocked the importation of the foreign-made textbooks.

---

[36]Argentina requires copyright holders to deposit copies of certain works (e.g., books and phonographs) with the government, subject to a "suspension of the rights of the author" for failing to comply. Argentina, Law No. 11,723 on Copyright, Articles 47–63 (September 28, 1933, as amended). France also requires registration of films, videograms, and contracts relating to such works, but failure to comply does not affect the author's copyright in the works. See Roland Dumas, *La Propriété littéraire et artistique*, pp. 325–327 (1987).

[37]United States, Copyright Act, § §401–407 (1976 as amended). A copyright holder also has a right (but no duty) to register a copyright with the Copyright Office. *Id*., §§408–412.

[38]For example, *United States Code*, Title 17, §602(a), provides that the unauthorized importation of copyrighted works constitutes infringement even when the copies were lawfully made abroad.

Duration The common rule for the duration of a copyright was established in 1948 in a revision of the Berne Convention. That is, a copyright lasts for 50 years *post mortem auctoris* (i.e., for 50 years following the author's death).[39] The WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights follows this precedent, requiring WTO member states to provide copyright protection of at least 50 years, and many nations, including the United States, have extended the duration to 70 years following the author's death.[40]

Exceptions to Copyright Protection Virtually every copyright law describes certain uses of works that do not constitute an infringement of the author's copyright. These exceptions, however, vary widely, and only a few main examples are listed here.

Copyrighted material can be used lawfully in at least some countries (1) in a court or administrative proceeding or by the police should the material (such as a portrait) be needed to maintain public safety[41]; (2) for instructional purposes in schools[42]; (3) for purely private use (except that computer programs may not be copied, regardless of the use involved)[43]; (4) in brief quotations in scholarly or literary works or in reviews[44]; and (5) in extended quotations of newsworthy speeches or political commentaries.[45]

Patents

patent
An incorporeal statutory right that gives an inventor, for a limited period, the exclusive right to use or sell a patented product or to use a patented method or process.

A **patent** is "a statutory privilege granted by the government to inventors, and to others deriving their rights from the inventor, for a fixed period of years, to exclude other persons from manufacturing, using, or selling a patented product or from utilizing a patented method or process."[46] Although a patent is commonly referred to as a monopoly, it is not truly so. The owner of a patent may be prevented from exploiting the grant by other laws (such as national security laws or unfair competition laws) or by contractual agreement. What a patent grants, rather, is the protection of a monopoly. As the U.S. Supreme Court put it in *Zenith Radio Corp. v. Hazeltine Research, Inc.*:

> The heart of [a patentee's] legal monopoly is the right to invoke the state's powers to prevent others from utilizing his discovery without his consent.[47]

Historically, two reasons have been given to justify the granting of patents. Those reasons are (1) that patents are a confirmation of the private property rights of the inventor and (2) that a patent is a grant of a special monopoly to encourage invention and industrial development.

The first of these two justifications—that patents are private property rights—can be found in the wording of the eighteenth- and nineteenth-century patent legislation of several continental European countries. For example, the French Patent Law of 1791 states:

> Every novel idea whose realization or development can become useful to society belongs primarily to the person who conceived it, and it would be a violation to the very essence of the rights of man if an industrial invention were not regarded as the property of its creator.

---

[40]Agreement on Trade-Related Aspects of Intellectual Property Rights, Article 12 (1994).
For example, all European Union countries grant protection for 70 years following the copyright owner's death. Many other nations, including the United States, Brazil, Argentina, and Australia, also provide copyright protection for "life plus 70 years." Canada as well as most countries in Asia and Africa, follow a "life plus 50 years" rule, and a few nations have different time lengths. For example, India follows a "life plus 60 years" rule, whereas Guatemala and Honduras provide copyright protection for "life plus 75 years." Colombia protects copyrights for 80 years *post mortem*, and the Ivory Coast 99 years *post mortem*.

All states also provide copyright protection when a work is created by a business firm or other juridical entity. Currently, the United States establishes a term of 95 years from the date of first publication or 120 years from the date of creation, whichever expires first, for such works. Sonny Bono Copyright Term Extension Act, Public Law 105–298 (1998) amending United States, Copyright Act, §102(b) (1976).

[41]E.g., Germany, Copyright Law, §47 (September 9, 1965, as amended).

[42]E.g., United States, Copyright Act, §110(01) (1976).

[43]E.g., Germany, Copyright Law, §53 (September 9, 1965, as amended).

[44]E.g., United Kingdom, Copyright Act, §6(2) (1956 as amended).

[45]E.g., France, Law No. 57–298, Article 41(3) (March 11, 1957, as amended).

[46]*The Role of Patents in the Transfer of Technology to Developing Countries*, p. 9 (UN Doc. Sales No. 65.II.B.1, 1964).

[47]*United States Reports*, vol. 395, p. 100 (Supreme Ct., 1917).

This private property justification for patents was also incorporated into the Paris Convention for the Protection of Industrial Property in 1878. The Paris Convention—now the principal international patent and trademark convention—includes the following statement:

> The right of inventors and of industrial creators in their own work, or the right of manufacturers and businessmen over their trademarks, is a property right. The law enacted by each nation does not create these rights, but only regulates them.

The private-property-right approach to patents has, however, some theoretical shortcomings. In particular, it does not take into account the restrictions that governments commonly impose on patents. Among these are a patent's fixed duration, its inapplicability to certain kinds of inventions, and its forfeiture or compulsory licensing when it is not worked. As a consequence, the second explanation for granting patents—to encourage inventors and public development—seems the better explanation.

This second public-interest justification for granting a patent monopoly appears in some of the earliest patent laws. For example, the Preamble to the Patent Law of 1474 of the Republic of Venice states that it was meant to serve as an incentive to inventors. It also is the underlying rationale of the English Patent Law of 1623, the first modern patent law.

In England, in the fourteenth and fifteenth centuries, a patent monopoly was a matter of sovereign prerogative, granted by the king. That power, however, was used almost exclusively as a way of raising revenue. As a consequence, many of the early English patents involved day-to-day necessities completely lacking in novelty or invention. To combat what was clearly an abuse of the royal prerogative, the English Parliament enacted the Statute of Monopolies in 1623. This made illegal all monopolies, grants, and patents that had given individuals the right to buy, sell, or use particular things within the country. Only one category was excepted: patents for inventions.

The English Statute of Monopolies also set down, for the first time, the principle that patents were to be made available on a uniform basis "to the true and first inventor" for the purpose of encouraging inventions and manufacturing. Later, a court decision construed the words *true and first inventor* to include the first person to introduce a new process or procedure from abroad, thereby extending patent protection to imported technologies, as well as to completely new inventions.

The idea that patents should be granted to reward inventors for advancing the public interest was incorporated in the U.S. Constitution of 1789. The Constitution gives the U.S. Congress the power "to promote the progress of science and useful arts by securing for a limited time to authors and inventors the exclusive right to their respective writings and discoveries."

In 1809, the emperor of Brazil promulgated the fourth modern patent law (following the British, U.S., and French statutes), which set out the following policy:

> It being highly convenient that inventors of any new machinery should have an exclusive privilege for a certain time, I hereby order that no matter who should be in such a position to submit the plans of his invention to the Royal Board of Trade which, verifying that such invention is really worthy, should be given the exclusive right for the period of fourteen years after which the invention should be published so that all the nation might have the right to share the benefits of such invention.

Today, both the private rights of inventors and the public's interest in promoting development continue to be the primary justifications given both in patent acts and by legal writers for the granting of inventors' privileges. In some respects, however, a patent is now viewed as a device for reconciling these two competing interests. For example, a 1964 United Nations study that compared the patent laws of the world concluded that a patent is "essentially a process in which account is taken of, and an attempt is made to reconcile and satisfy, the whole scheme of public and private interests pressing for recognition."[48] On the private side are the inventor's claims for recognition and economic advantage. On the public side, there is not only the interest of the government in promoting economic development but also the social benefit in encouraging invention, as well as the desire of consumers to purchase goods for fair value.

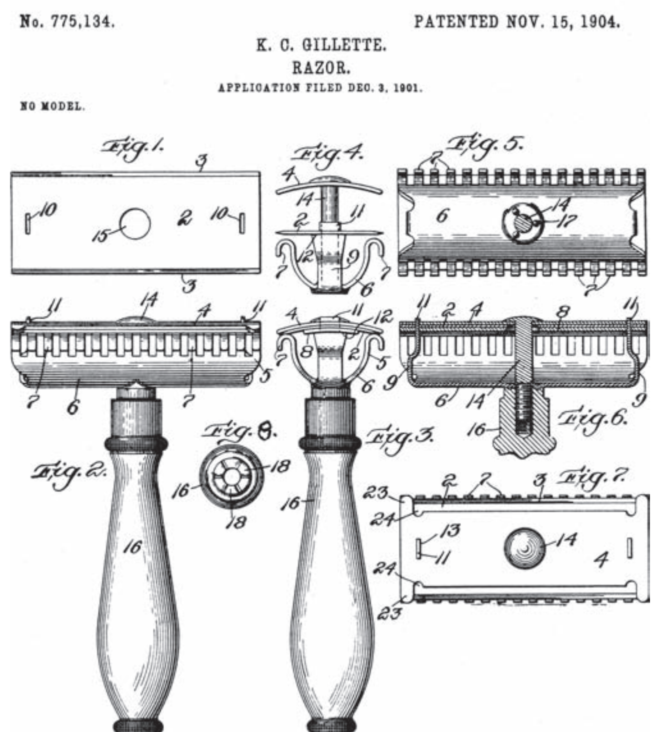
Patents and Other Inventor's Grants The primary method of protecting and rewarding inventors is the patent. As defined earlier, a patent is an exclusive privilege granted to an inventor, for a fixed

[48] *The Role of Patents in the Transfer of Technology to Developing Countries*, p. 10 (UN Doc. E/3861, 1964).

FIGURE 9.2

A U.S. Design Patent Drawing From 1904 for a Safety Razor.

Source: Pictorial Press Ltd/Alamy



term, to manufacture, use, and sell a product or to employ a method or a process. Most countries, accordingly, grant three basic kinds of patents:

- **Design patents** are granted to protect new and original designs of an article of manufacture (see Figure 9.2).
- **Plant patents** are granted for the creation or discovery of a new and distinct variety of a plant.
- **Utility patents** are granted for the invention of a new and useful process, machine, article of manufacture, or composition of matter.

design patent
Patent granted to protect new and original designs of an article of manufacture.

plant patent
Patent granted for the creation or discovery of a new and distinct variety of a plant.

utility patent
Patent granted for the invention of a new and useful process, machine, article of manufacture, or composition of matter.

There are also several variations on these basic patents, including *confirmation patents* (which are issued for inventions already patented in another country),[49] *patents of addition* (which cover improvements on already patented inventions), and *precautionary patents* (which are issued for short periods of time to an inventor who has not completely perfected an invention so that he or she will be notified when any other inventors apply for a patent on the same invention and so that he or she will have the opportunity to object to their applications).

In addition, a few countries provide protection for lesser inventions (i.e., technical improvements of a minor nature). Developed in Germany and Japan and adopted in a few other countries (most notably Spain), this form of protection is known as a **petty patent** or an inventor's right in a *utility model*.

petty patent
A statutory right given to the authors of minor inventions.

The German system of *Gebrauchmuster* (utility or working models) was established in 1891; the Japanese Utility Model Law was enacted in 1905. In Germany, a petty patent will be granted for a period of three years following a determination by the German Patent Office that the invention is novel (i.e., that no other inventor has obtained a patent or petty patent for the same invention). In Japan, a petty patent, which lasts for 15 years, will only be issued after the Patent Office determines both novelty and inventiveness (i.e., that the invention is not something that was obvious to the scientific community at the time of its invention).

Inventions That Qualify for Patent Protection Patents may be obtained for inventions in every field of technology, whether products or processes, as long as they are "new, involve an inventive step,

[49]Confirmation patents are most commonly recognized in Latin America, where they are seen as a device for promoting the introduction and domestic exploitation of foreign inventions. A similar device called a *patent of importation* is available in Belgium and Spain.

and are capable of industrial application."[50] An invention is (1) **new** if no other inventor has obtained a patent for the same invention; it (2) involves an **inventive step** if the "subject matter" of the invention was not "obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains"[51]; and it is (3) **capable of industrial application** if the product or process is one that can be used in industry or commerce.

Case 9-3 examines more fully what is meant by the term *inventive step*.

new
An invention is new if no other inventor has obtained a patent for the same invention.

inventive step
The subject matter of an invention was not obvious at the time of the invention's making to a person having ordinary skill in the art of the subject matter.

capable of industrial application
The product or process of an invention can be used in industry or commerce.

CASE 9-3 Monsanto Co. v. Coramandal Indag Products, (P) Ltd.

India, Supreme Court, 1986
Supreme Court Journal, vol. 1, p. 234 (1986)

MAP 9.3
India (1986)

Opinion of the Court—Judge C. Reddy

The long and grasping hand of a multinational company, the Monsanto Company of St. Louis, Missouri, United States of America, has reached out to prevent the alleged infringement of two of their patents (Numbers 104120 and 125381) by the defendant, an Indian Private Limited Company. Though the suit, as initially laid, was with reference to two patents, the suit was ultimately confined to one patent only (Number 125381), the period for which the other patent (104120) was valid having expired during the pendency of the suit. . . .

We may first refer to a few preliminary facts. Weeds, as is well known, are a menace to food crops, particularly crops like rice which belong to the grass variety. Research has been going on for years to discover a weed killer which has no toxic effect on rice, that is to say, an herbicide which will destroy the weeds but allow rice to survive without any deleterious effect. For long the research was futile. But in 1966–67 came a breakthrough. A scientist, Dr. John Olin, discovered CP 53619 with the formula 2-Chloro-2, 6-Diethyl-N-(Butoxy-Methyl)-Acetanilide, which satisfied

[50] Agreement on Trade-Related Aspects of Intellectual Property Rights, Article 27, para. 1 (1994). "For the purposes of this Article, the terms 'inventive step' and 'capable of industrial application' may be deemed by a member to be synonymous with the terms 'nonobvious' and 'useful' respectively." *Id*., n. 5.

[51] United States, Patent Act, §103 (1952).

the requirement of a weed killer which had no toxic effect on rice. The annual report of the International Rice Research Institute for 1968 stated: "Weed control in rice was an important part of the agronomy program. The first agronomic evidence of the efficacy of granular-trichloroethyl styrene for the selective control of annual grasses in transplanted rice was obtained at the Institute. *Another accession, CP 53619, gave excellent weed control in transplanted flooded and nonflooded, upland rice."* It was further stated: "CP 53619 at 2 and 4 kg/ha appeared at least twice among the 20 best treatments," and "the most outstanding new pre-emergence herbicide was 2-Chloro-2, 6-Diethyl-N-(Butoxy-Methyl)-Acetanilide (CP 53619)." The annual report of the International Rice Institute for 1969 shows that the herbicide CP 53619 came to acquire the name of Butachlor.

. . . The first plaintiff is the Monsanto Company and the second plaintiff is a subsidiary of the first plaintiff registered as a company in India. It was stated in the plaint that the first plaintiff was the patentee of inventions entitled "Phytotoxic Compositions" and "Grass Selective Herbicide Compositions," duly patented under patent numbers 104120 dated March 1, 1966, and 125381 dated February 20, 1970. The claims and the particulars relating to the inventions . . . stated . . . and this is very important, "the active ingredient mentioned in the claim is called 'Butachlor."' It suggested, without expressly saying it, that the plaintiffs' patents covered Butachlor also, which in fact it did not, as we shall presently see. It was next stated that the first plaintiff had permitted the second plaintiff to work the patents from 1971 onwards under an agreement dated September 3, 1980. . . . It came to the notice of the plaintiffs, it was averred, that the defendant was attempting to market a formulation of Butachlor covered by the said patents. They, therefore, wrote to the defendants drawing their attention to the existence of the patents in their favor. Some correspondence ensued. In the second week of May, 1981, the second plaintiff found that the defendant was marketing a formulation of Butachlor covered by the patents of the first plaintiff. Sample tins of "Butachlor 50" manufactured by the defendant were purchased by the plaintiffs. . . .

According to the plaintiffs, the legends on the tins containing substance manufactured by the defendant showed that what was sold by the defendant was nothing but a reproduction of the first plaintiff's patented formulation. The formulations of the defendant were sent to the Shri Ram Institute for analysis and they were said to contain the chemical "Butachlor, the chemical formula for which is 2 Chloro, 6-Diethyl-N-(Butoxymethyl) Acetanilide." On these averments the plaintiffs alleged that the defendant had infringed their patents, numbers 104120 and 125381, by selling formulations covered by them. The plaintiffs sued for an injunction. . . .

. . . [T]he defendant claimed, as he was entitled to do under Section 107 of the Patents Act 1970, that the patents were liable to be revoked. . . . The defendant also made a counterclaim seeking revocation of the patents.

A close scrutiny of the complaint and a reference to the evidence of the witnesses for the plaintiff at once exposes the hollowness of the suit. We must begin with the statement in the complaint that "the active ingredient mentioned in the claim is called 'Butachlor,"' which suggests that Butachlor was covered by the plaintiffs' patents and the circumstance now admitted that no one, neither the plaintiff nor anyone else, has a patent for Butachlor. The admission was expressly made by PW-2, the power of attorney holder of the first plaintiff and Director of the second plaintiff company. The learned counsel for the plaintiffs also admitted the same before us. PW-1, Dr. Dixon, a chemist of the first plaintiff company, after explaining the use of an emulsifying agent, in answer to a direct question, whether his company claimed any patent or special knowledge for the use of any particular solvent or particular emulsifying agent, in the formulation in their patent, had to admit that they had no such patent or special knowledge. He further admitted that the use of solvent and emulsifying agent on the active ingredient was one of the well-known methods used in the pesticide industry to prepare a marketable product. He also expressed his inability to say what dilutents or other emulsifying agents the defendant used in their process. PW-2 admitted that Butachlor was a common name and that the Weed Science Society of America had allotted the common name. He stated that "Machete" was the brand name under which their company manufactured Butachlor. He also stated that there could be a number of concerns all over the world manufacturing Butachlor, but he was not aware of them. He admitted that they did not claim a patent for Butachlor. He stated that though his company did not claim a patent for Butachlor, they claimed a patent for the process of making a Butachlor emulsifiable concentrate to be used as an herbicide composition for rice. Pursued further in cross-examination, he was forced to admit that they used kerosene as a solvent for Butachlor and an emulsifier manufactured by a local Indian company was an emulsifying agent. He then proceeded to state that he claimed secrecy with regard to the manufacture of their formulation. When he was asked further whether the secrecy claimed was with regard to the solvent or with regard to

the stabilizer, he answered in the negative. He finally admitted that his secret was confined to the active ingredient Butachlor about which, as we know, there is no secret. . . .

We, therefore, see that Butachlor (which was the common name for CP 53619) was discovered prior to 1968 as an herbicide possessing the property of nontoxic effect on rice. The formula for the herbicide was published in the report of the International Rice Research Institute for the year 1968 and its common name Butachlor was also mentioned in the report of the International Rice Research Institute for the year 1969. No one patented the invention Butachlor and it was the property of the population of the world. Before Butachlor, or for that matter any herbicide could be used for killing weeds, it had to be converted into an emulsion by dissolving it in a suitable solvent and by mixing the solution with an emulsifying agent. Emulsification is a well-known process and is no one's discovery. In the face of the now indisputable fact that there is no patent for or any secrecy attached to Butachlor, the solvent, or the emulsifying agent, and the further fact that the process of emulsification is no new discovery, the present suit based on the secrecy claimed in respect of the active ingredient Butachlor and the claim for the process of emulsification must necessarily fail. Under Section 61(1)(d) [of the Patents Act, 1970], a patent may be revoked on the ground that the subject of any claim of the complete specification is not an invention within the meaning of the Act. Under Section 64(e), a patent may be revoked if invention so far as claimed in any claim of the complete specifications is not new, having regard to what was publicly known or publicly used in India before the date of the claim, etc. Under Section 64(1)(f), a patent may be revoked if the invention so far as claimed in any claim of the complete specification is obvious or does not involve any inventive step having regard to what was publicly known or publicly used in India or was published in India before the priority date of the claim (the words "or elsewhere" are omitted by us as the patents in the present case were granted under the Indian Patents and Designs Act, 1911, i.e., before the Patents Act, 1970). "Inventions" has been defined by Section 2(j) as follows:

> Invention means any new and useful—(i) art, process, method, or manner of manufacture; (ii) machine, apparatus, or other article; (iii) substance produced by manufacture, and includes any new and useful improvement of any of them, and an alleged invention.

It is clear from the facts narrated by us that the herbicide CP 53619 (Butachlor) was publicly known before patent number 125381 was granted. Its formula and use had already been made known to the public by the report of the International Rice Institute for the year 1968. No one claimed any patent or any other exclusive right to Butachlor. To satisfy the requirement of being publicly known as used in clauses (e) and (f) of the Section 64(1), it is not necessary that it should be widely used to the knowledge of the consumer public. It is sufficient if it is known to the persons who are engaged in the pursuit of any knowledge of the patented product or process, either as men of science or men of commerce or consumers. The section of the public who, as men of science or men of commerce, were interested in knowing about herbicides which would destroy weeds but rice, must have been aware of the discovery of Butachlor. There was no secret about the active ingredient Butachlor, as claimed by the plaintiffs, since there was no patent for Butachlor, as admitted by the plaintiffs. Emulsification was a well-known and common process by which any herbicide could be used. Neither Butachlor nor the process of emulsification was capable of being claimed by the plaintiffs as their exclusive property. The solvent and the emulsifier were not secrets and they were admittedly ordinary market products. From the beginning to the end, there was no secret and there was no invention by the plaintiffs. The ingredients, the active ingredient, the solvent, and the emulsifier, were known; the process was known; the product was known; and the use was known. The plaintiffs were merely camouflaging a substance whose discovery was known throughout the world and trying to enfold it in their specification relating to patent number 125381. The patent is, therefore, liable to be revoked. . . . The appeal is dismissed with costs.

Casepoint

Monsanto Corporation and an Indian subsidiary brought this action in India for patent infringement against a local Indian company that manufactured and sold an herbicide product that killed weeds growing in rice fields. The court looked into the history of the product, and found that its active ingredient (Butachlor) and its composition were well known before the patent was granted, and that the emulsification necessary to apply the product was also a common practice in the industry. Thus, the court revoked the patent and found no infringement, since neither the product nor the process claimed by Monsanto were new, nor did they involve any inventive steps not already known.

TABLE 9.1

Procedures used in reviewing patent applications

Procedure	Countries Using Procedure
1. Examination of the application form only.	Egypt, Iran, Italy, Lebanon, Liberia, Morocco, Spain, Switzerland,[a] Tunisia, Turkey
2. Examination as to form, then publication followed by a period in which the public may object to the grant of a patent.	Colombia, Peru, Venezuela
3. Examination as to form and novelty. Only domestic patents are searched in ascertaining novelty.	Argentina
4. Examination as to form and novelty. Domestic and foreign patents are searched in ascertaining novelty.	India, Israel
5. Examination as to form and inventiveness. Domestic and foreign developments are searched in ascertaining inventiveness.	France
6. Examination as to form, novelty, and inventiveness. Only domestic patents and developments are searched in ascertaining novelty and inventiveness.	Mexico
7. Examination as to form, novelty, and inventiveness. Domestic and foreign patents and developments are searched in ascertaining novelty and inventiveness.	Brazil, Canada, Czechoslovakia, Germany, Japan, the Netherlands, Pakistan, Russia, Sweden, United Kingdom, United States

[a] Switzerland requires an examination as to form, novelty, and inventiveness for patents involving textiles and textile dyes.

Determining Qualifications Questions about the existence or nonexistence of newness, inventive steps, and industrial application may arise at various stages in the life of a patent. They may arise during the initial review of an application, during the appeal of a denial, during a revocation or cancellation hearing, or in suits for infringement where the person charged with infringement disputes the validity of the patent, as in the previous case.

With regard to the first of these questions—the review of an application by a patent office—procedures vary from country to country. They range from a simple review of the application form to an extensive search of domestic and foreign materials to determine if the product or process is both novel and inventive. The different procedures (for a select group of countries) are summarized in Table 9.1.

In completing an application form, an inventor is uniformly required to disclose sufficient information about the product or process "in such full, clear, concise, and exact terms as to enable any person skilled in the art to which it pertains, or with which it is most clearly connected, to make and use the same."[52] In addition, in the United States, the application must disclose the "best mode" known to the inventor for carrying out the invention.[53] Most other countries, however, allow an applicant to elect to disclose only one mode, and that does not necessarily have to be the best mode.

In Europe and Japan, and in most of the developing world, the information contained in a patent application has to be published before a patent will be granted. In the developing world, this publication requirement acts as a substitute for an examination of novelty and inventiveness by a patent office. In Colombia, for example, a patent will be issued 30 days after publication in the *Diario Official* (official journal) unless some private party raises an objection.[54] In the developed world, the publication date is the date on which the patent vests, although it will not be enforceable until it is formally granted by a patent office.

Publication during the application process is not required in the United States. Nevertheless, most litigation in the United States concerning the validity of a patent application arises during the application process. In part, this is because of the size and nature of the U.S. Patent Office. In most

[52]United States, Patent Act, §112 (1952).

[53]*Id.*

[54]Colombia, Patent Law (1925 as amended).

other countries (despite the requirements for disclosure during the application process), most challenges to the validity of a patent arise after a patent is granted.[55]

Inventions Excluded from Patent Protection Patents may be denied to inventions that do not meet the basic definition of patentability (i.e., being new, involving an inventive step, and being capable of industrial application). They may also be denied to inventions that violate basic social policies. The Agreement on Trade-Related Aspects of Intellectual Property Rights, for example, allows a WTO member state to deny a patent to an inventor in order "to protect ordre public (public order) or morality" so long as the state also forbids the commercial exploitation of the invention.[56] (That is, a state cannot deny an inventor a patent on this basis and still let the invention be exploited freely by others.) In particular, patents may be denied for this reason in order to protect the lives or health of humans, animals, or plants or to protect the environment from serious injury.

The TRIPS Agreement also allows WTO member states to deny patents for certain inventions without also prohibiting their commercial exploitation. (In other words, the invention may be freely exploited within the territory of the state.) These inventions may include (1) diagnostic, therapeutic, and surgical methods for the treatment of humans and animals; (2) plants and animals other than microorganisms (except that member states must provide patent protection or its equivalent for plant varieties); and (3) essentially biological processes for the production of plants or animals.[57]

Recent International Developments

PATENTING OF HUMAN GENETIC FEATURES

One controversial patent issue that has arisen due to developments in biotechnology is the patenting of genes or other human genetic features. Article 5 of the European Union Directive 98/44/EC (the "Biotech Directive") states that the human body, at the various stages of its formation and development, and the simple discovery of one of its elements, including the sequence or partial sequence of a gene, cannot constitute patentable inventions. However, an element isolated from the human body or otherwise produced by means of a technical process may constitute a patentable invention, even if the structure of that element is identical to that of a natural element. And Article 6 of the Biotech Directive makes inventions unpatentable where their commercial exploitation would be contrary to public order and morality. In particular it prohibits use of human embryos for industrial or commercial purposes.

In October 2011, the European Union Court of Justice issued its long-awaited opinion in the *Brüstle* case concerning the patentability of stem cell inventions. The case concerned the patentability of an invention that had been patented in Germany by the University of Bonn for converting human embryonic stem cells in the form of neural precursor cells into nerve cells for the treatment of a variety of conditions including Parkinson's disease. The granting of the patent was challenged by the organization Greenpeace and the case was referred to the Court of Justice of the European Union (CJEU). The CJEU held that an invention that uses human embryonic cells is not patentable if the destruction of a human embryo is required.

The Court gave a broad interpretation of the term "embryo" to include essentially anything that is capable of commencing the process of development of a human being. The court stated that:

> Any human ovum, as soon as it is fertilized, must be regarded as a "human embryo" if fertilisation is such as to commence the process of development of a human being: and including a non-fertilised human ovum into which the nucleus from a mature human cell has been transplanted and a non-fertilised human ovum whose division and further development have been stimulated by parthenogenesis must also be classified as a "human embryo."

In conclusion the Court held that an invention will be excluded from patentability where the implementation of the claimed process requires either the prior destruction of human embryos or their use as a base material. This decision is expected to have a major impact on the future of stem cell research in Europe.

---

[55]Alan Gutterman, "A Legal Due Diligence Framework for Inbound Transfers of Foreign Technology Rights," *The International Lawyer*, vol. 24, p. 982 (1990).

[56]Agreement on Trade-Related Aspects of Intellectual Property Rights, Article 27, para. 2 (1994).

[57]*Id*., para. 3.

Duration of Patents When the TRIPS Agreement came into effect on January 1, 1995, the minimum term of protection for patents was set at 20 years for WTO member states.[58] Previously, the terms that countries had established varied widely, ranging from 3 to 26 years (including extensions). The uniformity provided by the new 20-year standard provides encouragement to inventors, who can now exploit their inventions much more widely and for a longer period overall than they were able to do in the past.

Scope of Patents A patent is valid only within the territory of the state granting it; hence, states cannot prevent the use of patented technology outside their territory. States will, however, stop the importation of goods from countries that infringe a patent. On the other hand, many states will not stop someone inside their territory from using patented technology (without permission from the patent owner) to produce a product for export and sale abroad, although this is no longer allowed in the United States.[59]

true trademark
A mark or symbol used to identify goods of a particular manufacturer or merchant.

trade name
A mark or symbol used to identify a manufacturer or merchant.

service mark
A mark or symbol used to identify a person who provides services.

collective mark
A mark or symbol used by a group to identify itself to its members.

certification mark
A mark or symbol used by a licensee or franchisee to indicate that a particular product meets certain standards.

Trademarks

Merchants and others use five marks to identify themselves and their products. These are (1) trademarks (or sometimes *true trademarks* to distinguish them from other marks), (2) trade names, (3) service marks, (4) collective marks, and (5) certification marks. In practice, all five are commonly called *trademarks*.

A **true trademark** is "any word, name, symbol, or device or any combination thereof adopted and used by a manufacturer or merchant to identify his goods and distinguish them from those manufactured or sold by others."[60] It is different from a **trade name,** which is the name of the manufacturer rather than the manufacturer's products. *PepsiCo*, for example, is the well-known trade name of PepsiCo, Inc., a company that manufactures and sells products under trademarks such as *Pepsi-Cola*, *Fritos*, and *Gatorade*.

A **service mark** is a "mark used in the sale or advertising of services to identify the services of one person and distinguish them from the services of another."[61] Yum! Brands, Inc., for example, uses the service marks of *KFC*, *Pizza Hut*, and *Taco Bell* to identify its service establishments.

As the examples indicate, a mark can be used for more than one purpose. Thus, *KFC* is both a trademark and a service mark. Similarly, *Coca-Cola* is used both as a trade name and a trademark.

When trademarks or service marks are used by members of an association, collective, or cooperative organization to identify their products or services to members, they are called **collective marks.** Examples include the identifying names and insignias of the American Greek letter fraternities and sororities or the uniforms or cookies of Boy Scouts and Girl Scouts.

A **certification mark** is a mark used exclusively by a licensee or franchisee to indicate that a product meets certain standards. Examples include "*Champagne*," "*Roquefort*," and "*Grown in Idaho*," which indicate places of origin,[62] and the "*Underwriters' Seal of Approval*," which attests to certain standards of quality. Unlike true trademarks, trade names, and service marks, a licensor or franchisor may not use a certification mark.

Trademarks (using the term broadly) have several functions. From the perspective of an owner, a trademark is the right to put a product protected by the mark into circulation for the first time.[63]

---

[58] *Id.*, Article 33.

[59] For example, in *Deepsouth Packing Co. V. Laitram Corp.*, *United States Reports*, vol. 406, p. 518 at pp. 526–529 (1972), the U.S. Supreme Court held that the shipment overseas of materials that, when assembled in combination, violated a U.S. patent did not result in liability for contributory infringement. The U.S. Congress subsequently reversed this decision by statute. See Patent Law Amendments of 1984, codified as amended at *United States Code*, Title 35, §271(f) (1992). In the United States, accordingly, the manufacture of a product in the United States using a U.S.-patented process will infringe the patent, even if the product is intended for shipment abroad and requires final assembly overseas.

[60] Lanham Trademark Act (1946), in *United States Code*, Title 15, §1127.

[61] *Id.*

[62] The Agreement on Trade-Related Aspects of Intellectual Property Rights, Article 22 (1994), requires WTO member states to provide the legal means for interested parties to prevent the use of geographical indications of origin that mislead the public. Geographical indications of origin relating to wine are protected even if they are not misleading (for instance, even if the true geographical origin is accompanied by words such as *kind*, *type*, *imitation*, etc., it may not be used). *Id.*, Article 23. Also, the TRIPS Council (established by the agreement) is to undertake negotiations to establish a multilateral system for notifying and registering geographical indications of the origins of wines. *Id.*, para. 4.

[63] *Centrafarm v. Winthrop*, Case 16/74, *European Court Reports*, vol. 1974, p. 1183 (1974).

From the viewpoint of a consumer, a trademark serves to (1) designate the origin or source of a product or service, (2) indicate a particular standard of quality, (3) represent the goodwill of the manufacturer, and (4) protect the consumer from confusion.[64]

Reading 9-1 examines a dispute in recent years concerning the use of trademarks in international trade.

Reading 9-1 Starbucks and Ethiopia Dispute Coffee Trademark Issues

MAP 9.4

Ethiopia (2010)

Starbucks, the giant coffee chain, has been involved in a dispute with Ethiopia, one of the world's poorest countries, over the right to use certain place names on coffee. Ethiopia is considered—by Starbucks and others—as the birthplace of coffee. Among the country's limited tradable goods, coffee alone generates about 60 percent of Ethiopia's total export earnings. Indeed, coffee is closely tied to the culture and society of Ethiopia and an estimated 15 million people are directly or indirectly involved in the Ethiopian coffee industry. The African nation enjoys a strong reputation for its heritage coffees, which command a very high retail price in the international market. However, only 5 to 10 percent of the retail price actually goes back to Ethiopia; most of the profit is shared by distributors and middlemen in the marketing sector. In wealthy countries, a cup of cappuccino may be sold at U.S. $4.00–5.00, but many coffee growers in Ethiopia and other developing countries earn less than a dollar a day. There are instances where farmers abandoned coffee production due to low returns and engaged in growing more profitable narcotic plants.

Seeking to narrow down this gap between the retail price and the return to the producers, the Ethiopian government has been trying to use a range of intellectual property rights (IPRs) to differentiate their coffee in the market place and achieve higher returns. In 2004, the government launched the Ethiopian Coffee Trademarking and Licensing Initiative (the Initiative) to provide a practical solution to overcome the long-standing divide between what coffee farmers receive for a sack of their beans and what retailers charge for that coffee when they sell it in retail outlets in developed countries. The Initiative is organized and run by the Ethiopian Fine Coffee Stakeholder Committee (the Stakeholder Committee)—a consortium comprising cooperatives, private exporters, and the Ethiopian Intellectual Property Office (EIPO) as well as other concerned government bodies.

In March 2005 the Ethiopian government filed an application with the U.S. Patent and Trademark Office (USPTO) seeking to trademark the names of its most famous coffee regions—Sidamo, Harar, and Yirgacheffe—which names also appear on the packaging of Starbucks and some other coffee roasters. The goal of the trademark effort, said Ethiopian leaders, was to gain more control over the distribution and promotion of its coffee, and eventually to secure better prices for its farmers. The goal was to force those who use those particular Ethiopian coffees to sign licensing agreements, thus producing more income for Ethiopian farmers. The growers in Fero, in the Sidamo region, receive between 75 cents and $1 per pound for their coffee. Starbucks has sold the processed product for as much as $26 per pound.

[64]J. Gilson, *Trademark Protection and Practice*, §1.03 (1975). See, as well, *Hanover Star Milling Co. v. Metcalf* in *United States Reports*, vol. 240, at p. 412 (Supreme Ct., 1916).

However, the efforts to obtain trademark registration were held up by a protest from the National Coffee Association in the United States, which many people attributed to pressure from Starbucks. The international NGO Oxfam urged customers to send postcards to Starbucks complaining about its stance, and posted a video on YouTube regarding the trademark dispute and the low prices paid to Ethiopian farmers.

At least 70,000 customers contacted Starbucks to complain, prompting the firm to post leaflets in its stores defending its behavior and to create and post its own video on YouTube. Starbucks accused Oxfam of "misleading the public" and stated that the campaign "needs to stop." Starbucks was clearly stung by the criticism, having prided itself on its social responsibility efforts and pointing out that it had spent $2.4 million on social projects in Ethiopia. In past years, Starbucks has made a commitment to buy 6% of its coffee from "fair trade" certified co-ops, which guarantee farmers a minimum price. It has also bought 53% of its coffee from sellers who adhered to guidelines the company established to promote economic sustainability for farmers.

In this particular case, Starbucks' employees had gone to the Fero region and worked with farmers on a new method of drying the beans. After the first season flopped (and Starbucks bought all the coffee) the second year produced wonderful coffee which became very popular quickly. After receiving the protests from Ethiopia, Starbucks withdrew its trademark application for Shirkina Sun-Dried Sidamo. Ethiopia did successfully register some of its regional names in Canada, Japan, and the European Union, and secured a trademark on Yirgacheffe in the United States. However, the U.S. National Coffee Association later asked the U.S. trademark office to deny Ethiopia trademarks for Sidamo and Harar, arguing they were generic names. Trademark applications were also made by Ethiopia in Brazil, China, India, and South Africa.

Starbucks pointed out that it opposed the Ethiopian trademark idea because it believed that a "geographical certification" was a better plan, arguing that this was the preferred method around the world for guaranteeing to customers that a product comes from a certain region but allows companies to use the term in their branding. Products such as Idaho potatoes, Roquefort cheese, and Jamaican Blue Mountain and Hawaiian Kona coffee use geographic certifications. "I can't name one case where there are trademarks for coffee," said Dub Hay, senior vice-president for coffee and global procurement at Starbucks. Mr. Hay traveled to the Fero region of Ethiopia to meet with the farmers, but no agreement was reached. The Fero farmers said the best gift would be higher prices, stating that they only received 75 cents per pound of dried beans.

In June 2007, Starbucks and the Ethiopian intellectual property office announced that they had reached an agreement to work together to promote the three types of African coffee that were the subject of the dispute. The two entities announced that they had reached a licensing, marketing, and distribution agreement that acknowledges Ethiopia's ownership of the names Yirgacheffe, Hirar, and Sidamo, regardless of whether they are trademarked. Both sides hailed the resolution of the trademark dispute. "This agreement is broader than those proposed in the past," said Sandra Taylor, Starbucks' senior vice-president. "We are very excited about the opportunity to work cooperatively with Ethiopia in support of its coffee farmers." Getachew Mengistie, director of Ethiopia's intellectual property office, said, "This agreement marks an important milestone in our efforts to promote and protect Ethiopia's specialty coffee designations. . . . Having the commitment and support of Starbucks will enhance the quality of Ethiopian fine coffees and improve the income of farmers and traders."

Even the Oxfam praised the resolution of the dispute. "Congratulations to our Ethiopian coffee farming partners and to Starbucks on an agreement that recognizes Ethiopians' right to control the use of their specialty coffee brands. This agreement represents a business approach in step with 21st century standards in its concern for rights rather than charity and for greater equity in supply chains rather than short-term profits," said the president of Oxfam America.

Starbucks and Ethiopia Update

According to an article written by Wondwossen Mezlekia published in May 2010, since Starbucks and Ethiopia's June 2007 agreement there has been little benefit to local coffee farmers. Starbucks did purchase 26,000 black aprons from Almeda Textile Factory in Tigray, Ethiopia. However, the promised Farmer Support Center in Addis Ababa has not materialized as yet. While Starbucks is honoring its promise to intensify its support of Ethiopia's specialty coffee industry, the company is focusing more on working with the Ethiopian government and the farmers have not been helped.

Since 2007, support from Starbucks includes sponsoring Ethiopia Conference Dinners in Washington D.C., co-sponsoring Ethiopia at the 2008 Specialty Coffee Association of America Conference, hosting a delegation of Ethiopian farmers to travel to corporate buying offices in Switzerland for coffee quality training, and participation in the Ethiopia Coffee Exchange Specialty Coffee conference in Addis Ababa in 2009. However, Mr. Mezlekia argued that farmers would benefit more by additional sale and promotion of specialty Ethiopian blends in Starbucks stores. Starbucks has said that "Ethiopia is an important source of high quality East African coffee" and was featuring a portfolio of Ethiopian blends and single origin coffees such as "Ethiopian Yirgacheffe" and "Ethiopia Sidamo." But a "cursory survey" done for the Ethiopian article found that no single-origin Ethiopian coffee was found in the stores visited. When contacted, Starbucks acknowledged that "we and other coffee companies have experienced a temporary shortage of Ethiopian coffees due to supply issues."

Since the Ethiopia Commodity Exchange (ECX) has taken over the management of the coffee industry, the relationship between corporations and farmers has been significantly affected. In 2008 the government abolished the vertically integrated marketing system and routed the trade through the ECX. It seems that the ECX warehouse receipt system that was designed for trading grain does not work as well for the specialty coffee trade, which relies heavily on direct trade and long-term supplier–buyer relationships in order to maintain the quality and traceability of coffees. The result was that the specialty coffee trade in Ethiopia suffered greatly. The ECX claims that when it found out that Starbucks was claiming supply issues it put the company in contact with two local farmers who had taken the Coffee and Farmer Equity (CAFE) classes that Starbucks required, but Starbucks never purchased any beans from them.

The CAFE (Coffee and Farmer Equity) program is Starbucks' internal ethical sourcing program that uses a set of environmental and social guidelines in combination with long-term supplier–buyer relationship and financial incentives to score and award suppliers. Qualifying suppliers receive higher prices and earn Starbucks' preferential buying status. Another problem is that the Ethiopian government is in competition with the strong domestic consumption that continues to grow. Because it depends on the crop for most of its foreign exchange earnings, the government prohibits growers from selling export-grade coffees in domestic markets even though the domestic price may be higher. Unlike Brazil, Costa Rica, Columbia, and other nations, the government of Ethiopia does not compensate coffee growers and traders for the income they forego by exporting. Those who delay the export in hopes of higher prices sometimes go out of business.

There was hope that the trademark initiative, which sparked the dispute with Starbucks, would help farmers by increasing their share of the value of their intangible assets through brand promotion and improved distribution channels. Indeed, some of the coffee names are now registered in major markets, many businesses have signed licensing agreements, and there are logos developed for some names. But the Ethiopian Intellectual Property Office does not appear to be actively promoting the brands, the initiative's website has not been updated, and many small roasters and buyers feel that no one is working for them.

The agreement between Starbucks and the Ethiopian government is due to expire late in 2012 and the Ethiopian coffee farmers are still waiting for the full promised benefits to materialize. Some farmers featured in coffee advertisements have even pulled up their coffee crops and replaced them with crops such as Chat, which is more commonly known as an amphetamine that induces a high in its users and is illegal in some developed countries.

Sources: "The Coffee War: Ethiopia and the Starbucks Story," *World Intellectual Property Organization*, Nov. 2, 2010, accessed at www.wipo.int; Mezlekia, Wondowossen, "The saga of the Starbucks-Ethiopia affair," *Abugida Ethiopian American Information Center*, June 2, 2010, accessed at www.abugidainfo.com; "Storm in a Coffee Cup," *The Economist*, Nov. 30, 2006; "Starbucks and Ethiopia Make Bad Blend," ABC News.com, Oct. 26, 2006; J. Adamy and R. Thurow, "Ethiopia Battles Starbucks Over Rights to Coffee Names," *Wall Street Journal*, March 5, 2007; "Starbucks in Ethiopia Coffee Row," BBC News.co.uk, Oct. 26, 2006; "Starbucks vs. Ethiopia," *Fortune*, Feb. 26, 2007, accessed at CNN.Money.com; "Starbucks Recognizes Ethiopia's Ownership of Premium Coffee Strains," *International Herald Tribune*, June 21, 2007.

Acquiring Trademarks Trademarks are acquired in two ways: (1) by use and (2) by registration. In a few countries, registration is not available. In two countries—Canada and the Philippines—a trademark can be registered only if it has already been put into use. In the rest of the world, a mark can be registered even if it has never been used in commerce.[65]

The fact that a trademark cannot be registered does not mean that its owner is without rights. In *McDonald's Corp. v. Hassan Arzouni*, the Civil Court of Sharjah, one of the United Arab Emirates, held that McDonald's could enjoin a local entrepreneur from using its name and golden arches logo on a restaurant, even though Sharjah has no trademark registration law. The court said:

> The fact that such trademark has not been registered in the U.A.E. is irrelevant, because of the fame of this trademark worldwide and the possibility of the simultaneous presence of the two products in the U.A.E. market, considering the ease of transportation, the wide range of commerce, and the fact that the U.A.E. imports most of its consumer products, including foodstuffs.[66]

As the *Hassan Arzouni* case points out, "famous" trademarks (i.e., ones well known throughout the world) may not have to be registered to be protected. In another case involving McDonald's, *Colourprint Ltd. v. McDonald's Corp*., the American fast-food retailer opposed an application in Kenya by a local company to register the McDonald's name and double arches logo as a trademark. McDonald's had not registered its trademark and did not have it in any restaurants in Kenya. Nevertheless, the Kenyan deputy registrar of trademarks would not allow the local company to register the mark as its own. The deputy stated:

> I have no doubt in my mind that local reputation of the mark is very important, but I am also of the view that reputation outside Kenya cannot be ignored altogether. It is also important to consider whether any section of the Kenyan public were aware of the existence of the opponents' mark at the time when the applicants' mark was filed for registration. This is relevant because the likelihood of confusion or deception must be considered at the time of the application.
>
> A section of the Kenya public has not only seen the opponent's mark in the magazines referred to, but I accept that they have traveled to some countries outside Africa where the opponents' mark is well known. The opponents run the business of hotels [*sic*] and no doubt some Kenyans are familiar with the products of the opponent.[67]

[65]Prior to 1988, the United States also stated that a trademark could not be registered until it had been put in use. Now a trademark will be granted based on the applicant's intent to use the mark. The mark must then be used within six months (although extensions can be obtained so that the period can be three years) or the registration will be revoked. The Trademark Law Revision Act, Public Law 100–667, §134 (1988).

[66]*Case No. 823/85, decided January 13, 1986 (unpublished); quoted in Trademark Reporter,* vol. 76, p. 354 (1986).

[67]Decision by Deputy Registrar of Trademarks in Kenya, TM No. B23964, May 21, 1980, at p. 9 (unreported); quoted in Thomas Hoffmann and Susan Brownstone, "Protection of Trademark Rights Acquired by International Reputation without Use of Registration," *Trademark Reporter*, vol. 71, pp. 21–22 (1981).

The same result has been reached in Australia, Canada, Colombia, India, New Zealand, the United Kingdom, and the United States. In other countries (e.g., Panama and Taiwan), a foreign owner of a famous unregistered trademark can oppose registration but cannot sue a local company for infringement. In still other countries (e.g., most of those in South America), only a locally registered owner can protest either registration or infringing use.[68]

Of course, in any of the countries that allow an unregistered foreign trademark holder to challenge either a competing registration or an infringing use, the trademark in question must be well known. For example, in *Wienerwald Holding, A.G. v. Kawn, Wong, Tan, and Fong*, the High Court of Hong Kong concluded that the name "Wienerwald Restaurant," which was the service mark of a Swiss restaurant company, was so little known in Hong Kong that the Swiss owner could not object to a competing registration in Hong Kong by a local firm of chartered accountants.[69]

In addition to the objections that can be raised by famous trademark holders, most countries allow a local user of a mark to object to its registration by another individual—even if the mark is not famous—so long as the opponent's local use began before that of the applicant. However, a few states will register a trademark to the first person to apply for it, regardless. Thus, prior users are denied the right to challenge the application or to later seek cancellation of the registration.[70]

Registration One registers a trademark to publicly notify other potential users of one's claim to a mark. The registration process commonly begins with an examination done by an official in the Trademark Office to determine a mark's suitability for registration. In most countries, this consists simply of an examination of the application form for compliance with statutory definitions and an examination of the office's own records to ensure that the mark has not been previously registered. In wealthier countries with the resources to maintain a large library and a large staff, the examination can include the examination of records from other countries, records of the states of a federal or economic union, or private materials, such as newspapers, magazines, or trademark association reports.

Registration Criteria The common statutory definitional criterion that appears in all trademark laws is **distinctiveness.** This means that a mark must possess a unique design that functions to distinguish the product on which it is used from other similar products. In sum, to be registered, a trademark must (1) not infringe on another mark and (2) be distinctive.

distinctiveness Possessing a unique design that distinguishes a product from other similar products.

In Case 9-4, an international arbitration panel had to determine whether an Internet domain name—which is treated very much like a trademark—was confusingly similar to a registered mark.

CASE 9-4 Experience Hendrix, L.L.C. v. Hammerton

World Intellectual Property Organization Arbitration and Mediation Center, Administrative Panel Decision, Case No. D2000–0364, August 2, 2000

Panelist Marylee Jenkins

The Parties

Experience Hendrix, L.L.C. ("Complainant"), is a Washington limited liability company with a principal place of business at 14501 Interurban Avenue South, Tukwila, Washington, 98168, U.S.A. The company was formed in 1995 by the family of the late Jimi Hendrix, an internationally known guitarist and musician. Experience Hendrix, L.L.C., is the owner and administrator of substantially all rights relating to Jimi Hendrix, including rights in his music, name, image, and recordings.

[68]*Id*., pp. 1–37.

[69]*Fleet Street Patent Law Reports*, vol. 1979, p. 381 (January 20, 1979).

[70]American Bar Association, Section of Patent, Trademark and Copyright Law, *1990 Committee Reports*, p. 96 (1990).

MAP 9.5

Washington and Florida (2000)

The Respondent, Denny Hammerton ("Mr. Hammerton"), an individual, is listed as the administrative contact for the registration of the domain name in issue and lists a mailing address of P.O. Box 1103, Minneola, Florida, 34744, U.S.A. The Respondent, The Jimi Hendrix Fan Club ("Fan Club"), added by amendment to the Complaint, is the registrant of the domain name registration and has the same mailing address as Mr. Hammerton.

***

Factual Background

The Complainant is the owner of all rights in the name "JIMI HENDRIX," including all common law rights therein, and is the owner of several trademarks and service marks registered or pending with the U.S. Patent and Trademark Office. . . .

***

The Complainant is also the registrant of the domain names "jimi-hendrix.com," "jimi-hendrix.org," and "jimihendrix.org" and is the owner and operator of the "Experience Hendrix Interactive—The Official Jimi Hendrix Web site" located at "www.jimi-hendrix.com."

A search result from a query of the Registrar's Who is database shows that the domain name in issue was registered on April 5, 1996, to "The Jimi Hendrix Fan Club" with Mr. Hammerton listed as the administrative contact.

Some time between the domain name registration and April 30, 1997, the Respondent created a Web site at "www.jimihendrix.com" that offered for sale vanity e-mail addresses incorporating the "jimihendrix.com" domain name ("Site").

The Complainant's representatives communicated with the Registrar and asked the Registrar to initiate the Registrar's Domain Name Dispute Policy then in effect with respect to the domain name "jimihendrix.com." On April 30, 1997, the domain name was placed on "Hold" status by the Registrar.

In a letter dated March 21, 2000, the Registrar notified the Complainant's representatives that on May 2, 2000, the Registrar would terminate the dispute, remove the domain name registration from "Hold" status and reactivate the domain name unless the Registrar . . . received a complaint filed pursuant to the Policy and this proceeding was filed in response to the Registrar's March 21st letter.

Parties' Contentions

Complainant The Complainant contends that the domain name "jimihendrix.com" is identical or confusingly similar to the name and marks owned by the Complainant.

The Complainant contends that the Respondent has no rights or legitimate interests in the domain name based upon:

- **i.** the Respondent choosing the domain name in issue not arbitrarily but intending to misappropriate and use the goodwill in the Complainant's marks for his own commercial benefit by advertising vanity e-mail addresses for sale on a Web page located at "http://www.jimihendrix.com."
- **ii.** the Complainant having not at any time, assigned, granted, licensed, sold, or otherwise transferred any of its rights in the name and mark JIMI HENDRIX to the Respondent.
- **iii.** the Respondent's use of the domain name being purely commercial in nature with the effect of diluting and harming the Complainant's legitimate rights in the name and mark.
- **iv.** the Respondent, Mr. Hammerton, being a domain name speculator and registering and selling domain names for no legitimate purpose other than to profit from the name relying on a front page article in the *San Francisco Chronicle* quoting Mr. Hammerton as saying "[s]ome people like it, some people don't—that's tough. . . . It's real estate is what it is. If I buy land that somebody wants, then lucky me." The Complainant further quotes the article as stating that Mr. Hammerton claimed to own rights to "some 2,000 Web site names, including http://www.jimihendrix.com, www.jethrotull.com, and http://www.fleetwoodmac.com."

The Complainant contends that the Respondent has registered and used the domain name in bad faith based upon:

(i) the Respondent knowing at all times prior to, during, and following registration of the domain name that he did not own or have any legal rights to the name or mark JIMI HENDRIX.

***

(iii) a recent search of a domain name reseller site showing Mr. Hammerton advertising to sell the "jimihendrix.com" domain name for $1 million as "the most unique domain/jimi was a 'hit' maker."

***

(v–vi) Mr. Hammerton being a domain name speculator that registers and sells domain names for no legitimate purpose other than to profit from the name. [In the past he has advertised for sale many celebrity domain names, including] "elvispresley.net" for $39,000, "jethrotull.com" for $8,000, "lindamccartney.com" for $15,000–$25,000, "mickjagger.com" for $25,000, "paulmccartney.com" for $25,000–$51,000, "ringo.com" for $15,000–$21,000, "rodstewart.com" for $15,000–$21,000, and "twiggy.com" for $10,000 on different domain name reseller sites.

***

(viii) the Respondent, by using the domain name, having intentionally attempted to attract, for commercial gain, Internet users to his Web site by creating a likelihood of confusion with the Complainant's mark as to source, sponsorship, affiliation, and endorsement of his Web site or the services he offers on the site.

***

(ix) the Respondent, although having registered the domain name "jimihendrix.com" in the name of a fan club, not being a true "fan club" existing at the address "www.jimihendrix.com" or providing any traditional fan club services, but being nothing more than a sales promotion site—selling vanity e-mail addresses.

Based upon the above, the Complainant requests that the Panelist transfer the domain name "jimihendrix.com" to it.

Respondent The Respondent, Mr. Hammerton, contends that he registered the domain "jimihendrix.com" on April 5, 1996. Before registering the domain name, he contends that he conducted a search of the USPTO database for any trademarks on "Jimi Hendrix" and found none.

The Respondent contends that from April of 1996, he ran a Web site for "The Jimi Hendrix Internet Fan Club" on the Internet until a complaint by the Complainant was sent to the Registrar in 1997 resulting in the domain name "jimihendrix.com" being placed on Hold. . . .

The Respondent contends that a word with a .com on the end is not identical to a word without a .com on the end and inferentially asserts that the domain name is not identical or confusingly similar to the Complainant's mark.

The Respondent contends that he has never offered "jimihendrix.com" as a domain name for sale [and] . . . that he has never used the domain name "jimihendrix.com" in bad faith.

The Respondent contends that "it becomes a violation of human rights and free speech that an arbitrary board such as WIPO which contradicts itself [in] case after case should have any rights over any domain which is owned by the original paying domain name owner."

The Respondent contends that "once WIPO takes [*sic*] that domain name away from the original owner it constitutes theft under the American Constitution in that the Jurisdiction under Human Rights should not allow."

Discussion and Findings

* * *

The Proceeding—Three Elements Paragraph 4(a) of the Policy [of the domain name registrar, Network Solutions, Inc., governing dispute settlements, which the respondent agreed to be bound by,] states that the domain name holder is to submit to a mandatory administrative proceeding in the event that a third party complainant asserts to an ICANN approved dispute provider that:

- **i.** the domain name holder's domain name is identical or confusingly similar to a trademark or service mark in which the complainant has rights ("Element (i)"); and
- **ii.** the domain name holder has no rights or legitimate interests in respect of the domain name ("Element (ii)"); and
- **iii.** the domain name of the domain name holder has been registered and is being used in bad faith ("Element (iii)").

Element (i)—Domain Name Identical or Confusingly Similar to Mark The Complainant is the owner of both the common law trademark rights in the name JIMI HENDRIX as well as the registered trademarks identified above. Although the Respondent contends that a word with a ".com" on the end is not identical to a word without a ".com" on the end, the COM suffix is not relevant in determining whether a domain name is identical or confusingly similar to a mark. Rather, one looks to the second-level domain "jimihendrix" of the domain name for such a determination since the suffix COM is merely descriptive of the registry services and is not an identifier of a source of goods or services. Accordingly, the Panelist concludes that the domain name is identical to the mark JIMI HENDRIX and that Element (i) has been satisfied.

Element (ii)—Rights or Legitimate Interests in the Domain Name Paragraph 4(c) of the Policy sets out circumstances, in particular but without limitation, which, if found by the Panelist to be proved based on its evaluation of all evidence presented, can demonstrate the holder's rights to or legitimate interests in the domain name. These circumstances include:

- **i.** before any notice to the holder of the dispute, the holder's use of, or demonstrable preparations to use, the domain name or a name corresponding to the domain name in connection with a bona fide offering of goods or services; or
- **ii.** the holder (as an individual, business, or other organization) has been commonly known by the domain name, even if the holder has acquired no trademark or service mark rights; or

iii. the domain name holder is making a legitimate noncommercial or fair use of the domain name, without intent for commercial gain to misleadingly divert consumers or to tarnish the trademark or service mark at issue.

The Respondent contends that he registered the domain name prior to the Complainant's registration of the Complainant's marks and was unaware of the Complainant's trademark registrations at the time of registration. However, based upon the evidence presented, the registration and use of the domain name by the Respondent do not predate the Complainant's use and rights in the name and mark but rather appears to be an attempt to usurp the Complainant's rights therein. Indeed, the registration of the domain name by "The Jimi Hendrix Fan Club" is a clear indication of the Respondent's awareness of the wide recognition and fame associated with the name JIMI HENDRIX. The Respondent's alleged lack of knowledge concerning the trademark registrations involved in this proceeding is insufficient.

The Respondent further contends that the domain name was registered to "The Jimi Hendrix Fan Club" and that he was operating a Web site for the Fan Club. A review of the submitted evidence, however, shows that the Respondent was not operating as a fan club site but rather had created a site at "www.jimihendrix.com" advertising vanity e-mail addresses incorporating the domain name "jimihendrix.com" for sale on the Site. No evidence was presented that at any time had the Complainant ever assigned, granted, licensed, sold, transferred, or in any way authorized the Respondent to register or use the name and mark JIMI HENDRIX in any manner. Accordingly, the Panelist finds that the Respondent, prior to any notice of this dispute, had not used the domain name in connection with any type of bona fide offering of goods or services.

Additionally, no evidence has been presented that the Respondent is commonly known by the domain name or has been making any legitimate noncommercial or fair use of the domain name without the intent for commercial gain to misleadingly divert consumers or to tarnish the mark at issue. Indeed, the Respondent's use of the domain name cannot be characterized as non-commercial or fair use based on: (i) the creation and use of the Site located at "www.jimihendrix.com" for selling vanity e-mail addresses incorporating the "jimihendrix.com" domain name; (ii) the offering for sale of the domain name itself for $1,000,000 on a domain name reseller site; and (iii) a news article identifying Mr. Hammerton as a domain name speculator and quoting him as the owner of the rights to some 2,000 domain names for sale including "jimihendrix.com."

The Respondent also contends that this proceeding is a "violation of human rights," "free speech," and "theft under the American Constitution." The Panelist finds that these contentions lack foundation and that no evidence has been submitted by the Respondent to support these contentions.

Based upon the above, the Panelist concludes that the Respondent has no rights or legitimate interests in the domain name and that Element (ii) has been satisfied.

Element (iii)—Domain Name Registered and Used in Bad Faith Paragraph 4(b) of the Policy states that evidence of registration and use in bad faith by the holder includes, but is not limited to:

i. circumstances indicating that the holder has registered or has acquired the domain name primarily for the purpose of selling, renting, or otherwise transferring the domain name registration to the complainant who is the owner of the trademark or service mark or to a competitor of that complainant, for valuable consideration in excess of the holder's documented out-of-pocket costs directly related to the domain name; or

ii. the holder has registered the domain name in order to prevent the owner of the trademark or service mark from reflecting the mark in a corresponding domain name, provided that the holder has engaged in a pattern of such conduct; or

iii. the holder has registered the domain name primarily for the purpose of disrupting the business of a competitor; or

iv. by using the domain name, the holder has intentionally attempted to attract, for commercial gain, Internet users to the holder's Web site or other online location, by creating a likelihood of confusion with the complainant's mark as to the source, sponsorship, affiliation, or endorsement of your Web site or location or of a product or service on the holder's Web site or location.

Based upon the Respondent's contention that he registered the domain name prior to the Complainant's registrations of the above-identified marks, the Panelist finds that the Respondent had actual knowledge at the time he registered the domain name of the use

and rights of the Complainant in the name JIMI HENDRIX. Indeed, the record demonstrates that at the time of registering the domain name "jimihendrix.com" the Respondent was well aware of the name JIMI HENDRIX and the Respondent has not submitted evidence or argued to the contrary.

. . . The Respondent has contended that he never offered the domain name "jimihendrix .com" for sale and has never used the domain name in bad faith. The Complainant did submit copies of Web pages from a domain name reseller site located at "www.domainsmart .com" where the domain name "jimihendrix.com" is being offered for sale for $1,000,000. The Respondent has provided no evidence in rebuttal.

To further support its contention of bad faith by the Respondent, the Complainant submitted evidence of other domain names incorporating the names of well-known celebrities that the Respondent registered and which are being advertised for sale on different domain name reseller sites. Additionally, the Complainant submitted news articles that identified Mr. Hammerton as a domain name speculator who had registered and sold several domain names incorporating names of other celebrities.

Based upon these facts, the Panelist finds that the Respondent registered the domain name "jimihendrix.com" in order to prevent the Complainant from reflecting the name and mark in a corresponding domain name and that the Respondent has engaged in "a pattern of such conduct" of registering and offering for sale domain names incorporating well-known names in which the Respondent has no rights or legitimate interests.

The Panelist therefore concludes that the Respondent has registered and used the domain name "jimihendrix.com" in bad faith and that Element (iii) has been satisfied.

Decision

The Panelist concludes: (i) that the domain name in issue is identical to the Complainant's mark; (ii) that the Respondent has no rights or legitimate interests in the domain name; and (iii) that the Respondent registered and used the domain name in bad faith. Accordingly, the Panelist requires that the registration of the domain name "jimihendrix.com" be transferred to the Complainant.

Casepoint

The WIPO panelist heard considerable evidence about the company Experience Hendrix, LLC, which holds most of the legal rights to the Jimi Hendrix name and likeness and operates several Hendrix Web sites, and about Denny Hammerton, a man from Florida who created and registered the domain name "jimihenrix.com." The panelist decided that Mr. Hammerton had registered the domain name merely in order to make a profit, as he had done with several other domain names based on famous persons. The panelist found that Hammerton's domain name would be likely to confuse the public as to the identity of the real Jimi Hendrix Fan Club; that he had no legitimate rights to the name; and since he knew that Experience Hendrix, LLC, claimed all rights to the name "Jimi Hendrix," his actions were in bad faith. Thus, his domain name—jimihendrix.com—was transferred to Experience Hendrix, LLC.

Refusing Registration The statutory grounds for refusing a trademark vary from country to country. Nevertheless, most criteria are reasonably similar. For example, a mark or name will be denied in the United States if it

1. does not function as a trademark to identify the goods or services as coming from a particular source (for example, the matter applied for is merely ornamentation);
2. is immoral, deceptive, or scandalous;
3. may disparage or falsely suggest a connection with persons, institutions, beliefs, or national symbols, or bring them into contempt or disrepute;
4. consists of or simulates the flag or coat of arms or other insignia of the United States, or a state or municipality, or any foreign nation;

5. is the name, portrait, or signature of a particular living individual, unless he has given written consent; or is the name, signature, or portrait of a deceased President of the United States during the lifetime of his widow, unless she has given her consent;
6. so resembles a mark already registered in the Patent and Trademark Office as to be likely, when applied to the goods of the applicant, to cause confusion, or to cause mistake, or to deceive;
7. is merely deceptive or deceptively misdescriptive of the goods or services;
8. is primarily geographically descriptive or deceptively misdescriptive of the goods or services of the applicant; or
9. is primarily merely a surname.[71]

Registration Review Once a Trademark Office official determines that a mark is suitable for registration, the mark will be published in the office's official gazette. Opponents to the registration then have a period of time—typically 30 to 90 days—in which to oppose the registration or to ask for an extension to do so. An *opposition* hearing is then held before a review board of the Trademark Office. If no opposition is filed or if the review board rules in favor of the applicant, a registration will issue.[72]

Recent International Developments

Miss Sexy and Miss Sixty: Confusing?

Iris Line, Ltd., is an Israeli company that has used the MISS SEXY trademark since 2007 for the sale of fashion products. Iris filed a trademark application for registration of the MISS SEXY trademark for women's garments, such as blouses, shirts, coats, jackets, pants, dresses, and other items. The application was disputed by Fronsac TM SA, an Italian company, which owns the trademark MISS SIXTY, which it has used on its leather, imitation leather, and other products. Fronsac created the MISS SIXTY name in 1961 in Italy for its jeans and claims that it has since become the subject of worldwide goodwill in fashion Fronsac owns the trademark MISS SIXTY around the world and its annual sales are approximately $40 million. Fronsac argued that the MISS SEXY mark bore a resemblance to the MISS SIXTY mark, which could confuse consumers and mislead them as to the source of the products.

The Israeli Trademark Office rejected Fronsac's arguments. The office examined the resemblance between the two marks applying three tests: (1) the visual and phonetic test; (2) the type of customer and class of goods test; and (3) the remaining relevant circumstances and common-sense test. Finding the first test to be the most significant, the Trademark Office found that the two marks were designed in such a way that distinguished them from each other. The curved styling of the letters of the MISS SIXTY mark were different from the MISS SEXY mark, and the MISS SEXY mark also contained the trade name in Hebrew, whereas the other mark did not. Looking at the phonetic resemblance, the Office found that the word "sixty" did not resemble the word "sexy."

With respect to the type of customer and class of goods test, the Israeli Trademark office found that the Fronsac goods were marketed to clients of greater financial means than those of Iris Line, and through different means, and further that young women are not likely to confuse clothing brands. Regarding the relevant circumstances and common-sense test, the Trademark Office examined the resemblance of the conceptual message of the two trademarks, and found the marks to differ with respect to the indication of domestically manufactured or imported products. The MISS SEXY brand was in both English and Hebrew, and was thus taken to indicate domestically manufactured goods. The MISS SIXTY trademark was in English only, and was therefore perceived differently. The two marks were also found to have different connotation—while the word "sexy" indicated the attractiveness of the product or user, the word "sixty" is simply a number and may refer to age. Thus the Trademark Office determined that the two marks were not likely to mislead consumers and denied the opposition to the registration of the trademark MISS SEXY.

The Term of Registered Trademarks The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) requires WTO member states to protect trademarks for a term of at least seven years. Additionally, it provides that trademarks are to be indefinitely renewable.[73]

---

[71]U.S. Patent and Trademark Office, *Trademark Manual of Examining Procedure*, chap. 1200 (2002), available at http://tess2.uspto.gov/tmdb/tmep/.

[72]In the United States, the average length of time in which a mark will be registered or an application abandoned is 13 months from the date the application was filed. *Id*.

[73]Agreement on Trade-Related Aspects of Intellectual Property Rights, Article 18 (1994).

Usage Requirements After a trademark is registered, many countries require the holder to present proof, upon the renewal of registration, that the mark was actually used within the country during the prior term.[74]

A few countries require the trademark owner to present interim proof of use before the term expires. Mexico, for example, requires the holder to present evidence of usage at the end of the third year. The United States requires the same thing at the end of the sixth year.

What constitutes proof varies, of course, and many countries do not specify what may be used. Colombia does, and its listing is representative of actual practice in other countries. Colombia permits the trademark holder to use any of the following to establish usage: newspaper and magazine advertisements, catalogs, samples, sales invoices, sales licenses, import licenses, chamber of commerce certificates, health department registrations, advertising agency billings, depositions, and inspections by the reviewing officer.[75]

In addition to requiring the user to prove use at the time of renewal, many countries allow third parties to bring actions to cancel the trademark if it has not been used for some specified period of time. The TRIPS Agreement now sets this period of time at no less than three years.[76]

It must be pointed out that not all countries have a user requirement[77] and that a few, such as Canada and the United States, make it difficult for challengers to establish nonuse by additionally requiring them to prove that the owner intentionally abandoned the use of a trademark.[78] Also, it must be noted that challenges for nonuse are uncommon. Many trademark owners have a policy of never initiating a nonuse action against others for fear of retaliatory actions against their own unused marks. Similarly, challenges against new registrants attempting to file marks that are similar or identical to marks already in use are equally uncommon. What is more likely, in such a case, is a settlement and the establishment of a coexistence agreement.

Know-How

Know-how is practical expertise acquired from study, training, and experience. It has been defined as factual knowledge, not capable of separate description but that, when used in an accumulated form, after being acquired as a result of trial and error, gives to the one acquiring it an ability to produce something that he or she otherwise would not have known to produce with the same accuracy or precision found necessary for commercial success.[79]

know-how
Practical expertise acquired from study, training, and experience.

[74]The requirement is contained in the Trademark Law Treaty adopted in Geneva in 1994, to which the following states were parties as of May 2012: Australia, Austria, Bahrain, Belarus, Belgium, Bosnia and Herzegovina, Burkina Faso, Chile, China, Columbia, Costa Rica, Côte d'Ivoire, Croatia, Cuba, Cyprus, the Czech Republic, Denmark, the Dominican Republic, Egypt, El Salvador, Estonia, the European Community, Finland, France, Gabon, Germany, Greece, Guinea, Honduras, Hungary, Indonesia, Ireland, Israel, Italy, Japan, Kazakhstan, Kenya, Kyrgyzstan, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Mexico, Monaco, Montenegro, Morocco, the Netherlands, Nicaragua, Oman, Peru, Poland, Portugal, the Republic of Korea, the Republic of Moldova, Romania, Russia, Senegal, Serbia, Slovakia, Slovenia, South Africa, Spain, Sri Lanka, Swaziland, Sweden, Switzerland, Togo, Trinidad and Tobago, Turkey, Ukraine, the United Kingdom, the United States, Uruguay, and Uzbekistan. See www.wipo.int/treaties/en/ip/tlt. The text of the treaty is posted at www.wipo.int/treaties/en/ip/tlt/trtdocs_wo027.html.

The 1977 Bangui Agreement creating the African and Malagasy Intellectual Property Organization contains the same requirement. The Bangui Agreement is the law governing industrial property rights in each of the member states of the African Intellectual Property Organisation (OAPI). Established on November 13, 1962, in Libreville, this organization had, on July 20, 2011, 16 member states: Benin, Burkina Faso, Cameroon, Central Africa, Chad, Congo, Côte d'Ivoire, Equatorial Guinea, Gabon, Guinea, Guinea Bissau, Mali, Mauritania, Niger, Senegal, and Togo, and a population of more than 100 million inhabitants. Its headquarters is in Yaounde, Cameroon. The text of the agreement, in French, is posted at www.eldis.org/go/home&id=23785&type=Document.

[75]American Bar Association, Section of Patent, Trademark and Copyright Law, *1987 Committee Reports*, p. 98 (1987).

[76]Agreement on Trade-Related Aspects of Intellectual Property Rights, Article 19 (1994).

Prior to the adoption of this agreement, there was an extensive debate over what the proper time period of nonuse should be. See Richard Taylor, "Loss of Trademark Rights through Nonuse: A Comparative Worldwide Analysis," *Trademark Reporter*, vol. 80, pp. 207–208 (1990).

[77]E.g., Bolivia, Chile, Costa Rica, Denmark, El Salvador, Norway, and Uruguay.

[78]In the United States, nonuse during the initial two-year period following registration gives rise to a presumption of abandonment, thereby shifting the burden of proof to the trademark owner.

[79]*Mycalex Corp. of America v. Pemco Corp.*, *Federal Supplement*, vol. 64, p. 425 (Dist. Ct. for Maryland, 1946).

Unlike other forms of intellectual property, know-how is generally not protected by specific statutory enactments. It is protected, rather, by contract, tort, and other basic legal principles. When specific information or know-how is kept secret, it is often called trade secrets and protected in some countries by trade secrecy laws.

The TRIPS Agreement requires WTO member states to protect what the agreement calls "undisclosed information."[80] That is, natural and legal persons must be given the legal means to prevent information from being disclosed to, acquired by, or used by others without their consent in a manner contrary to honest commercial practice. The information, however, must (1) be secret, (2) have commercial value because it is a secret, and (3) have been reasonably protected from disclosure by its owner.[81]

Most commonly, the legal protection given know-how comes about in connection with its use by an assignee, licensee, or employee. That is, the owner of know-how may prevent an assignee, licensee, or employee from disclosing secret know-how to third parties and may require these same people to pay for the training or assistance or use of the know-how they acquire from the owner. Because owners' rights in know-how are determined by the contractual relationship they have with assignees, licensees, and employees, the discussion of these rights is included with the materials on transfer and licensing considered later in this chapter.

B. International Intellectual Property Organizations

Two main international organizations take an active role in defining and protecting international intellectual property rights: the World Intellectual Property Organization (WIPO) and the Council for Trade-Related Aspects of Intellectual Property Rights (TRIPS Council) of the World Trade Organization.[82]

World Intellectual Property Organization

World Intellectual Property Organization (WIPO)
Intergovernmental organization responsible for administering the principal international intellectual property conventions.

The **World Intellectual Property Organization (WIPO)** was created in 1967 with the adoption of the Stockholm Convention.[83] WIPO succeeded the International Bureau of Paris and the International Bureau of Berne, which had administered the International Convention for the Protection of Industrial Property (Paris Convention) and the Berne Convention for the Protection of Literary and Artistic Works (Berne Convention). These two bureaus had been supervised by the Swiss Federal Council and, functionally, were joined together as the United International Bureaus for the Protection of Intellectual Property (*Bureaux Internationaux Réunis pour la Protection de la Propriéte Intellectuelle* [BIRPI]).

In contrast to its predecessors, WIPO has much broader authority. It is responsible for administering the Paris and Berne Conventions (as well as several new conventions established since its creation) and, generally, promoting intellectual property rights. WIPO's governing body, the General Assembly, is made up of representatives of states parties to the Stockholm Convention that are also parties to either the Paris or Berne Convention. WIPO is also a specialized agency of the

[80]Agreement on Trade-Related Aspects of Intellectual Property Rights, Article 39 (1994).

[81]*Id.*, para. 2.

[82]With the advent of the WTO and the WTO's TRIPS Council, the international influence of other organizations has diminished. The Intergovernmental Copyright Committee of the United Nations Educational, Scientific and Cultural Organization (UNESCO) no longer plays much of a role in this area following the decision by the United States and several other states to become parties to the Berne Convention and to, in effect, abandon their commitments under the Universal Copyright Convention that UNESCO had sponsored and overseen. The United Nations Conference on Trade and Development (UNCTAD), which was primarily interested in devising a Code of Conduct on Technology Transfer, has seen many of its proposals incorporated into the Agreement Establishing the World Trade Organization and that agreement's annexes. Moreover, the institutional role that UNESCO had played has now been taken over by the WTO.

[83]The convention is formally known as the Convention Establishing the World Intellectual Property Organization. It is posted at www.wipo.int/treaties/en/convention/trtdocs_wo029.html.

United Nations.[84] There are now 185 states (nations) that are parties to the Stockholm Convention.[85]

WIPO's Web site is
www.wipo.int/portal/index.html.en.

WIPO's promotional activities include the sponsoring and hosting of conferences for the development of new intellectual property rights agreements. The Patent Cooperation Treaty, for example, was the result of a WIPO initiative. WIPO also studies, through the appointment of expert committees, new legal and technological developments, and it regularly reports the results through both monthly journals and occasional reports.[86]

One of WIPO's more important tasks is to facilitate the transfer of technology, especially to and among developing countries. Two permanent committees—one for Development Cooperation Related to Industrial Property and one for Development Cooperation Related to Copyrights and Neighboring Rights—are responsible for helping countries modernize their national intellectual property laws, for helping them develop administrative agencies for supervising those laws, and for helping them increase, both in quantity and quality, the creation of new intellectual property by their own nationals.

Since 1994, the WIPO Arbitration and Mediation Center based in Geneva, Switzerland, has offered Alternative Dispute Resolution (ADR) options, in particular arbitration and mediation, for the resolution of international commercial disputes between private parties. Developed by leading experts in cross-border dispute settlement, the procedures offered by the center are widely used to resolve disputes involving technology, entertainment, and other intellectual property issues. An increasing number of cases are being filed with the center under the WIPO Arbitration, Expedited Arbitration, Mediation, and Expert Determination Rules. The subject matter of these proceedings includes both contractual disputes (e.g., patent and software licenses, trademark coexistence agreements, distribution agreements for pharmaceutical products, and research and development agreements) and noncontractual disputes (e.g., patent infringement).[87]

The WIPO Arbitration and Mediation Center has proved to be an effective way for parties to solve complex international patent, copyright, and trademark issues. Several examples are given on the WIPO Web site, including the following dispute:

WIPO Arbitration of a Biotech/Pharma Dispute

A French biotech company, holder of several process patents for the extraction and purification of a compound with medical uses, entered into a license and development

---

[84]For more information about the history and operation of WIPO, see its home page at www.wipo.int/portal/index.html.en.

[85]The states parties as of November 2011 were Afghanistan, Albania, Algeria, Andorra, Angola, Antigua and Barbuda, Argentina, Armenia, Australia, Austria, Azerbaijan, Bahamas, Bahrain, Bangladesh, Barbados, Belarus, Belgium, Belize, Benin, Bhutan, Bolivia, Bosnia and Herzegovina, Botswana, Brazil, Brunei Darussalam, Bulgaria, Burkina Faso, Burundi, Cambodia, Cameroon, Canada, Cape Verde, the Central African Republic, Chad, Chile, China, Colombia, Comoros, Congo, Costa Rica, Côte d'Ivoire, Croatia, Cuba, Cyprus, the Czech Republic, Democratic Republic of the Congo, Denmark, Djibouti, Dominica, the Dominican Republic, Ecuador, Egypt, El Salvador, Equatorial Guinea, Eritrea, Estonia, Ethiopia, Fiji, Finland, France, Gabon, Gambia, Georgia, Germany, Ghana, Greece, Grenada, Guatemala, Guinea, Guinea-Bissau, Guyana, Haiti, Holy See, Honduras, Hungary, Iceland, India, Indonesia, Iran, Iraq, Ireland, Israel, Italy, Jamaica, Japan, Jordan, Kazakhstan, Kenya, Kuwait, Kyrgyzstan, Laos, Latvia, Lebanon, Lesotho, Liberia, Libya, Liechtenstein, Lithuania, Luxembourg, Macedonia, Madagascar, Malawi, Malaysia, Maldives, Mali, Malta, Mauritania, Mauritius, Mexico, Moldova, Monaco, Mongolia, Montenegro, Morocco, Mozambique, Myanmar, Namibia, Nepal, the Netherlands, New Zealand, Nicaragua, Niger, Nigeria, North Korea, Norway, Oman, Pakistan, Panama, Papua New Guinea, Paraguay, Peru, the Philippines, Poland, Portugal, Qatar, Romania, Russia, Rwanda, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Samoa, San Marino, Sao Tome and Principe, Saudi Arabia, Senegal, Seychelles, Sierra Leone, Singapore, Slovakia, Slovenia, Somalia, South Africa, South Korea, Spain, Sri Lanka, Sudan, Suriname, Swaziland, Sweden, Switzerland, Syria, Tajikistan, Thailand, Togo, Tonga, Trinidad and Tobago, Tunisia, Turkey, Turkmenistan, Uganda, Ukraine, the United Arab Emirates, the United Kingdom, the United Republic of Tanzania, the United States, Uruguay, Uzbekistan, Venezuela, Vietnam, Yemen, Yugoslavia, Zambia, and Zimbabwe. See WIPO, "Member States" at www.wipo.int/treaties/en.

[86]The *WIPO Magazine* and other WIPO publications are posted at www.wipo.int/freepublications/en.

[87]See the WIPO Arbitration and Mediation Center Web site at www.wipo.int/amc/en.

agreement with a large pharmaceutical company. The pharmaceutical company had considerable expertise in the medical application of the substance related to the patents held by the biotech company. The parties included in their contract a clause stating that all disputes arising out of their agreement would be resolved by a sole arbitrator under the WIPO Arbitration Rules.

Several years after the signing of the agreement, the biotech company filed a request for arbitration with the Center alleging that the pharmaceutical company had deliberately delayed the development of the biotech compound and claiming substantial damages.

The Center proposed a number of candidates with considerable expertise of biotech/pharma disputes, one of whom was chosen by the parties. Following the parties' written submissions, the arbitrator held a three-day hearing in Geneva, Switzerland for the examination of witnesses. This not only served for the presentation of evidence but also allowed the parties to re-establish a dialogue. On the last day of the hearing, the disputants accepted the arbitrator's suggestion that they should hold a private meeting. As a result of that meeting, the parties agreed to settle their dispute and continued to cooperate towards the development and commercialization of the biotech compound.[88]

Another responsibility taken on by WIPO is that of resolving Internet domain disputes. In 1999, WIPO's Arbitration and Mediation Center was selected by the Internet Corporation for Assigned Names and Numbers (ICANN), which then oversaw the Internet, and was given responsibility for implementing ICANN's Uniform Domain Name Dispute Resolution Policy. The policy gives holders of trademarks a procedure for efficiently resolving disputes involving bad-faith cybersquatting of trademarks. The center is authorized to resolve disputes if (1) the domain name registered by the domain name registrant is identical or confusingly similar to the complainant's trademark or service mark; (2) the domain name registrant has no rights or legitimate interests in the disputed domain name; and (3) the domain name was registered and is being used in bad faith.[89] Earlier in this chapter, Case 9-4 (the Jimi Hendrix Web site case) was an example of a trade name dispute decided by WIPO.

Council for Trade-Related Aspects of Intellectual Property Rights

Council for Trade-Related Aspects of Intellectual Property Rights (TRIPS Council) Organ of the World Trade Organization responsible for administering the Agreement on Trade-Related Aspects of Intellectual Property Rights.

The **Council for Trade-Related Aspects of Intellectual Property Rights (TRIPS Council)** was created in 1995 with the adoption of the Agreement Establishing the World Trade Organization (WTO Agreement). The council is charged with overseeing the operation of the Agreement on Trade-Related Aspects of Intellectual Property Rights, which is an annex to the WTO Agreement. In particular, the council is responsible for monitoring WTO member state compliance with the Agreement on TRIPS, for helping members consult with each other on trade-related aspects of intellectual property rights, and for assisting members in settling disputes. The council consults with WIPO and cooperates with WIPO's constituent bodies.[90]

The Web site for the TRIPS Council is
www.wto.org/english/tratop_e/trips_e/trips_e.htm.

C. Intellectual Property Treaties

Intellectual property rights are protected and regulated internationally by both bilateral treaties and multilateral conventions. Bilateral treaties were the original means of preventing illegal copying, and they were once quite commonplace. With the growing popularity of multilateral conventions in the mid-nineteenth century, their use has diminished. Today, most bilateral intellectual property treaties are used by states that are not parties to the multilateral conventions. This does not mean that parties

[88] www.wipo.int/amc/en/arbitration/case-example.html

[89] See WIPO's Domain Name Dispute Resolution Service at www.wipo.int/amc/en/domains.

[90] Agreement on Trade-Related Aspects of Intellectual Property Rights, Article 68 (1994).

to multilateral agreements are prevented from entering into bilateral arrangements. For example, the Berne Convention for the Protection of Literary and Artistic Works specifically provides:

> The governments of the countries of the Union reserve their rights to enter into special agreements among themselves, in so far as such agreements grant to authors more extensive rights than those granted by the Convention, or contain other provisions not contrary to the Convention.[91]

Similar provisions can be found in the International Convention for the Protection of Industrial Property.[92] Nevertheless, multilateral treaties nowadays regulate most matters relating to intellectual property rights. These treaties generally cover industrial property or artistic property, but not both together. Moreover, patents, petty patents, and trademarks are commonly dealt with in a single treaty, while copyrights are dealt with separately. As already mentioned, most of these conventions are administered by WIPO and the TRIPS Council.

Comprehensive Agreements

The principal comprehensive agreement establishing general intellectual property obligations for most of the world's states is the Agreement on Trade-Related Aspects of Intellectual Property Rights.

Agreement on Trade-Related Aspects of Intellectual Property Rights The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement), which is an annex to the Agreement Establishing the World Trade Organization, came into effect with the WTO in 1995.[93] As is the case for the WTO Agreement's other multilateral annexes, all of the WTO member states are automatically members of the TRIPS Agreement.

The purpose of the TRIPS Agreement is to create a multilateral and comprehensive set of rights and obligations governing the international trade in intellectual property. As a consequence, the agreement establishes a common minimum of protection for intellectual property rights applicable within all the WTO member states. It does this in five ways.[94] First, it requires WTO members to observe the substantive provisions of the most important existing multilateral intellectual property treaties: the 1883 International Convention for the Protection of Industrial Property (Paris Convention) as revised in 1967; the 1886 Berne Convention for the Protection of Literary and Artistic Works (Berne Convention) as revised in 1971; the 1961 International Convention for the Protection of Performers, Producers of Phonograms, and Broadcasting Organizations (Rome Convention); and the 1989 Treaty on Intellectual Property in Respect of Integrated Circuits (IPIC Treaty). Moreover, the TRIPS Agreement provides that its substantive provisions do not in any way reduce the obligations of WTO member states under the Paris, Berne, and Rome Conventions or the IPIC Treaty.[95]

Second, the substantive provisions of the TRIPS Agreement create obligations that are meant to "fill in the gaps" in the other international intellectual property conventions. Some important provisions are otherwise missing, such as the length of life for a patent.[96]

Third, the TRIPS Agreement establishes criteria for the effective and appropriate enforcement of intellectual property rights[97] and for the prevention and settlement of disputes between the governments of the WTO member states.[98]

Fourth, to encourage the widest possible adoption and application of the common rules and obligations set out in the TRIPS Agreement, the agreement establishes transitional arrangements that give more time to developing member states and to member states in transition from a centrally planned economy to a free market economy to comply, and even more time to those that are the least

[91]Berne Convention for the Protection of Literary and Artistic Works, Article 20(1) (1886 as revised in 1971).

[92]International Convention for the Protection of Industrial Property, Article 19 (1883 as revised in 1967).

[93]The TRIPS Agreement is posted at www.wto.org/english/docs_e/legal_e/27-trips.doc.

[94]Agreement on Trade-Related Aspects of Intellectual Property Rights, Preamble (1994).

[95]*Id.*, Articles 1–2.

[96]*Id.*, Articles 9–40.

[97]*Id.*, Articles 41–62.

[98]*Id.*, Articles 63–64.

developed. Developed member states were required to be in full compliance by January 1, 1996; developing member states and states transitioning to a market economy were required to comply by January 1, 2000; and the least developed states have until January 1, 2016.[99]

Finally, and most importantly, the TRIPS Agreement extends the basic principles of the General Agreement on Tariffs and Trade (GATT) to the field of international intellectual property rights. The *national treatment* principle requires each member state to extend to nationals of other members treatment no less favorable than that which it gives its own nationals regarding protection of intellectual property.[100] The *transparency* principle requires member states to publish and notify the Council for TRIPS of all relevant laws, regulations, and the like and to respond to requests from other members for information.[101]

National treatment and transparency provisions are found, of course, in other intellectual property agreements. The TRIPS Agreement is unique, however, in including a provision requiring *most-favored-nation treatment* for such property. Under this provision, "any advantage, favor, privilege, or immunity granted by a member to the nationals of any other country [whether or not it is a WTO member] shall be accorded immediately and unconditionally to the nationals of all other members."[102] Read together with the national treatment provision and the transparency provision, this requires each member state to treat the nationals of other member states as least as well as (and possibly better than) it treats its own nationals.[103]

Artistic Property Agreements

The main international agreements dealing with artistic property are the Berne Convention for the Protection of Literary and Artistic Works; the International Convention for the Protection of Performers, Producers of Phonograms, and Broadcasting Organizations; the Patent Cooperation Treaty; the Satellite Transmission Convention; and the WIPO Copyright Treaty.

Berne Convention for the Protection of Literary and Artistic Works
Requires member states to establish common minimum rules to protect the pecuniary and moral rights of authors without requiring them to comply with particular formalities.

Berne Convention

Adopted in Paris in 1886, the **Berne Convention for the Protection of Literary and Artistic Works (Berne Convention)** came into force in 1887.[104] Its nine original member countries[105] have now grown to 165.[106]

The original text of the convention established procedures for its revision, and revisions have been regularly made: in Paris in 1896, Berlin in 1908, Berne in 1914, Rome in 1928, Brussels in 1948, Stockholm in 1967, and Paris in 1971.

---

[99] *Id.*, Articles 65–66. The date for compliance for least developed states was extended to 2016 at the WTO Doha Ministerial Conference. See "Least-Developed Country Members—Obligations Under Article 70.9 of the TRIPS Agreement with Respect to Pharmaceutical Products" at www.wto.org/english/tratop_e/trips_e/art70_9_e.htm.

[100] Agreement on Trade-Related Aspects of Intellectual Property Rights, Article 3 (1994).

[101] *Id.*, Article 63.

[102] *Id.*, Article 4.

[103] John Kraus, *The GATT Negotiations: A Business Guide to the Results of the Uruguay Round*, p. 52 (1994).

[104] The text of the convention is posted at www.wipo.int/treaties/ip.

[105] Belgium, Britain, France, Germany, Haiti, Italy, Spain, Switzerland, and Tunisia. Haiti, however, withdrew in 1941, and it did not rejoin until 1996.

[106] As of April 2012, the member states of the Berne Convention were Albania, Algeria, Andorra, Antigua and Barbuda, Argentina, Armenia, Australia, Austria, Azerbaijan, Bahamas, Bahrain, Bangladesh, Barbados, Belarus, Belgium, Belize, Benin, Bhutan, Bolivia, Bosnia and Herzegovina, Botswana, Brazil, Brunei, Bulgaria, Burkina Faso, Cameroon, Canada, Cape Verde, the Central African Republic, Chad, Chile, China, Colombia, Comoros, Congo, Costa Rica, Côte d'Ivoire, Croatia, Cuba, Cyprus, the Czech Republic, Democratic Republic of the Congo, Denmark, Djibouti, Dominica, the Dominican Republic, Ecuador, Egypt, El Salvador, Equatorial Guinea, Estonia, Fiji, Finland, France, Gabon, Gambia, Georgia, Germany, Ghana, Greece, Grenada, Guatemala, Guinea, Guinea-Bissau, Guyana, Haiti, Holy See, Honduras, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, Jamaica, Japan, Jordan, Kazakhstan, Kenya, Kyrgyzstan, Latvia, Lebanon, Lao People's Democratic Republic, Lesotho, Liberia, Libya, Liechtenstein, Lithuania, Luxembourg, Macedonia, Madagascar, Malawi, Malaysia, Mali, Malta, Mauritania, Mauritius, Mexico, Micronesia, Moldova, Monaco, Mongolia, Montenegro, Morocco, Namibia, Nepal, the Netherlands, New Zealand, Nicaragua, Niger, Nigeria, North Korea, Norway, Oman, Pakistan, Panama, Paraguay, Peru, the Philippines, Poland, Portugal, Qatar, Romania, Russia, Rwanda, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Samoa, Saudi Arabia, Senegal, Serbia, Singapore, Slovakia, Slovenia, South Africa, Spain, Sri Lanka, Sudan, Suriname, Swaziland, Sweden, Switzerland, Syria, Tajikistan, Tanzania, Thailand, Togo, Tonga, Trinidad and Tobago, Tunisia, Turkey, Ukraine, the United Arab Emirates, the United Kingdom, the United States, Uruguay, Uzbekistan, Venezuela, Vietnam, Venezuela, Yemen, Zambia, and Zimbabwe. See www.wipo.int/treaties/en/ip/berne.

The Berne Convention establishes a "union" of states that is responsible for protecting artistic rights. Four basic principles underlie the members' obligations: (1) The principle of *national treatment* requires each member state to extend to nationals of other member states treatment no less favorable than that which it gives its own nationals. (2) **Nonconditional protection** is the requirement that member states must provide protection without any formalities. A country of origin may, however, condition protection on the author's first making an application for registration, or registering the work, or reserving rights in a contract of sale, or a similar condition. (3) The principle of **protection independent of protection in the country of origin** allows authors who are nationals of nonmember states to obtain protection within the Berne Union by publishing their works in a member state. (4) The **principle of common rules** establishes minimum standards for granting copyrights common to all member states. These and the other requirements of the Berne Convention are summarized in Table 9.2.

nonconditional protection principle
Protection is not to be conditioned on the use of formalities.

common rules principle
Common minimum standards for granting copyrights must be observed by all member states.

protection independent of protection in the country of origin principle
Protection is granted to any person publishing a work in a member state, even if he or she is not a national of a member state.

Rome Convention The **International Convention for the Protection of Performers, Producers of Phonograms, and Broadcasting Organizations (Rome Convention)** was agreed to in 1961.[107] The draft for the convention was prepared by a joint committee of experts appointed by the Berne Union, UNESCO, and the International Labor Organization. The convention, accordingly, attempts to balance the interests of performers, producers of phonograms, and broadcasting organizations. Currently, there are 91 states parties.[108]

The Rome Convention protects artists from the unauthorized recording of their original performances and from the use of authorized recordings for a purpose other than that to which the artist consented. Producers of phonograms are protected from the direct or indirect reproduction of their works. Broadcasters are protected from the unauthorized recording, rebroadcasting, and use of their broadcasts.

TABLE 9.2

Principal provisions of the Berne convention

Provision	Description
Persons entitled to protection	Nationals and habitual residents of any member state and persons of any state who publish first or simultaneously in a member state
Definition of "publication"	Manifestation in a tangible form (may not include intangible reproduction by performance or telecommunication)
Definition of "simultaneous publication"	Publication within a 30-day period
Protected works	Literary, artistic, scientific, and architectural
Author's rights	Pecuniary and moral rights
Formalities	Member states may not require formalities (except that protection in the country of origin may be conditioned on application, registration, reservation of rights, etc.)
Translations	Author loses right to make a translation if it is not published within 10 years of original publication
Exemptions for developing countries	Developing country may grant a nonexclusive nonassignable compulsory license to make copies for use in teaching, scholarship, and research if the author fails to grant such a license
Term	Author's life plus 50 years

International Convention for the Protection of Performers, Producers of Phonograms, and Broadcasting Organizations (Rome Convention)
Prohibits the unauthorized recording of live performances, the unauthorized reproduction of recordings, and the unauthorized recording or rebroadcasting of broadcasts.

[107]The text of the convention is posted at www.wipo.int/treaties/en/ip/rome.

[108]The 91 states parties as of April 2012, were Albania, Algeria, Andorra, Argentina, Armenia, Australia, Austria, Azerbaijan, Bahrain, Barbados, Belarus, Belgium, Bolivia, Bosnia and Herzegovina, Brazil, Bulgaria, Burkina Faso, Cambodia, Canada, Cape Verde, Chile, Colombia, Congo, Costa Rica, Croatia, Cyprus, the Czech Republic, Denmark, Dominica, the Dominican Republic, Ecuador, El Salvador, Estonia, Fiji, Finland, France, Georgia, Germany, Greece, Guatemala, the Holy See, Honduras, Hungary, Iceland, India, Ireland, Israel, Italy, Jamaica, Japan, Kyrgyzstan, Latvia, Lebanon, Lesotho, Liechtenstein, Lithuania, Luxembourg, Macedonia, Mexico, Moldova, Monaco, Montenegro, the Netherlands, Nicaragua, Niger, Nigeria, Norway, Panama, Paraguay, Peru, the Philippines, Poland, Portugal, Republic of Korea, Romania, Russia, Saint Lucia, Serbia, Slovakia, Slovenia, Spain, Sweden, Switzerland, Syria, Tajikistan, Togo, Turkey, Ukraine, the United Arab Emirates, the United Kingdom, Uruguay, Venezuela, and Vietnam. See www.wipo.int/treaties/en/ip/rome.

In addition to these rights, the Rome Convention provides that a broadcaster making a public communication or broadcast of an authorized phonogram is required to pay the producer or the artist, or both, a single equitable payment. This caused some consternation among several countries, which feared that such a system of compensation would diminish the proceeds that their artists were entitled to under their own laws. As a consequence, the convention allows member states to make reservations to this provision.

Convention for the Protection of Producers of Phonograms Against Unauthorized Duplication of Their Phonograms Requires member states to protect producers of phonograms from the unauthorized reproduction of their works.

Phonogram Piracy Convention The **Convention for the Protection of Producers of Phonograms Against Unauthorized Duplication of Their Phonograms** was signed in 1971 at Geneva.[109] It provides that member states must protect producers of phonograms from the unauthorized reproduction and importation of their works for a period of not less than 20 years. The means for doing this, however, is left to each individual state. In the common law countries, including the United Kingdom and the United States, protection is provided through copyright legislation. Most of the countries of continental Europe use neighboring rights laws. Japan provides protection with penal sanctions. In April 2012 , there were 77 states parties to the Phonogram Piracy Convention.[110]

Convention Relating to the Distribution of Program-Carrying Signals Transmitted by Satellite Requires member states to prevent the unauthorized transmission of electronic communications by satellite from their territory.

Satellite Transmission Convention The **Convention Relating to the Distribution of Program-Carrying Signals Transmitted by Satellite,** sponsored jointly by WIPO and UNESCO, was concluded in Brussels in 1974.[111] It requires member states to take "adequate measures" to prevent the unauthorized distribution in or from their territory of any program-carrying signal transmitted by satellite. As with the Agreement on Phonogram Piracy, the means of implementing this convention is left up to each member state. The number of states parties at present is 35.[112]

World Intellectual Property Organization Copyright Treaty Requires member states to extend the provisions of the Berne Convention to computer programs and databases.

WIPO Copyright Treaty The **World Intellectual Property Organization Copyright Treaty** was adopted in 1996 by a conference of member states of the Berne Union for the purpose of extending the provisions of the Berne Convention to computer programs and databases and protecting copyright ownership information embedded in programs and databases.[113] There are currently 89 states parties.[114]

---

[109]The text of the convention is posted at www.wipo.int/treaties/en/ip/phonograms.

[110]The member-states parties as of April 2012, were Albania, Argentina, Armenia, Australia, Austria, Azerbaijan, Barbados, Belarus, Bosnia and Herzegovina, Brazil, Bulgaria, Burkina Faso, Canada, Chile, China, Colombia, Costa Rica, Croatia, Cyprus, the Czech Republic, Democratic Republic of the Congo, Denmark, Ecuador, Egypt, El Salvador, Estonia, Fiji, Finland, France, Germany, Greece, Guatemala, the Holy See, Honduras, Hungary, India, Iran, Israel, Italy, Jamaica, Japan, Kazakhstan, Kenya, Latvia, Liberia, Liechtenstein, Lithuania, Luxembourg, Mexico, Moldova, Monaco, Montenegro, the Netherlands, New Zealand, Nicaragua, Norway, Panama, Paraguay, Peru, the Philippines, South Korea, Romania, Russia, Saint Lucia, Serbia, Slovakia, Slovenia, Spain, Sweden, Switzerland, Macedonia, Togo, Trinidad and Tobago, Ukraine, the United Kingdom, the United States, Uruguay, Venezuela, and Vietnam. See www.wipo.int/treaties/en/ip/phonograms.
A related convention is the 1996 WIPO Performances and Phonograms Treaty, which establishes both moral and pecuniary rights for performers and creators of phonograms. The text of that treaty is posted at www.wipo.int/treaties/en.

[111]The text of the convention is posted at www.wipo.int/treaties/en.

[112]The states parties to the Satellite Transmission (Brussels) Convention as of April 2012, were Argentina, Armenia, Australia, Austria, Bahrain, Belgium, Bosnia and Herzegovina, Brazil, Chile, Costa Rica, Côte d'Ivoire, Croatia, Cyprus, El Salvador, France, Germany, Greece, Honduras, Israel, Italy, Jamaica, Kenya, Lebanon, Mexico, Moldova, Montenegro, Morocco, Nicaragua, Oman, Panama, Peru, Portugal, Russia, Rwanda, Senegal, Serbia, Singapore, Slovenia, Spain, Switzerland, Macedonia, Togo, Trinidad and Tobago, the United States, and Vietnam. See http://www.wipo.int/treaties/en/ip/brussels/.

[113]The text of the convention is posted at www.wipo.int/treaties/en/ip/wct/.

[114]As of April 2012, the states party to the World Intellectual Property Organization Copyright Treaty included Albania, Argentina, Armenia, Australia, Austria, Azerbaijan, Bahrain, Belarus, Belgium, Benin, Bolivia, Bosnia and Herzegovina, Botswana, Bulgaria, Burkina Faso, Canada, Chile, China, Colombia, Costa Rica, Croatia, Cyprus, the Czech Republic, Denmark, the Dominican Republic, Ecuador, El Salvador, Estonia, the European Community, Finland, France, Gabon, Georgia, Germany, Ghana, Greece, Guatemala, Guinea, Honduras, Hungary, Indonesia, Ireland, Israel, Italy, Jamaica, Japan, Jordan, Kazakhstan, Kenya, Kyrgyzstan, Latvia, Liechtenstein, Lithuania, Luxembourg, Mali, Malta, Mexico, Moldova, Monaco, Mongolia, Montenegro, Morocco, Namibia, the Netherlands, Nicaragua, Nigeria, Oman, Panama, Paraguay, Peru, the Philippines, Poland, Portugal, Qatar, the Republic of Korea, Romania, Russia, Saint Lucia, Senegal, Serbia, Singapore, Slovakia, Slovenia, South Africa, Spain, Sweden, Switzerland, the former Yugoslav Republic of Macedonia, Togo, Trinidad and Tobago, Turkey, Ukraine, the United Arab Emirates, the United Kingdom, the United States, Uruguay, and Venezuela. see www.wipo.int/treaties/en/showresults.jsp?lang=en&treaty_id=16.

Industrial Property Agreements

The principal international conventions concerned with industrial property are the International Convention for the Protection of Industrial Property, the Treaty on Intellectual Property in Respect of Integrated Circuits, the Madrid Agreement for the Repression of False or Deceptive Indications of Sources of Goods, the Patent Cooperation Treaty, and the Trademark Law Treaty.

Paris Convention Drafted in 1880, the **International Convention for the Protection of Industrial Property (Paris Convention)** was ratified by 11 states in 1883 and came into effect in 1884. As of April 2012, the number of participants has grown to 174.[115]

International Convention for the Protection of Industrial Property (Paris Convention) Requires member states to provide national treatment, right of priority, and common minimum rules to protect owners of industrial property rights.

The convention establishes a "union" of states responsible for protecting industrial property rights. Among the members' duties is the obligation to participate in regular revisions. Revision conferences to expand the coverage of the convention have been held regularly: in Rome in 1886, Madrid in 1890 and 1891, Brussels in 1897 and 1900, Washington in 1911, The Hague in 1925, London in 1934, Lisbon in 1958, and Stockholm in 1967.

Three basic principles are incorporated in the Paris Convention: (1) national treatment, (2) right of priority, and (3) common rules. National treatment is the requirement that each member state must grant the same protection to the nationals of other states that it grants to its own nationals. The **right of priority** gives an applicant who has filed for protection in one member country a grace period of 12 months in which to file in another member state, which then must treat the application as if it were filed on the same day as the original application. The principle of common rules sets minimum standards for the creation of intellectual property rights. These are as follows: (1) a member state may not deny protection to industrial property because the work incorporating an invention was not manufactured in that state; (2) member states must protect trade names without requiring registration; (3) member states must outlaw false labeling (i.e., any indication that falsely identifies the source of goods, or the trader or manufacturer); and (4) each member state is required to take "effective" measures to prevent unfair competition. Beyond these common rules, the convention leaves to each member the right to make rules governing the application, registration, scope, and duration of patents, trademarks, and other forms of industrial property.

right of priority For a period of one year, an application for a patent in a second member country will be treated as though it had been filed on the same date as the application made in the first member country.

Treaty on Intellectual Property in Respect of Integrated Circuits The **Treaty on Intellectual Property in Respect of Integrated Circuits (Washington Treaty),** adopted in 1989, obligates member states to protect the designs used in integrated circuits (such as the designs of computer memory chips).[116] Like the Berne Convention, this treaty incorporates the principles of national treatment and common rules. The common rules include the obligation of member states to protect against the making of unauthorized copies and the importing of contraband copies.[117]

Treaty on Intellectual Property in Respect of Integrated Circuits (Washington Treaty) Requires member states to provide national treatment and common minimum rules to protect owners of integrated circuits.

[115]As of April 2012, the states party to the International Convention for the Protection of Industrial Property were Albania, Algeria, Andorra, Angola, Antigua and Barbuda, Argentina, Armenia, Australia, Austria, Azerbaijan, Bahamas, Bahrain, Bangladesh, Barbados, Belarus, Belgium, Belize, Benin, Bhutan, Bolivia, Bosnia and Herzegovina, Botswana, Brazil, Brunei, Bulgaria, Burkina Faso, Burundi, Cambodia, Cameroon, Canada, the Central African Republic, Chad, Chile, China, Colombia, Comoros, Congo, Costa Rica, Côte d'Ivoire, Croatia, Cuba, Cyprus, the Czech Republic, Democratic People's Republic of Korea, Democratic Republic of the Congo, Denmark, Djibouti, Dominica, the Dominican Republic, Ecuador, Egypt, El Salvador, Equatorial Guinea, Estonia, Finland, France, Gabon, Gambia, Georgia, Germany, Ghana, Greece, Grenada, Guatemala, Guinea, Guinea-Bissau, Guyana, Haiti, the Holy See, Honduras, Hungary, Iceland, India, Indonesia, Iran (Islamic Republic of), Iraq, Ireland, Israel, Italy, Jamaica, Japan, Jordan, Kazakhstan, Kenya, Kyrgyzstan, Lao People's Democratic Republic, Latvia, Lebanon, Lesotho, Liberia, Libyan Arab Jamahiriya, Liechtenstein, Lithuania, Luxembourg, Madagascar, Malawi, Malaysia, Mali, Malta, Mauritania, Mauritius, Mexico, Moldova, Monaco, Mongolia, Montenegro, Morocco, Mozambique, Namibia, Nepal, the Netherlands, New Zealand, Nicaragua, Niger, Nigeria, Norway, Oman, Pakistan, Panama, Papua New Guinea, Paraguay, Peru, the Philippines, Poland, Portugal, Qatar, the Republic of Korea, Romania, the Russian Federation, Rwanda, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, San Marino, Sao Tome and Principe, Saudi Arabia, Senegal, Serbia, Seychelles, Sierra Leone, Singapore, Slovakia, Slovenia, South Africa, Spain, Sri Lanka, Sudan, Suriname, Swaziland, Sweden, Switzerland, the Syrian Arab Republic, Tajikistan, Thailand, the former Yugoslav Republic of Macedonia, Togo, Tonga, Trinidad and Tobago, Tunisia, Turkey, Turkmenistan, Uganda, Ukraine, the United Arab Emirates, the United Kingdom, the United Republic of Tanzania, the United States, Uruguay, Uzbekistan, Venezuela, Vietnam, Yemen, Zambia, and Zimbabwe. See www.wipo.int/treaties/en/ShowResults.jsp?lang=en&treaty_id=2.

[116]The text of the Washington Treaty is posted at www.wipo.int/treaties/en/ip/washington.

[117]Article 6.

Although the member states of the WTO are obliged to comply with the provisions of the Washington Treaty,[118] the treaty itself is not currently in force.[119]

Patent Cooperation Treaty
Establishes an international mechanism that allows inventors to make a single application for patent protection that is equivalent to making a filing in all member states.

Patent Cooperation Treaty The **Patent Cooperation Treaty,** agreed to in 1970, establishes a mechanism for making an international application whose effect in each member state is the same as the filing for a national patent.[120] Applications are submitted to a member state's patent office, which forwards them to one of several international searching authorities, where an international search is made to determine novelty. The goal of the treaty is the elimination of unnecessary repetition by both patent offices and applicants. Eventually, the member states plan to establish a single international search authority. In April 2012, there were 144 states parties to the Patent Cooperation Treaty.[121]

Madrid Agreement for the Repression of False or Deceptive Indications of Sources of Goods
Requires member states to deny importation to goods bearing false or misleading indications as to their source.

Agreement on Sources of Goods The **Madrid Agreement for the Repression of False or Deceptive Indications of Sources of Goods,** drafted in 1891, requires its members to either deny importation to or confiscate at the time of importation any goods bearing false or deceptive indications about their source.[122] There are 35 states parties to the agreement at present.[123]

Trademark Law Treaty
Requires member states to establish common minimum rules to protect trademarks.

Trademark Law Treaty The **Trademark Law Treaty,** adopted in 1994, is meant to simplify both national and regional trademark registration systems by establishing common minimum rules.[124]

---

[118]Agreement on Trade-Related Aspects of Intellectual Property Rights, Articles 1 and 2 (1994).

[119]See World Trade Organization, "Intellectual Property: Protection and Enforcement," posted at www.wto.org/english and www.wipo.int/treaties/en/ip/washington.

[120]The text of the Patent Cooperation Treaty is posted at www.wipo.int/treaties/en.

[121]The 144 members in April 2012 were Albania, Algeria, Angola, Antigua and Barbuda, Argentina, Armenia, Australia, Austria, Azerbaijan, Bahrain, Barbados, Belarus, Belgium, Belize, Benin, Bosnia and Herzegovina, Botswana, Brazil, Bulgaria, Burkina Faso, Cameroon, Canada, the Central African Republic, Chad, China, Colombia, Comoros, Congo, Costa Rica, Côte d'Ivoire, Croatia, Cuba, Cyprus, the Czech Republic, Democratic People's Republic of Korea, Denmark, Dominica, the Dominican Republic, Ecuador, Egypt, El Salvador, Equatorial Guinea, Estonia, Finland, France, Gabon, Gambia, Georgia, Germany, Ghana, Greece, Grenada, Guatemala, Guinea, Guinea-Bissau, the Holy See, Honduras, Hungary, Iceland, India, Indonesia, Iran (Islamic Republic of), Ireland, Israel, Italy, Japan, Kazakhstan, Kenya, Kyrgyzstan, the Lao People's Democratic Republic, Latvia, Lesotho, Liberia, Libyan Arab Jamahiriya, Liechtenstein, Lithuania, Luxembourg, Madagascar, Malawi, Malaysia, Mali, Malta, Mauritania, Mexico, Moldova, Monaco, Mongolia, Montenegro, Morocco, Mozambique, Namibia, the Netherlands, New Zealand, Nicaragua, Niger, Nigeria, Norway, Oman, Papua New Guinea, the Philippines, Poland, Portugal, Qatar, the Republic of Korea, Romania, Russian Federation, Rwanda, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, San Marino, Sao Tome and Principe, Senegal, Serbia, Seychelles, Sierra Leone, Singapore, Slovakia, Slovenia, South Africa, Spain, Sri Lanka, Sudan, Swaziland, Sweden, Switzerland, the Syrian Arab Republic, Tajikistan, Thailand, the former Yugoslav Republic of Macedonia, Togo, Trinidad and Tobago, Tunisia, Turkey, Turkmenistan, Uganda, Ukraine, the United Arab Emirates, the United Kingdom, the United Republic of Tanzania, the United States, Uzbekistan, Vietnam, Zambia, and Zimbabwe. See www.wipo.int/treaties/en/ShowResults.jsp?lang=en&treaty_id=6.
Related treaties are the 1925 Hague Agreement Concerning the International Deposit of Industrial Designs (posted at www.wipo.int/treaties/en/registration/hague), which sets up a mechanism for registering industrial designs with WIPO, which then handles individual filings in member states; the 1968 Locarno Agreement Establishing an International Classification for Industrial Designs (posted at www.wipo.int/treaties/en/classification/locarno); and the 1971 Strasbourg Agreement Concerning the International Patent Classification (posted at www.wipo.int/treaties/en/classification/strasbourg), which classifies technologies in eight main categories and approximately 52,000 subcategories, each of which is assigned a symbol.
Additionally, Articles 25 and 26 of the Agreement on Trade-Related Aspects of Intellectual Property Rights (1994) address industrial designs. This agreement establishes, among other things, that the term of protection is a minimum of 10 years. *Id.*, Article 26, para. 3.

[122]The text of the Madrid treaty is posted at www.wipo.int/treaties/en/ip/madrid.

[123]In April 2012, the states parties to the Madrid Agreement as revised in 1958 were Algeria, Brazil, Bulgaria, Cuba, the Czech Republic, the Dominican Republic, Egypt, France, Germany, Hungary, Iran, Ireland, Israel, Italy, Japan, Lebanon, Liechtenstein, Moldova, Monaco, Montenegro, Morocco, New Zealand, Poland, Portugal, San Marino, Serbia, Slovakia, Spain, Sri Lanka, Sweden, Switzerland, Syria, Tunisia, Turkey, and the United Kingdom. See www.wipo.int/treaties/en/ShowResults.jsp?lang=en&treaty_id=3.
Another agreement dealing with the origins of goods is the 1958 Lisbon Agreement for the Protection of Appellations of Origin and Their International Registration (posted at www.wipo.int/treaties/en/registration/lisbon), which provides protection for geographic names used to designate agricultural products (e.g., wines, spirits, cheeses).

[124]The text of the treaty is posted at www.wipo.int/treaties/en/.

In addition, the term for renewal of a trademark is set at 10 years. Currently, this treaty is in effect in 50 states.[125]

D. The International Transfer of Intellectual Property

There are five ways in which intellectual property rights are transferred from one country to another: (1) the owner may work the property rights abroad, (2) the owner may transfer or assign the rights to another, (3) the owner may license another to work them, (4) the owner may establish a franchise, or (5) a government may grant a compulsory license so that a third party may exploit them.

The procedures and international regulations for setting up a business, a subsidiary, or a joint venture were discussed in Chapters 4 and 5. Those same procedures and regulations apply to firms established to work intellectual property rights.

The rules and procedures for transferring or making a full assignment of an owner's rights in intellectual property are the same as those for any other sale. Those rules and procedures are discussed in Chapter 10.

A **license** is a nonexclusive revocable privilege that allows a licensee to use a licensor's property. A license is created by contract, and standard contractual rules are used to interpret it. It is to be distinguished from a **franchise,** which is a specialized license that requires a franchisee to work the property under the supervision and control of a franchisor.

A license allows a licensee to use a property for the licensee's own purposes. Depending on the licensing agreement, the licensee may use the property as a component in its own products, it may sell the property or the products derived from it under the licensor's name, or it may do the same thing under its own name. Sometimes the licensee may even sell the property, or the products derived from it, in direct competition with the licensor.

By contrast, a franchisee has more limited rights. The key difference is that a franchisee is regarded as a unit or element of the franchisor's business. Three types of franchises have evolved since their initial establishment at the beginning of the twentieth century: (1) distributorships, (2) chain-style businesses, and (3) manufacturing or processing plants.

A **distributorship** franchise exists when a manufacturer licenses a dealer to sell its products. A common example is an automobile dealership.

A **chain-style business** franchise is an arrangement in which a franchisee operates under a franchisor's trade name and is identified as part of the franchisor's business chain. Examples include McDonald's, KFC, Pizza Hut, and other fast-food restaurants.

A **manufacturing or processing plant** franchise comes about when a franchisor provides the franchisee with the formula or the essential ingredients to make a particular product. The franchisee then wholesales or retails the product according to the standards established by the franchisor. Examples of this kind of franchise are Coca-Cola, Pepsi-Cola, and the other soft-drink firms.

Although a franchisee has more limited rights than a licensee, the rules and regulations that govern franchise agreements are the same as those governing licenses.

Compulsory licenses are common in most countries of the world, especially developing countries. In these countries, if the owner of intellectual property (in particular, patents or copyrights)

license
Authority granted by the owner of an intellectual property to another allowing the latter the right to use it in some limited way.

franchise
Special license that requires the franchisee to work the licensed property under the supervision and control of the franchisor.

distributorship
A franchise in which a manufacturer licenses a dealer to sell its products.

chain-style business
A franchise in which a franchisee operates under the franchisor's trade name and is identified as part of the franchisor's business.

manufacturing or processing plant franchise
A franchise in which the franchisee sells products it manufactures from a formula or from ingredients provided by the franchisor.

[125]In April 2012, the contracting parties to the Trademark Law Treaty were: Australia, Bahrain, Belgium, Bosnia And Herzegovina, Chile, Costa Rica, Croatia, Cyprus, The Czech Republic, Denmark, The Dominican Republic, Egypt, El Salvador, Estonia, France, Germany, Honduras, Hungary, Indonesia, Ireland, Italy, Japan, Kazakhstan, Kyrgyzstan, Latvia, Liechtenstein, Lithuania, Monaco, Montenegro, Morocco, the Netherlands, Nicaragua, Oman, Peru, the Republic of Korea, Republic of Moldova, Romania, the Russian Federation, Serbia, Slovakia, Slovenia, Spain, Sri Lanka, Switzerland, Trinidad and Tobago, Turkey, Ukraine, the United Kingdom, the United States and Uzbekistan. See www.wipo.int/treaties/en/showresults.jsp?lang=en&treaty_id=5.

Other agreements dealing with trademarks are the 1881 Madrid Agreement Concerning the International Registration of Marks (posted at www.wipo.int/treaties/en/registration/madrid), which establishes a mechanism for registering marks with WIPO, which then handles the filing in the individual member states where registration is sought; the 1957 Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks (posted at www.wipo.int/treaties/en/classification/nice), which sets up a uniform classification system involving 34 classes of goods and eight classes of services; the 1973 Vienna Agreement Establishing an International Classification for the Figurative Elements of Marks (posted at http://www.wipo.int/treaties/en/classification/vienna); and the 1981 Nairobi Treaty for the Protection of the Olympic Symbol (posted at www.wipo.int/treaties/en/ip/nairobi).

refuses to work the property in the country within a certain period of time, a third party may apply for a compulsory license. The government issues such a license without the consent of the owner, so it is not subject to the same rules that apply to licensing and franchising. This topic is discussed in more detail later in the chapter.

E. Licensing Regulations

Grants of patents, trademarks, and copyrights create monopolies. In free-market countries, these grants run contrary to unfair competition laws.[126] In centrally planned economies, they run contrary to the notion of state ownership of the means of production. To balance the interests of consumers in free-market countries and the interests of the state in planned-economy countries with the rights of intellectual property owners, most countries treat intellectual property rights as special exceptions to their general laws prohibiting monopolies. As such, the rights held by patent, trademark, and copyright owners are strictly construed and limited to the narrow confines of the grant. The U.S. Supreme Court, for example, has stated that the grant of a patent is

> . . . an exception to the general rule against monopolies and to the right to access to a free and open market. The far-reaching social and economic consequences of a patent, therefore, give the public a paramount interest in seeing that patent monopolies spring from backgrounds free from fraud or other inequitable conduct and that such monopolies are kept within their legitimate scope.[127]

Licensing arrangements involving statutory grants must, accordingly, be limited to the rights contained in the grant. Any attempt to go beyond the scope of the grant—such as trying to license an expired patent, trademark, or copyright—is a misuse of the grant and (depending on the country) is either without effect or illegal.

Nonstatutory grants (in particular, know-how) do not qualify for the special exceptions granted to patents, trademarks, and copyrights. As such, any licensing of these rights has to comply with the appropriate unfair competition laws.

The propriety of states adopting rules to regulate the anticompetitive aspects of intellectual property licenses is now specifically recognized in international law. Article 40, paragraph 2, of the Agreement on Trade-Related Aspects of Intellectual Property Rights provides:

> Nothing in this Agreement shall prevent [WTO] members from specifying in their national legislation licensing practices or conditions that may in particular cases constitute an abuse of intellectual property rights having an adverse effect on competition in the relevant market. As provided above, a member may adopt, consistently with the other provisions of this Agreement, appropriate measures to prevent or control such practices, which may include for example exclusive grantback conditions, conditions preventing challenges to validity, and coercive package licensing, in the light of the relevant laws and regulations of that member.

In developing countries (including Hungary, Mexico, Poland, Russia, and the members of the Andean Common Market), such anticompetition rules are commonly found in transfer-of-technology codes. In the developed free-market countries (e.g., Germany, France, the United Kingdom, and the United States), they are found in long-standing antimonopoly legislation. The U.S. Sherman

---

[126]The conflict between intellectual property rights and unfair competition laws is not a new problem. As the U.S. District Court in SCM Corp. v. Xerox Corp., *Federal Supplement*, vol. 463, p. 996 (1978), pointed out: "Ever since the [English Court of] King's Bench considered a patent-antitrust conflict in 1602 in the first reported case on the subject [*Darcy v. Allein*, *English Reports*, vol. 77, p. 1260 (1602)] the issues arising in this field have yielded few clear or satisfying answers. Economic arguments could be made that these statutes have a common goal of maximizing wealth by facilitating the production of what consumers want at the lowest cost. . . . Whatever their economic congruency, there can be little doubt that these two sets of laws are juridicially divergent."

[127]*Walker Process Equipment, Inc. v. Food Machines & Chemical Corp.*, *United States Reports*, vol. 382, p. 177 (Supreme Ct., 1965).

Antitrust Act, among the oldest laws prohibiting unfair competition, is a good example of this type of legislation. It provides:

1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is hereby declared to be illegal. . . .
2. Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several states, or with foreign nations, shall be deemed guilty of a felony. . . .[128]

Similar provisions are found in Articles 81 and 82[129] of the EU's European Community Treaty.[130] Unlike the Sherman Antitrust Act, however, the EC Treaty provisions contain an express exemption (Article 81(3)) that allows the European Commission to authorize arrangements that would otherwise violate the general prohibitions, either through block grants (that apply to a particular category of agreements) or on a case-by-case basis. The commission may do so when the overall effect of a challenged activity is one that "contributes to improving the production or distribution of goods, or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit." The same result is achieved in the United States with the development of a court-made **rule of reason.** Except for certain agreements, such as horizontal price-fixing, which the courts regard as illegal *per se*,[131] the rule of reason requires courts to consider the overall impact of the particular agreement on competition within the relevant market. Courts, accordingly, must identify the procompetitive effects of the agreement and then weigh them against its anticompetitive effects. A common example involves the sale of a firm. In order to sell the firm, the seller may have to agree not to compete with the buyer by setting up a new business in the same area for a reasonable period of time. Such an agreement allows the seller to make a sale and the buyer to protect the goodwill it has purchased, and overall, it increases competition.[132]

rule of reason
Court-adopted rule that allows a reviewing court to consider the overall impact of a particular agreement on competition within its relevant market.

Although it can be stated as a general proposition that (1) licenses granting statutory intellectual rights are enforceable exceptions to technology transfer codes and the unfair competition laws and that (2) licenses granting nonstatutory rights must comply with both, this is only a general statement. Countries differ in their application of these general rules. We will look, therefore, at several examples of how particular licensing clauses are regulated in different countries.

In considering the following licensing provisions and their corresponding regulations, one needs to keep in mind that they apply to different kinds of intellectual property in varying degrees. Export restrictions, for example, apply to all kinds of intellectual property (including copyrights, patents,

[128]*United States Code*, Title 15, §§1 and 2.

[129]Articles 81 and 82 were previously Articles 85 and 86 prior to the renumbering of the Treaty Establishing the European Community agreed to by the Treaty of Amsterdam.

[130]European Union, Treaty Establishing the European Community, Article 81, provides:

1. The following shall be prohibited as incompatible with the common market: all arrangements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market. . . .
2. Any agreement or decision prohibited pursuant to this Article shall be automatically void.
3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of: any agreement or category of agreements between undertakings; any decision or category of decisions by associations of undertakings; any concerted practice or category of concerted practices; which contributes to improving the production or distribution of goods, or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:
   a. impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
   b. afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

Article 82 provides: "Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as incompatible with the common market in so far as it may affect trade between Member States. . . ."

[131]From Latin: "by itself" or "in itself"; "intrinsically."

[132]See *National Society of Professional Engineers v. United States*, *United States Reports*, vol. 435, p. 689 (Supreme Ct., 1978).

trademarks, and know-how), whereas restrictions on research and development, as another example, apply—obviously—only to patents and know-how.

Territorial Restrictions

In almost every country, a restriction on the territorial scope granted in the license of a statutory right (i.e., a patent, trademark, or copyright) is treated as a normal incidence of that right. Article 24 of the 1919 Honduran Law on Patents provides a typical example:

> In the instrument of transfer an indication shall be given of whether . . . the transfer is effective in a certain area only or throughout the Republic.

Such restrictions, however, apply only to the immediate licensee. Attempts to limit the territory in which an article can be traded after it has left the hands of the licensee are universally condemned. The rationale underlying this is a doctrine known as *exhaustion of rights*.

exhaustion-of-rights doctrine
Once a good made or sold under license is in circulation, the licensor has no further right to control its distribution.

Although the **exhaustion-of-rights doctrine** first appeared as a court-made rule in the United States and Germany,[133] the European Court of Justice has given the doctrine its broadest application and its most careful analysis. This is because the EU is confronted with the problem of rationalizing the separate intellectual property laws of its member states with its own express goal of establishing the free movement of goods among those states. As the Court of Justice observed in *Parke, Davis v. Centrafarm* many years ago:

> The national rules relating to the protecting of industrial property have not yet been unified within the Community. In the absence of such unification, the national character of the protection of industrial property and the variations between the different legislative systems on this subject are capable of creating obstacles both to the free movement of the patented products and to competition within the common market.[134]

This rationalization problem is, in some respects, made more difficult by the EU's fundamental law—the EC Treaty—which expressly recognizes the rights of the member states to regulate intellectual property rights. Article 30 of the treaty provides:

> The provisions of Articles 28 and 29 [which establish the free movement of goods within the EU] shall not preclude prohibitions or restrictions on imports, exports, or goods in transit justified on grounds of . . . the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or disguised restriction on trade between Member States.

To avoid the conflict between the rights of the EU and the rights of the member states, which Article 30 seems to create, the Court of Justice has taken the novel, although somewhat obvious, step of narrowly defining the "industrial and commercial property" rights retained by the member states. Thus, in the landmark case of *Terrapin v. Terranova* the court stated:

> . . . whilst the Treaty does not affect the existence of rights recognized by the legislation of the Member States in matters of industrial and commercial property, yet the exercise of those rights may nevertheless, depending on the circumstances, be restricted by the prohibitions in the Treaty. Inasmuch as it provides an exception to one of the fundamental principles of the common market, Article 30 in fact admits exceptions to the free movement of goods only to the extent to which such exceptions are justified for the purposes of safeguarding the rights which constitute the specific subject-matter of the property.[135]

---

[133]The first statement of the rule by the U.S. Supreme Court was in *Adams v. Burks*, *United States Reports*, vol. 84, p. 453 (1873). In Continental T.V., Inc. v. GTE Sylvania, Inc., *id.*, vol. 433, p. 36 (1977), the Supreme Court set out the rule this way: "[U]nder the Sherman Act, it is unreasonable without more for a manufacturer to restrict and confine areas or persons with whom an article may be traded after the manufacturer has parted with dominion over it."
For a statement of the German rule, see Federal Cartel Office decision of May 5, 1960, *Wirtschaft und Wettbewerb, Entscheidungssammlung*, p. 251.

[134]Case 24/67, *European Court Reports*, vol. 1968, p. 71 (1968).

[135]Case 119/75, *id.*, vol. 1976, p. 1039 (1976).

In other words, although the court recognizes that the member states can create and grant rights in the "specific subject-matter" of intellectual property, when the "exercise" of those rights impacts on the EU, then EU law will govern. Put yet another way, the rights created by the member states are "exhausted" whenever the protected goods move across the national boundaries of the member states.

The leading EU patent case dealing with the exhaustion-of-rights doctrine is *Centrafarm v. Sterling Drug*.[136] The case involved patents for a drug used in the treatment of urinary infections that were held by Sterling Drug, an American company, in the Netherlands and the United Kingdom. Sterling sued Centrafarm (a company famous in the annals of the Court of Justice as a parallel importer of pharmaceuticals) for infringement of the Dutch patent. Centrafarm's alleged impropriety was the importation into the Netherlands for sale of certain quantities of the patented drug that had been lawfully marketed in the United Kingdom by Sterling licensees. This was commercially attractive to Centrafarm because the goods were marketed in the United Kingdom under government price regulations for about half of what they sold for in the Netherlands.

The Court of Justice defined the rights that member states could grant to the owner of a patent. Thus, a patent is

> . . . the guarantee that the patentee, to reward the creative effort of the inventor, has the right to use an invention with the view to manufacturing industrial products and putting them into circulation for the first time, either directly or by the grant of licenses to third parties, as well as the right to oppose infringements.

By this definition, a patent's essential function is to reward and encourage creative effort. The reward comes from the grant of a monopoly, which allows the patent owner to manufacture the protected product and to put it into circulation for the first time. This monopoly may be exercised either directly or through licensees. It is a significant grant, because the patent owner is also given the corollary right of objecting to its infringement.

The patent owner's rights, however, are significantly limited by this definition. The monopoly consists only of manufacturing the protected products and putting them into circulation for the first time. In other words, the patent owner may not restrict any subsequent circulation of the products.

Considering this limitation, the Court of Justice gave two examples of when a patent owner in one member state could restrict imports from another member state. One example is where a product is patentable in State A but not in State B. If it is manufactured in State B by a third party without the consent of the State A patent owner and then imported into State A, the patent owner may object. The other example is where the product is patented in both State A and State B, but the original owners of the two patents are persons who are legally and economically independent.[137] Either may object to the other's product being imported into its state.

In contrast to these two cases, the Court of Justice said that a patent owner would not be justified in opposing importation "where the product has been put onto the market in a legal manner, by the patentee himself or with his consent, in the member states from which it has been imported, in particular in the case of a proprietor of parallel patents." To hold otherwise, the court said, would allow a patent owner to cordon off each member state into a separate national market—something that is contrary to the notion of the free movement of goods, which is basic to the EU common market. In conclusion, the court noted:

> [T]he exercise, by a patentee, of the right which he enjoys under the legislation of a Member State to prohibit the sale, in that state, of a product protected by the patent which has been marketed in another Member State by the patentee or with his consent is incompatible with the rules of the EEC Treaty concerning the free movement of goods within the common market.

In *Centrafarm v. Winthrop*,[138] the Court of Justice applied the exhaustion-of-rights doctrine—with the same result—to a trademark infringement case. The court also applied the doctrine to a copyright case in

---

[136]Case 15/74, *id*., vol. 1974, p. 1147 (1974); *Common Market Law Reports*, vol. 1974, pt. 2, p. 480 (1974).

[137]The converse of this situation is the *common origin* doctrine, discussed below.

[138]Case 16/74, *European Court Reports*, vol. 1974, p. 1183 (1974).

Deutsche Gramophone v. Metro[139] and to a neighboring rights case in *Coditel v. Ciné Vog Films* (No. 1).[140] The EU Commission's Block Exemption for Know-how Licensing extends it to know-how licenses.[141]

The European Court of Justice has devised another doctrine, related to the doctrine of exhaustion of rights, to promote the free movement of goods at the expense of trademark owners. This is the **common origin doctrine,** which was first announced in the case of *Van Zuylen v. Hag*, then revised and narrowed in *CNL-Sucal v. Hag*.

common origin doctrine
Owners of the same intellectual property right who acquired it from a common predecessor cannot restrict each other from using the right.

The *Van Zuylen* case was a trademark infringement action that arose as the result of the importation into Luxembourg of decaffeinated coffee manufactured in Germany by Hag AG and bearing the HAG trademark. In 1927, Hag AG had established a subsidiary in Belgium to which it assigned the rights to the HAG trademark for both Belgium and Luxembourg. After World War II, the Belgian government expropriated the subsidiary as enemy property and ultimately sold it to the Van Oevelen family, who, in 1971, assigned the trademark to Van Zuylen Frères. Van Zuylen Frères was the owner of the mark at the time that Hag AG began its imports to Luxembourg. In sum, the case involved a trademark that had originally been the property of a common owner but that was now owned in one member state by the original owner and in another state by a legally and economically unrelated company. The Court of Justice concluded that the Belgian expropriation of the subsidiary did not break the common origin of the HAG trademark. It therefore held that the parallel importation into Luxembourg had to be allowed. The court stated:

> The exercise of a trademark right tends to contribute to the partitioning off of the markets and thus to affect the free movement of goods between Member States, and all the more so since—unlike other rights of industrial and commercial property—it is not subject to limitations in point of time.
>
> Accordingly, one cannot allow the holder of a trademark to rely upon the exclusiveness of a trademark right—which may be the consequence of the territorial limitation of national legislations—with a view to prohibiting the marketing in a Member State of goods legally produced in another Member State under an identical mark having the same origin. Such a prohibition, which would legitimize the isolation of national markets, would collide with one of the essential objects of the Treaty, which is to unite national markets in a single market.

The holding in the *Van Zuylen* case was later summarized by the Court of Justice in *Terrapin v. Terranova*. There the court said that a trademark could not be used to prevent goods from being sold in the state granting the mark when the mark was "the result of the subdivision, either by voluntary act or a result of public constraint, of a trademark right which originally belonged to one and the same proprietor."[142]

In 1990, the Court of Justice overruled its decision in the *Van Zuylen* case. In *CNL-Sucal v. Hag*, the court held that the expropriation of the HAG mark by Belgium after World War II had indeed broken the unity of the trademark and destroyed the common origin. As a consequence, there were now two separate marks, which enjoyed full protection in their respective territories. Each owner was now "able to prevent the importation and marketing in the Member State where the mark belongs to him, of products originating from the other owner."[143]

Although there is some authority for the proposition that the EU's common origin doctrine may apply to other forms of intellectual property, there are several good arguments for believing that it applies only to trademarks. In particular, the primary function of a trademark is to assure consumers of the place of origin of a product, while the primary function of patents and copyrights is to reward creativity. Also, the subdivision of a market through the use of trademarks is a reasonably serious matter because a trademark is essentially permanent, whereas patents and copyrights are temporary monopolies.[144]

It is important to note that both the exhaustion-of-rights doctrine and the common origin doctrine apply only in cases involving the movement of goods between the member states of the

[139]Case 78/70, *id*., vol. 1971, p. 487 (1971).

[140]Case 62/79, *id*., vol. 1980, p. 881 (1980). The particular case involved the unauthorized rebroadcast over a cable network of a film that had been broadcast over a different network in another member state.

[141]European Union, Block Exemption for Know-How Licensing, Articles 3(6), 3(7), 3(12), and 9(5) (1987).

[142]Case 119/76, *European Court Reports*, vol. 1976, p. 1039 (1976); *Common Market Law Reports*, vol. 2, p. 482 (1976).

[143]Case 10/89, *Common Market Law Reports*, vol. 3, p. 571 at 609 (1990).

[144]For additional reasons, see Derrick Wyatt and Alan Dashwood, *The Substantive Law of the EEC*, p. 499 (2nd ed., 1987).

EU.[145] When protected products are manufactured outside the EU, they may not be imported into the EU without the express consent of the EU intellectual property owner. This was the circumstance in the *EMI v. CBS* cases.[146] Until 1917, the same company had owned the COLUMBIA trademark in Europe and the United States. In 1931, however, EMI acquired the European mark, and in 1938 CBS acquired the American mark. Because the trademarks were of a common origin, CBS attempted to take advantage of the common origin doctrine announced in *Van Zuylen v. Hag* to be able to sell its products in Europe. The Court of Justice rejected CBS's arguments, holding:

> [T]he exercise of a trademark right in order to prevent the marketing of products coming from a third country under an identical mark, even if this constitutes a measure having an effect equivalent to a quantitative restriction, does not affect the free movement of goods between Member States and thus does not come under the prohibitions set out in Article 30 [now Article 28] *et seq* of the Treaty.

Like the European Court of Justice, U.S. courts have faced the problem of parallel imports of protected products that have been lawfully manufactured outside the United States—a problem known in the United States as **gray marketing**—and have come to very similar conclusions.

gray marketing The domestic sale of products manufactured under a license that only grants a foreign licensee the right to sell the goods overseas.

Online Marketplaces and Trademark Infringement by Users

All of the legal rules discussed in the previous section face new challenges as more and more international commerce (and everyday activity) takes place in "cyberspace." Many of us are "online" most of every day, in one way or another, both for social and business reasons. In recent years there has been a significant increase in the buying and selling of goods through online "auction" sites (such as eBay) whereby a seller posts an item for sale and buyers make bids to purchase the item. Many of these purchases and sales take place across international boundaries, using the Internet and World Wide Web to select and purchase the goods. Unfortunately for producers of name brand, trademarked products, some of the items sold over these sites are counterfeit and others have been lawfully manufactured in one country but were not intended or licensed to be sold in other countries (parallel imports). One important question is the extent to which the operator of the online marketplace is required to bear responsibility for dealing with such infringement. The following case from the highest court in the European Union dealt with this question.

Export Restrictions

Export restrictions limit, partially or entirely, the rights of a licensee to export goods from the territory where the licensee or its production facilities are located. Most countries, as a general rule, prohibit export restrictions.[147] This rule, however, is often subject to many exceptions.

In some countries, restrictions will be tolerated if they limit exports to a country where (1) the licensor owns intellectual property rights and (2) the local laws allow the licensor to restrict foreign imports.[148] In other countries, export restrictions will be tolerated if the limitation applies to a territory where (1) the licensor is manufacturing or distributing the restricted goods or (2) the licensor has granted an exclusive license to a third party to manufacture or distribute the goods.[149]

[145]The exhaustion-of-rights doctrine and the common origin doctrine also do not apply in the European Free Trade Area, which is a free-trading group made up of the EU, Iceland, Liechtenstein, Norway, and Switzerland. Case E2/97, *Mag Instrument Inc. v. California Trading Company* (EFTA Court of Justice, 1997), posted at www.dinesider.no/customer/770660/archive/files/Decided%20Cases/1997/97%2002%20advisory%20opinion.pdf.

[146]Case 51/75, *EMI Records v. CBS United Kingdom*, *European Court Reports*, vol. 1976, p. 811 (1976); *Common Market Law Reports*, vol. 1976, pt. 2, p. 235 (1976); Case 86/75, EMI Records v. CBS Grammofon, *European Court Reports*, vol. 1976, p. 871 (1976); Case 96/75, *EMI Records v. CBS Schallplatten*, *id.*, vol. 1976, p. 913 (1976).

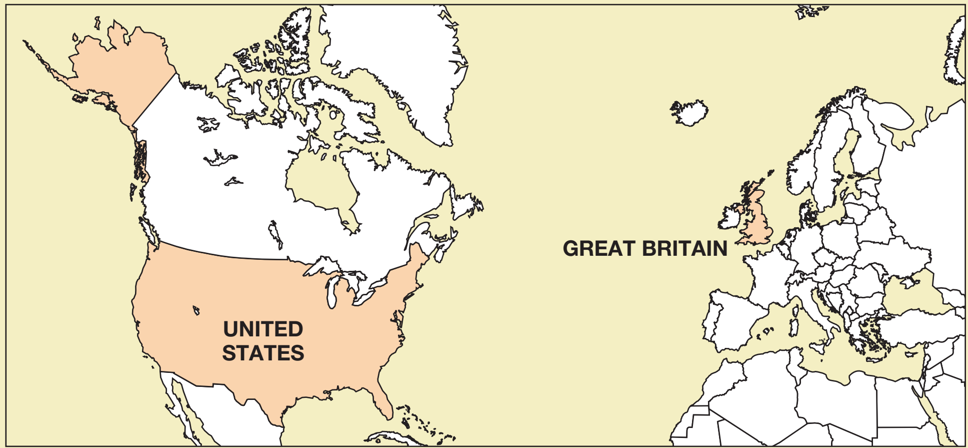
[147]E.g., India, *Guidelines for Industries*, Chap. 3, Article 9(v) (1988), provides: "To the fullest extent possible, there should be no restrictions on free exports to all countries." Similar provisions exist in Nigeria, the Philippines, Portugal, Spain, and Zambia.

[148]E.g., Brazil, Normative Act No. 015 of the National Institute of Industrial Property, Articles 2.5.2(b)(i), 3.5.2(c)(i), 4.5.2(d)(i), and 5.5.2(d)(i) (1975); Japan, Antimonopoly Act Guidelines for International Licensing Agreements, § 1.1(a) (1969); Mexico, Summary of the General Criteria for the Application of the Law Concerning Registration of the Transfer of Technology and the Use and Working of Patents, Trade Names and Trademarks (September 1974).

[149]E.g., Argentina, Law No. 21617 on the Transfer of Technology, Article 10(c) (August 12, 1972); Japan, Antimonopoly Act Guidelines for International Licensing Agreements, §1.1(b) (1969); Mexico, Summary of the General Criteria for the Application of the Law Concerning Registration of the Transfer of Technology and the Use and Working of Patents, Trade Names and Trademarks (September 1974); Serbia and Montenegro, Law on Long-term Cooperation in Production, Commercial-Technical Cooperation and the Awarding and Acquiring of Technology Between Organizations of Associated Labor and Foreign Persons, Article 37(10) (1978).

CASE 9-5 L'Oréal v. eBay

Court of Justice of the European Union, July 2011
European Court Reports, C-324/09 (2010)



MAP 9.6

The United States and Great Britain (2011)

This case came to the ECJ upon a request for a preliminary ruling by the English high court. The plaintiff, L'Oréal, is suing the defendant eBay, seeking to hold it partially responsible for trademark infringement by the users of eBay's online marketplace. One of the key issues concerned the liability for keyword advertising, by which advertisers are able to select registered trademarks of their competitors as keywords to prompt advertisements for their own goods and services. Another issue was whether brand owners could legitimately prevent the offering for sale of testers, product samples, and the resale of goods without their original packaging.

The defendant eBay is the operator of an online marketplace that facilitates the exchange of goods on the Internet by individuals through a search engine and a secure payment system, covering a widespread geographical area. The defendant has designed and incorporated certain compliance mechanisms on its site to combat the sale of counterfeit goods. It has also purchased keywords—including well-known trademarks—from sites like Google AdWords, in order to attract new individuals to its electronic marketplace. When searched for, the keywords prompt an advertisement to pop up on the side of the search results, leading customers directly to the eBay marketplace and often to a competitor's advertisement.

The plaintiff is a global producer with a large product range, considerable trademark protection, and a worldwide reputation for some of its trademarked cosmetics, perfume, and other products. The plaintiff alleges that counterfeit L'Oréal products have been sold on the defendant's marketplace. Furthermore, the plaintiff has claimed that some of the products exchanged on the marketplace were licensed for sale only in North America and were not meant for sale in the European Economic Area (EEA)—a practice also known as "parallel importing." Also, some of the cosmetic products sold on the defendant's marketplace are sold without their original packaging, which damages the plaintiff's global reputation. The plaintiff views the purchasing and use of trademarked keywords by the defendant to attract new business as trademark infringement because customers are led to believe that they can purchase L'Oréal-sponsored products on eBay's marketplace. The plaintiff is seeking court orders against the defendant in order to stop individual sellers on the electronic marketplace from distributing trademarked products and to better protect its trademarks in the future.

The Court of Justice issued a judgment deciding the following:

1. Trademark owners may only exercise their rights in the context of commercial activity. Private sellers using the defendant's electronic marketplace are not infringing on the plaintiffs trademarks as long as the sales of each individual seller do not become commercial activity, in view of the volume, frequency, or other such characteristics.

2. Parallel importing is seen as an infringement on a trademark in the European Union when the seller of the goods on the electronic marketplace is located in a country outside of the EU and the purchaser resides in a country within the European Union and/or the defendant advertises products that are not being sold in the European Union to consumers in the EU. Such sellers have no permission to market L'Oreal goods in the EU and those goods have not been "placed in the market in the EU" by L'Oreal. These claims of trademark infringement should be heard at the national court level on a case-by-case basis.
3. Regarding the resale of unboxed/unpackaged L'Oréal products, such as product testers, or dramming (bottles bearing the trademark from which small quantities can be taken to supply to consumers as samples), where a reseller of branded products removes the packaging prior to sale, the trademark owner may oppose the resale, as that may harm the image of the product and thus the reputation of the trademark. Such sample products have not been "put on the market" under Article 7 of the Trademark Directive (which causes the exhaustion of the trademark owner's rights to prevent further distribution). Also essential information required as a matter of law (such as the identity of the manufacturer under the EU cosmetics directive) is no longer on the product and so the trademark owner is entitled to seek prevention of the sale of such products.
4. Applying the rationale of the recent *Google France* decision, the court found that the defendant can be found liable for trademark infringement if it uses sources such as Google Adwords to advertise products offered in its electronic marketplace that are trademarked, using a keyword that is identical to the trademark. This liability may exist *unless* the advertising enables "a reasonably well-informed and reasonably observant internet user to ascertain—without difficulty—whether the goods concerned originate from the trademark proprietor or on the contrary, a third party." Furthermore, the operator of the marketplace, eBay, must make it clear to customers of the site that the trademarked products being exchanged in its marketplace are being resold by persons other than the original seller.
5. The European Union E-Commerce Directive (Directive 2000/31) provides immunity from liability for an "information society service provider" for information stored by it on behalf of the recipient of its services. The court said that this directive does provide protection to an Internet service provider as long as the ISP plays a "neutral" role. However, the immunity can be lost if the operator:
   a. has provided the seller with some sort of "active" assistance, such as optimizing the presentation of the offer for sale or promoting the offer; or
   b. was aware of facts or circumstances on the basis of which a diligent economic operator should have realized that the offers for sale in question were unlawful, and in the event of being so aware, failed to act expeditiously in accordance with article 12(1)(b) of the directive.
6. The EU Court of Justice did not ultimately make any decisions on these issues with respect to ebay, but left the determination to national courts after further facts have been presented and developed. the court said several times that such determinations should be made on a case-by-case basis by national courts by applying the general principles set forth in this decision.

Casepoint

The decision of the European Union Court of Justice in this case will affect not only the defendant, eBay, but all other online auction sites. eBay and other online auction sites can be held liable for advertisements by users of their sites if the ads do not clearly show that the offered goods do not originate from the trademark owner. An online provider will also need to put better monitoring systems in place regarding the products sold on its site, as well as the geographical location of individual buyers and sellers, and remove trademarked keywords from their advertising, or face severe legal consequences. This court decision will not only tighten restrictions of online marketplaces within the European Union, but all over the world.

horizontal competition agreements
Agreements between competitors that have the effect of diminishing competition.

vertical competition agreements
Agreements between sellers and buyers.

In the United States, export restriction agreements between competitors (so-called **horizontal competition agreements**) have been held to be *per se* violations of the Sherman Antitrust Act.[150] For example, in *United States v. National Lead Co*., the U.S. Supreme Court found a worldwide patent pool covering an entire industry and dividing the whole world into exclusive territories to be illegal.[151] On the other hand, agreements between a seller and a buyer (**vertical competition agreements**) are not bad *per se* and will be tested by a *rule of reason*.[152]

In the EU, export restriction agreements that affect the movement of goods between EU member states violate the Union's European Community Treaty's unfair competition article (Article 81), whether they are reasonable or not. Restrictions on exports to countries outside the EU, however, are prohibited only if they can be shown to have a direct effect on the member states. Such a case exists where, because of geographical proximity and the absence of tariff duties, the goods could easily be reimported from a third country into a member state. Otherwise, export restrictions that apply outside the EU are enforceable in the Union.[153]

Cartels

cartel
A combination of independent business firms organized to regulate the production, pricing, and marketing of goods by its members.

A **cartel** is an agreement between several business enterprises that is designed, among other things, to allocate markets, to fix prices, to promote the exchange of knowledge resulting from technical and scientific research, to exchange patent rights, or to standardize products. Arrangements of this sort are often called *cross-licensing agreements*, *patent pools*, and *multiple licensing agreements*.

cross-licensing agreement
An agreement to exchange licenses.

patent pool
An agreement to share patents and other technology.

A **cross-licensing agreement** is an arrangement between two parties to exchange licenses; that is, each party is both a licensor and a licensee. A **patent pool** is an agreement among several owners of related technology to "pool" their patents and other related technology. A **multiple licensing agreement** involves the licensing of technology to a number of recipients by a single licensor. In themselves these agreements are not restrictive, but they may contain restrictive clauses. When they do, some countries prohibit them.

The EU, for example, forbids cartel-type arrangements when they have as their purpose or effect the prevention, restriction, or distortion of competition between EU member states. Such arrangements may include agreements to allocate markets between competitors (i.e., *horizontal* market allocation), horizontal price fixing, and patent pools.[154] In its Block Exemption for Know-how Licensing, the EU Commission has indicated that it will not object to information exchanges and cross-licensing agreements between a single licensor and a single licensee that involve know-how, patents, and trademarks so long as they do not have the effect of stifling competition. In particular, agreements to cross-license improvements and new applications are valid for up to seven years so long as licensees are not precluded from using their own improvements or licensing them to third parties.[155] On the other hand, cross-licensing agreements that involve any territorial restraint with respect to the manufacture, use, or marketing of goods are invalid.[156]

multiple licensing agreement
A contract for the licensing of industrial property rights to two or more licensees.

bottleneck principle
Participants in an industry-wide patent pool must grant reasonable access to the pool to any firm wishing to compete so that no firm will be disadvantaged.

In the United States, cross-licensing and patent pooling are not unlawful unless they are used to divide up territories among competitors, exclude others from competing, or otherwise restrain trade.[157] Moreover, a rule known as the **bottleneck principle** may require the participants in an industry-wide patent exchange to grant reasonable access to any firm wishing to compete so that no

---

[150]United States v. Topco Associates, Inc., *United States Reports*, vol. 405, p. 596 (Supreme Ct., 1972); United States v. Sealey, Inc., *id*., vol. 388, p. 350 (Supreme Ct., 1967).

[151]*Federal Supplement*, vol. 63, p. 513 (Dist. Ct. for S. Dist. of New York, 1945), affirmed *United States Reports*, vol. 332, p. 319 (Supreme Ct., 1947).

[152]For patent licenses, see *Continental T.V., Inc. v. GTE Sylvania, Inc*., *United States Reports*, vol. 433, p. 36 (1977); for trade secret licenses, see *United States v. E.I. Du Pont de Nemours and Co*., *Federal Supplement*, vol. 118, p. 41 (Dist. Ct. for Delaware, 1953), affirmed *United States Reports*, vol. 351, p. 377 (Supreme Ct., 1956); for trademarks, see United States v. Topco Associates, Inc., *id*., vol. 405, p. 596 (Supreme Ct., 1972).

[153]See, for example, Junghans, *id*., No. L 30, p. 10 (February 2, 1977) (Commission Decision).

The rule in Germany parallels that of the EU. Restrictions on exports to territories within Germany or to EU member states are unenforceable, but restrictions on exports to countries outside the EU are valid. See Bundeskartellamt, Decision of June 20, 1963, *Wirtschaft und Wettbewerb, Entscheidungssammlung*, p. 254 (1963).

[154]European Union, Block Exemption for Know-how Licensing, Articles 3(8) and 5.1(1).

[155]Licensees may, however, be restricted from disclosing secret know-how to third parties. *Id*., Article 2.1(4).

[156]*Id*., Articles 5.1(3) and 5.2.

[157]See *United States v. National Lead Co*., *Federal Supplement*, vol. 63, p. 513 (Dist. Ct. S. Dist. of New York, 1945), affirmed *United States Reports*, vol. 332, p. 319 (Supreme Ct., 1947); *Zenith Radio Corp. v. Hazeltine Research, Inc*., *id*., vol. 395, p. 100 (Supreme Ct., 1969).

firm will be disadvantaged and competition will not be impaired.[158] Price-fixing and division of markets between competitors, however, are held illegal *per se* in both the United States and the EU.

Japan provides much broader exemptions to its basic prohibition against cartels than do either the European Community or the United States. Thus, manufacturing cartels, which are designed to avoid economic depression of an industry through restrictions on production facilities, production quantities, or sales volumes, are valid.[159] Likewise, manufacturers' rationalization cartels aimed at improving technology, productivity, product quality, cost reduction, or any similar entrepreneurial rationalization scheme are also legal.[160] Other cartel-type arrangements are reviewed by the Japanese Fair Trade Commission using a rule-of-reason standard to determine if they have the effect of unreasonably restraining trade.[161]

Exclusive Licenses

Laws in several countries expressly state that the grant of a patent, trademark, or copyright gives the owner the right to confer either an **exclusive license** or a nonexclusive license.[162] In most other countries, both the government and the courts have held that such arrangements are implicitly proper.

exclusive license
A license that restricts who may compete with the licensee.

Parties to agreements granting these rights need to be careful, however, in defining the terms they use. A licensee may receive *sole rights* (to the exclusion of all others, including the licensor), *exclusive rights* (preventing everyone except the licensor from competing), or *nonexclusive rights* (which allow the licensor to grant other licenses). Merely using these terms, however, may cause confusion because the terms are interpreted differently in different countries. For example, in the United States, the term *exclusive rights* is generally held to mean that the licensor may not give a license to another licensee or exploit the licensed property himself unless he specifically reserves the right to do so.[163] In France, on the other hand, an exclusive license does not prevent the licensor from personally competing unless the agreement specifically provides otherwise.[164]

The importance of fully and carefully defining the terms used in a licensing contract is illustrated by Case 9-6.

CASE 9-6 Ransome-Kuti v. Phonogram, Ltd.

Ghana, High Court at Accra, 1976
Ghana Law Reports, vol. 1, p. 220 (1976)

Judge Edusei

The plaintiff in this application is seeking an order of this court "restraining the defendant by itself, its agents, servants, and privies from publishing or causing to be published for distribution, sale, or use in Ghana, a musical tape e'ntitled 'Everything Scatter' owned and produced by the plaintiff between May and October 1975."

The facts as revealed by the rival affidavits are not seriously in dispute. It is admitted by the defendants that the plaintiff created and composed a musical work entitled "Everything Scatter" in Nigeria, but by an agreement, Exhibit A, made between the plaintiff and Phonogram, Ltd. (Nigeria) dated 14 October 1975, the plaintiff assigned to Phonogram, Ltd. (Nigeria) the sole

[158]*Standard Oil Co. (Indiana) v. United States*, *id*., vol. 283, p. 163 (Supreme Ct., 1931).

[159]Law No. 54 on the Prohibition of Private Monopolies and the Preservation of Fair Trade, Articles 24–3.1, 24–3.2, and 24–3.3 (April 14, 1974).

[160]*Id*., Article 24–4.1.

[161]*Id*., Articles 24–3 and 24–4.

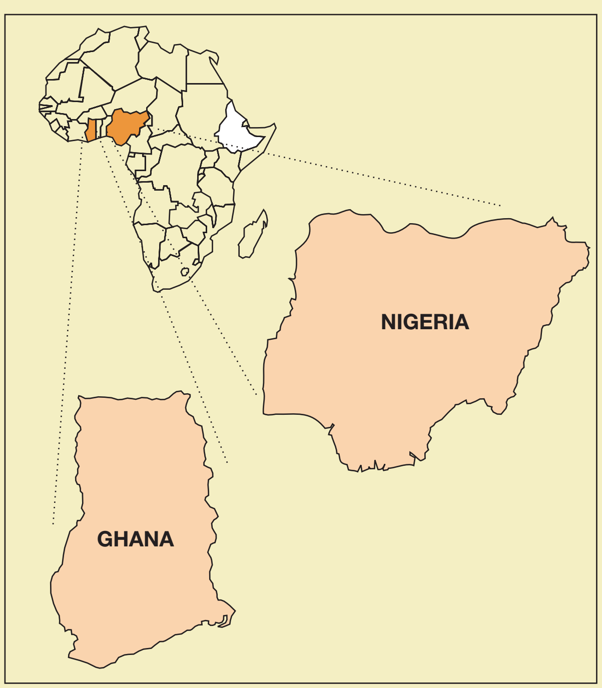
[162]E.g., Austria, Korea, and Zambia.

[163]See *Cutter Laboratories, Inc. v. Lyophile-Cryochem Corp*., *Federal Reports, Second Series*, vol. 179, p. 80 (Ninth Circuit Ct. of Appeals, 1949).

[164]Philippe Nouel, "Licensing in France," *International Licensing Agreements*, p. 158 (2nd ed., Götz M. Pollizen & Eugen Langen, eds., 1973).

MAP 9.7

Ghana and Nigeria (1976)



and exclusive right to produce or reproduce and sell the work on records and tapes as a single album as well as recordings on cassette tapes and cartridges all over the continent of Africa for a period of three years from 14 October 1975, in consideration of sums of money specified in the said agreement.

The plaintiff is contending that Phonogram, Ltd. (Nigeria) (hereinafter referred to as the Nigerian company) has no right whatsoever to delegate its duty of publishing to the defendants, and counsel for the plaintiff referred to the case of *Griffith v. Tower Publishing Co., Ltd.*,[165] where it was decided that a publishing agreement between an author and his publisher or firm of publishers is personal to the parties and cannot be assigned without the author's consent. In that case, the plaintiff agreed with the defendant-company, a firm of publishers, for the printing and selling of his three novels, but the publishers went into liquidation and were arranging for another company to publish the said novels. On application for an injunction to restrain the defendants and the receiver, the court said an injunction should go. It is clear from the judgment that the copyright in the novels remained in the plaintiff, who was entitled to protect his interest in so far as the printing and selling of the novels were concerned. And, in the absence of any power in the defendants to assign their right and interest in the agreement, it is clear that they could not without the consent of the author (the plaintiff) attempt to assign the publication of the novels to another company. Again, it seems that the right to assign any interest in the agreement was not reserved to either of the parties. There can be no doubt that this decision confirms the principle that such contracts are personal and on the facts of the case the decision in my view was correct.

In the case before me the parties entered into a formal agreement, Exhibit A, in which the parties include their successors-in-title and assigns. The opening words of the agreement, Exhibit A, presuppose that the right to assign the interest in the agreement is reserved to both parties unless there is a term to the contrary further down in Exhibit A. Again, by paragraph (5) of Exhibit A, the copyright in the musical work has passed to the Nigerian company for a period of three years during which the sole and exclusive right to produce or reproduce and sell the work in records and tapes over the continent of Africa is vested in the Nigerian company. The Nigerian company has licensed the defendants, a sister company in Ghana (part of Africa) to reproduce the said musical work in Ghana for them, and Section 10(5) of the *Copyright Act*, 1961 (Act No. 85), which permits the grant of licenses, stipulates as follows: "A license to do an act falling within

[165] *All England Law Reports*, vol. 1895–99, p. 323.

the copyright may be written or oral, or may be inferred from conduct, and may be revoked at any time." Also, Section 10(2) states:

> An assignment or testamentary disposition may be limited so as to apply to only some of the acts which the owner of the copyright has the exclusive right to control or to a part only of the period of the copyright.

By virtue of Exhibit A, the plaintiff has no copyright in the said musical work to protect—at least for three years in Africa. Indeed, paragraph (6) of Exhibit A makes the position of the plaintiff clearer. It states:

> The author [i.e., the plaintiff] further warrants that any records or works pressed or waxed on any other label . . . shall not be sold . . . in any part of the continent of Africa by the author, his agents, his representatives or any other person to whom the copyright shall be granted by the author outside the continent of Africa.

This quotation from Exhibit A means that the plaintiff is at liberty to grant to any other person outside the continent of Africa [the right] to reproduce the work on records and cassette tapes, but such records and cassette tapes cannot in any way be sold in Africa. In so far as the continent of Africa is concerned, the copyright in the musical work is vested in the Nigerian company. The Nigerian company—that has the copyright for a period of three years in Africa—has, in my opinion, every right to permit anyone in Africa under license to reproduce the work for that company.

. . . Since the copyright in the musical work is vested in the Nigerian company and the said company has given license to the defendant to reproduce the tape in this country which is part of the continent of Africa, I cannot see any infringement of the copyright by the defendants. It seems to me that I should be doing wrong if I decided that there has been an infringement in the face of Exhibit A and the facts in this case. . . .

The plaintiff's application was dismissed.

Casepoint

In this case the court was faced with the question of whether the license granted to a Nigerian company to reproduce the plaintiff's copyrighted musical work throughout Africa for three years also gave the licensee the right to subcontract the rights to produce records in Ghana to another firm. The plaintiff cited a previous case that had prohibited such secondary assignment regarding a book. However, in that case, the contract had said nothing about reassignment, while in this case, the contract used the phrase "successors and assigns" right at the beginning. Thus, the court found that reassignment of the right to produce records to another company in Ghana was allowed.

Sales and Distribution Arrangements

A sales or distribution arrangement limits a licensee's freedom to organize its distribution system independently of the licensor.

There are three basic approaches to the regulation of these agreements. One group of developing countries (e.g., Serbia and Montenegro and Zambia) prohibits any interference by the licensor in the licensee's distribution system.[166] A second group of developing and developed countries (e.g., Japan, Mexico, Nigeria, and Venezuela) prohibits only those provisions that give the licensor exclusive distribution rights.[167] Finally, a third group of generally developed countries (e.g., Germany, Portugal, Spain, the United States, and the European Community) only prohibit those exclusive sales arrangements that tend to allocate or monopolize markets.[168]

[166]For example, Zambia's Industrial Development Act, Article 16 (1977), provides: "A contract for the transfer of technology and expertise shall not contain any condition: . . . (c) Which restricts the manner of sale of products or the export of products to any country. . . ."

[167]For example, Venezuela's Decree No. 746 on Transfer of Technology Agreements, Article 1(e) (February 11, 1975), forbids any clause in a transfer of technology contract that "requires all or part of the goods produced to be sold to the supplier."

[168]See, for example, *Elder-Beerman Stores Corp. v. Federated Dept. Stores, Inc*., *Federal Reports, Second Series*, vol. 459, p. 138 (Sixth Circuit Ct. of Appeals, 1972); *United States v. Imperial Chemical Industries, Ltd*., *Federal Supplement*, vol. 105, p. 215 (Dist. Ct. for S. Dist. of New York, 1952).

Price-Fixing

price-fixing clause Provision requiring a licensee to sell products at a price set by the licensor.

A **price-fixing clause** requires a licensee to sell products at a price specified by the licensor. It may specify either maximum or minimum prices. It may be restricted to the technology or goods being licensed, or it may cover other products as well. It may apply only to the price charged by the licensee, or it may extend to the prices charged by retailers who purchase the goods from a wholesaler-licensee.

Price-fixing also arises in the context of cartels, particularly cross-licensing and patent pools.

Most countries—both developed and developing—prohibit all forms of price-fixing.[169] One exception is India, which allows a licensor to specify the price at which a licensee may sell a product manufactured using the licensor's technology or to which the licensor's trademark has been affixed (i.e., a vertical licensing arrangement).[170]

Noncompetition Clauses

noncompetition clause Provision forbidding a licensee from competing with the licensor.

Noncompetition clauses forbid a licensee from entering into agreements to acquire or distribute technologies or products that compete with ones furnished or designated by the licensor. Direct prohibitions may include an understanding that the licensee is not to manufacture or sell competing technologies, or that the licensee is to terminate the use of particular technologies or terminate the manufacture and distribution of particular products. Indirect prohibitions may require the licensee not to cooperate with a competing business or not to pay higher royalties for competing products.[171]

In general, noncompetition clauses are prohibited in all countries.[172] A few countries allow them under exceptional circumstances. The German Federal Cartel Office, for example, has sometimes granted an exemption to the German Act against Restraints on Competition when the restriction is narrowly drawn and when it is meant to prevent disclosure of confidential technical information.[173] In the United States, the courts have held that a clause prohibiting a trademark licensee from dealing in competing goods is not *per se* unlawful. Applying a rule of reason, the U.S. courts will consider the need to protect the mark, the need to avoid public confusion, and the impact of the restriction on competition.[174] Also, in connection with patent licenses, the U.S. courts have sometimes tolerated a noncompetition clause where the licensee has acquired an exclusive license.[175]

[169]E.g., Argentina, Law No. 21617 on the Transfer of Technology, Article 10(i) (August 12, 1972); Brazil, Normative Act No. 015 of the National Institute of Industrial Property, Articles 2.5.2(b)(i) 3.5.2.(c)(i), 4.5.2(d)(i), and 5.5.2.(d)(i) (1975); Japan, Antimonopoly Act Guidelines for International Licensing Agreements, § 1.6 (1969); Mexico, Law on the Registration of the Transfer of Technology and the Use and Working of Patents, Trade Names, and Trade Marks, Article 7(xi) (December 29, 1972); Nigeria, Decree No. 70 Establishing the National Office of Industrial Property, Article 6.2.(j) (September 14, 1979); the Philippines, Regulation to Implement Article 5 of Presidential Decree No.1520 establishing the Technology Board within the Ministry of Industry, Article 5.1(c) (October 10, 1978); Portugal, Foreign Investment Code (Legislative Decree No. 348/77, August 24, 1977), Article 28.1(f); Spain, Ministry of Industry Order Regulating the Entry of Contracts for the Transfer of Technology in the Register Established by Decree No. 2342 of September 21, 1973, §3.6 (December 5, 1973); Serbia and Montenegro, Law on Long-Term Cooperation in Production, Commercial-Technical Cooperation and the Awarding and Acquiring of Technology between Organizations of Associated Labor and Foreign Persons, Article 37.9 (1978); European Union, Treaty Establishing the European Community, Article 81.1(a) (1957 as amended).

Price-fixing in the United States is *per se* illegal. *Northern Pacific R. Co. v. United States*, *United States Reports*, vol. 356, p. 1 (Supreme Ct., 1958); United States v. Trenton Potteries Co., *id.*, vol. 273, p. 392 (Supreme Ct., 1927).

[170]Monopolies and Restrictive Trade Practices Act No. 54, Article 39.3 (1969).

[171]A clause requiring a licensee to use its best efforts may sometimes work as an indirect noncompetition clause.

[172]A typical prohibition is australia's patents act 1990 no. 83 of 1990, article 144(1): "a condition in a contract relating to the sale or lease of, or a license to exploit, a patented invention is void if the effect of the condition would be: (a) to prohibit or restrict the buyer, lessee or licensee from using a product or process (whether patented or not) supplied or owned by a person other than the seller, lessor or licensor, or a nominee of the seller, lessor or licensor. . . ." the australian patents act is at www.austlii.edu.au/au/legis/cth/consol_act/pa1990109/.

Similar statutory prohibitions exist in Argentina, Austria, India, Japan, Mexico, Nigeria, the Philippines, Portugal, Serbia and Montenegro, Spain, the United Kingdom, and Zambia.

[173]E.g., Bundeskartellamt Decision of June 20, 1963, *Wirtschaft und Wettbewerb, Entscheidungssammlung*, p. 254 (1963).

[174]See *American Motor Inns, Inc. v. Holiday Inns, Inc*., *Federal Reporter, Second Series*, vol. 521, p. 1230 (Third Circuit Ct. of Appeals, 1975); *Susser v. Carvel Corp*., *id*., vol. 332, p. 505 (Second Circuit Ct. of Appeals, 1964), *certoriari* denied, *United States Reports*, vol. 381, p. 125 (Supreme Ct., 1965); *Denison Mattress Factory v. Spring-Air Co*., *Federal Reports*, *Second Series*, vol. 308, p. 403 (Fifth Circuit Ct. of Appeals, 1962).

[175]See *Carbo-Frost, Inc. v. Pure Carbonic*, Inc., *Federal Reporter, Second Series*, vol. 103, p. 210 (Eighth Circuit Ct. of Appeals, 1964), *certoriari* denied, *United States Reports*, vol. 308, p. 569 (Supreme Ct., 1939); see also *Wood v. Lucy, Lady Duff-Gordon*, *North East Reporter*, vol. 118, p. 214 (New York Ct. of Appeals, 1917).

Challenges to Validity

No-challenge clauses forbid a licensee from challenging the validity of the statutory right granted by the licensor. The purpose of these clauses is to ensure that a licensee will comply with the agreed-to restrictions and payment obligations.

no-challenge clause
Provision forbidding a licensee from challenging the validity of a licensor's claim to a particular statutory right.

Only a few countries (e.g., Germany) permit no-challenge clauses generally.[176] Most consider such a clause in a patent or copyright license to be a restrictive trade practice. Many developing countries (e.g., the Philippines, and Serbia and Montenegro) expressly condemn them in their transfer-of-technology codes.[177] Most developed countries (including the United States and EU member states) interpret their unfair competition laws as forbidding no-challenge clauses in patent and copyright licenses.[178]

No-challenge clauses in trademark licenses are regarded in the same negative way by developing countries[179] and some developed countries. The EU, accordingly, views such clauses as a violation of the unfair competition article (Article 81(1)) of the European Community Treaty.[180]

The United States, however, does not regard a no-contest clause in a trademark license as violating either its trademark laws or its anti-trust laws.[181]

Tying Clauses

A **tying clause** is a provision that requires a licensee to acquire or use, separately from the technology wanted, additional goods (such as raw materials, intermediate products, machines, or additional technology) or designated personnel either from the licensor or from a source named by the licensor. In other words, the acquisition of these additional goods or services is a prerequisite to obtaining the technology license.

tying clause
A provision requiring a licensee to acquire or use, apart from the technology wanted, goods or personnel designated by the licensor.

In general, tying clauses are illegal in virtually every country. Most countries, however, provide for exemptions in varying degrees. The most common exemption is granted on the grounds that a tie-in is necessary to protect quality standards or to protect the goodwill of a trademark.[182] Other exemptions (in a few countries) allow tie-ins if the licensee is not charged an excessive price,[183] if the licensee is free to terminate the tie-in arrangements at any time,[184] or if the licensee is allowed to terminate the clause as soon as a dependable local source of supply can be found.[185]

Between 2000 and 2010 the European Union and Microsoft Corp. engaged in a long battle over tying. Microsoft consistently bundled its Windows operating system (which enjoyed a huge market share) with its Media Player software. Because there were other competing media programs which

---

[176]Germany, Act against Restraints on Competition, Article 20.2(4).

[177]The Philippines, Regulation to Implement Article 5 of Presidential Decree No. 1520 establishing the Technology Board within the Ministry of Industry, Article 5.1.c.5 (October 10, 1978); Serbia and Montenegro, Law on Long-Term Cooperation in Production, Commercial-Technical Cooperation, and the Awarding and Acquiring of Technology between Organizations of Associated Labor and Foreign Persons, Article 37(4) (1978).

[178]See *Lear, Inc. v. Adkins*, *United States Reports*, vol. 395, p. 653 (Supreme Ct., 1969); AOIP/Beyard, *Official Journal*, No. L, p. 31 (January 13, 1976) (Commission Decision).

[179]E.g., Serbia and Montenegro's Law on Long-Term Cooperation in Production, Commercial-Technical Cooperation and the Awarding and Acquiring of Technology between Organizations of Associated Labor and Foreign Persons, Article 37(4) (1978), prohibits all no-contest clauses affecting rights in any form of industrial property.

[180]See Goodyear Italiana/Euram, *Official Journal*, No. L 38, p. 11 (February 12, 1975) (Commission Decision); but compare Penneys, *Official Journal*, No. L 60, p. 19 (March 2, 1978) (Commission Decision), in which the Commission held that a no-contest clause that ran for a period of only 5 years was not an appreciable restriction on competition.

[181]See Beer Nuts, Inc. v. Kings Nut Co., *Federal Reporter, Second Series*, vol. 477, p. 328, *certiorari* denied, *United States Reports,* vol. 414, p. 585 (Supreme Ct., 1973); Seven-Up Bottling Co. v.The Seven-Up Co., *Federal Supplement,* vol. 420, p. 1246 (Dist. Ct. for E. Dist. of Montana, 1976).

[182]E.g., India, Patents Act, Article 140.4(c) (1970); United Kingdom, Patents Act, Article 44.6 (1977); European Union, Block Exemption for Patent Licensing, Article 2(9).

In the United States, a tying clause was held to be justified to protect the licensor's goodwill in *Dehydrating Process Co. v. A. O. Smith Corp*., *Federal Reporter, Second Series*, vol. 292, p. 1 (1st Circuit Ct. of Appeals, 1961), *certiorari* denied, *United States Reports*, vol. 368, p. 931 (Supreme Ct., 1961.

[183]E.g., Australia's Patents Act 1990 No. 83 of 1990, Article 144(2)(a); United Kingdom, Patents Act, Article 44.4(a) (1977).

[184]E.g., Australia's Patents Act 1990 No. 83 of 1990, Article 144(2)(b); United Kingdom, Patents Act, Article 44.4(b) (1977).

[185]E.g., Mexico, Law on the Registration of the Transfer of Technology and the Use and Working of Patents, Trade Names and Trade Marks, Article 7(x) (December 29, 1972).

were for sale to consumers in the EU, the fact that Microsoft was giving away Media Player and installing it on computers equipped with Windows had a dramatic negative effect on the competition in the market for such programs. The EU Commission charged Microsoft with illegal tying under EU Competition rules. Citing ongoing abuse by Microsoft, the EU reached a preliminary decision in the case in 2003 and ordered the company to offer both a version of Windows without Windows Media Player and the information necessary for competing networking software to interact fully with windows desktops and servers. In March 2004, the EU ordered Microsoft to pay €497 million ($794 million), the largest fine ever handed out by the EU at the time, in addition to the previous penalties, which included 120 days to divulge the server information and 90 days to produce a version of Windows without Windows Media Player. In September 2007, Microsoft lost its appeal against the European Commission's case. The EU Court of Justice upheld the €497 million fine, as well as the requirements regarding server interoperability information and bundling of media player. In addition, Microsoft had to pay 80 percent of the legal costs of the commission.

In a later action the EU Commission charged Microsoft with illegal antitrust/competition actions by bundling its Internet Explorer browser with the Windows operating system. In late 2009 The European Union settled the case by accepting the software giant's promise to provide current and new Windows users with more choices in selecting an alternative to Internet Explorer. The agreement provides that for the following five years, Windows XP, Windows Vista, and Windows 7 users in 30 European countries will be shown a "browser choice" screen through Windows update, giving them the opportunity to download an alternative browser. Microsoft agreed to provide a "ballot box" screen letting users choose one of twelve popular products listed in random order. The twelve browsers were Avant, Chrome, Firefox, Flock, GreenBrowser, Internet Explorer, K-Meleon, Maxthon, Opera, Safari, Sleipnir, and Slim, which are accessible via BrowserChoice.eu. Those purchasing a new Microsoft-powered computer from third-party manufacturers will see a similar screen. Microsoft thus appeared to end more than a decade of anti-trust disputes with the European Union, which had resulted in a total of $1.26 billion in fines. "I hope that today's decision closes a long chapter in Microsoft's sometimes uneasy relationship with the commission," said Competition Commissioner Neelie Kroes.

However, in May 2011, Microsoft appealed to EU regulators for a reduction in the massive fine imposed upon it three years earlier, calling it "excessive" and "especially unfair." Meted out after it was determined that Microsoft had failed to comply with the 2004 antitrust judgment, the $1.26 billion fine was the largest ever imposed by the EU against a single company, the first to be issued for noncompliance with a court order, and, in Microsoft's opinion, "unnecessary, unlawful and totally disproportionate." Microsoft argued that it was the commission's fault the fine was so high because the Commission had not given Microsoft the full compliance information it needed to avoid it in the first place. However, according to commission lawyers, Microsoft is on record claiming it understood what was required by the court order.

Quantity and Field-of-Use Restrictions

quantity restriction Provision in a license limiting the quantity of goods that may or must be produced.

field-of-use restrictions Provision limiting the fields in which goods acquired or produced under license may be used.

Countries regulate licensing arrangements with **quantity** and **field-of-use restrictions** in three ways. Developing countries (with transfer-of-technology codes) generally regard limitations on the quantity of goods that may or must be produced, or limits on the fields in which goods may be used or sold, as illegal. The prohibition in Article 16 of Zambia's Industrial Production Act of 1977 is a typical example:

> A contract for the transfer of technology and expertise shall not contain any condition: . . .
>
> a. Which restricts the volume or structure of production;
> b. Which limits the ways in which patents or other know-how may be used. . . .

Similar provisions exist in Brazil,[186] Mexico,[187] and the Philippines.[188]

[186]Brazil, Normative Act No. 15 of the National Institute of Industrial Property, Article 2.5.2 (September 11, 1975).

[187]Mexico, Law on the Registration of the Transfer of Technology and the Use and Working of Patents, Trade Names and Trade Marks, Article 7 (December 29, 1972).

[188]Philippines, Regulation to Implement Article 5 of Presidential Decree No. 1520 establishing the Technology Board within the Ministry of Industry, Article 28.1 (October 10, 1978).

A second group of countries, including Japan, the European Community, the United States, and most countries in the developed world, regard quantity and field-of-use restrictions as implicit elements in the statutory rights of a licensor. Section III of Japan's Antimonopoly Act Guidelines for International Licensing Agreements of 1969 is a representative example:

> In international licensing agreements on patent rights, etc., the following acts shall be regarded as the exercise of rights under the Patent Act or the Utility Model Act: . . .
>
> 1. To restrict the manufacture of patented goods to a limited field of technology or to restrict the sale thereof to a limited field of sales;
> 2. To restrict the use of patented processes to a limited field of technology;
> 3. To restrict the amount of output or the amount of sales of patented goods or to restrict the frequency of the use of patented processes; . . .

Most of these countries do not, however, allow licensors to impose quantity or field-of-use limitations on nonstatutory rights. When they relate to know-how and other contractually based rights, these provisions are typically held to violate unfair competition rules.[189] When they attempt to expand a statutory grant beyond its ordinary scope, such a license is treated as a misuse of the grant. For example, in *United States v. Studiengesellschaft Kohle, M.B.H.*, an American court found that a sales limit imposed on unpatented goods produced according to a patented process was a form of patent misuse.[190] One exception to this is the EU's *Block Exemption for Know-How Licensing*, which expressly allows licensors to confine a licensee's exploitation of know-how to a specific field of application or market. However, restrictions on customers who may be supplied within a particular field of use or market, restrictions on quantities sold, or restrictions on supplying persons who would resell the product within the EU are all illegal.[191]

A third approach to quantity and field-of-use restrictions is found in Germany. There, restrictions on both statutory and nonstatutory rights—including limitations on the use of know-how and trade secrets—are expressly allowed. Article 20.1 of Germany's 1957 Act Against Restraints on Competition expressly states that "restrictions pertaining to the type, extent, quantity, territory, or period of exercise" of statutorily granted industrial property rights are "within the scope" of the statutory grant itself, and therefore valid and enforceable. Article 21.1 states that the same rule applies to agreements limiting the use of "legally unprotected inventions, manufacturing methods, instructions, technique-improving processes and secret plant-breeding methods."

Recent International Developments

U.S. USES INTERNATIONAL TRADE COMMISSION TO BLOCK IMPORTS

One new legal theory was used in the United States in 2011 to block the importation of products based on the misappropriation of trade secrets in a foreign nation. In the case *TianRui Group Co., Ltd. v. ITC,* the U.S. Court of Appeals for the Federal Circuit upheld an order of the International Trade Commission (ITC) banning the import of certain products from China. In this case a U.S. company (Amsted), which owned secret processes (the "ABC process") for manufacturing cast steel railway wheels, had licensed its process to certain Chinese companies. Another Chinese company, TianRui, had also sought such a license from Amsted, but an agreement was never reached. Later, TianRui hired nine employees with knowledge of the ABC process from one of the Chinese licensees and those employees then revealed the trade secrets, despite signing agreements not to do so. TianRui then manufactured steel railway wheels using the ABC process.

When TianRui attempted to export those wheels into the United States, Amsted filed a complaint with the ITC seeking to block the importation, arguing that the misappropriation of its trade secrets constituted an "unfair method of competition and unfair act in the importation of articles . . . into the United States" in violation of Section 337 of U.S trade law (see Figure 9.3). After a 10-day hearing the ITC Administrative Law Judge found that TianRui had misappropriated 128 trade secrets relating to the ABC process and had used those secrets in manufacturing the cast steel railway wheels that were being imported into the United States.

---

[189]See *Continental T.V., Inc. v. GTE Sylvania, Inc.*, *United States Reports*, vol. 433, p. 36 (Supreme Ct., 1977).

[190]*Federal Supplement*, vol. 426, p. 143 (Dist. Court for the District of Columbia, 1976).

[191]European Union, Block Exemption for Know-how Licensing, Articles 2.1(10), 3(6), 3(7), 3(12), and 9.5 (1987).

FIGURE 9.3

The United States Blocked Importation of Chinese Products That Were Created Based on U.S. Trade Secrets.

On appeal the Federal Circuit acknowledged that there is a general presumption that U.S. legislation should not have extraterritorial effect, but in a 2–1 decision, decided that the presumption did not apply in this case and upheld the exclusion order. The Court pointed out that Section 337 is expressly directed at unfair methods of competition and unfair acts "in the importation of articles" in the United States. Further, the Court found that the exclusion order did not attempt to regulate foreign unfair activity except where that action results in the importation of goods into the United States, thus causing domestic injury. This decision substantially expands the reach of the ITC to acts that occur overseas and provides an effective remedy to trade secrets misappropriation. Trade secret owners can now seek an exclusion order from the ITC to ban the imports of products using misappropriated trade secrets, rather than having to file a lawsuit in the country where the misappropriation occurs.

Restrictions on Research and Development

Restrictions on research and development may relate to two different kinds of activities: (1) the research, adaptation, and improvement of the transferred technology or (2) the research and development of competing technologies. Both of these are condemned in almost all countries.[192] The one significant exception is the United States, where a restriction on research to adapt transferred technology will be tolerated if it preserves a product's reputation or protects the licensor from liability. Also, if the restriction is comparable to a valid field-of-use restriction, it may also be justified.

Quality Controls

quality control clause Provision requiring a licensee to meet quality standards or operate under quality controls set by a licensor.

Requirements that a licensor meet certain quality standards or comply with certain quality controls imposed by the licensor are almost uniformly accepted in all countries. In particular, **quality control clauses** are justified where the trademark of the licensor is being applied to a product manufactured and/or distributed by the licensee.[193] They are also justified when they are imposed for the purpose of avoiding product liability.

[192]A typical provision is found in nigeria's decree no. 70 establishing the national office of industrial property, article 6.2(3) (september 14, 1979), which prohibits any transfer-of-technology provision "where limitations are imposed on technological research or development by the transferee."

[193]Germany, Act against Restraints on Competition, Article 20.2(1) (1957). United States, Lanham Trademark Act, para. 1127 (1976); European Union, Block Exemption for Patent Licensing, Article 2(9).

A leading U.S. case, *Siegel v. Chicken Delight*, Inc., *Federal Reporter, Second Series*, vol. 448, p. 51 (Ninth Circuit Ct. of Appeals, 1971), *certiorari* denied, *United States Reports*, vol. 405, p. 955 (Supreme Ct., 1972), observed: "For a licensor, through relaxation of quality control, to permit inferior products to be presented to the public under his licensed mark, might well constitute a misuse of the mark." An often-cited decision of the EU Commission, Campari, *Official Journal*, No. L 70, p. 69 (March 13, 1978), makes a similar observation.

Quality control clauses are prohibited, however, where they are used as a means of improperly tying in other products or services, where they seek to make the licensee dependent on the licensor,[194] or where they seek to allocate trade territories.

Grant-Back Provisions

grant-back provision Agreement that a technology licensee will transfer to the licensor any improvements, inventions, or know-how it acquires while using the technology.

A **grant-back provision** requires a technology recipient (i.e., a patent or know-how recipient) to transfer back to the supplier any improvements, inventions, or special know-how that it acquires while using the technology. Such a provision may be unilateral or reciprocal, exclusive or nonexclusive. A unilateral grant-back provision requires one of the parties—usually the licensee—to transfer back new knowledge, whereas a reciprocal provision requires both to do so. Sometimes a reciprocity agreement will require both parties to exchange their developments (i.e., a true reciprocal exchange), but at other times only one party will be required to transfer new knowledge, while the other will be required merely to pay adequate compensation (i.e., a compensated unilateral exchange).

An exclusive grant-back provision requires one of the parties—usually the licensee—to transfer any rights (i.e., patent or know-how rights) in the new development to the other party. A nonexclusive (or *sharing*) provision allows the parties to share these rights.

Most countries prohibit grant-back provisions that unilaterally require the licensee to transfer exclusive rights to the licensor. One exception is the United States, which permits such a provision so long as it has no anti-competitive effect.[195]

In contrast, most countries do not prohibit (and a few expressly allow) grant-back provisions that are reciprocal and nonexclusive—that is, provisions that require the parties to share the new knowledge. This is so for both *true* reciprocal exchanges (i.e., technology exchanged for technology) and compensated unilateral exchanges (i.e., technology exchanged for money). Table 9.3 summarizes the different approaches to grant-back provisions in several representative countries.

TABLE 9.3

Regulation of grant-back provisions

Types of Provisions	Expressly Prohibited	Expressly Permitted
Reciprocal exchange True reciprocal exchange (Technology for technology)		Argentina, Germany, Japan, Mexico
Compensated exchange (Technology for money)		Portugal, Serbia and Montenegro
Unilateral Exchange Exclusive (Transfer of all rights to one party)	Argentina, Japan, Mexico, Nigeria, Philippines, Spain, Venezuela, European Union	United States[a]
Nonexclusive (Sharing of rights with the other party)	Philippines	Brazil

[a]Permitted so long as there is no anti-competitive effect.

[194]Nigeria, Decree No. 70 Establishing the National Office of Industrial Property, Article 6.2(o) (September 14, 1979); Venezuela, Decree No. 746 on Transfer of Technology Agreements, Article 1(d) (February 11, 1975).

[195]See *Transparent Wrap Machine Corp. v. Stokes and Smith Co.*, *United States Reports*, vol. 329, p. 637 (Supreme Ct., 1947). There the U.S. Supreme Court said that a unilateral grant-back of exclusive rights to a licensor was not a *per se* violation of the antitrust laws and would be permitted so long as it had no anticompetitive effect beyond that inherent in patents or know-how. This decision was followed in *Santa Fe Pomeroy, Inc. v. P. and Z. Co.*, *Federal Reporter, Second Series*, vol. 569, p. 1084 (Ninth Circuit Ct. of Appeals, 1978), where the evidence showed that the grant-back provision did not unduly restrain trade or suppress industry development. A grant-back provision was held illegal in *United States v. Aluminum Co. of America*, *Federal Supplement*, vol. 333, p. 410 (Dist. Ct. for S. Dist. of New York, 1950) because it tended to enhance the technological superiority of a company with monopoly or near-monopoly power.

Restrictions That Apply After the Expiration of Intellectual Property Rights

Countries generally hold that payment obligations or restrictions based on statutory intellectual property rights must terminate when the statutory right expires.[196] The reason for this was stated succinctly by the U.S. Supreme Court in *Scott Paper Co. v. Marcalus Mfg. Co.*, a patent case:

> If a manufacturer or user could restrict himself, by express contract . . . from using the invention of an expired patent, he would deprive himself and the consuming public of the advantage to be derived from his free use of the [patent] disclosures. . . . Hence, any attempted reservation or continuation in the patentee or those claiming under him of the patent monopoly, after the patent expires, whatever the legal device employed, runs counter to the policy and purpose of the patent laws.[197]

package licensing The transfer of multiple statutory rights under a single license.

The principal problem that arises in connection with the expiration of statutory rights involves package licenses. **Package licensing** is the transfer of multiple statutory rights (often including multiple patents and multiple trademarks) under a single license. Generally, if the licensing agreement was entered into voluntarily by both sides and the payment obligations do not extend beyond that of the last-to-expire statutory right, these agreements will be enforceable. On the other hand, if the licensee was at an economic disadvantage and given only the option of taking or leaving the arrangement, it will commonly be found to be illegal as a form of statutory misuse. For example, in the American case of *McCullough Tool Co. v. Well Surveys, Inc.*, the court upheld a licensing arrangement under which the licensee agreed to pay level royalties on a package of patents, some of which were to expire during the period of the agreement. The court did so because the term of the license did not extend beyond the last-to-expire patent and because the licensee was not required to accept the package on a take-it-or-leave-it basis.[198] On the other hand, in *American Securit Co. v. Shatterproof Glass Corp.*, the court found that a package of patents, which the licensee was required to accept on a take-it-or-leave-it basis, was patent misuse.[199]

Concerning restrictions and payment obligations in connection with nonstatutory rights, in particular trade secrets and other secret know-how, there are several different approaches. In Germany, for example, a licensor may not enforce payment obligations or other restrictions once the know-how has lost its secret character or becomes economically worthless or technically outdated.[200] With respect to package licenses, a German licensee may bring suit to obtain an adjustment in the payment obligation or termination of the entire contract if some of the rights become worthless and the amount being paid is not reasonably related to the value of the remaining rights.[201]

In some developing countries, such as Serbia and Montenegro, national legislation prohibits any restriction on the free use of know-how once a reasonable period has lapsed following the transfer

---

[196]As to payment obligations, most countries simply state that the obligations cease when the statutory right expires. Thus, Article 71 of Venezuela's Decree No. 2442 on the Treatment of Foreign Capital, Trademarks, Patents, Licenses and Royalties (1977) provides: "No payments shall be permissible by way of royalties or other charges in respect of the use of trademarks, processes, patents or industrial models for a period exceeding the period of validity of the industrial property rights recognized by the relevant legislative provision."

In the United Kingdom and many of its former colonies, including Australia and India, the obligations that arise under an intellectual property license will terminate at the time that the underlying statutory right expires and upon the licensee giving three months' notice to the licensor. See United Kingdom, Patents Act, Article 45(1) (1977); Australia's Patents Act No. 83 of 1990, Article 144(2)(b); India, Patents Act, Article 141(1) (1970).

As to restrictions on the free use of the protected technology after the expiration of the underlying statutory grant, countries commonly hold that it expires with the grant (e.g., Germany) or within a reasonable time after the grant (e.g., Brazil). See Germany, Act Against Restraints on Competition, Article 20.1 (1957); Brazil, Normative Act No. 015 of the National Institute of Industrial Property, Article 4.5.2(d)(vi) (1975).

[197]*United States Reports,* vol. 326, p. 29 (Supreme Ct., 1945).

[198]*Federal Reporter, Second Series*, vol. 343, p. 381 (Tenth Circuit Ct. of Appeals, 1965).

[199]*Id.*, vol. 268, p. 769 (Third Circuit Ct. of Appeals, 1959).

[200]*Bericht der Bundeskartellamtes über seine Tätigkeit im Jahre 1974 sowie über Lage und Entwicklung auf seinem Ausgabengebeit*, p. 90.

[201]*Id.*, p. 104, item 3.

of the technology. This is so even if secret know-how has not lost its secret character.[202] In other developing countries, including Zambia, the obligation to pay for the use of secret know-how will cease when it "becomes public knowledge otherwise than through the fault of the licensee."[203]

By contrast, in the United States, a licensee's agreement to pay for the use of secret know-how will remain in effect even after the secret becomes public knowledge, so long as the licensee's contractual obligation was "freely undertaken in arm's length negotiations."[204]

Restrictions That Apply After the Expiration of the Licensing Agreement

Licensing agreements may impose obligations on the licensee that continue even after the expiration of the license. Common examples include noncompetition agreements, limitations on the right to carry out research and development activities related to the technology transferred by the licensor, and, in particular, the obligation to keep secret and not make use of confidential information after the licensing arrangement expires.

The national regulations that apply to these kinds of arrangements can be categorized into three groups. One group of countries—including Germany and the United States—allows licensors to impose most types of reasonable restrictions. Continuing restrictions on the use of statutory rights (i.e., patents, trademarks, and copyrights) are valid, but only if the statutory rights have not expired. Restrictions on the use of secret know-how are valid as long as the know-how has not entered the public domain.[205] Noncompetition agreements must be reasonable to avoid conflict with unfair competition laws. In particular, they must (1) be *ancillary* to the license (i.e., they must relate to the use of the subject matter of the license), (2) not be overly broad (i.e., they must relate only to matters in the license), and (3) be limited in duration and geographical scope.

The second group of countries, including India and the European Community, generally takes the same approach as the countries in the first group, except that they hold that a former licensee has a right to continue to use any acquired know-how (despite the expiration of the license) so long as the licensee pays reasonable compensation.[206]

The third group of countries—which includes Brazil, Mexico, the Philippines, Serbia and Montenegro, Venezuela, and Zambia—holds that a former licensee is free to use or dispose of the statutory property rights or secret know-how once the licensing agreement terminates.[207]

F. Compulsory Licenses

As mentioned earlier, **compulsory licenses** are common in most countries, especially in developing countries. They arise when the owner of intellectual property (in particular, patents or copyrights) refuses or is unable to work the property in a particular country within a certain period of time. In

compulsory license
The grant, by state decree, of a license to use a statutory right when the owner has failed to work it.

[202]Serbia and Montenegro, Law on Long-Term Cooperation in Production, Commercial-Technical Cooperation and the Awarding and Acquiring of Technology between Organizations of Associated Labor and Foreign Persons, Article 37(5) (1978).

[203]Zambia, Industrial Development Act, Article 15(b) (1977).

[204]See *Aronson v. Quick Point Pencil Co.*, *United States Reports*, vol. 440, p. 266 (Supreme Ct., 1979).

[205]See *Bericht der Bundeskartellamtes über seine Tätigkeit im Jahre 1976 sowie über Lage und Entwicklung auf seinem Ausgabengebeit*, p. 107, for the German rules on statutory property rights and secret know-how. The U.S. rule on statutory property rights can be found in *Scott Paper Co. v. Marcalus Mfg. Co.*, *United States Reports*, vol. 326, p. 249 (Supreme Ct., 1945); and the rule on secret know-how in *Kewanee Oil Co. v. Bicron Corp.*, *id.*, vol. 416, p. 470 (1974).

[206]See India's Guidelines for Industries, Chap. 3, Article 9.ix (1976–1977). For the EU's position, see the decision of the European Commission in Kabelmetal/Luchaire, *Official Journal*, No. L 222, p. 34 (August 22, 1975).

[207]See Brazil, Normative Act No. 015 of the National Institute of Industrial Property, Articles 4.5.2(d)(vi), 5.2.(d)(vi), 6.5.2(b) (1975); Mexico, Law on the Registration of the Transfer of Technology and the Use and Working of Patents, Trade Names and Trade Marks, Article 7(xi) (December 29, 1972); the Philippines, Regulation to Implement Article 5 of Presidential Decree No. 1520 Establishing the Technology Board within the Ministry of Industry, Article 5.1(c)(1) (October 10, 1978); Venezuela, Decree No. 2442 on the Treatment of Foreign Capital, Trademarks, Patents, Licenses, and Royalties, Article 1 (1977); Serbia and Montenegro, Law on Long-Term Cooperation in Production, Commercial-Technical Cooperation and the Awarding and Acquiring of Technology Between Organizations of Associated Labor and Foreign Persons, Article 37(5) (1978); Zambia, Industrial Development Act, Article 15(b) (1977).

such a case, a third party may apply for a compulsory license, which will be issued by the government without the consent of the owner.[208]

Patents

The International Convention for the Protection of Industrial Property (the Paris Convention) recognizes the right of countries to "grant . . . compulsory licenses to prevent abuses of the exclusive rights conferred by the patent."[209] The WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) similarly allows its member countries to grant "use of the subject matter of a patent without the authorization of the right holder,"[210] provided that

- such use may only be permitted if, prior to such use, the proposed user has made efforts to obtain authorization from the right holder on reasonable commercial terms and conditions and that such efforts have not been successful within a reasonable period of time. This requirement may be waived by a Member in the case of a national emergency or other circumstances of extreme urgency or in cases of public non-commercial use. In situations of national emergency or in other circumstances of extreme urgency, the right holder shall, nevertheless, be notified as soon as reasonably practicable. In the case of public noncommercial use, where the government or contractor, without making a patent search, knows or has demonstrable grounds to know that a valid patent is or will be used by or for the government, the right holder shall be informed promptly.[211]
- such use shall be non-exclusive.[212]
- such use shall be non-assignable.[213]
- any such use shall be authorized predominantly for the supply of the domestic market of the Member authorizing such use.[214]
- the right holder shall be paid adequate remuneration in the circumstances of each case, taking into account the economic value of the authorization.[215] Reading 9-2 describes how compulsory licenses are sometimes used by countries to protect vital national interests.

Copyrights

statutory copyright license
Authorizes a third party to use a copyrighted work for a fee stipulated in the statute.

Two types of compulsory licensing apply to copyrights. A **statutory copyright license** authorizes third parties to use a copyrighted work in exchange for a fee, which is fixed either in the legislation itself or by a public or private agency authorized to fix, collect, and distribute license fees.[216]

[208]See, e.g., Poku Adusei, "Exploiting Patent Regulatory "Flexibilities" to Promote Access to Antiretroviral Medicines in Sub-Saharan Africa," 14 *The Journal of World Intellectual Property*, 1–20, January 2011; Robert Bird and Daniel Cahoy, "The Impact of Compulsory Licensing on Foreign Direct Investment: A Collective Bargaining Approach," 45 *American Business Law Journal*, 283–330, Summer 2008.

[209]States with compulsory patent-licensing provisions include the member states of the African Intellectual Property Organization (Benin, Cameroon, the Central African Empire, Chad, Congo, Ivory Coast, Mauritania, Niger, Senegal, Togo, and Upper Volta), Algeria, Australia, Austria, Bangladesh, Barbados, Bermuda, Bolivia, Brazil, Bulgaria, Canada, Chile, China, Columbia, the Czech Republic, Denmark, Ecuador, Egypt, El Salvador, Finland, France, Germany, Greece, Guatemala, Guyana, Honduras, Hungary, Iceland, India, Iraq, Israel, Italy, Japan, Jordan, Libya, Luxembourg, Malawi, Malta, Mexico, Monaco, Namibia, Nauru, the Netherlands, New Zealand, Nigeria, Norway, Pakistan, Paraguay, Peru, the Philippines, Portugal, Romania, Russia, Serbia and Montenegro, Slovakia, South Africa, South Korea, Spain, Sri Lanka, Sweden, Switzerland, Taiwan, Thailand, Turkey, the United Kingdom, Uruguay, Zambia, and Zimbabwe.

[210]For an analysis of the TRIPS Agreement's compulsory license provisions and their application to pharmaceuticals, see James Love, "Compulsory Licensing: Models for State Practice in Developing Countries, Access to Medicine and Compliance with the WTO TRIPS Accord," Consumer Project on Technology (Prepared for the United Nations Development Program, January 21, 2001); see www.cptech.org/ip/health/cl/recommendedstatepractice.html.

[211]Agreement on Trade-Related Aspects of Intellectual Property Rights, Article 31(b) (1994).

[212]*Id*., Article 31(d).

[213]*Id*., Article 31(e).

[214]*Id*., Article 31(f).

[215]*Id*., Article 31(h).

[216]Statutory licenses for the recording of musical works are provided, for example, in the United States, Copyright Act, §115 (1976), and in the United Kingdom, Copyright Act, Article 12 (1956).

Reading 9-2 Compulsory Licensing of Patents on Aids and other Drugs: WTO Rules and Actions by Certain Nations

The AIDS Crisis

AIDS (acquired immunodeficiency syndrome) is the most severe health issue facing the world. One author has described it as the 4th most deadly epidemic in the history of the world, after the Black Death (Bubonic Plague), the Spanish Flu of 1918–19, and malaria.

There is no cure for AIDS and it can be a swift killer. However, with aggressive treatment, including use of highly active anti-retroviral therapy (HAART), very effective control of the disease can be achieved. Unfortunately, in the past, HAART was not widely used in the countries where it is most needed because of its high cost—which was approximately $10,000–15,000 per year per patient in 2004, but is lower today, as discussed below. According to the 2006 report on the global AIDS epidemic, the World Health Organization (WHO) stated that there were then 38.6 million people living with AIDS (0.6% of the world population) and 2.8 million deaths a year. The WHO estimated that, at that time, in many poor countries in Africa, Asia, and South America, less than 10% of the infected people who need anti-retroviral (ARV) medication were receiving it. Since the Doha meeting, when compulsory licenses were added to the TRIPS agreement, these numbers have decreased because HAART medication has become more readily available to the countries that need it the most. According to the WHO 2009 report, there were then 33.3 million people living with AIDS and HIV and 1.8 million deaths a year. The 2009 report also estimated that in many poor countries in Africa, Asia, and South America, 37% of those needing the ARV medication were receiving it.

The large pharmaceutical companies which make the most effective drugs have spent millions of dollars researching and testing these drugs, and vigorously protect and enforce their patent rights. When the TRIPS agreement was reached in 1995, the developed nations made sure that intellectual property rights were fully protected (as this chapter has discussed). But as the AIDS epidemic spread, governments around the world began to demand that the drugs be sold to them more cheaply, or that compulsory licenses be issued so they could make the drugs locally at much lower cost. Drug makers serving poor nations in Africa, Asia, and Latin America face challenges in striking a balance between meeting public health needs and maximizing profits. "There is a special duty when you are selling medicine, as opposed to pantyhose or hubcaps," says Arthur Caplan, director of the Center for Bioethics at the University of Pennsylvania. Companies have been guided by codes of ethics and corporate social responsibility.

The WTO Compulsory License Rule Modifications

At the request of African governments, and other less developed countries, the WTO revisited the drug patent issue, regarding AIDS and other urgent questions of public health. At the 2001 Doha meeting of the WTO, new agreements were reached regarding the sections of TRIPS that allowed, in some cases, for compulsory licensing of drugs essential to public health. The following information is from the WTO website, in the section titled "TRIPS and Pharmaceutical Patents" (www.wto.org).

The Doha Declaration on TRIPS and Public Health

Some WTO member governments were unsure of how these TRIPS flexibilities would be interpreted, and how far their right to use them would be respected. A large part of this was settled at the Doha ministerial conference in November 2001. WTO member governments stressed that it is important to implement and interpret the TRIPS agreement in a way that supports public health—by promoting both access to existing medicines and the creation of new medicines.

The members therefore adopted a separate declaration on TRIPS and public health. They agreed that the TRIPS agreement does not and should not prevent members from taking measures to protect public health. They underscored countries' ability to use the flexibilities that are built into the TRIPS agreement, including compulsory licensing and parallel importing. And they agreed to extend exemptions on pharmaceutical patent protection for least-developed countries until 2016.

On one remaining question, they assigned further work to the TRIPS council—to sort out how to provide extra flexibility, so that countries unable to produce pharmaceuticals domestically can obtain supplies of copies of patented drugs from other countries (sometimes called the "paragraph 6 issue" because it comes under that paragraph in the separate Doha declaration on TRIPS and public health).

Importing Under Compulsory Licensing ("Paragraph 6")

Article 31(f) of the TRIPS agreement says products made under compulsory licensing must be "predominantly for the supply of the domestic market." This applies to countries that can manufacture drugs—it limits the amount they can export when the drug is made under compulsory license. And it has an impact on countries unable to make medicines and therefore wanting to import generics. They would find it difficult to find countries that can supply them with drugs made under compulsory licensing.

The legal problem for exporting countries was resolved in August 2003 when WTO members agreed on legal changes to make it easier for countries to import cheaper generics made under compulsory licensing if they are unable to manufacture the medicines themselves. When members agreed on the decision, the general council chairperson also read a statement setting out members' shared understandings on how the decision would be interpreted and implemented. This was designed to assure governments that the decision will not be abused.

"This is a historic agreement for the WTO," said then Director-General Supachai Panitchpakdi. "The final piece of the jigsaw has fallen into place, allowing poorer countries to make full use of the flexibilities in the WTO's intellectual property rules in order to deal with the diseases that ravage their people. It proves once and for all that the organization can handle humanitarian as well as trade concerns."

Carefully negotiated conditions apply to pharmaceutical products imported under the system. These conditions aim to ensure that beneficiary countries can import the generics without undermining patent systems, particularly in rich countries. They include measures to prevent the medicines

from being diverted to the wrong markets. And they require governments using the system to keep all other members informed, although WTO approval is not required. At the same time, phrases such as "reasonable measures within their means" and "proportionate to their administrative capacities" are included to prevent the conditions becoming burdensome and impractical for the importing countries.

All WTO member countries are eligible to import under this decision. But 23 developed countries announced voluntarily that they will not use the system to import. And after they joined the EU in 2004, another 10 Eastern European countries have been added to the list. And 11 more said they would only use the system to import in national emergencies or other circumstances of extreme urgency: Hong Kong, China, Israel, Korea, Kuwait, Macao, Mexico, Qatar, Singapore, Chinese Taipei, Turkey, United Arab Emirates.

At first the rules only allowed production for domestic use, but they were expanded in 2003, when the members of the WTO made the "waiver" a permanent amendment to the TRIPS agreement. This amendment would allow the exportation of generic drugs, with compulsory licenses, to poorer countries in need. Canada was the first to use this system in 2008 to ship medicines to Rwanda and planned to send a second shipment in 2009. The deadline for formal approval of this amendment—which requires 2/3 of the WTO members to formally accept the amendment—has been extended 3 times since the original deadline in December 2007. Currently 34 of the 153 members of the WTO have formally accepted.

Medicines Patent Pool

One attempt to decrease the need for compulsory licenses is a patent pool program for AIDS medicines set up by UNITAID, the UN agency dedicated to helping increase access to medical treatment in developing countries. The pool was discussed at the WHO in 2008 and in December 2009 UNITAID developed the medicines patent pool as a separate entity. With the patent pool, licenses are "pooled" out in multiples in order to cut costs for all parties. The expected cost savings with the patent pool on ARV drugs is U.S. $1 billion per year. Not only will the pool cut costs for all parties, and provide much needed medication to poor countries faster, but it will also allow for the development of new products that do not currently exist—such as fixed-dose combination (FDC) medications, which would contain two or more newer medications in one pill.

Patent holders are compensated for the medicines that they add to the pool, generic companies can produce the patented medicines, and people in need receive their medicine faster. First, patent holders negotiate with the pool for a given medication. Next, the licenses are "pooled" out to generic manufacturers, allowing FDCs to be developed more rapidly. The generic manufacturers then use the compulsory licenses that they obtained through the pool to make, sell, and distribute the medicines. Once the licenses are "pooled" out and production commences, the competition ensures lower and more sustainable prices.

In July 2011, Gilead Sciences became the first drug manufacturer to allow its drugs to be manufactured under a pool agreement. Gilead agreed to license four ARV medicines separately and one FDC to the pool. UNITAID has also negotiated with Boehrigner-Ingelheim and Bristol-Meyers Squibb.

Compulsory License Issues in Brazil, Thailand, and Ecuador

In February 2007 Thailand's ministry of public health announced that it was "breaking" a patent on Abbott Laboratories' anti-retroviral drug Kaletra by issuing a compulsory license to produce a lower-cost version, under the WTO rules allowing such action in a "national emergency." Thailand had, at that time, about 580,000 people living with HIV/AIDS and had launched a national drug program treating more than 82,000 HIV-positive people. However, Kaletra cost $347 per patient monthly, while the lower-cost version was expected to cost about $120 per patient monthly. "We have to do this," said Thai Health Minister Mongkol Na Songkhla, "because we don't have enough money to buy safe and necessary drugs for the people under the universal health scheme."

The pharmaceutical companies criticized the decision. According to the chair of the Pharmaceutical Industry Association, "After the company does 10 years of research, then suddenly the Thai government would like to impose the compulsory license, taking away their property, their assets—this is not a good practice."

Abbott labs, a large U.S.-based drug company, was not happy. Abbott pulled its seven drug applications pending before health regulators in Thailand, thus cutting off the country's 65 million residents from new medications developed by the company. Abbott had issued massive price cuts on Kaletra in dozens of developing countries, and offered to submit a cheaper version of the drug to Thai regulators in exchange for continued patent protection, but the country rejected its offer.

Health Minister Mongkol has said, "The excessively high drug prices have obstructed us from achieving real universal access." Meanwhile, drug industry officials are worried that other nations may adopt Thailand's practices. "This misguided focus on short-term 'budget fixes' could come at a far greater long-term cost, potentially limiting important incentives for research and development that are necessary to positively impact the lives of millions of patients worldwide," said the head of the American Pharmaceutical Association.

In 2007, Thailand also had removed seven licenses from the WTO to treat diseases such as cancer, heart disease, and HIV/AIDS. These licenses belonged to pharmaceutical companies located in the European Union (EU). Although the companies protested, the EU announced in 2008 that it was not filing a complaint with the WTO regarding these licenses. The WTO Commission did contact Thailand to ensure that the country understood that compulsory licensing should be a last resort.

In 2007, Brazilian President Luiz Inacio Lula da Silva authorized Brazil to break the patent on the AIDS drug Efavirenz made by Merck & Co. and import a generic version from India instead. Efavirenz is the principal component in a 17-drug cocktail to treat AIDS and is used by 38% of AIDS patients. Talks with Merck broke off when the Health Ministry rejected the drug company's offer to cut its $1.59 per pill price by 30%. Brazil began to import a generic version from India at $0.44 per pill. In 2009 Brazil gave the rights to Merck's drug to a Brazilian lab, which began making it locally.

Brazil's government provides free universal access to AIDS drugs and distributes condoms and syringes as part of a prevention program the United Nations has praised. The program has helped slow infection rates and avoid what experts predicted would become an epidemic. But government spending on antiretroviral drugs had doubled in the previous 4 years prior to the patent "break."

The government pointed out that the decision follows World Trade Organization rules, which allow countries with emergency health issues could, within limits, break patent protection because of public health concerns. Merck said it was "profoundly disappointed," but remained open to further discussions, calling the decision a misappropriation of intellectual property that would stifle research. The government agreed to pay Merck 1.5% of the price of the generic drug as a royalty for three years.

Other developing countries have dropped hints that they, too, might need to employ compulsory licensing. Drug company executives are furious, saying that compulsory licensing was meant to be used only as "a last resort," only in emergencies, and only after lengthy efforts to negotiate prices with firms. "It's easy to see big pharma as a source of evil," said Daniel Vasella,

Chairman of Novartis, a Swiss drug giant. He asserts that without patent protection, research and innovation will suffer and future generations will have fewer life-saving drugs–"which is equally unethical as lack of access."

Other complicating issues are the role of middle-income countries and the rising generics industry. One analyst says that middle-income countries have long used the threat of compulsory licensing to win discounts, thus shifting the balance of power away from the drug companies. The result may be that these countries are getting cheaper drugs than poorer but quieter neighbors. "Brazil is not Rwanda, which cannot afford to pay," says Tadataka Yamada of The Gates Foundation.

In November 2009 Ecuador President Rafael Correa issued Decree 118, which declares that it is in the public interest to have access to medicines used for the treatment of illnesses affecting the Ecuadorian people. The decree was drawn up in response to the suffering endured by people in various areas of Ecuador (in particular in its tropical regions) following severe outbreaks of dengue fever and other diseases.

The legal basis of the decree, according to President Correa, was as follows:

- Article 32 of the Ecuador constitution, which establishes that health is a right guaranteed by the state;
- Article 31 of the Agreement On Trade-Related Aspects Of Intellectual Property Rights (TRIPS), which recognizes the right of countries to grant compulsory licenses for patented medicines in order to combat and mitigate the effects of illnesses; and
- The Doha Declaration regarding the TRIPS agreement and public health, which states that each World Trade Organization member state "has the right to grant compulsory licenses and the freedom to determine the bases upon which such licenses may be granted."

In order to apply for a noncommercial public use compulsory license, the applicant must prove that the product or medicine which it will produce or import is "primarily intended for supply within the domestic market" and is intended for noncommercial public use. "Noncommercial public use" is understood to refer to the acquisition of drugs required for health programs by public sector entities.

One sure winner in the trend toward compulsory licensing is the generic drug industry. Under the TRIPS treaty, countries that invoke compulsory licensing but lack domestic manufacturing are allowed to import generic drugs from another country. Canada encourages firms to produce copycat drugs for just such a purpose. Several firms in India are producing large quantities of even cheaper generic drugs for export. Brazil has become a large producer of generic drugs, where sales of such drugs increased 53% from 2009 to 2010 to a total of U.S. $3.5 billion. The growth potential is recognized by big pharma, as evidenced when Pfizer (the world's largest drug maker) purchased 40% of a Brazilian generic pharmaceutical firm in 2010.

In 2005, the EU began confiscating generic drug shipments from India that were bound for Brazil and other South American countries, after major pharmaceutical companies complained. The last seizure took place in December 2008, bringing the total confiscated shipments to seventeen. In May 2010, India and Brazil filed separate complaints with the WTO against the EU. In December 2010, India and the EU had seemed to have made peace because India did not pursue its complaint, but negotiations between the two countries continued. In May 2011, the negotiations reached their 10th round. The 9th round had failed because India had insisted that a data exclusivity (DE) clause be added to the two countries free-trade agreement (FTA). India had refused the addition of the clause because it would have prevented the country from selling generic drugs to people in developing countries. In July 2011 the EU formally agreed to stop confiscating shipments from India.

Sources: T. G. Agitha, "International Norms for Compulsory Licensing and the Indian Copyright Law" *The Journal of World Intellectual Property*, Volume 15, Issue 1, pages 26–50, January 2012; Wei Shi, "Globalization and Indigenization: Legal Transplant of a Universal TRIPS Regime in a Multicultural World," *American Business Law Journal*, Volume 47, Issue 3, pages 455–507, Fall 2010; Sean Flynn, Aidan Hollis, and Mike Palmed, "An Economic Justification for Open Access to Essential Medicine Patents in Developing Countries," *The Journal of Law, Medicine & Ethics*, Volume 37, Issue 2, pages 184–208, Summer 2009; "Thai Health Ministry Breaks Patent, Issues Compulsory License for Abbott's Antiretroviral Kaletra," *medicalnewstoday.com*, Feb. 1, 2007; J. Godoy, "EU Trade Deal with India Stalemated By Threat of Affordable Drugs," *Ips News*, May 18, 2011; T. Johnson, "The Debate Over the Generic-Drug Trade," *Council On Foreign Relations*, Aug. 3, 2011; "Brazil: Generic Drugs Boom," *Latin Business Chronicle*, Apr. 26, 2011; *World Health Report 2009*, World Health Organization, www.who.int; AFP, "Brazil, India Take EU to WTO Over Generic Drug Seizures," *Google News*, May 12, 2010; "EU Agrees to Stop Confiscation of Indian Generic Drugs," Aug. 29, 2011, http://pharmamarkets.blogspot.com/2011/07/EU-agrees-to-stop-confiscation; "Compulsory Licenses for Medicines in Ecuador," *Tobar & Bustamante Abogados*, April 19, 2010; internationallawoffice.com, "How It Works"; "How the Medicines Patent Pool Came About," *Medicines Patent Pool*, www.medicinespatentpool.org; S. Rimmington, "Briefing Note: No EU WTO Challenge on Thai Compulsory Licenses," Mar. 12, 2008, www.wto.org; "Members Accepting Amendment of the TRIPS Agreement," World Trade Organization, 2010, www.wto.org; *Annual Report, World Trade Organization, 2010*, www.wto.org/TRIPS; S.S. Abdool Karim, Introduction To *HIV/AIDS In South Africa* (S.S. Abdool Karim and Q. Abdool Karim, Eds.), pp. 405–418 (2006); Ricardo Amaral, "Brazil Bypasses Patent on Merck Aids Drug," *Reuters*, May 4, 2007; Celia W. Dugger, "Thailand: Plan to Override Patent for AIDS Drug," *New York Times*, December 1, 2006. ; R.A. Smith and P. D. Siplon, *Drugs Into Bodies: Global Aids Treatment Activism* (2006); "Pharmaceuticals: A Gathering Storm," *The Economist*, June 9, 2007; "Thai Health Ministry Breaks Patent, Issues Compulsory License for Abbott's Antiretriviral Kaletra," *Medical News Today*, Feb. 1, 2007; World Health Organization, "Significant Growth in Access to HIV Treatment in 2006—More Efforts Needed for Universal Access to Services," www.who.int.

A **compulsory copyright license** compels a copyright owner to grant a license, but it allows the owner to negotiate the terms of the license (subject to the intervention of a court or an administrative tribunal if the parties cannot agree).

compulsory copyright license
Compels a copyright owner to grant a license but allows the owner to negotiate the fee.

The Berne Convention for the Protection of Literary and Artistic Works recognizes the right of countries to impose compulsory licenses for broadcasting and recording. This right is limited, however, by the proviso that compulsory licenses may "not in any circumstances be prejudicial to the moral rights of the author, nor to his right to obtain equitable remuneration which, in the absence of agreement, shall be fixed by competent authority."[217]

[217] Berne Convention for the Protection of Literary and Artistic Works, Article 11 bis, §2 (broadcast rights) (1886). A similar provision relating to recording rights is in *id.*, Article 13(1).

Chapter Questions

Copyright Infringement

1. Alvin, Bob, Calvin, Don, and Edgar are friends who enroll in a university course to study international business law. The textbook required for the course costs $50, which the five friends agree is expensive. They agree to chip in $10 each and buy one copy from a bookstore. They then take the copy to the local Discount Copy Store and make five copies of the complete book for $15 a copy. Then they return the book to the bookstore and get a refund of their original purchase price. Have the five friends done anything wrong? If so, what? Explain.

Moral Rights of Authors and Artists

2. Elvira is an abstract painter with incredible talent but little fame. One of her paintings, entitled *Blue Lady 13*, is a work of intense power and sensuality. In 1990, she sold it to Mega Company for display in the main public entrance of the business's new headquarters building. Several art critics attending the opening of the building mistook the painting for a long-lost work of Pablo Picasso. They wrote about it in their newspaper columns as though they had made a great discovery. When people began flooding into the Mega Building to see *Blue Lady 13*, the directors of Mega were delighted. They even went so far as to put up a sign that said: "This painting, entitled *La Dama Azul*, was probably painted by Pablo Picasso during his blue period, ca. 1913." Is there anything that Elvira can do? Explain.

Can a Similar "Look and Feel" Be Copyright Infringement?

3. The First-to-Market Computer Software Company owns the copyright to a highly successful spreadsheet program—Blossom 3-2-1—which has dominated the worldwide market for several years. Recently, Clone Software Co. devised a look-alike program that does everything that the Blossom 3-2-1 program does, except that the Clone sells for only one-tenth the price of the original. First-to-Market has sued Clone for copyright infringement. Clone defends itself by saying that the coding of its program is entirely different from that of Blossom 3-2-1 and that the only similarity between the programs is that the images that appear on the computer screen and the key sequences used to operate the program are identical. Has Clone infringed First-to-Market's copyright? Explain.

Patents on Previously Known Technology

4. The Whopper Co. is a manufacturer of gumballs. The technology and know-how to do this are well known in the scientific and engineering community in Whopper's home country, where gumballs have been popular with consumers for decades. Whopper decided recently to expand into Country X and to introduce gumballs to a market that has never seen them before. Before doing so, Whopper filed for a patent in Country X. The local patent office examined the application as to form (it was fine), searched the local records to determine if the technology was known locally (it was not), and then published notice of the application in the *Patent Gazette* for public comment. There was no public comment, and the patent was issued. Now Bubble Co., a local Country X business, has begun manufacturing and selling gumballs in Country X that are identical to those being manufactured and sold by Whopper. Whopper brings suit for patent infringement. Bubble countersues to have Whopper's patent revoked. Who will win? Explain.

Trademarks and the Shape of Goods

5. Jacques Pierre manufactures and sells a line of perfume—Le Peux—in distinctively shaped containers that are instantly recognizable. May Jacques Pierre register the shape of the containers as a trademark? Explain. If not, how else might Jacques Pierre keep competitors from selling their perfumes in similar containers?

Nonuse of a Trademark

6. Barley Beer Co. owns the trademark "Super Suds" for use on bottled and canned beer in Country X. Barley has not used the mark in Country X for six years. Hops Beer Co. would like to use the mark, and it brings suit in a Country X court to have Barley's trademark revoked. Will Hops succeed? Explain.

Importation of Gray Market Goods

7. A Japanese firm, Omega Company, manufactures cassette tapes with the trademark TXX. Omega licensed Alpha Company to distribute and sell the tapes in Australia and Sigma Company to do the same in South Africa. The license with Sigma expired after three years, and Omega refused to renew the license. Sigma then began buying cassettes from Alpha in Australia in bulk quantities and importing them into South Africa. These tapes had no individual wrappers or labels, and Sigma affixed both wrappers and labels with the TXX trademark on the cassettes, which it then sold throughout South Africa. Omega, which owns the TXX trademark in South Africa, has brought suit to enjoin Sigma from importing the cassettes into South Africa. Will Omega succeed? Would it make any difference if Omega's license with Alpha forbade Alpha from selling tapes for export to South Africa? Explain.
8. "Preventing the importation of gray goods legitimately manufactured outside the country is, in reality, injurious to consumers and contrary to basic principles of unfair competition laws." Comment.

Legality of Patent Pools and Cross-Licensing Agreements

9. The world's seven principal manufacturers of widgets have entered into an agreement to exchange with each other for a period of seven years all of their patents, petty patents, and know-how, and to enter into jointly funded research and development activities to improve widgets. Is this agreement enforceable? Explain. Would it matter if all of the participants were located in the EU? Japan? the United States?

Noncompetition Clauses

10. The Slinky Co. is a manufacturer of revealing bedroom apparel, especially negligees and pajamas, which it sells through franchised retail outlets that operate under its trade name. The franchisees are prohibited from handling any other line of clothing. One franchisee has challenged this particular provision in court, arguing that it is an invalid noncompetition clause. Will the franchisee be successful? Explain.

CHAPTER 10

Sales

Chapter Outline

A. United Nations Convention on Contracts for the International Sale of Goods
B. Transactions Covered in CISG
   Opting In and Out
   Sales Defined
   Goods Defined
   Mixed Sales
C. Contractual Issues Excluded from the Coverage of CISG
   Illegality and Incompetency
   Third-Party Claims and Personal Injuries
   Preemption
D. Interpreting CISG
   The Convention
   General Principles
   Rules of Private International Law
E. Interpreting Sales Contracts
   Statements and Conduct of the Parties
   Negotiations
   Practices and Usages
   Form
F. Formation of the Contract
   The Offer
   Effectiveness of an Offer
   Acceptance
   Acceptance with Modifications
G. General Standards for Performance
   Fundamental Breach
   Avoidance
   Requests for Specific Performance
H. Seller's Obligations
   Place for Delivery
   Time for Delivery
   The Turning Over of Documents
   Conformity of Goods
I. Buyer's Obligations
   Payment of the Price
   Taking Delivery

J. The Passing of Risk
Agreement of the Parties
Means of Delivery
Breach of Contract
K. Remedies
Buyer's Remedies
Seller's Remedies
Remedies Available to Both Buyers and Sellers
L. Excuses for Nonperformance
Force Majeure
Dirty Hands
Chapter Questions

A. United Nations Convention on Contracts for the International Sale of Goods

The 1980 United Nations Convention on Contracts for the International Sale of Goods (CISG) came into force January 1, 1988, climaxing more than 50 years of negotiations. CISG supersedes two earlier conventions, the Convention Relating to a Uniform Law on the International Sale of Goods (ULIS) and the Convention Relating to a Uniform Law on the Formation of Contracts for the International Sale of Goods (ULF), which were never widely adopted.

Support for ULIS and ULF was limited because they were drafted without the participation of the Third World or the Eastern bloc. CISG, on the other hand, is the work of more than 62 states and 8 international organizations. Adopted at a conference in Vienna in 1980, it incorporates rules from all the major legal systems. It has, accordingly, received widespread support from developed, developing, and communist countries. See Table 10.1.

CISG is organized in four parts: Part I (Articles 1–13) contains the convention's general provisions, including rules on the scope of its applications and rules of interpretation. Part II (Articles 14–24) governs the formation of contracts. Part III (Articles 25–88) governs the rights and obligations of buyers and sellers. Part IV (Articles 89–101) contains provisions for the ratification and the entry into force of the Convention.

B. Transactions Covered in CISG

international sale
A sale involving a buyer and seller with places of business in different states.

CISG applies to contracts for the **international sale** of goods—that is, the buyer and seller must have their places of business in different states.[1] In addition, either (1) both of the states must be contracting parties to the convention or (2) the rules of private international law must "lead to the application of the law of a contracting state."[2]

[1]Contracts carried out entirely within one country's borders are governed by that country's laws. In the United States, the principal domestic law governing the sales of goods is the Uniform Commercial Code (UCC); in the United Kingdom, the Sale of Goods Acts (1893 and 1979) apply; in France, sales of goods are regulated by both the law of obligations in the Civil Code (*Code Civil*) of 1804 and the Code of Commerce (*Code de Commerce*) of 1807; in Germany, the law of obligations in the Civil Code (*Bürgerliches Gesetzbuch*) of 1896 applies.

[2]UN Convention on Contracts for the International Sale of Goods, Article 1 (1980), provides: "(1) This Convention applies to contracts of sale of goods between parties whose places of business are in different states: (a) when the states are contracting states; or (b) when the rules of private international law lead to the application of the law of a contracting state. (2) The fact that the parties have their places of business in different states is to be disregarded whenever this fact does not appear either from the contract or from any dealings between, or from information disclosed by, the parties at any time before or at the conclusion of the contract. (3) Neither the nationality of the parties nor the civil or commercial character of the parties or of the contract is to be taken into consideration in determining the application of this Convention."

TABLE 10.1

Parties to the United Nations convention on contracts for the international sale of goods

Ratifying Country—Became Party On	Ratifying Country—Became Party On
Albania—01/06/2010	Kyrgyzstan—01/06/2000
Argentina—01/01/1988	Latvia—01/08/1998
Armenia—01/01/2010	Lebanon—01/12/2009
Australia—01/04/1989	Lesotho—01/01/1988
Austria—01/01/1989	Liberia—01/10/2006
Belarus—01/11/1990	Lithuania—01/02/1996
Belgium—01/11/1997	Luxembourg—01/02/1998
Benin—01/08/2012	Mauritania—01/09/2000
Bosnia and Herzegovina—06/03/1992	Mexico—01/01/1989
Bulgaria—01/08/1991	Mongolia—01/01/1999
Burundi—01/10/1999	Montenegro—03/06/2006
Canada—01/05/1992	Netherlands—01/01/1992
Chile—01/03/1991	New Zealand—01/10/1995
China—01/01/1988	Norway—01/08/1989
Colombia—01/08/2002	Paraguay—01/02/2007
Croatia—08/10/1991	Peru—01/04/2000
Cuba—01/12/1995	Poland—01/06/1996
Cyprus—01/04/2006	Republic of Korea—01/03/2005
Czech Republic—01/01/1993	Republic of Moldova—01/11/1995
Denmark—01/03/1990	Romania—01/06/1992
Dominican Republic—01/07/2011	Russian Federation—01/09/1991
Ecuador—01/02/1993	Saint Vincent and the Grenadines—01/10/2001
Egypt—01/01/1988	Serbia—27/04/1992
El Salvador—01/12/2007	Singapore—01/03/1996
Estonia—01/10/1994	Slovakia—01/01/1993
Finland—01/01/1989	Slovenia—25/06/1991
France—01/01/1988	Spain—01/08/1991
Gabon—01/01/2006	Sweden—01/01/1989
Georgia—01/09/1995	Switzerland—01/03/1991
Germany—01/01/1991	Syrian Arab Republic—01/01/1988
Ghana—signed, but not in effect	The former Yugoslav Republic of Macedonia—17/11/1991
Greece—01/02/1999	Turkey—01/08/2011
Guinea—01/02/1992	Uganda—01/03/1993
Honduras—01/11/2003	Ukraine—01/02/1991
Hungary—01/01/1988	United States of America—01/01/1988
Iceland—01/06/2002	Uruguay—01/02/2000
Iraq—01/04/1991	Uzbekistan—01/12/1997
Israel—01/02/2003	Venezuela—signed but not in effect
Italy—01/01/1988	Zambia—06/06/1986
Japan—01/08/2009	

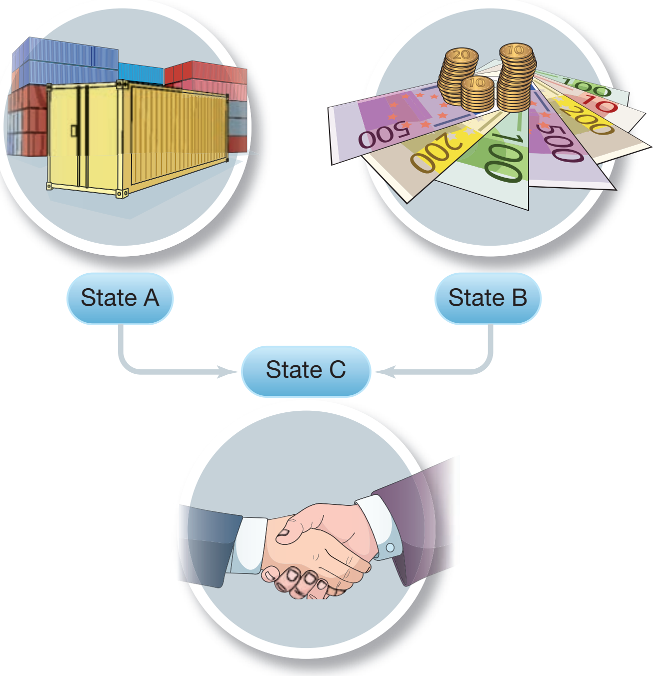
Source: From UNCITRAL Web site, June 10, 2012: www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html. Provided as file 10table01.docx.

CISG may apply even if the buyer's and seller's places of business are not in a contracting state. For example, assume that Seller has a place of business in State A (a noncontracting state) and Buyer a place of business in State B (also a noncontracting State). They enter into a contract in State C (which is a contracting state) and the Seller breaches performance in State C. Buyer brings an action in State B, whose choice-of-law rules point to the laws of State C as applying to the contract. Because State C is a contracting party and the transaction is international, CISG would apply (see Figure 10.1).

This possibility—that the convention could apply in situations where neither the seller nor the buyer had a place of business in a contracting state—was a cause of concern for some of the

FIGURE 10.1

How CISG Would Apply to Two Business Firms from Different States Conducting Business in a Third State That Is a Contracting Party



convention's drafters. They feared that the choice-of-law rules might lead to the application of one state's laws for the formation of a contract and to another state's laws for its performance. This could mean that only parts of CISG might apply, when the convention was meant to apply as a unified whole. As a consequence, the final provisions of the convention allow a ratifying state, if it wishes, to declare that it will apply CISG only when the buyer and seller are both from contracting states.[3]

Opting In and Out

While either the contracting states or the choice-of-law rules may direct that CISG apply, the parties to a contract may exclude (i.e., they may opt out) or modify its application by a **choice-of-law clause**.[4] Whether they can use that same clause to exclude a domestic law and adopt CISG in its place (i.e., opt in) depends on the rules of the state where the case is heard.

choice-of-law clause Contractual provision that identifies the law to be applied in the event of a dispute over the terms or the performance of the contract.

Case 10-1 deals with the question of when the CISG applies and what parties to a contract must do to opt out of the convention.

CASE 10-1 Asante Technologies, Inc. v. PMC-Sierra, Inc.

United States, District Court for the Northern District of California
Federal Supplement, Second Series, vol. 164, p. 1142 (2001)

District Judge Ware

I. Introduction

This lawsuit arises out of a dispute involving the sale of electronic components. Plaintiff, Asante Technologies Inc., filed the action in the Superior Court for the State of California, Santa Clara County, on February 13, 2001. Defendant, PMC-Sierra, Inc., removed the action

[3] *Id.*, Article 95 states: "Any state may declare at the time of the deposit of its instrument of ratification, acceptance, approval or accession that it will not be bound by subparagraph (1)(b) of Article 1 of this Convention." The United States, for one, has so declared.

[4] *Id.*, Article 6: "The parties may exclude the application of this Convention or, subject to Article 12, derogate from or vary the effect of any of its provisions."

MAP 10.1

British Columbia and California (2001)

to this Court, asserting federal question jurisdiction pursuant to *United States Code*, title 28, section 1331. Specifically, Defendant asserts that Plaintiff's claims for breach of contract and breach of express warranty are governed by the United Nations Convention on Contracts for the International Sale of Goods ("CISG"). Plaintiff disputes jurisdiction and filed [a] Motion to Remand. . . .

II. Background

The Complaint in this action alleges claims based in tort and contract. Plaintiff contends that Defendant failed to provide it with electronic components meeting certain designated technical specifications. Defendant timely removed the action to this Court on March 16, 2001.

Plaintiff is a Delaware corporation having its primary place of business in Santa Clara County, California. Plaintiff produces network switchers, a type of electronic component used to connect multiple computers to one another and to the Internet. Plaintiff purchases component parts from a number of manufacturers. In particular, Plaintiff purchases application-specific integrated circuits ("ASICs"), which are considered the control center of its network switchers, from Defendant.

Defendant is also a Delaware corporation. However, defendant asserts that, at all relevant times, its corporate headquarters, inside sales and marketing office, public relations department, principal warehouse, and most design and engineering functions were located in Burnaby, British Columbia, Canada. Defendant also maintains an office in Portland, Oregon, where many of its engineers are based. Defendant's products are sold in California through Unique Technologies, which is an authorized distributor of Defendant's products in North America. It is undisputed that Defendant directed Plaintiff to purchase Defendant's products through Unique, and that Defendant honored purchase orders solicited by Unique. Unique is located in California. Determining Defendant's "place of business" with respect to its contract with Plaintiff is critical to the question of whether the Court has jurisdiction in this case.

Plaintiff's Complaint focuses on five purchase orders. Four of the five purchase orders were submitted to Defendant through Unique as directed by Defendant. However, Plaintiff does not dispute that one of the purchase orders, dated January 28, 2000, was sent by fax directly to Defendant in British Columbia, and that Defendant processed the order in British Columbia. Defendant shipped all orders to Plaintiff's headquarters in California. Upon delivery of the goods, Unique sent invoices to Plaintiff, at which time Plaintiff tendered payment to Unique either in California or in Nevada.

***

Plaintiff now requests this Court to remand this action back to the Superior Court of the County of Santa Clara pursuant to *United States Code*, title 28, section 1447(c), asserting lack of subject matter jurisdiction. . . .

III. Standards

A defendant may remove to federal court any civil action brought in a state court that originally could have been filed in federal court.[5] When a case originally filed in state court contains separate and independent federal and state law claims, the entire case may be removed to federal court.[6]

The determination of whether an action arises under federal law is guided by the "well-pleaded complaint" rule.[7] The rule provides that removal is proper when a federal question is presented on the face of the Complaint.[8] However, in areas where federal law completely preempts state law, even if the claims are purportedly based on state law, the claims are considered to have arisen under federal law. Defendant has the burden of establishing that removal is proper. . . .

The Convention on Contracts for the International Sale of Goods ("CISG") is an international treaty which has been signed and ratified by the United States and Canada, among other countries. The CISG was adopted for the purpose of establishing "substantive provisions of law to govern the formation of international sales contracts and the rights and obligations of the buyer and the seller."[9] The CISG applies "to contracts of sale of goods between parties whose places of business are in different States . . . when the States are Contracting States."[10] Article 10 of the CISG provides that "if a party has more than one place of business, the place of business is that which has the closest relationship to the contract and its performance."

IV. Discussion

Defendant asserts that this Court has jurisdiction to hear this case pursuant to *United States Code*, title 28, section 1331, which dictates that the "district courts shall have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States." Specifically, Defendant contends that the contract claims at issue necessarily implicate the CISG, because the contract is between parties having their places of business in two nations which have adopted the CISG treaty. . . .

A. **Federal Jurisdiction Attaches to Claims Governed by the CISG**—Although the general federal question statute, *United States Code*, title 28, §1331(a), gives district courts original jurisdiction over every civil action that "arises under the . . . treaties of the United States," an individual may only enforce a treaty's provisions when the treaty is self-executing, that is, when it expressly or impliedly creates a private right of action.[11] The parties do not dispute

[5] *United States Code*, title 28, §1441(a).

[6] *Id*., §1441(c).

[7] *Franchise Tax Board v. Construction Laborers Vacation Trust, United States Reports*, vol. 463, p. 1 (Supreme Ct., 1983).

[8] *Id*. at p. 9.

[9] U.S. Ratification of 1980 United Nations Convention on Contracts for the International Sale of Goods: Official English Text, *United States Code*, title 15, App. at p. 52 (1997).

[10] *United States Code*, title 15, App. Article 1 (1)(a).

[11] See *Tel-Oren v. Libyan Arab Republic, Federal Reporter, Second Series*, vol. 726, p. 774 at p. 808 (District of Columbia Circuit Ct. of Appeals, 1984) (Judge Bork concurring).

that the CISG properly creates a private right of action.[12] Therefore, if the CISG properly applies to this action, federal jurisdiction exists.

B. **The Contract in Question Is Between Parties from Two Different Contracting States**—The CISG only applies when a contract is "between parties whose places of business are in different States."[13] If this requirement is not satisfied, Defendant cannot claim jurisdiction under the CISG. It is undisputed that Plaintiff's place of business is Santa Clara County, California, U.S.A. It is further undisputed that during the relevant time period, Defendant's corporate headquarters, inside sales and marketing office, public relations department, principal warehouse, and most of its design and engineering functions were located in Burnaby, British Columbia, Canada. However, Plaintiff contends that, pursuant to Article 10 of the CISG, Defendant's "place of business" having the closest relationship to the contract at issue is the United States. [The court looked at Plaintiff's claim that Unique Technologies was an agent for PMC-Sierra and found no evidence of consent or authorization as an agent, and thus ruled that PMC's place of business was in Canada.]

***

C. **The Effect of the Choice of Law Clauses**—Plaintiff next argues that, even if the Parties are from two nations that have adopted the CISG, the choice of law provisions in the "Terms and Conditions" set forth by both Parties reflect the Parties' intent to "opt out" of application of the treaty.[14] Article 6 of the CISG provides that "the parties may exclude the application of the Convention or, subject to Article 12, derogate from or vary the effect of any of its provisions."[15] Defendant asserts that merely choosing the law of a jurisdiction is insufficient to opt out of the CISG, absent express exclusion of the CISG. The Court finds that the particular choice of law provisions in the "Terms and Conditions" of both parties are inadequate to effectuate an opt out of the CISG.

Although selection of a particular choice of law, such as "the California Commercial Code" or the "Uniform Commercial Code," could amount to implied exclusion of the CISG, the choice of law clauses at issue here do not evince a clear intent to opt out of the CISG. For example, Defendant's choice of applicable law adopts the law of British Columbia, and it is undisputed that the CISG is the law of British Columbia.[16] Furthermore, even Plaintiff's choice of applicable law generally adopts the "laws of" the State of California, and California is bound by the Supremacy Clause to the treaties of the United States.[17] Thus, under general California law, the CISG is applicable to contracts where the contracting parties are from different countries that have adopted the CISG. In the absence of clear language indicating that both contracting parties intended to opt out of the CISG, and in view of Defendant's Terms and Conditions which would apply the CISG, the Court rejects Plaintiff's contention that the choice of law provisions preclude the applicability of the CISG.

D. **Federal Jurisdiction Based upon the CISG Does Not Violate the Well-Pleaded Complaint Rule**—The Court rejects Plaintiff's argument that removal is improper because of the well-pleaded complaint rule. The rule states that a cause of action arises under federal law only when the plaintiff's well-pleaded complaint raises issues of federal law.[18]

---

[12]See *Delchi Carrier v. Rotorex Corp., Federal Reporter, Third Series*, vol. 71, p. 1024 at p. 1027–28 (2nd Circuit Ct. of Appeals, 1995).

[13]*United States Code*, title 15, App. Article 1(1)(a).

[14]Plaintiff's Terms and Conditions provides "APPLICABLE LAW. The validity [and] performance of this [purchase] order shall be governed by the laws of the state shown on Buyer's address on this order." The buyer's address as shown on each of the Purchase Orders is San Jose, California.

Defendant's Terms and Conditions provides "APPLICABLE LAW: The contract between the parties is made, governed by, and shall be construed in accordance with the laws of the Province of British Columbia and the laws of Canada applicable therein, which shall be deemed to be the proper law hereof. . . ." It is undisputed that British Columbia has adopted the CISG.

[15]*United States Code*, title 15, App. Article 6.

[16]International Sale of Goods Act, chap. 236, *Statutes of British Columbia*, vol. 1996, §1 *et seq*.

[17]U.S. Constitution, Article 6, clause 2: "This Constitution, and the laws of the United States which shall be made in pursuance thereof; and all treaties made, or which shall be made, under the authority of the United States, shall be the supreme law of the land."

[18]*Gully v. First National Bank*, *United States Reports*, vol. 299, p. 109 (Supreme Ct., 1936).

It is undisputed that the Complaint on its face does not refer to the CISG. However, Defendants argue that the preemptive force of the CISG converts the state breach of contract claim into a federal claim. Indeed, Congress may establish a federal law that so completely preempts a particular area of law that any civil complaint raising that select group of claims is necessarily federal in character.[19]

It appears that the issue of whether or not the CISG preempts state law is a matter of first impression. In the case of federal statutes, "the question of whether a certain action is preempted by federal law is one of congressional intent. The purpose of Congress is the ultimate touchstone."[20] Transferring this analysis to the question of preemption by a treaty, the Court focuses on the intent of the treaty's contracting parties.[21]

In the case of the CISG treaty, this intent can be discerned from the introductory text, which states that "the adoption of uniform rules which govern contracts for the international sale of goods and take into account the different social, economic and legal systems would contribute to the removal of legal barriers in international trade and promote the development of international trade."[22] The CISG further recognizes the importance of "the development of international trade on the basis of equality and mutual benefit."[23]These objectives are reiterated in the President's Letter of Transmittal of the CISG to the Senate as well as the Secretary of State's Letter of Submittal of the CISG to the President.[24] The Secretary of State, George P. Shultz, noted:

> Sales transactions that cross international boundaries are subject to legal uncertainty—doubt as to which legal system will apply and the difficulty of coping with unfamiliar foreign law. The sales contract may specify which law will apply, but our sellers and buyers cannot expect that foreign trading partners will always agree on the applicability of United States law. . . . The Convention's approach provides an effective solution for this difficult problem. When a contract for an international sale of goods does not make clear what rule of law applies, the Convention provides uniform rules to govern the questions that arise in making and performance of the contract.[25]

The Court concludes that the expressly stated goal of developing uniform international contract law to promote international trade indicates the intent of the parties to the treaty to have the treaty preempt state law causes of action.

***

V. Conclusion

For the foregoing reasons, Plaintiff's Motion to Remand is DENIED. . . .

Casepoint

In this case, the real legal issue before the U.S. federal court was whether it had jurisdiction of this case. In order to possess jurisdiction to hear the case, it was necessary that federal law was involved. The court considered whether the parties were from different states (nations), decided that they were, and thus the CISG applied to this contract dispute. Then the court analyzed the plaintiff's claim that the parties had opted out of the CISG (as they are entitled to do) but found little factual evidence to support that argument. Finally, the court ruled that when Congress ratified the CISG, it intended to preempt conflicting state laws; thus, although the CISG was not specifically mentioned in the complaint, it was the law that applied here.

---

[19]*Metropolitan Life Ins. Co. v. Taylor*, *id*., vol. 481, p. 58 at p. 62 (Supreme Ct., 1987).

[20]*Pilot Life Ins. Co. v. Dedeaux*, *id*., vol. 481, p. 41 at p. 45 (Supreme Ct., 1987).

[21]See *Husmann v. Trans World Airlin es, Inc*., *Federal Reporter, Third Series*, vol. 169, p. 1151 at p. 1153 (8th Circuit Ct. of Appeals, 1999).

[22]*United States Code*, title 15, App. 15 at p. 53.

[23]*Id*.

[24]*Id*., at pp. 70–72.

[25]*Id*., at p. 71.

Sales Defined

CISG does not directly define **sales**. Instead, it speaks of the seller's and buyer's obligations. The seller is to "deliver the goods, hand over any documents relating to them and transfer the property in the goods, as required by the contract and this Convention"[26]; the buyer, in exchange, is to "pay the price."[27] Although not stated in a single article, this is the same definition found in many domestic laws, including the U.S. Uniform Commercial Code, which describes a sale as the "passing of title from the seller to the buyer for a price."[28]

sale
The exchange of goods for an amount of money or its equivalent.

Goods Defined

CISG also does not directly define **goods**. Instead, it defines those kinds of sales that are *not* governed by the convention. Six specific categories are excluded. Three are based on the nature of the transaction, three on the kinds of goods. The excluded transactions are (1) "goods bought for personal, family, or household use"; (2) auction sales; and (3) sales "on execution or otherwise by authority of law." The excluded goods are (1) stocks, shares, investment securities, negotiable instruments, or money; (2) ships, vessels, hovercraft, or aircraft; and (3) electricity.[29]

good
A movable, tangible object. For the purposes of CISG, goods do not include things bought for personal use or at an auction or foreclosure sale, nor may they be oceangoing vessels or aircraft.

The drafters adopted this list of exclusions on the assumption that the convention applies only to goods that are movable and tangible. The nature of goods was made clearer in the French-language version of the 1964 *Convention Relating to a Uniform Law on the International Sale of Goods*, which used the phrase *objets mobiliers corporels*.[30] In CISG, however, the French version uses the term *marchandises*.[31] Regardless, legal usage internationally is consistent in its interpretation of the word *goods* (*marchandises*). In addition, many transactions, such as the sale of real property, are by their very nature domestic rather than international. The list of exclusions, therefore, only includes goods that the drafters felt were not already obviously excluded.[32]

Goods bought for personal, family, or household use are excluded for two reasons. First, a double standard could arise if different rules governed sales by local shopkeepers to foreigners. Second, many local laws protect consumers, and that protection would be lost if CISG applied. This exclusion does not apply, however, "unless" the seller "knew or ought to have known" that the goods were bought for personal use or consumption.

This "unless" clause is best illustrated by an example. Seller, a computer retailer, receives an order for a computer from Buyer, a resident of State B. The order is for a powerful, expensive computer of the sort commonly bought for use in business firms. When a dispute about the sale arises, Seller relies on CISG. Buyer then offers evidence that he bought the computer for his personal use as a hobbyist. In this example, Seller should be able to show that he neither knew nor ought to have known that the computer was bought for personal use. The convention would then apply.

Auction sales, sales on execution, and sales "otherwise by authority of law" are excluded because of the uniqueness of the transactions involved. Auction sales present problems in determining when the contract was formed. Executions and other kinds of forced sales do not involve the negotiation of terms by the parties. Special local laws govern these sales, and CISG does not disturb that arrangement.

Transactions in stocks, shares, investment securities, negotiable instruments, and money are excluded because a wide variety of local rules govern them, and the drafters could not agree on how to harmonize the rules in this convention. However, the drafters did not exclude a long list of other similar assets, such as patent rights, copyrights, and trademarks, whose international sale is now governed by CISG.

---

[26]UN Convention on Contracts for the International Sale of Goods, Article 30.

[27]*Id.*, Article 54.

[28]Uniform Commercial Code, §2-106.

[29]UN Convention on Contracts for the International Sale of Goods, Article 2 (1980).

[30]From French: "tangible movable objects."

[31]From French: "goods," "wares," or "commodities."

[32]See John Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention*, pp. 85–87 (1982), for a discussion of the drafters' intent on the meaning of goods.

Sales of ships, vessels, hovercraft, aircraft, and electricity were also excluded from CISG because most domestic legal systems have special rules that apply to them.

Mixed Sales

A seller of goods often furnishes services when delivering a product to a buyer. For example, restaurants provide both food and service. Manufacturers that contract to produce goods similarly provide both goods and services. Are these sales of goods or sales of services?

CISG looks upon mixed sales and services contracts—the restaurant example—as sales of goods, unless "the preponderant part of the obligations" of the seller "consists in the supply of labor or other services." One may assume that *preponderant* has its normal meaning of "more than half," but whether this is measured by the cost, the sale price, or some other basis is something the convention does not make clear.

Contracts for goods to be manufactured are treated by CISG as sales of goods unless the buyer "undertakes to supply a substantial part of the materials." Although *substantial* probably means less than half, how much less is unclear. The French-language version of the convention suggests a possible test, as it uses the term *une part essentielle*.[33] Thus, if the buyer provides the components essential to the manufacture of a product—regardless of their size or value—the convention would not apply.

Recent International Developments

Are Contracts for Enriched Uranium the Sale of Goods or Services?

Sometimes the determination of whether the contract is for the sale of goods or the provision of services is a difficult one. In *United States v. Eurodif S.A.*, a case decided by the U.S. Supreme Court in 2009, there was a contract between a group of companies that operate the only uranium enrichment factory in the United States, and several European firms that supplied them with low-enriched uranium (LEU). Nuclear utilities generally procure their fuel, LEU, through one of two types of contracts. Under an "enriched uranium product" (EUP) contract, the utility simply pays the enricher cash for LEU of a desired quantity and "assay" (i.e., its percentage of the isotope necessary for a nuclear reaction).

The amount of energy required to enrich a quantity of "feed uranium" to a given assay is described in terms of an industry standard called a "separative work unit" (SWU). Under the second type of contract, a "SWU contract," the utility provides a quantity of feed uranium and pays the enricher for the SWUs to produce the required LEU quantity and assay. SWU contracts do not require that the required number of SWUs actually be applied to the utility's uranium. Because feed uranium is fungible and essentially trades like a commodity, and because profitable operation of an enrichment plant requires the constant processing of feed uranium from the enricher's undifferentiated stock, the LEU provided to a utility under a SWU contract cannot be traced to the particular unenriched uranium the utility provided.

The importers petitioned the U.S. Commerce Department (the Department) for relief under the Tariff Act of 1930, which calls for "antidumping" duties on "foreign merchandise" sold in this country at "less than its fair value," and the key question was whether the contract was predominantly for the sale of goods or for services. The resolution of this issue would determine whether the CISG would apply and whether the anti-dumping duties were approprate. The Department concluded that LEU from France, including LEU acquired under SWU contracts, was sold in the United States at less than fair value, and rejected the claim that such transactions were sales of enrichment services, as the SWU contracts provided. The Court of International Trade (CIT) later reversed the decision, holding that the contract was primarily a services contract and that decision was then upheld by the Court of Appeals for the Federal Circuit.

The U.S. Supreme Court, in a unanimous opinion written by Justice Souter, reversed the appellate court and held that the Commerce Department was correct in finding the contract for the "sale of goods" and thus one in which anti-dumping duties could apply. The Court first found that the Department's decision that the transactions at issue were sales of goods rather than services reflected a permissible interpretation and application of §1673. Because §1677(1) gave this determination to the Department in the first instance, the Department's interpretation should govern in the absence of

[33]From French: "an essential part."

unambiguous statutory language to the contrary or an unreasonable resolution of ambiguous language, citing *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U. S. 837.

Second, the Supreme Court found that the Department was not bound by the legal fiction created by SWU contracts that the very feed uranium delivered by a utility to an enricher is enriched and then returned as LEU to the utility. Although it was undisputed that §1673 (the anti-dumping law) applies to the sale of goods, not services, the Court found that the section simply did not speak with the precision necessary to say definitively whether it applied to this contract. But, said the Court, this is the very situation in which the Court should look to an authoritative agency for a decision about a statute's scope. Once the choice is made, the Court asks only whether the Department's application of the statute was reasonable. Where, as here, cash plus an untracked fungible commodity were exchanged for a substantially transformed version of the same commodity, the Department may reasonably treat the transaction as the sale of a good.

The Supreme Court noted that the Commerce Department's position was reinforced by practical reasons aimed at preserving antidumping duties' effectiveness. It was undisputed that such duties would apply to LEU sold to a domestic utility by foreign enrichers under an EUP contract calling for a single cash price that is less than fair value. Such a transaction obviously opens the domestic enrichment industry to material injury, the very threat that §1673 was meant to counter. But the Court stated that the same injury will occur if a SWU contract is untouchable.

Under a SWU contract, the domestic utility pays cash to a third party for unenriched uranium and provides this along with additional cash in exchange for LEU; any EUP contract could be structured as a SWU contract simply by splitting the transaction in two, one contract to buy unenriched uranium and another to enrich it. The restructuring would not stop with uranium, stated the Court; contracts for many types of goods would be replaced by separate contracts for the goods and for processing services and anti-dumping duties would primarily chastise the uncreative. Finding that the Commerce Department's attempt to foreclose this absurd result by treating such transactions as sales of goods was eminently reasonable, the Supreme Court reversed the Court of Appeals decision and held that the anti-dumping duties were appropriate because this was predominantly the sale of goods.

C. Contractual Issues Excluded from the Coverage of CISG

Courts face a variety of issues in determining if a contract should be enforced or if a remedy should be granted when a contract is breached. CISG only deals with (1) the formation of the contract and (2) the remedies available to the buyer and seller. It specifically excludes questions about (1) the legality of the contract, (2) the competency of the parties, (3) the rights of third parties, and (4) liability for death or personal injury.[34]

Illegality and Incompetency

Domestic laws vary greatly in determining when a contract is illegal and when it is void or voidable because one or both of the parties are incompetent. Contraband, for example, cannot be legally sold. However, what constitutes contraband in one country may not in another; for example, alcohol, drugs, pornography, religious tracts, political tracts, and so on, may be treated differently from one country to the next. Similarly, the extent to which a contract can be avoided because it was fraudulently obtained varies greatly. Domestic rules on insanity, infancy, and other contractual disabilities are equally diverse.

The drafters of the convention recognized that legality and competency are sensitive issues that reflect the mores and social values of particular cultures. To avoid a disagreement that might have jeopardized the adoption of CISG, these questions were left for settlement by domestic law.

[34]UN Convention on Contracts for the International Sale of Goods, Article 4 (1980), provides: "This Convention governs only the formation of the contract of sale and the rights and obligations of the seller and the buyer arising from such a contract. In particular, except as otherwise expressly provided in this Convention, it is not concerned with: (a) the validity of the contract or any of its provisions or of any usage; (b) the effect which the contract may have on the property in the goods sold."

Article 5 states: "This Convention does not apply to the liability of the seller for death or personal injury caused by the goods to any person."

Third-Party Claims and Personal Injuries

Equally diverse domestic laws apply to the matters of third-party claims and the liability of a seller for death or personal injury. Again, to avoid the possibility of a deadlock in the drafting of the convention, the drafters left them out.

Preemption

preempt
To take precedence over.

To determine if CISG applies to a particular contractual issue, one must look to the convention itself, not to domestic law. If the convention does apply, domestic law is **preempted**. That is, the remedies provided in CISG are the only remedies available. This result is the consequence of the convention's basic function: to establish uniform rules for international sales contracts.[35]

Preemption applies both in cases where domestic law calls the matter contractual and where it gives it some other name. Consider the following example. A seller delivers to a buyer chemicals that are defective. The chemicals spontaneously burst into flames, burning down the buyer's warehouse. In such a circumstance, some domestic law systems would impose a sanction in tort that is commonly called *product liability*. To prove product liability, the injured buyer must typically show (1) that the goods failed to conform to the contract, (2) that the damage resulted from the defect, and sometimes (3) the buyer must also show that the seller failed to exercise due care, especially if the suit involves a claim of negligence. Under CISG, however, a remedy is available if the goods failed to conform to the contract (Article 35) and damage resulted from the defect (Article 74). Despite the fact that local law may require a third proof element to establish product liability, this does not mean that a tort remedy is available. The only permissible remedy is the one provided by CISG.

For reference, a summary comparison of CISG rules and the sale-of-goods rules in France and the United States is set out in Table 10.2.

TABLE 10.2

Comparative summary of French, United States, and United Nations convention sale of goods (CISG) provisions

Contract Provision	French Civil Code and Code of Commerce	United States Uniform Commercial Code	United Nations Convention on Contracts for the International Sale of Goods (CISG)
Sale is a passage of title for a price.	Yes	Yes	Yes
Goods are movable and tangible things.	Yes	Yes	Yes
Mixed sales and service transactions that predominantly involve the delivery of goods are governed by sales law provisions.	Yes	Yes	Yes
Sales law applies only to merchants.	No	No	Yes
A merchant is	A person who engages in a defined list of commercial acts.	A person who deals in goods of the kind involved in a particular transaction, or who by his occupation holds himself out as having special knowledge or skill related to the sale, or who is represented by a merchant.	A person who has a place of business.
Parties must act in good faith.	Yes	Yes	Yes
Unconscionable contracts are unenforceable.	Yes	Yes	Yes

[35] *Id*., Article 7(1).

Contract Provision	French Civil Code and Code of Commerce	United States Uniform Commercial Code	United Nations Convention on Contracts for the International Sale of Goods (CISG)
A sales contract must be memorialized in a writing signed by the party against whom it is being asserted.	Yes, if the party against whom the contract is being asserted is a nonmerchant and the price is €800 or more; no, if the party against whom the contract is being asserted is a merchant.	Yes, if the price is $500 or more; no, if both parties are merchants and one of the parties sends a written confirmation that is not promptly objected to.	No
Subjective intent of parties may be used to interpret contracts.	Yes	No	Yes
Parol evidence is admissible to interpret written contracts the parties intended to be a final expression of their agreement.	Yes, if the party objecting is a merchant; no, if the party is a nonmerchant unless the parol evidence is supported by a written memorandum originating with the objecting party.	No	Yes
A contract may be explained or interpreted by a course of performance, a course of dealing, and a usage of trade.	Yes	Yes	Yes
Terms that should not be left open are	Price	Quantity	Price and quantity
Firm offers can be made by	Anyone	Merchants in a signed writing	Merchant
If offeror does not specify a medium for acceptance, any reasonable medium may be used.	Yes	Yes	Yes
An offer may be revoked prior to an acceptance's	Receipt	Dispatch	Dispatch
Acceptance is effective upon	Receipt	Dispatch	Receipt
Acceptance is valid even if it contains additional terms.	No	Yes	No
Additional terms in an acceptance become proposals for addition that offeror may accept or reject.	No	Yes, when either party is a nonmerchant	No
Additional terms become part of a contract unless promptly objected to by offeror.	No	Yes, if both parties are merchants	No
Offeree who accepts by performance must notify the offeror within a reasonable time after beginning performance.	No	Yes	No
The scope of a specific performance decree is to	Carry out any terms of the contract	Deliver the goods	Same as local law
Place for delivery	(1) As specified in contract; (2) Location of goods at time of sale; (3) Seller's residence	(1) As specified in contract; (2) Seller's business place; (3) Seller's residence; (4) Known location of goods	(1) As specified in contract; (2) Carrier's business place; (3) Known location of goods
Time for delivery	(1) As specified in contract	(1) As specified in contract; (2) Reasonable time after contracting	(1) As specified in contract; (2) Reasonable time after contracting

(*continued*)

TABLE 10.2

(*continued*)

Contract Provision	French Civil Code and Code of Commerce	United States Uniform Commercial Code	United Nations Convention on Contracts for the International Sale of Goods (CISG)
Conformity of goods (guarantees and warranties)	(1) Fit for ordinary purpose; (2) Fit for a particular purpose	(1) Warranty of merchantability; (2) Warranty of fitness for a particular purpose	(1) Fit for ordinary purpose; (2) Fit for a particular purpose
Waiver of guarantees conformity requires use of specific words.	No	Yes	No
Waiver of guarantee of conformity must be made expressly.	Yes	Yes	No
Buyer must promptly notify seller of any nonconformity.	Yes	Yes	Yes
Seller may cure defects before delivery time.	Yes	Yes	Yes
Seller may cure defects after delivery time.	No	No	No
Time and place when buyer must pay is	Delivery	Delivery	Delivery
Seller must make formal demand for payment.	Yes	No	No
Buyer must pay price once risk passes.	Yes	Yes	Yes
Risk passes when goods are delivered.	Yes	Yes	Yes
Risk passes for goods sent by carrier when the goods are identified to contract and delivered to carrier.	Yes	Yes	Yes
Remedies and damages are cumulative.	Yes	Yes	Yes
A period of grace is available to delay the granting of remedies.	Yes	No	No
Nonconforming party is entitled to *Nachfrist* notice.	Yes	No	Yes
Buyers' remedies include price reduction.	Yes	No	Yes
General remedies include suspension of performance and anticipatory avoidance.	Yes	Yes	Yes
Injured party has duty to mitigate damages.	Yes	Yes	Yes
Excuse of force majeure is available.	Yes	Yes	Yes

D. Interpreting CISG

The underlying goal of CISG is the creation of a uniform body of international commercial sales law. In deciding legal questions governed by the convention, Article 7(2) directs a court to look to the following sources, in the following order (see Figure 10.2): (1) the convention itself, (2) the general principles on which the convention is based, and (3) the rules of private international law.

The Convention

When the words of CISG itself require interpretation, Article 7(1) directs a court to consider (1) the international character of the convention, (2) the need to promote uniformity in the convention's application, and (3) the observance of good faith. Article 7(1), however, does not describe the sources the court may—or must—use in making its interpretation.

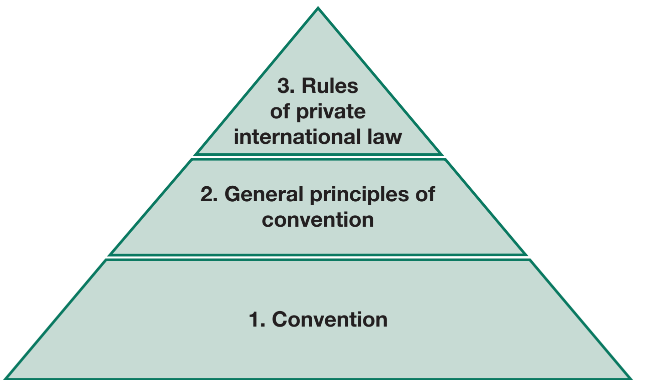


FIGURE 10.2

The Hierarchy of Sources Defined by Article 7(2)

On its face, CISG implies that a court may use only the plain meaning of the language in the convention. The "**plain meaning rule**" is common to countries whose judicial practices follow those of England. In England, at least until very recently, courts may deduce the meaning of legislation only from the words contained in a statute.[36] In most other countries, however, including the United States and the civil law countries, the courts also look to a statute's legislative history—the *travaux préparatoires*—to determine its intent. Additionally, when an international tribunal interprets a treaty, its legislative history is commonly used both to confirm the meaning derived from the treaty's terms and to determine the treaty's meaning when the terms are ambiguous or obscure.[37] Considering the widespread general use of ***travaux préparatoires***, it seems likely that most courts will turn to it in interpreting CISG's provisions, especially as the record of the convention's preparation is now widely available.[38]

plain meaning rule
A statute or treaty is to be interpreted only from the words contained within the statute or treaty.

travaux préparatoires
From French: "preparatory work." The legislative history of a statute or treaty, that is, the negotiations leading up to its final drafting and adoption.

In addition to *travaux préparatoires*, courts in most countries use case law to interpret statutes and treaties.[39] The number of cases that have interpreted CISG has increased over the past 10 years. The courts attempt to keep in mind the convention's admonitions: that CISG is an international treaty, that its purpose is to establish uniform international rules; and that the courts are bound by the principle of good faith in interpreting the convention. Because CISG is an international treaty, the courts of many countries will interpret it. The directive that it be interpreted to promote uniformity in its application compels courts to examine and follow the decisions of the courts in other contracting

[36] In 1980, the English House of Lords used legislative history in interpreting the Warsaw Convention's provisions on the liability of air carriers. In the landmark decision of *Fothergill v. Monarch Airlines, All England Law Reports*, vol. 1980, pt. 2, p. 696 (1980), a majority of opinions relied on the rules of interpretation in the Vienna Convention on the Law of Treaties (1969). Article 32 of that treaty expressly provides for the use of "the preparatory work of the treaty and the circumstances of its conclusion" in interpreting international conventions.

[37] Article 31(1) of the Vienna Convention on the Law of Treaties (1969) provides: "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." Article 32 adds: "Recourse may be had to supplementary means of interpretation including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of Article 31, or to determine the meaning when the interpretation according to Article 31 (a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable."

[38] See John Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention* (1982); John Honnold, *Documentary History of the Uniform Law for International Sales* (1989); John Honnold and Harry M. Flechtner, *Uniform Law for International Sales Under the 1980 United Nations Convention* (2009).

Professor Honnold, who is cited often in this text, passed away in early 2011 at the age of 95. A long-time professor at the University of Pennsylvania, he was considered one of the greatest scholars of international law, and was often called "The Father of the Vienna Convention." He wrote extensively on the CISG and other international agreements, and his comments are considered authoritative by many international law experts.

[39] Scholarly writings (doctrine) are also widely relied on in civil law and the United States to interpret legislative materials. In England, and in the countries that derive their judicial practice from England, scholarly writing is generally given little weight. Because the convention does not name the sources that courts are to use in its interpretation, this disparity will undoubtedly continue. Interestingly, the United Kingdom is one of the few major nations that has never adopted the CISG.

states. The requirement to use good faith means that courts must accept foreign decisions as precedents and depart from them only when they are clearly distinguishable, clearly erroneous, or no longer applicable to changed international circumstances.[40]

General Principles

general principles Those principles underlying and common to a statutory scheme or treaty.

CISG calls for courts to look to the **general principles** on which the convention is based when interpreting its provisions, but it gives no list of general principles. It is for the courts to divine those principles. The following two have been suggested: (1) A party to a contract has the duty to communicate information needed by the other party, and (2) parties have the obligation to mitigate damages resulting from a breach.[41] Both concepts appear, in varying forms, throughout the convention.[42]

Although CISG does not give a list of general principles, it does set out the mechanism for determining them. They must be derived (as is the case for the suggestions listed above) from particular sections of the convention and then extended, by analogy, to the case at hand.[43] In choosing this particular mechanism, the drafters rejected the adoption of general principles derived from public or private international law, as well as from domestic law codes. This limitation on the sources that the courts may turn to in creating general principles was consciously made, and it reflects the drafters' concern for uniformity and consistency, both in the drafting and in the evolution of the convention.

Rules of Private International Law

The rules of private international law are the third and final source for interpreting the convention. They may be used, however, only when CISG itself does not directly settle a matter or when the matter cannot be resolved by the application of a general principle derived from the convention itself.

Private international law rules vary from country to country. Some states—notably those in Central and Eastern Europe—have enacted private international law codes, whereas others—such as the English common law countries—rely on case law. This will undoubtedly produce inconsistent holdings. Nevertheless, these rules are much more harmonious internationally than other rules of domestic law, and adoption of their use represents a pragmatic decision by the authors of the convention. By allowing courts to turn to the rules of private international law, the convention avoids the possibility that courts will adopt interpretive aids on an entirely *ad hoc*[44] basis.

E. Interpreting Sales Contracts

In determining if a contract has been made, in interpreting its terms, and in ascertaining if it has been performed as agreed, courts throughout the world look at the statements, the conduct, and the usages and practices of the parties, as well as the practices of the trade to which the contract relates. Article 8 of CISG establishes rules for interpreting the statements and conduct of the parties; Article 9 deals with usages and practices.

---

[40]The use of case law will present difficulties when different courts come to different conclusions based on similar facts. Absent the existence of a single appellate court to harmonize differing opinions, the principle of "good faith" imposes on every court that is hearing a dispute the obligation to harmonize its decision with those of other courts and, where there are conflicting precedents, to harmonize the precedents. The principle of good faith that appears in CISG is apparently limited. The drafters meant that it be used only in interpreting the provisions of the convention, and not as a loose or general obligation imposed on the parties. This is in contrast to its much broader application in the German Civil Code, §242; the United States Uniform Commercial Code, §1–203; and other code systems. However, one might note that the drafters of the German Civil Code also originally meant for good faith to be used in a similar limited way. Nevertheless, German judges ignored the drafters' intention because the principle proved to be a convenient tool for adding flexibility. One can also anticipate that courts accustomed to a more liberal use of the concept will apply it in a similar liberal way when interpreting CISG.

[41]John Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention* (1982); John Honnold and Harry M. Flechtner, *Uniform Law for International Sales Under the 1980 United Nations Convention* (2009).

[42]The general duty to communicate is in the UN Convention on Contracts for the International Sale of Goods, Articles 19(2), 21(2), 26, 39(1), 48(2), 65, 71(3), 72(2), 79(4), and 88(1) (1980). The duty to mitigate is in *id*., Articles 77, 85, and 86.

[43]*Id*., Article 7(2), states: "Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based. . . ."

[44]From Latin: "for this." Something done for a specific purpose, circumstance, or case.

Statements and Conduct of the Parties

A contract is sometimes said to be formed only when the parties have a "meeting of the minds" or a "common intent." This comes from the idea, commonly accepted in many civil law countries, that parties are only bound by a contract when they subject their "will" to its terms. Such a **subjective intent approach**, however, has its problems. If a dispute arises about the meaning of the contract, the parties are hardly impartial witnesses about what was in their minds at the time they made the contract. This shortcoming has led some courts, notably those in the common law countries, to reject completely the use of subjective intent in the interpretation of a contract. As Oliver Wendell Holmes, a noted American judge, once wrote: "The law has nothing to do with the actual state of the parties' minds. In contract, as elsewhere, it must go by the externals, and judge parties by their conduct."[45]

Of course, the subjective intent of the parties is the best evidence for interpreting a contract—if it can be fairly ascertained—and CISG allows courts to turn to it first. Thus, courts are to use the subjective intent of a speaker, but only if "the other party knew or could not have been unaware" of the speaker's intent. When a speaker's intent is not clear, CISG directs the court to look at **objective intent**. In that case, a party's statements and other conduct "are to be interpreted according to the understanding that a reasonable person of the same kind as the other party would have had in the same circumstances."

subjective intent approach
Rule that contracts should be interpreted according to the actual intent and understanding of the parties at the time they made their agreement.

objective intent approach
Rule that contracts should be interpreted according to the understanding that a reasonable person would have had at the time the agreement was made.

Negotiations

When a court is to determine intent—be it the party's subjective intent or a reasonable person's objective understanding—Article 8(3) of CISG directs that "due consideration" be given "to all relevant circumstances," including (1) the **negotiations** leading up to the contract, (2) the practices that the parties have established between themselves, and (3) the parties' conduct after they agree to the contract.

The purpose of Article 8(3) is to do away with the technical rules that domestic courts sometimes use to interpret contracts. One notable example is the common law's **parol evidence rule**.[46] This rule forbids a court from considering any "prior" or any "contemporaneous oral understanding" when it is interpreting a writing that the parties intended as a "final expression of their agreement."[47] Article 8(3) specifically allows courts to consider the parties' preliminary negotiations when they interpret a contract.

Nevertheless, while Article 8(3) gives a court the flexibility to consider all relevant evidence, Article 6 allows the parties to "derogate from or vary the effect of" any of the provisions of the convention. Thus, if the parties include a contract term (often called an *integration clause*) that directs a court to ignore all prior or contemporaneous agreements, the court will have to give effect to that term. In other words, if the parties choose to adopt the parol evidence rule, they can do so. However, unless they specifically do so, the court will look at all the relevant circumstances of the case.

In addition to considering prior and contemporaneous conduct, CISG lets a court consider the parties' subsequent conduct. Again, this is contrary to the practice in some domestic tribunals.[48] CISG, however, does reflect the most widely followed practice and, as is the case for parol evidence, the parties are free to insert a provision in their contract excluding its consideration.

negotiations
The preliminary discussions leading up to the adoption of an agreement.

parol evidence rule
When a contract describes itself as being complete and final, preliminary or informal agreements made *prior to* or at the same time the contract was made will be ignored when interpreting it.

Practices and Usages

Both Article 8(3) and Article 9(1) of CISG state that parties are bound by "any **practices** which they have established between themselves." Article 9(1) also allows a court to consider any **usages** that the parties agreed to,[49] and Article 9(2) lets it consider "a usage of which the parties knew or ought

practice
The method of performance established between parties by their actions or conduct.

usage
The customary method of performing or acting that is followed by a particular group of people, such as people within a particular trade.

[45] Oliver W. Holmes, *The Common Law*, p. 242 (M. A. DeWolfe Howe, ed., 1963).

[46] CISG does not directly mention the parol evidence rule. To have done so, one commentator has suggested, "would have mystified jurists from legal systems that have no such rule." John Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention* (1982); John Honnold and Harry M. Flechtner, *Uniform Law for International Sales Under the 1980 United Nations Convention* (2009).

[47] United States, Uniform Commercial Code, §2-202.

[48] Lord Denning's criticism of the English practice is in *Port Soudan Cotton Co. v. Chettiar and Sons*, *Lloyd's Law Reports*, vol. 2, p. 5 at p. 11 (Ct. of Appeal, 1977).

[49] An example would be a provision that trade terms, such as *FOB*, *CIF*, and the like, must comply with the International Chamber of Commerce's Incoterms.

to have known and which in international trade is widely known to, and regularly observed by parties to contracts of the type involved in the particular trade concerned."

Article 9(2) was a compromise between the capitalist and communist delegates who participated in the drafting of CISG. In the former Soviet bloc, certainty was more important than flexibility. Trade usages are not considered unless a contract specifically adopted them and they did not violate statutory rules. In the Western world, on the other hand, flexibility and freedom of contract are more important than certainty. In some circumstances, trade usages apply in the West even when they contradict a statutory provision or the contract is silent.[50] The delegates ultimately agreed to let a court consider international trade usages, but only if they are "widely known" and "regularly observed."

Case 10-2 concerns a contract dispute in which the primary legal issue is whether a term's *customary usage in trade* should take precedence over the parties' understanding of that term based on their course of dealings.[51]

CASE 10-2 Treibacher Industrie, A.G. v. Allegheny Technologies, Inc.

United States Court of Appeals, Eleventh Circuit
464 F.3d 1235 (11th Cir., 2006)

MAP 10.2

Austria (2006)

Opinion by Circuit Judge Tjoflat

I. (A) This lawsuit arises out of two contracts, executed in November and December of 2000, respectively, whereby Treibacher Industrie, AG ("Treibacher"), an Austrian vendor of hard metal powders, agreed to sell specified quantities of tantalum carbide ("TaC"), a hard metal powder, to TDY Industries, Inc. ("TDY") for delivery to "consignment." TDY planned to use the TaC in manufacturing tungsten-graded carbide powders at its plant in Gurney, Alabama.

[50]See United States, Uniform Commercial Code, §§1-205 and 2-208.

[51]For an interesting and thorough analysis of this case, see Trevor Perea, "*Treibacher Industrie, A.G. v. Allegheny Technologies, Inc.*: A Perspective on the Lackluster Implementation of the CISG by American Courts," *Pace International Law Review*, vol. 20, p. 191 (2008).

After it had received some of the amount of TaC specified in the November 2000 contract, TDY refused to take delivery of the balance of the TaC specified in both contracts, and, in a letter to Treibacher dated August 23, 2001, denied that it had a binding obligation to take delivery of or pay for any TaC that it did not wish to use.

Unbeknownst to Treibacher, TDY had purchased the TaC it needed from another vendor at lower prices than those specified in its contracts with Treibacher. Treibacher eventually sold the quantities of TaC of which TDY refused to take delivery, but at lower prices than those specified in its contracts with TDY. Treibacher then filed suit against TDY, seeking to recover the balance of the amount Treibacher would have received had TDY paid for all of the TaC specified in the November and December 2000 contracts.

The case proceeded to a bench trial, where TDY and Treibacher disputed the meaning of the term "consignment"—the delivery term contained in both contracts. TDY introduced experts in the metal industry who testified that the term "consignment," according to its common usage in the trade, meant that no sale occurred unless and until TDY actually used the TaC. Treibacher introduced evidence of the parties' prior dealings to show that the parties, in their course of dealings (extending over a seven-year period), understood the term "consignment" to mean that TDY had a binding obligation to pay for all of the TaC specified in each contract but that Treibacher would delay billing TDY for the materials until TDY had actually used them.

The district court ruled that, under the United Nations Convention on Contracts for the International Sale of Goods ("CISG"), evidence of the parties' interpretation of the term in their course of dealings trumped evidence of the term's customary usage in the industry, and found that Treibacher and TDY, in their course of dealings, understood the term to mean "that a sale had occurred, but that invoices would be delayed until the materials were withdrawn." The court therefore entered judgment against TDY, awarding Treibacher $5,327,042.85 in compensatory damages (including interest).

(B) TDY now appeals, contending that, under the CISG, a contract term should be construed according to its customary usage in the industry unless the parties have expressly agreed to another usage. TDY argues, in the alternative, that the district court erred in finding that, in their course of dealings, Treibacher and TDY understood the term "consignment" to require TDY to use and pay for all of the TaC specified in each contract.

Reviewing the district court's legal conclusions de novo and factual findings for clear error, we hold that the district court properly construed the contract under the CISG—according to the parties' course of dealings—and did not commit clear error in finding that the parties understood the contracts to require TDY to use all of the TaC specified in the contracts. We therefore affirm the judgment of the district court.

II. (A) We begin our analysis by discussing the CISG, which governs the formation of and rights and obligations under contracts for the international sale of goods (CISG, arts. 1, 4). The parties do not dispute that the CISG governs their dispute. Article 1 of the CISG provides, in relevant part, that it "applies to contracts of sale of goods between parties whose places of business are in different States . . . when the States are Contracting States." The United States and Austria are contracting states. Article 4 of the CISG provides, in relevant part, that it "governs . . . the formation of the contract and the rights and obligations of the seller and buyer arising from such a contract." The parties dispute their respective "rights and obligations" under the contracts at issue in this case.

Article 9 of the CISG provides the rules for interpreting the terms of contracts. Article 9(1) states that, "parties are bound by any usage to which they have agreed and by any practices which they have established between themselves." Article 9(2) then states that, "parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract . . . a usage of which the parties knew or ought to have known and which in international trade is widely known to . . . parties to contracts of the type involved in the particular trade concerned."

Article 8 of the CISG governs the interpretation of the parties' statements and conduct. A party's statements and conduct are interpreted according to that party's actual intent "where the other party knew . . . what that intent was" [CISG, art. 8(1)], but, if the other party was unaware of that party's actual intent, then "according to the understanding that a reasonable person . . . would have had in the same circumstances" [CISG, art.

8(2)]. To determine a party's actual intent, or a reasonable interpretation thereof, "due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties" [CISG, art. 8(3)].

In arguing that a term's customary usage takes precedence over the parties' understanding of that term in their course of dealings, TDY seizes upon the language of article 9(2), which states that "parties are considered, unless otherwise agreed, to have made applicable to their contract" customary trade usages. TDY contends that article 9(2) should be read to mean that, unless parties to a contract expressly agree to the meaning of a term, the customary trade usage applies.

In support of its argument, TDY points to the language of article (9)(1), which binds parties to "any usage to which they have agreed and by any practices which they have established between themselves." According to TDY, the drafters of the CISG, by separating the phrase "usages to which they have agreed" from the phrase "practices which they have established between themselves," intended the word "agreed," in article 9, to mean express agreement, as opposed to tacit agreement by course of conduct. Applying this definition to the language of article 9(2), TDY contends that contract terms should, in the absence of express agreement to their usage, be interpreted according to customary usage, instead of the usage established between the parties through their course of conduct.

TDY's construction of article 9 would, however, render article 8(3) superfluous and the latter portion of article 9(1) a nullity. The inclusion in article 8(3) of "any practices which the parties have established between themselves," as a factor in interpreting the parties' statements and conduct, would be meaningless if a term's customary usage controlled that term's meaning in the face of a conflicting usage in the parties' course of dealings. The latter portion of article 9(1) would be void because the parties would no longer be "bound by any practices which they have established between themselves."

Instead, in the absence of an express agreement as to a term's meaning, the parties would be bound by that term's customary usage, even if they had established a contrary usage in their course of dealings. We therefore reject TDY's interpretation of article 9(2), and, like the district court, adopt a reading that gives force to articles 8(3) and 9(1), namely, that the parties' usage of a term in their course of dealings controls that term's meaning in the face of a conflicting customary usage of the term. A previous case decided by this court held that "A statute should be construed so that effect is given to all its provisions, so that no part of it will be inoperative or superfluous, void or insignificant."

(B) The district court did not commit clear error in finding that, in their course of dealings, TDY and Treibacher defined the term "consignment" to require TDY to accept and pay for all of the TaC specified in each contract. The parties do not dispute that they executed, between 1993 and 2000, a series of contracts in which Treibacher agreed to sell certain hard metal powders, such as TaC, to TDY. In each instance, TDY discussed its needs with Treibacher, after which Treibacher and TDY executed a contract whereby Treibacher agreed to sell a fixed quantity of materials at a fixed price for delivery to "consignment." Treibacher then delivered to TDY the specified quantity of materials—sometimes in installments, depending upon TDY's needs.

TDY kept the materials it received from Treibacher in a "consignment store," where the materials were labeled as being from Treibacher and segregated from other vendors' materials. As it withdrew the materials from the consignment store for use, TDY published "usage reports," which documented the amounts of materials withdrawn. TDY sent the usage reports to Treibacher, and Treibacher, in turn, sent TDY invoices for the amounts of materials withdrawn at the price specified in the relevant contract. TDY then paid the invoices when they came due. In each instance, TDY ultimately withdrew and paid for the full quantity of materials specified in each contract.

Atchley told Hinterhofer that TDY would keep the TaC. TDY subsequently used the TaC and sent a usage report to Treibacher, for which Treibacher sent TDY an invoice, which TDY paid. This interaction—evidencing TDY's acquiescence in Treibacher's interpretation of the contract—along with TDY's practice, between 1993 and 2000, of using and paying for all of the TaC specified in each contract amply support the district court's finding that the parties, in their course of dealings, construed their contracts to require TDY to use and pay for all of the TaC specified in each contract.

III. In sum, the district court properly determined that, under the CISG, the meaning the parties ascribe to a contractual term in their course of dealings establishes the meaning of that term in the face of a conflicting customary usage of the term. The district court was not clearly erroneous in finding that Treibacher and TDY understood their contracts to require TDY to purchase all of the TaC specified in each contract and that Treibacher took reasonable measures to mitigate its losses (selling the unused TaC whenever possible) after TDY breached. Accordingly, the judgment of the district court is AFFIRMED.

Casepoint

In this case, the court had to decide how to interpret, under the CISG, the word *consignment* in a contract between two business firms—one in Austria and one in the United States. The result of the case turned on whether that word should be interpreted according to its meaning based on the "course of dealings" between the parties or on its "customary usage in trade." After reviewing the relevant sections of the CISG, the court found that, in the course of their dealings, TDY and Treibacher had defined the term *consignment* to require TDY to accept and pay for all of the TaC specified in each contract, and that this is how the term should be interpreted.

Form

Traditionally, many countries have required that a contract be in writing. The English Statute of Frauds of 1677 required a signed writing to enforce a wide variety of contracts, including contracts for the sale of goods.[52] This same requirement reappears in the U.K. Sale of Goods Act of 1893, the U.S. Uniform Sales Act of 1896 and, more recently, the U.S. Uniform Commercial Code.[53] In 1954, however, the United Kingdom repealed the writing requirement when it revised its Sale of Goods Act,[54] and this revision was adopted by many former colonies that had inherited the British act.[55]

In the civil law countries, the requirement that a contract be in writing generally does not apply to commercial transactions.[56] In socialist countries, on the other hand, the need for certainty both in interpreting and enforcing foreign trade contracts is of paramount concern. The laws of the former Soviet Union, and now the Russian Federation, for example, imposed strict writing and registration requirements on foreign trade contracts.[57]

Most of the delegates involved in the drafting of CISG were of the opinion that a writing requirement is inconsistent with modern commercial practice, especially in market economies where speed and informality characterize so many transactions. The Soviet delegates, however, insisted that a writing requirement is important for protecting their country's longtime pattern of making foreign trade contracts. The result of this disagreement was a compromise. First, Article 11 of the convention states:

A contract of sale need not be concluded in or evidenced by writing and is not subject to any other requirements as to form. It may be proved by any means, including witnesses.

Article 96, however, authorizes a contracting state "whose legislation requires contracts of sale to be concluded in or evidenced by writing" to make a declaration at the time of ratification that

[52] *Charles II*, Year 29, chap. 3, §17.

[53] United States, Uniform Commercial Code, § 2-201.

[54] United Kingdom, Law Reform (Enforcement of Contracts) Act (1954).

[55] Including Australia and Canada. See Kenneth C. Sutton, "Formation of Contract: Unity in International Sales of Goods," *University of Western Ontario Law Review*, vol. 16, pp. 148–150 (1977).

[56] E.g., France, Civil Code, Article 1341; and see Stojan Cigoj, "International Sales, Formation of Contracts," *Netherlands International Law Review*, vol. 23, pp. 270–272 (1976), which surveys the rules of many countries.

[57] John Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention* (2009); John Honnold and Harry M. Flechtner, *Uniform Law for International Sales Under the 1980 United Nations Convention* (2009).

Article 11 (and some other provisions of the convention involving requirements of form) "does not apply where any party has his place of business in that state."[58]

F. Formation of the Contract

A contract is formed, and the parties are bound by its provisions, when an offer to buy or sell a good is accepted.[59]

The Offer

offer
A proposal by one person to another indicating an intention to enter into a contract under specified terms.

An **offer** is a proposal addressed to specific persons indicating an intention by the offeror to be bound to the sale or purchase of particular goods for a price.[60] The pro forma invoice shown in Figure 10.3 is an example of an offer commonly used in international trade. Should there be some doubt whether a communication is an offer or not, CISG directs a court to ascertain if the offeror communicated an intention to be bound. This can be determined from the general rules of interpretation in Article 8 of the convention—that is, by looking at the offeror's proposal within its full context, including any negotiations, any practices between the parties, any usages, and any subsequent conduct. It can also be determined from the subsidiary rules contained in Article 14.

Definiteness According to Article 14, a "proposal is sufficiently definite if it indicates the goods and expressly or implicitly fixes or makes provision for determining the quantity and price." In other words, an offer must describe the goods with sufficient clarity that the parties know what is being offered for sale, and it must also state the quantity and price.

The price provision in Article 14 has to be read together with Article 55, which was added to the convention at the last minute, during the Diplomatic Conference that adopted CISG. The delegates to the conference were concerned that Article 14, standing alone, could be confusing. For example, if a buyer needs a particular part for a machine to keep a production line operational, he may ask the seller to rush it to him without first agreeing to the price, assuming that the seller will charge the customary price. In such a circumstance, the seller would probably treat the buyer's request as an offer. However, if the seller was unaware of the urgency of the buyer's request, the seller might well disregard it, because the proposal does not fix a price. If the seller did so, would the buyer be entitled to a remedy under CISG? Probably not, because Article 14 suggests that it is the duty of the offeror (the buyer in this example) to communicate the means for fixing a price. On the other hand, if the seller shipped the part anyway and the buyer changed his mind, would the seller have a remedy? Possibly, because the buyer originally subjectively intended to be bound, even though he did not objectively indicate this. Remember that Article 8 allows courts to rely on subjective intent in interpreting the terms of a contract.

To avoid any possible confusion, Article 55 was added to CISG. It provides:

> Where a contract has been validly concluded but does not expressly or implicitly fix or make provision for determining the price, the parties are considered in the absence of any indication to the contrary, to have impliedly made reference to the price generally charged at the time of the conclusion of the contract for such goods sold under comparable circumstances in the trade concerned.

---

[58]UN Convention on Contracts for the International Sale of Goods, Article 12 (1980), further describes the effect of a state making a declaration under Article 96: "Any provision of Article 11, Article 29 or Part II of this Convention that allows a contract of sale or its modification or termination by agreement or any offer, acceptance or other indication of intention to be made in any form other than in writing does not apply where any party has his place of business in a contracting state which has made a declaration under Article 96 of this Convention. The parties may not derogate from or vary the effect of this Article."

A few provisions of the convention refer to the use of a writing. Article 21(2) refers to a "letter or other writing containing a late acceptance," and Article 29(2) states that a "contract in writing which contains a provision requiring any modification or termination by agreement to be in writing may not be otherwise modified or terminated by agreement." Neither of these requires that a writing be signed. Article 13 states that "for the purposes of this Convention 'writing' includes telegram and telex."

[59]*Id.*, Article 23.

[60]*Id.*, Article 14(1): "A proposal for concluding a contract addressed to one or more specific persons constitutes an offer if it is sufficiently definite and indicates the intention of the offeror to be bound in case of acceptance. A proposal is sufficiently definite if it indicates the goods and expressly or implicitly fixes or makes provision for determining the quantity and price."

FIGURE 10.3

An Offer: Pro Forma Invoice

<table>
<tr><td colspan="3">International Sales Company
1234 Main Street
Pullman, Washington 99163
U.S.A.</td><td colspan="3">Pro Forma
INVOICE</td></tr>
<tr><td colspan="3">Date: July 1, 2012</td><td colspan="3">Invoice No. 030701</td></tr>
<tr><td colspan="3" rowspan="3">To: Compañía Mundial, S.A.
567 Avenida de Mayo
Buenos Aires
1103 Argentina</td><td colspan="3">Order No.</td></tr>
<tr><td colspan="3">Shipped:</td></tr>
<tr><td colspan="3">Payment:</td></tr>
<tr><td>Identifying Marks & Nos.</td><td>Qty</td><td colspan="2">Description</td><td>Unit Price</td><td>Amt.</td></tr>
<tr><td></td><td>

Each
Each
Each</td><td colspan="2">Widgets
As per specification and samples forwarded by air parcel on June 7, 2012.

Type "A"
Type "B"
Type "C"</td><td>FOB
port of Seattle

US$
1.23
4.56
7.89</td><td></td></tr>
<tr><td></td><td></td><td colspan="4">Packing: Each in inner box; 144 per double export carton weighing 14 kg and measuring 25 x 25 x 10 cm.

Shipment within 30 days after receipt of your firm order and payment.

Payment: Irrevocable Letter of Credit for 100% of invoice value payable at sight through Washington National Bank of Pullman.

Minimum Order: 144 each per type.

Offer Duration: Effective until August 15, 2012.</td></tr>
<tr><td colspan="6">International Sales Company

Jane Doe
Jane Doe, Pres.</td></tr>
</table>

Thus, even though an offer does not "expressly or implicitly" fix a price, it is still a valid offer. The offeror is assumed to have "impliedly made reference to the price generally charged."[61]

Specific Offerees For a proposal to be an offer, it must be addressed to "one or more specific persons." Proposals made to the public are ordinarily intended to be nothing more than invitations to negotiate. For example, an advertisement in a newspaper for the sale of goods at a particular price might put the

[61] *Id.*, Article 55. If a contract fixes a price based on weight but does not specify the gross or net weight, Article 56 says that "in case of doubt it is to be determined by the net weight."

advertiser in the awkward position of having to deliver more goods than he has on hand because of heavier than expected demand, or of absorbing a substantial loss because of an increase in the cost of the goods between the time the advertisement was placed and the time it appeared. CISG, accordingly, adopts the rule that public offers are only invitations to negotiate "unless the contrary is clearly indicated."[62]

Effectiveness of an Offer

An offer becomes effective only after it reaches the offeree.[63] Thus, offers—including offers that promise that they are irrevocable—can be withdrawn before they reach the offeree.[64]

revocation
Cancellation by the offeror of an offer.

Revocation Offers that do not state that they are irrevocable can be revoked any time before the offeree dispatches an acceptance.[65] This **revocation** rule is based on the famous English common law *mailbox rule*,[66] which limits the ability of the offeror to cancel an offer where the offeree has reasonably relied on it. Under the common law, the acceptance had to be returned using the same medium in which the offer was originally sent (e.g., a mailed offer had to be accepted by mail). Under CISG, the acceptance can be sent by any means.

firm offer
An offer that the offeror promises to keep open for a fixed period of time.

Firm Offers Under traditional Anglo-American common law rules, the doctrine of consideration prevents an offeror from making an offer irrevocable. An option contract (i.e., one in which the offeree pays the offeror for the promise to keep the offer open) has to be used. The doctrine of consideration does not apply to CISG, however, and **firm offers** (i.e., ones where the offeror promises to keep the offer open for a fixed period) are enforceable. Most common law countries have modified the traditional rule, allowing offerees to enforce firm offers made by merchants if they are made in writing, are signed by the offeror, and are effective for only a limited time period. This is the rule regarding the sale of goods in the United States as established by the Uniform Commercial Code (UCC).[67] CISG goes further than this. The promise of irrevocability does not have to be signed, does not have to be in writing, and there is no time limitation. A firm offer is enforceable if the offeror makes the offer irrevocable or if the offeree can reasonably rely on conduct that implies that the offer is firm.[68]

Acceptance

acceptance
Agreement to enter into a contract proposed by an offeror.

A contract comes into existence at the point in time an offer is accepted. **Acceptance** is a statement or conduct by the offeree indicating assent that is communicated to the offeror. The form or mode in which an offeree expresses assent is unlimited; however, the offeree must communicate his assent to the offeror.[69] The purchase order shown in Figure 10.4 is an example of an acceptance commonly used in international trade.

Silence Silence or inactivity does not, in and of itself, constitute acceptance. For example, if a seller sends a buyer an offer that says, "I know that this is such a good deal that I will assume that you have accepted unless I hear otherwise," the fact that the buyer does not respond will not create a contract. A different result will occur, however, if the seller sends the buyer an invitation to negotiate that says, "Unless you hear otherwise from me within three days after I receive your order, I will deliver the widgets you need at $100 each." In such a case, the seller's silence constitutes acceptance. In the first instance, the seller attempted to force acceptance on the buyer. In the second, the seller voluntarily assumed the duty to respond.

[62] *Id.*, Article 14(2).

[63] *Id.*, Article 24, defines when a communication reaches an addressee as follows: "For the purposes of this Part of the Convention, an offer, declaration of acceptance or any other indication of intention 'reaches' the addressee when it is made orally to him or delivered by any other means to him personally, to his place of business or mailing address or, if he does not have a place of business or mailing address, to his habitual residence."

[64] *Id.*, Article 15.

[65] *Id.*, Article 16(1).

[66] The mailbox rule applies in most Anglo-American common law countries, including England, Australia, Canada, New Zealand, and the United States. The original cases developing the rule are *Adams v. Lindsell*, *English Reports*, vol. 106, p. 250 (1818), and *Dunlop v. Higgins*, *English Reports*, vol. 9, p. 805 (House of Lords, 1848).

[67] See United States, Uniform Commercial Code, §2-205.

[68] UN Convention on Contracts for the International Sale of Goods, Article 16(2) (1980).

[69] *Id.*, Article 18(1).

FIGURE 10.4

An Acceptance: Purchase Order

Compañia Mundial, S.A.
567 Avenida de Mayo
Buenos Aires
1103 Argentina

PURCHASE ORDER

Date: August 2, 2012	No. 080203
To: International Sales Company 1234 Main Street Pullman, Washington 99163 U.S.A.	Date Required: Sept. 15, 2012 Deliver to: Address above Packing: Standard Export Payment: Irrevocable Letter

Identifying Marks & Nos.	Qty.	Description	Unit Price	Amt.
		FOB Port of Seattle	US $	US $
	Each	Type "A"	1.23	531.36
	Each	Type "B"	4.56	1313.28
	Each	Type "C"	7.89	1136.16
				2980.80

Packing: As per your offer sheet, each in cardboard inner box, 144 per double export carton weighing 14 kg and measuring 25 x 25 x 10 cm.
Shipment via M/V El Mar from port of Seattle to Buenos Aires
Payment: Irrevocable Letter of Credit for 100% of invoice value payable at sight through Banco del Sur, Buenos Aires, to Washington National Bank of Pullman.
Notify party: Agencia Rosas, 989 Calle de los Marineros, Buenos Aires, 1117 Argentina

Case Mark: Cia Mundial
Buenos Aires
Made in USA
C/No. _____

Accepted

____

Confirmed

Juan Valdez
J. Valdez, Gte.

Time of Acceptance Acceptance must be received by the offeror within the time period specified in the offer. If no time period is given, acceptance must be received within a reasonable time. If the offer is oral, the acceptance must be made immediately, unless the circumstances indicate otherwise.[70]

In devising the acceptance rule for CISG, the drafters opted for the receipt theory used in civil law countries. In common law countries, the dispatch or mailbox theory is used. The difference between the two relates to the allocation of risk when an acceptance is lost or delayed. For example, suppose that a

[70] *Id.*, Article 18(2).

buyer sends a seller an acceptance through the mail and the acceptance is lost. If the dispatch theory were applied, a contract would have come into existence at the time the acceptance was mailed, and the seller would be required to perform. Under the receipt rule adopted by CISG, however, no contract would exist, and the buyer would be left empty-handed. The reason the drafters chose the receipt rule was a perception that it more fairly allocates responsibility for loss or delay. Because it is the offeree who chooses the medium through which to send a response, it is the offeree who is better able to avoid the risk of loss or delay, and therefore CISG imposes responsibility for avoiding that risk on the offeree.[71]

Assent by Performance of an Act If the offeror asks for performance of an act rather than the indication of acceptance, the acceptance is effective at the moment the act is performed. However, the offer, a trade usage, or the practice of the parties must make it clear that the offeree is not required to notify the offeror.[72] Consider the following example. A buyer sends a seller the following offer: "Ship me 100 widgets at your customary price for delivery on or before May 31." The seller responds by shipping the goods for delivery on May 30. The day after the goods are shipped, however, the buyer calls the seller and withdraws his offer. Can the buyer withdraw the offer? The buyer might argue that Article 18(2) says that a contract only becomes effective when "the indication of assent reaches the offeror." Here, of course, the buyer would not have been aware of the acceptance until the goods arrived. The seller would, however, be able to rely on Article 18(3), which says that an offeree "may indicate assent by performing an act . . . without [giving] notice to the offeror." The seller shipped the goods precisely in the manner requested by the buyer, and the buyer's offer did not ask for notice of acceptance or even confirmation of shipment.

withdrawal
Cancellation by the offeree of an acceptance.

Withdrawal Because an acceptance is normally not effective until the offeror receives it, an offeree may **withdraw** his acceptance any time before or simultaneous with its receipt.[73]

rejection
Refusal by an offeree to become a party to a proposed contract.

Rejection A **rejection** becomes effective when it reaches the offeror.[74] If an offeree were to dispatch both a rejection and an acceptance at the same time, the one that reached the offeror first would be the one given effect.

Acceptance with Modifications

A seller sends an offer to a buyer. The buyer responds with an acceptance that modifies some of the terms in the offer. Is there a contract?

This scenario—commonly called the *Battle of the Forms*—occurs when merchants use preprinted forms both to make offers and to send back acceptances. The typed-in descriptions commonly match up; it is the "fine print" on the back of the forms, however, that contains differences.[75] Under CISG, if the inconsistencies are "material" the would-be acceptance is a counteroffer.[76] Article 19(3) states:

> Additional or different terms relating, among other things, to the price, payment, quality of the goods, place and time of delivery, extent of one party's liability to the other, or the settlement of disputes are considered to alter the terms of the offer materially.

Terms that are not material are considered to be proposals for addition that will become part of the contract unless the offeror promptly objects.[77]

Case 10-3 compares the way that CISG and the U.S. Uniform Commercial Code treat acceptances with additional terms.

---

[71] *Id.*, Article 21(1), allows an offeror to treat a late acceptance as valid "if without delay the offeror orally so informs the offeree or dispatches a notice to that effect." Article 21(2) says that an offeror who receives a late acceptance under such circumstances that he can see that it was delayed in transmission must give the acceptance effect "unless, without delay, the offeror orally informs the offeree that he considers his offer as having lapsed or dispatches a notice to that effect."

[72] UN Convention on Contracts for the International Sale of Goods, Article 18(3) (1980).

[73] *Id.*, Article 22.

[74] *Id.*, Article 17.

[75] One businessperson wryly observed when responding to a survey on the use of forms that business would come to a halt if buyers and sellers "read the backsides of the other's forms." Quoted in John Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention*, p. 166 (1982).

[76] UN Convention on Contracts for the International Sale of Goods, Article 19(1) (1980).

[77] *Id.*, Article 19(2). This CISG rule is based on legislation originally drafted in the Scandinavian countries. Article 19 is based on Article 6 of the Swedish Conclusion of Contracts Act (1915). The same act was adopted in Denmark in 1917, Norway in 1918, Finland in 1929, and Iceland in 1936. John Honnold and Harry M. Flechtner, *Uniform Law for International Sales Under the 1980 United Nations Convention* (2009).

CASE 10-3 Filanto, SpA v. Chilewich International Corp.

United States, District Court, Southern District of New York
Federal Supplement, vol. 789, p. 1229 (1992)

MAP 10.3

United States, United Kingdom, Union of Soviet Socialist Republics, and Italy (1991)

Filanto, SpA, the plaintiff, was an Italian corporation engaged in the manufacture and sale of footwear. Chilewich International Corp. (Chilewich), the defendant, was an export–import firm incorporated in New York.

On February 28, 1989, Chilewich's agent in the United Kingdom, Byerly Johnson, Ltd., signed a contract with the Soviet Union's Foreign Economic Association (known as Raznoexport) that obligated Byerly Johnson and Chilewich to deliver footwear to Raznoexport in what is now Russia. This contract (the Russian Contract) contained an arbitration clause that read, in part, as follows:

> All disputes or differences which may arise out of or in connection with the present Contract are to be settled, jurisdiction of ordinary courts being excluded, by the Arbitration at the USSR Chamber of Commerce and Industry, Moscow, in accordance with the Regulations of the said Arbitration. [sic]

In order to fulfill the Russian Contract, Chilewich and Byerly Johnson met with Filanto, which was then supplying them with footwear under various ongoing contracts. On July 27, 1989, Mr. Melvin Chilewich sent a letter to Mr. Antonio Filograna, chief executive officer of Filanto, which summarized the negotiations at this meeting and then stated:

> Attached please find our contract to cover our purchase from you. Same is governed by the conditions which are enumerated in the standard contract with the Soviet buyers [the Russian Contract], copy of which is also enclosed.

Filanto claims that it sent a reply on September 2, 1989, that excluded the arbitration provision of the Russian Contract and that requested Chilewich to accept Filanto's counteroffer. Chilewich claimed not to have received this correspondence.

On March 13, 1990, Chilewich sent Filanto a Memorandum Agreement to confirm that Filanto was to deliver a total of 250,000 pairs of boots to Chilewich. This memo again referred to the arbitration provision in the Russian Contract. Filanto did not immediately respond, and Chilewich proceeded to obtain a letter of credit in Filanto's favor in the sum of $2,595,600 on May 11, 1990.

On August 7, 1990, Filanto signed and returned the Memorandum Agreement. Filanto's cover letter, however, stated that it would not be bound by several provisions of the Russian Contract, including the arbitration provision and the provision governing procedures for making claims.

Chilewich accepted delivery and paid Filanto for 100,000 boots on September 15, 1990. Then in January 1991, Chilewich accepted and paid for another 60,000 boots. However, because Chilewich claimed that some of these boots were defective, it never purchased the 90,000 boots that made up the balance of its original order. Filanto, as a consequence, filed a complaint in

a U.S. federal trial court in New York on May 14, 1991, alleging breach of contract. Chilewich answered the complaint by asking the court to stop the proceedings while the matter was arbitrated in the Soviet Union.

Chief Judge Brieant . . .

. . . [The law] to be capplied in this case is found in the United Nations Convention on Contracts for the International Sale of Goods (the CISG). This Convention, ratified by the Senate in 1986, is a self-executing agreement which entered into force between the United States and other signatories, including Italy, on January 1, 1988. Although there is as yet virtually no U.S. case law interpreting the Sale of Goods Convention, it may safely be predicted that this will change: absent a choice-of-law provision, and with certain exclusions not here relevant, the Convention governs all contracts between parties with places of business in different nations, so long as both nations are signatories to the Convention. Since the contract alleged in this case most certainly was formed, if at all, after January 1, 1988, and since both the United States and Italy are signatories to the Convention, the Court will [apply] . . . the substantive international law of contracts embodied in the Sale of Goods Convention.[78]

Not surprisingly, the parties offer varying interpretations of the numerous letters and documents exchanged between them. The Court will briefly summarize their respective contentions.

Defendant Chilewich contends that the Memorandum Agreement dated March 13, which it signed and sent to Filanto, was an offer. It then argues that Filanto's retention of the letter, along with its subsequent acceptance of Chilewich's performance under the Agreement—the furnishing of the May 11 letter of credit—estops it from denying its acceptance of the contract. Although phrased as an estoppel argument, this contention is better viewed as an acceptance by conduct argument, e.g., that in light of the parties' course of dealing, Filanto had a duty timely to inform Chilewich that it objected to the incorporation by reference of all the terms of the Russian Contract. Under this view, the return of the Memorandum Agreement, signed by Filanto, on August 7, 1990, along with the covering letter purporting to exclude parts of the Russian Contract, was ineffective as a matter of law as a rejection of the March 13 offer, because this occurred some five months after Filanto received the Memorandum Agreement and two months after Chilewich furnished the Letter of Credit. Instead, in Chilewich's view, this action was a proposal for modification of the March 13 Agreement. Chilewich rejected this proposal, by its letter of August 7 to Byerly Johnson, and the August 29 fax by Johnson to Italian Trading SRL, which communication Filanto acknowledges receiving. Accordingly, Filanto under this interpretation is bound by the written terms of the March 13 Memorandum Agreement; since that agreement incorporates by reference the Russian Contract containing the arbitration provision, Filanto is bound to arbitrate.

Plaintiff Filanto's interpretation of the evidence is rather different. While Filanto apparently agrees that the March 13 Memorandum Agreement was indeed an offer, it characterizes its August 7 return of the signed Memorandum Agreement with the covering letter as a counteroffer. While defendant contends that under *Uniform Commercial Code* § 2–207 this action would be viewed as an acceptance with a proposal for a material modification, the *Uniform Commercial Code*, as previously noted, does not apply to this case, because the State Department undertook to fix something that was not broken by helping to create the Sale of Goods Convention, which varies from the *Uniform Commercial Code* in many significant ways. Instead, under this analysis, Article 19(1) of the Sale of Goods Convention would apply. That section, as the Commentary to the Sale of Goods Convention notes, reverses the rule of *Uniform Commercial Code* § 2–207, and reverts to the common law rule that "A reply to an offer which purports to be an acceptance but contains additions, limitations or other modifications is a rejection of the offer and constitutes a counteroffer."[79] Although the Convention, like the *Uniform Commercial Code*, does state that nonmaterial terms do become part of the contract unless objected to,[80] the Convention treats inclusion (or deletion) of an arbitration provision as "material."[81] The August 7 letter, therefore, was a counteroffer which, according

[78]United Nations Convention on Contracts for the International Sale of Goods (1980), Article 1 (1)(a).

[79]*Id*., Article 19(1).

[80]*Id*., Article 19(2).

[81]*Id*., Article 19(3).

to Filanto, Chilewich accepted by its letter dated September 27, 1990. Though that letter refers to and acknowledges the "contractual obligations" between the parties, it is doubtful whether it can be characterized as an acceptance.

Since the issue of whether and how a contract between these parties was formed is obviously related to the issue of whether Chilewich breached any contractual obligations, the Court will direct its analysis to whether there was objective conduct evidencing an intent to be bound with respect to the arbitration provision.

The Court is satisfied on this record that there was indeed an agreement to arbitrate between these parties.

There is simply no satisfactory explanation as to why Filanto failed to object to the incorporation by reference of the Russian Contract in a timely fashion. As noted above, Chilewich had in the meantime commenced its performance under the Agreement, and the Letter of Credit it furnished Filanto on May 11 itself mentioned the Russian Contract. An offeree who, knowing that the offeror has commenced performance, fails to notify the offeror of its objection to the terms of the contract within a reasonable time will, under certain circumstances, be deemed to have assented to those terms.[82] The Sale of Goods Convention itself recognizes this rule.

Article 18(1) provides that "A statement made by or other conduct of the offeree indicating assent to an offer is an acceptance." Although mere "silence or inactivity" does not constitute acceptance,[83] the Court may consider previous relations between the parties in assessing whether a party's conduct constituted acceptance.[84] In this case, in light of the extensive course of prior dealing between these parties, Filanto was certainly under a duty to alert Chilewich in timely fashion to its objections to the terms of the March 13 Memorandum Agreement—particularly since Chilewich had repeatedly referred it to the Russian Contract and Filanto had had a copy of that document for some time.

. . . [Filanto's letter of June 21, 1991, to Byerly Johnson], which responds to claims by Johnson that some of the boots that were supplied were defective, expressly relies on Section 9 of the Russian Contract—another section which Filanto had in its earlier correspondence purported to exclude. The Sale of Goods Convention specifically directs that "[i]n determining the intent of a party . . . due consideration is to be given to . . . any subsequent conduct of the parties."[85] In this case, as the letter postdates the partial performance of the contract, it is particularly strong evidence that Filanto recognized itself to be bound by all the terms of the Russian Contract.

In light of these factors . . . the Court holds that Filanto is bound by the terms of the March 13 Memorandum Agreement, and so must arbitrate its dispute in Moscow.

Casepoint

This case involves a contract between two parties in different countries concerning the sale of a large quantity of shoes. The buyer later claimed that the shoes furnished did not meet the contract specifications and never completed the purchase of all the shoes under the contract, leading to this lawsuit. The key legal issue is whether, under the CISG, the parties were bound to a contract provision requiring arbitration of any contractual disputes in Russia. After reviewing all the correspondence and the conduct of each party, the court concluded that the arbitration clause was indeed part of the contract.

G. General Standards of Performance

CISG imposes general standards of performance on both the buyer and seller. In general, both parties are entitled to get from their contract what they expect.[86] A party that fails to perform accordingly is in breach of contract. When one party breaches, the other party may avoid the contract or make a demand for specific performance.

[82]Restatement (Second) of Contracts, §69 (1981).

[83]United Nations Convention on Contracts for the International Sale of Goods (1980), Article 18(1).

[84]*Id*., Article 8(3).

[85]*Id*.

[86]UN Convention on Contracts for the International Sale of Goods, Articles 53 and 54 (1980).

Fundamental Breach

When one party substantially fails to deliver what the other reasonably anticipated receiving, there is a fundamental breach. Article 25 defines a fundamental breach this way:

> A breach of contract committed by one of the parties is fundamental if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result.

Avoidance

avoidance
Notification by a party that he is canceling a contract and returning everything already received.

If there has been a fundamental breach, one remedy available to the injured party is **avoidance** (i.e., notification by the party that he is canceling the contract). To be entitled to avoid a contract, however, the injured party must—in all cases—notify the other party[87] and be able to return any goods he has already received.[88]

When a party avoids, only the obligation to perform is affected. Avoidance does not cancel (1) any provision in the contract concerning the settlement of disputes (such as arbitration, choice-of-law, or choice-of-forum clauses) or (2) any other provisions governing the rights and duties of the parties "consequent upon the avoidance of the contract."[89]

Requests for Specific Performance

CISG authorizes an injured party to ask a court "to require performance" if the other party fails to carry out his obligations.[90] A court is not obliged to grant this request, however, unless the court can do so under its own domestic rules.[91]

specific performance
A court order directing a party to carry out the obligations he had contractually promised to do.

What constitutes **specific performance** varies from country to country, and the rule in CISG reflects the difficulties the drafters had in defining the concept. In common law countries, the concept is fairly narrow, referring to a court decree that compels a defendant to do a specific act, such as delivering goods. Disobeying the decree can be serious. It is treated as a *contempt of court* punishable by fine or imprisonment. In the civil law countries, the idea of *requiring performance* is much broader and includes such things as the buying of a substitute at the defaulting party's expense; however, the sanctions are not as burdensome—a court may not impose a fine or throw a disobedient party into jail.[92]

The prerequisites that must be shown before a party can obtain specific performance also vary. The United Kingdom's Sale of Goods Act of 1893, which is widely followed in the common law world, states that a court, "if it thinks fit," may enter a decree requiring a party in breach of contract to deliver "specific or ascertained goods."[93] The difficulty of determining when goods are "specific or ascertained," however, is a problem that limits the application of this section. In the United States, the Uniform Commercial Code allows for decrees of specific performance that "a court may deem just," so long as "the goods are unique" or "in other proper circumstances."[94] A U.S. court will not normally order a party to perform in a sale of goods contract unless the goods are specially made or quite unusual or distinctive ("unique"). For example, specific performance would not be ordered for the breach of a contract to sell a 2009 Ford automobile (there are many of them and money damages would suffice), but might be ordered if the item was a 1943 Rolls Royce auto (quite rare). In the civil law countries, a party is "entitled" to require performance. Civil judges do not have the discretion to deny a decree, as their common law brethren do, nor is the remedy limited by the nature of the goods involved.[95]

---

[87] *Id.*, Article 26.

[88] *Id.*, Article 82.

[89] *Id.*, Article 81(1).

[90] *Id.*, Article 46, provides that "[t]he buyer may require performance by the seller of his obligations," and Article 62 states that "[t]he seller may require the buyer to pay the price, take delivery or perform his other obligations."

[91] *Id.*, Article 28.

[92] Harry M. Flechtner, "Buyers' Remedies in General and Buyers' Performance-Oriented Remedies," *Journal of Law and Commerce*, vol. 25, pp. 339–347 (2005–2006).

[93] United Kingdom, Sale of Goods Act, §52 (1893).

[94] United States, Uniform Commercial Code, § 2-716(1).

[95] See Shael Herman, "Specific Performance: A Comparative Analysis," *Edinburgh Law Review*, vol. 7, issue 1, pp. 5–26 (January 2003) and issue 2, pp. 194–217 (May 2003) (article comparing specific performance in Spain and the United States under common law and civil law principles).

H. Seller's Obligations

A seller is required to (1) deliver the goods, (2) hand over any documents relating to them, and (3) ensure that the goods conform with the contract.[96] If a contract fails to specify how this is done, CISG provides rules to fill in the gaps.

Place for Delivery

The place for delivery is the place agreed to in the contract; otherwise, it is (1) the first carrier's place of business if the contract involves the carriage of goods or (2) the place where the parties knew the goods were located or were to be manufactured or produced.[97]

If the contract requires the seller to arrange for shipping but does not specify the carrier or the terms, the transportation selected must be "appropriate in the circumstances" and made "according to the usual terms for such transportation."[98] Also, if the seller is not required to arrange for insurance, "he must, at the buyer's request, provide him with all available information necessary to enable him to effect such insurance."[99]

In addition to providing insurance information when requested, the seller must, at the time he delivers the goods to a carrier, either (1) identify to the carrier both the goods and the buyer "by markings on the goods, by shipping documents or otherwise," or (2) "give the buyer notice of the consignment of the specifying goods."[100] Failure to comply with this requirement is a breach of the contract, and the seller will be liable for any damages that may result.[101]

Time for Delivery

The seller is to deliver the goods on the date fixed in the contract or, if no date is fixed, within a reasonable time after the conclusion of the contract.[102] If a time period is provided, the seller may deliver at any time within that period, unless the contract expressly says that the buyer is to choose the time.[103]

The Turning Over of Documents

At the time and place for delivery, the seller must turn over any documents relating to the goods that the contract requires. If he does so early, he has the right to "cure any lack of conformity in the documents," so long as this does not cause the buyer "unreasonable inconvenience or unreasonable expense."[104]

Conformity of Goods

Article 35(1) of CISG states that the seller "must deliver goods which are of the quantity, quality, and description required by the contract and which are contained or packaged in the manner required by the contract." This provision is similar to many warranty provisions found in common law countries, with the notable exception that it does not use the terms *warranty* or *guarantee*.[105] This is important, because the seller's obligation (and the buyer's right) arises—and can be waived—without the use of these terms.[106]

Determining Conformity The rules for determining whether the goods conform are set out in Article 35(2).

[96]UN Convention on Contracts for the International Sale of Goods, Article 30 (1980).

[97]*Id*., Article 31.

[98]*Id*., Article 32(2).

[99]*Id*., Article 32(3).

[100]*Id*., Article 32(1).

[101]*Id*., Articles 45, 49, and 74.

[102]*Id*., Article 33.

[103]*Id*., Article 33(b).

[104]*Id*., Article 34.

[105]United States, Uniform Commercial Code, §2–313 (express warranties) and §2–314 (implied warranties). United Kingdom, Sale of Goods Act, §14 (warranties) (1979).

[106]See Peter Schlechtriem, "Subsequent Performance and Delivery Deadlines—Avoidance of CISG Sales Contracts Due to Non-conformity of the Goods," *Pace International Law Review*, vol. 18, issue 1 (Spring 2006).

Except where the parties have agreed otherwise, the goods do not conform with the contract unless they:

a. are fit for the purposes for which goods of the same description would ordinarily be used;
b. are fit for any particular purpose expressly or impliedly made known to the seller at the time of the conclusion of the contract, except where the circumstances show that the buyer did not rely, or that it was unreasonable for him to rely, on the seller's skill and judgment;
c. possess the qualities of goods which the seller has held out to the buyer as a sample or model;
d. are contained or packaged in the same manner usual for such goods or, where there is no such manner, in a manner adequate to preserve and protect the goods.

Third-Party Claims Goods also do not conform if they are subject to third-party claims. Third-party claims include assertions of ownership[107] and rights in intellectual property such as patents, copyrights, and trademarks.[108]

Waiver Although the seller is obliged to produce goods that conform to the contract, the parties may (1) expressly excuse him/her from complying[109] or (2) impliedly excuse him/her if the buyer knew or "could not have been unaware" that the goods were nonconforming.[110] These rules are similar to the waiver provisions found in most common law countries, except—as mentioned earlier—there is no requirement to use any particular terms to make the waiver.[111] Moreover, unlike the practice in many civil law countries, a waiver can be implied from the buyer's conduct.[112]

The basic philosophy of the convention—that the parties should determine the terms of their contract—compelled the drafters of CISG to adopt these waiver provisions. As noted earlier, the parties under Article 6 may "derogate from or vary the effect of any" provision; and under Article 35(2), the convention-defined obligation of the seller to produce conforming goods does not apply "where the parties have agreed otherwise."

Time for Examining Goods The buyer has an obligation to examine the goods for defects "within as short a period as is practicable" after delivery. If the goods are shipped, the examination "may be deferred until after the goods have arrived at their destination" and, if the buyer has to redirect or redispatch the goods while they are in transit, the examination "may be deferred until after the goods have arrived at the new destination," so long as the seller "knew or ought to have known of the possibility of such redirection or redispatch."[113]

Notice of Defect In order for the buyer to avoid waiving his rights to require performance, he is obligated to inform the seller of any defects he discovers within a reasonable time after delivery. If the buyer discovers a defect at some later time, he must also promptly notify the seller in order to preserve his rights.[114] In any event, the seller will not be responsible for a defect that arises more than two years after delivery unless (1) the seller knew or ought to have known of a nonconformity and did not disclose it to the buyer or (2) the contract establishes a longer "period of guarantee."[115]

CISG does not describe specifically what the buyer has to do in notifying the seller of a defect, but the notice undoubtedly must be sufficient to inform the seller of the problem.

Curing Defects If the seller delivers his goods early, he may correct or cure any defect up to the agreed-upon date for delivery, so long as this does not cause the buyer any unreasonable inconvenience or expense. Nevertheless, even if the seller does make a cure, the buyer retains the right to claim any damages that are provided for in CISG.

[107] UN Convention on Contracts for the International Sale of Goods, Article 41 (1980).

[108] *Id*., Article 42. Third-party claims to intellectual property will make goods nonconforming, but only if the claims exist in (a) the state where the goods are sold or (b) the state where the buyer has his or her place of business.

[109] *Id*., Articles 35(3), 41, and 42.

[110] *Id*., Articles 35(2) and 42.

[111] *Id*., Articles 35(3), 41, and 42.

[112] *Id*., Articles 35(2) and 42.

[113] *Id*., Article 38(3).

[114] *Id*., Article 39(1).

[115] *Id*., Articles 39(2) and 40.

I. Buyer's Obligations

A buyer is required to (1) pay the price and (2) take delivery of the goods.[116] Again, as is the case for the seller's obligations, CISG's rules apply only when a contract fails to describe how this is done.

Payment of the Price

The buyer is obliged to take whatever preliminary steps are necessary "under the contract or any laws or regulations to enable payment to be made."[117] He is then to pay the price at the time and place designated in the contract. If no time is specified, the buyer is to pay when "the goods or the documents controlling their disposition" are delivered.[118]

Contrary to the practice in some civil law countries (of requiring the seller to make a formal demand for payment), the buyer has to pay "without the need for any request or compliance with any formality on the part of the seller."[119] However, unless the parties agree otherwise, the buyer does not have to pay until after he has had a chance to examine the goods.[120]

If the parties have not agreed to a place for payment but have agreed to a place for the delivery of either the goods or their controlling documents, then payment will be made at that place.[121] If they did not specify a place for delivery, then the buyer must pay at the seller's place of business.[122]

In Case 10-4, the court was asked to determine if the buyer had breached its obligation to make payment to the seller.

CASE 10-4 The Natural Gas Case

Austria, Supreme Court, 1996
Case No. 518/95

Österreichische Zeitschrift für Rechtsvergleichung, vol. 1996, p. 248 (1996)

In the fall of 1990, the plaintiff, a German company, negotiated to buy natural gas from the defendant, an Austrian partnership. After a series of proposals and counterproposals, the plaintiff faxed the defendant on December 18, 1990, offering to buy 700–800 metric tons of propane gas from the defendant. The defendant responded the next morning that it could ship the propane from the United States for delivery to the plaintiff in Belgium for $376 per ton, and the plaintiff agreed. Because the parties had not dealt with each other before, the plaintiff agreed to secure its purchase with a letter of credit. In the December 19 fax, the plaintiff asked the defendant to identify the place in the United States where the gas would be loaded aboard a tanker, because the plaintiff's bank needed this information before it would issue a letter of credit. The defendant responded by fax, stating that it was waiting to get the information from the United States as to the place of loading.

While this exchange of faxes was taking place, the parties were talking to each other on the telephone. The defendant wanted the plaintiff to order a larger quantity of propane to make the transaction more worth its time. The plaintiff, in response to this request, contacted a Dutch natural gas reseller that agreed to buy 3,000 tons of propane at $381 per ton. The plaintiff then increased its order by 3,000 tons.

On January 2 and 3, 1991, [not having heard if the propane had been loaded for shipment as the parties had agreed,] the plaintiff sent two faxes to the defendant asking to be notified of the place where the propane would be loaded and stating that its bank would not process the letter of credit without this information. On January 7, 1991, the defendant informed the plaintiff by fax that its U.S. supplier would not agree to let the propane gas be exported to Belgium, and therefore that

[116] *Id.*, Article 53.

[117] *Id.*, Article 54.

[118] *Id.*, Articles 58(1) and 58(2).

[119] *Id.*, Article 59. In France the request is called a *mise en demeure*, in Germany a *Mahnung*. See Konrad Zweigert and Hein Kötz, *An Introduction to Comparative Law*, vol. 2, pp. 164, 171 (Tony Weir, trans., 1977).

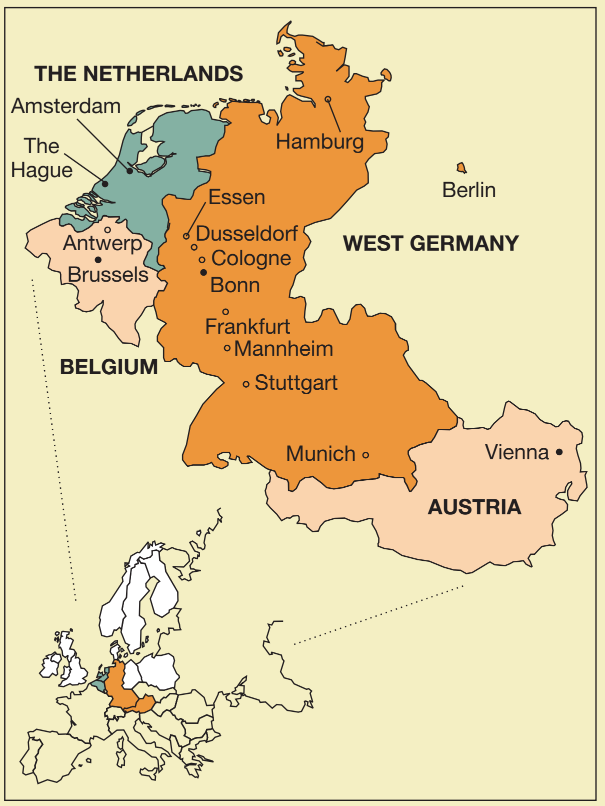
[120] UN Convention on Contracts for the International Sale of Goods, Article 58(3) (1980).

[121] *Id.*, Article 57(1)(b).

[122] *Id.*, Article 57(1)(a).

MAP 10.4

Austria, Belgium, West Germany, and the Netherlands (1991)



the defendant could not deliver the propane. The next day the plaintiff notified the defendant that, because of the defendant's breach, the Dutch natural gas reseller had made a substitute purchase at a price above what the defendant had promised, and later the plaintiff forwarded the Dutch company's claim for $141,131 for the increased costs. The defendant rejected this claim, and the Dutch gas reseller and the plaintiff sued the defendant to cover their increased costs and the plaintiff's loss of profits of $15,000.

The trial court held in favor of the plaintiff, and the court of appeals affirmed its decision. The defendant then appealed to the Supreme Court.

Decision of the Court

[The Breach]

[Following the making of the contract,] the plaintiff did not open a letter of credit and the plaintiff did not deliver the agreed goods (the natural gas).

[The United Nations Convention on Contracts for the International Sale of Goods (CISG),] Article 54, provides that "[t]he buyer's obligation to pay the price includes taking such steps and complying with such formalities as may be required under the contract or any laws and regulations to enable payment to be made." In light of this, a buyer in a sale of goods contract who has agreed to open a letter of credit must do so in a timely manner. In the case at hand, however, the plaintiff did not open the letter of credit because the defendant failed to notify it of the place where the natural gas would be loaded. And this was so, even though the defendant had expressly promised to do so in its fax of December 19, 1990. . . . The defendant cannot complain that the plaintiff did not fulfill its obligation [to open a letter of credit,] as the defendant's own obligation to notify the plaintiff as to the place where the goods were to be loaded had to happen first. The defendant knew that the plaintiff had to know the place of loading in order to open the letter, and it was the defendant's failure to notify the plaintiff of the place of loading that led to the plaintiff's failure to open the letter of credit. . . . In other words, the failure of the plaintiff to open the letter of credit was caused by the defendant's own failure to act. And, as

stated in CISG, Article 80, "[a] party may not rely on a failure of the other party to perform, to the extent that such failure was caused by the first party's act or omission."

More significantly, the failure of the plaintiff to open a letter of credit was not the reason for the breach of this contract. As the lower courts have held, it was the defendant's failure to obtain the appropriate clearances . . . needed to export the propane gas to Belgium that was the cause of the breach. According to CISG, Article 30, "[t]he seller must deliver the goods, hand over any documents relating to them and transfer the property in the goods, as required by the contract. . . ." The defendant's argument (first made in this appeal) that it was the buyer that was obliged to obtain the appropriate authorization for the goods to be imported into Belgium is without merit. . . . A buyer is not obliged to ask a seller if there are any unusual restrictions that may keep the seller from performing. If the seller does not inform the buyer of such restrictions, the seller may reasonably assume that such circumstances do not exist. CISG, Article 41, says that "[t]he seller must deliver goods which are free from any right or claim of a third party" unless the buyer had agreed to accept such goods. If the seller's supplier will not allow the goods to be exported, then the goods are subject to a restriction. The buyer, of course, may agree to accept the goods anyway, but it doesn't have to. And, if the buyer doesn't agree to accept the goods, and the seller is then unable to deliver them because of the restriction, it is the seller that has breached the contract.

[Indemnification]

Because the seller breached the contract, the buyer is entitled to be fully indemnified for its losses. In other words, the non-breaching party is to be put in the position that it would have been had the breaching party performed as promised. The breaching party, moreover, does not have to be at fault or to have acted illegally to be liable in such a case.

[The parties sought to apply CISG, Articles 75 and 76, in ascertaining the damages due the plaintiff.]

The provisions in the CISG, Articles 75 and 76, deal with the awarding of damages when one party avoids the contract because of a breach by the other party. However, because there has been a breach, does not necessarily mean that there will be an avoidance. The CISG does not provide for avoidance as a matter of law, even if the non-breaching party is deprived of what it expected to receive.[123] Avoidance, under the CISG, can only come about by a unilateral declaration of the non-breaching party. Such a declaration, however, does not have to be in any particular form, nor (with the exception of certain cases set out in CISG, Article 49(2) which are inapplicable here) is it subject to any time limit.

The parties to this case argued over whether the declaration of avoidance described in CISG, Article 49(1), had to be made expressly or whether it could be implied from the non-breaching party's conduct. This argument, however, is irrelevant, because it is not the mere giving of notice that constitutes avoidance, but the non-breaching party's intention not to adhere to the contract that is important. This intention, moreover, must be clear to the breach party.

The findings of fact in the lower courts suggest that the plaintiff never actually notified the defendant that it was avoiding the contract. Indeed, the plaintiff never claimed that it had given such notice. Nor can one imply that such notice was given merely from the fact that the plaintiff gave the defendant a list of the losses suffered by its customer [the Dutch natural gas reseller].

Because the contract was not avoided, the damages [are not to be determined in accordance with CISG, Articles 75 and 76, but rather] are to be determined in accordance with CISG, Article 74. Article 74 applies to those cases when the damages come about because of delay in delivery or because of some defect in the goods.

[Loss of Profits]

When, as the case here, the non-breaching party is claiming a loss of profits from an expected resale of the goods to a third party, the loss of profits will only be considered if the breaching party had reason to know of this expected resale. Of course, when merchantable goods are sold to a merchant, the expected resale can be presumed. The defendant does not challenge this. Indeed, it has conceded that it knew that the plaintiff intended to resell the goods. [The plaintiff, accordingly, is entitled to the $15,000 claimed in lost profits.]

[123] Articles 25 and 49.

Duty to Mitigate

A non-breaching party may not claim damages, including a loss of profits, if it fails to make reasonable efforts to mitigate its losses. Such efforts are reasonable if a reasonable person in the position of the non-breaching party would have undertaken them in good faith.[124]

The defendant argues that the plaintiff breached this obligation. However, the burden of proving such a breach is on the defendant, and the defendant has failed to meet its burden. . . . It has not shown what the plaintiff did to breach this obligation, it has not shown that the plaintiff had other alternatives to what it did, nor has it shown how much the damages would have been lessened if the plaintiff had engaged in some alternative conduct. [In addition to lost profits, therefore, the plaintiff is entitled to recoup the $141,131 due the Dutch natural gas reseller.]

***

The decision of the Court of Appeals is affirmed.

Casepoint

In this case, the court considered whether a seller of propane gas had breached its contractual duties by failing to deliver the gas as promised and, if so, what damages were appropriate. First, the court looked at each party's duties under the CISG and found that the buyer was supposed to open a letter of credit. But here, the buyer could not do so because the seller never supplied the necessary information for the letter. Also, the breach was really due to the seller's failure to make proper arrangements to ship the gas, not because of the letter of credit. So, the court concluded that the seller had breached the contract and the buyer was entitled to damages.

Taking Delivery

In connection with the taking of delivery, a buyer is obligated to cooperate with the seller to facilitate the transfer and to actually "take over the goods."[125] A buyer who fails to cooperate will be responsible for any resulting costs, and one who fails to take delivery assumes the risk for any damage to the goods after that time.[126]

J. The Passing of Risk

passage of risk
The point in time when the buyer becomes responsible for losses to the goods.

The loss of goods through fire, theft, or other means can occur at any time: prior to delivery, during transit or inspection, or after delivery. The legal concept of **passage of risk** determines who is responsible for the loss. In most cases, the loss will be covered by insurance. Even so, it is important to determine whether the buyer or seller is responsible for obtaining the insurance.

To begin with, *passage of risk* is defined as the shifting of responsibility for loss or damage from the seller to the buyer. This means that once the risk passes, the buyer must pay the agreed-upon price for the goods involved. The buyer must then absorb the cost of the loss or lodge a claim against his insurer. Only if he can show that the loss or damage was due to an act or omission of the seller is he excused from paying the price.[127]

Like most domestic sales codes, CISG allocates risks by considering the agreement of the parties and the means of delivery. Unlike some domestic laws, however, CISG's risk allocation is not affected by breach of contract.

[124]United Nations Convention on Contracts for the International Sale of Goods, Article 77, [which provides: "A party who relies on a breach of contract must take such measures as are reasonable in the circumstances to mitigate the loss, including loss of profit, resulting from the breach. If he fails to take such measures, the party in breach may claim a reduction in the damages in the amount by which the loss should have been mitigated."]

[125]UN Convention on Contracts for the International Sale of Goods, Article 60 (1980).

[126]See *id.*, Articles 66–70.

[127]*Id.*, Article 66. This rule is common to virtually all domestic sale-of-goods laws: e.g., United Kingdom, Sale of Goods Act, §20(2) (1893); Federal Republic of Germany, Civil Code, §447(2); United States, Uniform Commercial Code, §2–501.

Agreement of the Parties

CISG allows parties to allocate risk among themselves and to specify when the risk will pass between them.[128] The parties most commonly do so through the use of trade terms, such as *Free on Board* (*FOB*) or *Cost, Insurance, and Freight* (*CIF*). Unlike most domestic sales laws,[129] CISG does not define any trade terms. The parties may use domestic trade terms or (in what is the most common practice) they may use the terms defined by the International Chamber of Commerce known as *Incoterms*. Chapter 11 contains a more detailed description of Incoterms, which are well known and regularly used in international sales by trade councils, courts, and international lawyers. The following case involves a situation where the goods became spoiled at some point in their journey from seller to buyer and the key issue was which party should bear the risk of loss.

CASE 10-5 Chicago Prime Packers, Inc. v. Northam Food Trading Co.

United States Court of Appeals, 7th Circuit, 2005
No. 04-2551
Before FLAUM, Chief Judge, and EVANS and WILLIAMS, Circuit Judges

MAP 10.5

Colorado, United States, and Ontario, Canada

Chicago Prime Packers, Inc., a seller of pork ribs, filed suit against Northam Food Trading Co., a purchaser of its ribs, in order to recover the purchase price of the product after Northam refused to pay for ribs that arrived in an "off condition." Chicago Prime, a Colorado corporation, and Northam, a partnership formed under the laws of Ontario, Canada, are both wholesalers of meat products.

Following a bench trial, the district court awarded Chicago Prime $178,200.00, the contract price, plus prejudgment interest of $27,242.63. Northam appealed the award. The United States Court of Appeals, Seventh Circuit affirmed the lower court judgment, after determining that the burden of proving nonconformity of the goods fell on Northam, under the Convention on Contracts for the International Sale of Goods (CISG) and that the finding that the pork ribs were not rotten at the time they were transferred to Northam's carrier was not clearly erroneous.

[128]UN Convention on Contracts for the International Sale of Goods, Article 6 (1980).

[129]Most, but not all, countries use trade terms. Japan, for example, has no established set of domestic trade terms.

On March 30, 2001, Chicago Prime and Northam entered into a contract calling for Chicago Prime to provide Northam with 1,350 boxes (40,500 pounds) of pork ribs and for Northam to pay $178,200 due within seven days of receipt of the shipment. The contract clearly stated a description of the ribs, the price of the ribs, and the date and location for pick-up of the ribs.

Chicago Prime purchased the pork ribs from meat processor Brookfield Farms. When a pork loin is processed at Brookfield, it is broken into various segments, one of which is the back rib. After processing, Brookfield packages back ribs "flat" (horizontally), layer by layer, in 30-pound boxes. The ribs are placed first in a blast freezer and then transferred to an outside freezer where they remain until shipped. Brookfield stored the rib order in its own and two independent cold storage facilities: B & B Pullman Cold Storage and Fulton Market Cold Storage. According to quality control records presented in court, both Brookfield and B & B maintained the ribs at or below acceptable temperatures. No information was offered regarding the storage of the ribs at Fulton.

On April 24, 2001, Brown Brothers Trucking Company picked up 40,500 pounds of ribs from B & B on behalf of Northam—the ribs were never in Chicago Prime's possession. When Brown picked up the shipment, it signed a bill of lading acknowledging that the ribs were "in apparent good order," and also indicating that the "contents and condition of the contents of the packages [were] unknown." The goods were delivered to Beacon Premium Meats, Northam's customer, on April 25, 2001—the ribs were never in Northam's possession. Beacon signed a second bill of lading acknowledging that it received the rib shipment "in apparent good order."

Having not received a payment on May 2, 2001—one day later than the contracted terms stated—Chicago Prime demanded payment from Northam. On May 4, 2001, Beacon began "processing" the rib shipment and noticed that the ribs appeared to be in an "off condition." Beacon then asked Ken Ward, an inspector from the USDA, to examine the ribs. After examining the ribs, Mr. Ward determined that the meat "did not look good," and ordered Beacon to stop processing the ribs. The inspector noted the following problems with the ribs, "yellow, green, temperature, abused, spoiled," placed a "U.S. Retained" tag on the shipment, and had the ribs stored in Beacon's freezer. Simultaneously, Northam and Chicago Prime learned of the potential problem with the ribs.

The ribs and Beacon's freezers were further inspected by Mr. Ward on May 7 and 8. On May 23, 2001, Dr. John Maltby, Ward's supervisor, also conducted an on-site inspection of the ribs. When Dr. Maltby arrived, Beacon employees were "reworking" the ribs, trying to salvage any good portions. The freezers were found to have no "anomalies" or "gaps" during the relevant time period. Dr. Maltby examined 20 cases of ribs, some of which were untouched by Beacon and some that Beacon had reworked. In the untouched cases, the supervisor noted that the ribs were stacked both horizontally and vertically and were frozen individually and in larger groups. The ribs that were frozen individually were "putrid," but the ribs that were frozen in larger groups were "good."

Examining samples of the thawed, reworked product, Dr. Maltby found putrid, green, slimy ribs, but no sign of temperature abuse. He concluded in his report that the inspected product was rotten, that it arrived at Beacon in a rotten condition, and that it appeared to have been "assembled from various sources." Dr. Maltby also concluded that there was no opportunity for salvage and that all of the product should be condemned. The same day, the USDA issued a Notice of Receipt of Adulterated or Misbranded Product and the entire shipment of 1,350 boxes of ribs was condemned. After Northam informed it of the results of Dr. Maltby's inspection, Chicago Prime continued to demand payment and eventually filed suit.

At trial, it was undisputed that the parties entered into a valid and enforceable contract for the sale and purchase of ribs, that Chicago Prime transferred a shipment of ribs to a trucking company hired by Northam, and that Northam had not paid Chicago Prime for the ribs. Northam argued that it was relieved of its contractual payment obligation because the ribs were spoiled when its agent, Brown, received them. The district court concluded that it was Northam's burden to prove nonconformity, and held that Northam had failed to prove that the ribs from Chicago Prime were spoiled at the time of transfer to Brown. The court went on to state alternative holdings in favor of Chicago Prime based on its finding that, "even if the ribs were spoiled at the time of transfer, Northam failed to prove that it examined the ribs, or caused them to be examined, within as short a period as is practicable under the circumstances, or that it rejected or revoked its acceptance of the ribs within a reasonable time after it discovered or should have discovered the alleged non-conformity."

Furthermore, the court held, and the parties do not disagree, that the contract between the two parties is governed by the United Nations Convention on Contracts for the International Sale of Goods ("CISG"), a self-executing agreement between the United States and other signatories, including Canada. CISG Art. 35(1)-(2) states that "[t]he seller must deliver the goods which are of the quantity, quality, and description required by the contract," and "the goods do not conform with the contract unless they . . . [a]re fit for the purposes for which goods of the same description would ordinarily be used." CISG Art. 67(1) further states that the risk of loss passes from the seller to the buyer once the goods are in the possession of the buyer's carrier. CISG Art. 36(1) and CISG Art. 66(1) also provide that while the seller is liable "for any lack of conformity which exists at the time when risk passes to the buyer," it is the buyer who bears all risk of "[l]oss of or damage to the goods after the risk has passed to the buyer . . . unless the damage is due to an act or omission of the seller."

In other words, Chicago Prime is responsible for the loss if the ribs were spoiled (nonconforming) at the time Northam's agent, Brown, received them from Chicago Prime's agent, Brookfield, while Northam is responsible if they did not become spoiled until after the transfer. The parties agree that the main factual issue before the district court was whether the ribs were spoiled at the time of transfer.

Legal Discussion

A. **Burden of Proof** Northam asserts that Chicago Prime should bear the burden of proving that the ribs were not spoiled at the time of transfer because the quality of the goods is an essential element of Chicago Prime's breach of contract claim. Chicago Prime counters that nonconformity is an affirmative defense for which Northam, as the defendant-buyer, has the burden of proof. The CISG does not state expressly whether the seller or buyer bears the burden of proof as to the product's conformity with the contract. Because there is little case law under the CISG, we interpret its provisions by looking to its language and to "the general principles" upon which it is based. The CISG is the international analogue to Article 2 of the Uniform Commercial Code ("UCC"), a model law covering the sale of goods which has been adopted by 49 states in the USA. Many provisions of the UCC and the CISG are the same or similar, and "[c]aselaw interpreting analogous provisions of Article 2 of the [UCC], may inform a court where the language of the relevant CISG provision tracks that of the UCC. A comparison with the UCC reveals that the buyer bears the burden of proving nonconformity under the CISG. Under the UCC, the buyer may plead breach of the implied warranty of fitness for ordinary purpose as an affirmative defense to a contract action by the seller for the purchase price. *See* 77A *Corpus Juris Secundum* Sales §287 (2004) ("[T]he buyer, when sued for the purchase price, may set up a breach of warranty as a defense to the seller's action."). In such an action it is the defendant-buyer's burden to prove the breach of the warranty.

Section 2-314 of the UCC provides that a warranty that goods are "fit for the ordinary purpose for which such goods are used" is implied unless the contract states otherwise. Mirroring the structure and content of this section, Article 35(2) of the CISG provides that unless the contract states otherwise, "goods do not conform with the contract unless they . . . [a]re fit for the purposes for which goods of the same description would ordinarily be used." Accordingly, just as a buyer-defendant bears the burden of proving breach of the implied warranty of fitness for ordinary purpose under the UCC, under the CISG, the buyer-defendant bears the burden of proving nonconformity at the time of transfer. The district court was correct to conclude that Northam bears the burden of proving that the ribs were spoiled at the time of transfer.

B. **Conformity of the Ribs at the Time of Transfer** The district court held that Northam failed to prove that the ribs were spoiled, or nonconforming, at the time of transfer. First, the court found that other evidence undermined Dr. Maltby's testimony that the ribs were rotten when they arrived at Beacon, such as: (1) neither Dr. Maltby nor anyone else could confirm that the meat Dr. Maltby inspected was in fact the product that was sold to Northam by Chicago Prime, and evidence was produced at trial to suggest that they were not the

same ribs; (2) Furthermore, some of the ribs examined by Dr. Maltby (from one of the Intact Pallets) were stacked both horizontally and vertically. Brookfield packages its loin back ribs only horizontally. (3) Dr. Maltby had no personal knowledge of how or where the meat was stored from April 25, 2001, to May 23, 2001, and the first time any government inspector viewed the meat was on May 4, 2001; (4) the district court found that three witnesses had credibly testified that "the ribs delivered by Brookfield were processed and stored in acceptable conditions and temperatures from the time they were processed until they were transferred to Northam on April 24, 2001." Based on these factual findings, the district court concluded that Northam had not met its burden of demonstrating that the ribs were spoiled at the time of transfer.

On appeal from a bench trial, we will not set aside the factual conclusions of the district court "unless clearly erroneous." Under this standard, one who contends that a finding is clearly erroneous has an exceptionally heavy burden to carry on appeal. This is especially true when the appellant argues that the district court erred in crediting or discrediting a witness's testimony.

Northam argues that the district court erred in discrediting Dr. Maltby's testimony, and contends that Dr. Maltby's conclusion that the ribs were rotten before the transfer should be determinative. Even if the district court could have given Dr. Maltby's conclusion more weight, however, Northam has not shown that the court clearly erred in finding the evidence undermining his conclusion to be more persuasive. Northam offered no credited evidence showing that the ribs were spoiled at the time of transfer or excluding the possibility that the ribs became spoiled after the transfer. Also, Northam did not present a witness from Beacon to respond to the evidence suggesting that the ribs examined by Dr. Maltby were not those sold to Northam by Chicago Prime. Upon this record, the district court did not clearly err in finding that Northam did not meet its burden of proof as to its affirmative defense of nonconformity. Thus we (the appellate court) affirm the verdict in favor of Chicago Prime.

Casepoint

The CISG does not clearly state which party has the burden of proof in a case involving whether a product conforms to a purchase and sale contract. Therefore the U.S. Court of Appeals looked at a comparable law, the Uniform Commercial Code, which governs most contracts for the sale of goods in the United States, and closely parallels the CISG in many respects. Finding that the UCC puts the burden on the buyer, the Court upheld the lower court verdict that in this case the buyer had not proved conclusively (although there was much conflicting evidence) that the goods were spoiled when the risk of loss passed to the buyer. Generally an appellate court will not reverse a "finding of fact" by the lower court unless it can be shown that the decision was "clearly erroneous."

Means of Delivery

Goods may be transported by a carrier or delivered by the seller without being transported by a carrier.

Goods Transported by Carrier CISG distinguishes between shipment, transshipment, in-transit, and destination contracts. No matter which of these contracts is used, however, the risk of loss will not pass until the goods are clearly "identified" to the contract by markings on the goods, shipping documents, notice given to the buyer, or otherwise.[130]

Shipment Contracts When a contract requires the seller to deliver the goods to a carrier for shipment and does not require the seller to deliver them to a particular place, the risk of loss passes when the goods are "handed over" to the first carrier.[131] For example, if the delivery term in a contract between a seller in Paris, France, and a buyer in Denver, Colorado, is "Free Carrier (FCA) Paris," the risk of loss will pass to the buyer when the seller delivers the goods to the trucking company in Paris that will transport them to the international carrier in Le Havre, France.

[130] UN Convention on Contracts for the International Sale of Goods, Article 67(2) (1980).

The CISG rule for assigning risk when goods are shipped is the same rule found in many domestic codes: e.g., United States, Uniform Commercial Code, §2–509; Federal Republic of Germany, Civil Code, §§446(1) and 447(1); Israel, Sales Law, §22(b); Sweden, Sales Act, §10; United Kingdom, Sale of Goods Acts, §20 (1893 and 1979).

[131] UN Convention on Contracts for the International Sale of Goods, Article 67(1) (1980).

Transshipment Contracts If a contract requires the seller to deliver the goods to a carrier at a named place, who will then carry the goods to the buyer, the risk of loss passes to the buyer when the goods are handed over to the carrier at that place.[132] Thus, if the contract contains a "Free Alongside Ship (FAS) M/V *Ocean Trader*, Vancouver, British Columbia" delivery term, the seller in Calgary will bear the risk of loss until the goods are delivered alongside the M/V *Ocean Trader* at the port of Vancouver.

In-Transit Contracts Sometimes goods are sold after they are already aboard a carrier. In such a case, the risk of loss passes to the buyer at the time the contract is concluded. However, if, at the time the contract was made, the seller knew or ought to have known that goods had been lost or damaged and he did not disclose this to the buyer, the risk will remain with the seller.[133] For example, if the owner of crude oil being transported on a tanker from the Middle East to Houston, Texas, contracts to sell the oil to a buyer, the risk of loss will pass to the buyer at the time the contract is made. If, however, the seller knew that the oil had been contaminated and did not tell the buyer, the risk of loss will not pass.

Destination Contracts When a contract requires the seller to arrange transportation to a named place of destination, the risk of loss passes to the buyer when the goods are handed over or placed at his disposal at that place.[134] A contract by which goods are sold from a seller in Tokyo to a purchaser in Seattle, containing a "Delivered Duty Paid (DDP) Seattle, Washington" trade term, for example, would require a seller in Tokyo to bear the risk of transporting the goods to Seattle.

Goods Delivered Without Being Transported When goods are not shipped to the buyer, the risk of loss passes when the goods are handed over by the seller or otherwise put at the buyer's disposal.[135] The goods are not considered to be put at the buyer's disposal, however, until they are clearly identified to the contract.[136] An example of such a contract is one containing an "Ex Works (EXW) Seller's City" trade term.

Breach of Contract

Unlike the U.S. Uniform Commercial Code and some other domestic sales laws, the CISG rules on risk of loss are not concerned with breach of contract. That is, with the exception of in-transit contracts (in which risk passes at the time of contracting unless the seller knows or ought to know that the goods are lost or damaged), the risk of loss passes to the buyer at the agreed-upon time and place of delivery.

K. Remedies

CISG provides for remedies that are (1) unique to the buyer, (2) unique to the seller, and (3) available to either party. Although the buyer's and seller's remedies relate to their specific needs, they are also interrelated, and anyone studying CISG's remedies must keep this in mind.

Buyer's Remedies

The buyer's remedies are **cumulative**. That is to say, the right to recover damages is not lost if a buyer exercises any other available remedy.[137] They are also immediate. In other words, unlike the rules in some civil law countries, CISG forbids a court or arbitral tribunal from granting the seller a period of grace (*délai de grâce*) in which to comply with a buyer's demand for a remedy.[138]

cumulative
Able to be joined or taken together.

[132] *Id.*, Article 67(1).

[133] *Id.*, Article 68.

[134] *Id.*, Article 69(2).

[135] *Id.*, Article 69(1).

[136] *Id.*, Article 69(3).

[137] *Id.*, Article 45(2).

[138] UN Convention on Contracts for the International Sale of Goods, Article 45(3) (1980). See G H. Treitel, "Remedies for Breach of Contract," in *International Encyclopedia of Comparative Law*, vol. 7, chap. 16, §§147–148 (1976), for a discussion of the French *délai de grâce*.

The remedies that are unique to the buyer are (1) to compel specific performance, (2) to avoid the contract for fundamental breach or nondelivery, (3) to reduce the price, (4) to refuse early delivery, and (5) to refuse excess quantities. Most of these remedies are common to virtually every legal system, but two—the right to set an additional time in which to perform and the right to reduce the price—are not. All are applicable whether the seller's breach affects the whole contract or only a part.

Specific Performance As we have already seen, the availability of a decree of specific performance depends on the domestic rules applicable to the court hearing the suit. Assuming it is available, a buyer can ask that a seller either (1) deliver substitute goods or (2) make repairs. In either case, the buyer must first notify the seller that the goods are nonconforming and, if he is asking for substitute goods, the nonconformity must amount to a fundamental breach. Also, the buyer cannot have avoided the contract or resorted to some other inconsistent remedy.[139]

Avoidance CISG's provisions for avoidance by a buyer are patterned after German law, especially in the convention's adoption of the German ***Nachfrist***[140] ***notice***.

> ***Nachfrist notice*** The fixing by the buyer of an additional reasonable period of time in which the seller may perform.

Under CISG, a buyer may avoid a contract if either (1) the seller commits a fundamental breach or (2) the buyer gives the seller a *Nachfrist* notice and the seller rejects it or does not perform within the period it specifies.[141] A buyer's *Nachfrist* notice is the fixing of "an additional period of time of reasonable length for performance by the seller of his obligations."[142] The period must be definite, and the obligation to perform within that period must be clear. Once the *Nachfrist* period has run, or once the fundamental breach becomes clear, the buyer has a reasonable time in which to avoid the contract.[143]

During the *Nachfrist* period, the seller is entitled to correct (i.e., cure) the nonconformity at his own expense. Even if there has been a breach, the seller is entitled to make a cure, unless the circumstances—including the circumstance of the offer to make the cure—indicate that the breach is fundamental and the buyer chooses to avoid the contract.[144]

When a buyer's avoidance remedy may be applied is considered in Case 10-6.

CASE 10-6 The Shoe Seller's Case

Germany, Court of Appeals, Frankfurt am Main, 1994
Case 5 U 15/93
Journal of Law and Commerce, vol. 14, p. 201 (1995)

The plaintiff, an Italian business, contracted in January 1991 to sell women's shoes to the defendant, a German businesswoman. The plaintiff-seller was late in making its delivery, and the shoes did not completely conform to the original sample that had been shown to the defendant-buyer. Although the defendant accepted delivery, she refused to pay on two of the plaintiff's invoices. The plaintiff then brought suit in a German court to recover the amounts it had billed the defendant on its invoices. In the defendant's answer to the plaintiff's complaint, the defendant relied on the remedy of avoidance, maintaining that she was entitled to avoid the contract and be excused from any liability on the unpaid invoices because of (1) the plaintiff's late delivery and (2) the nonconformity of the goods. The court found in favor of the plaintiff and the defendant appealed.

---

[139] UN Convention on Contracts for the International Sale of Goods, Article 46 (1980).

[140] From German: "to fix an appointed time."

[141] UN Convention on Contracts for the International Sale of Goods, Article 49(1) (1980).

[142] *Id*., Article 47(1).

[143] *Id*., Article 49(2): "[I]n cases where the seller has delivered the goods, the buyer loses the right to declare the contract avoided unless he does so: (a) in respect of late delivery, within a reasonable time after he has become aware that delivery has been made; (b) in respect of any breach other than late delivery, within a reasonable time: (i) after he knew or ought to have known of the breach; [or] (ii) after the expiration of any additional period of time fixed by the buyer . . . or after the seller has declared that he will not perform his obligations within such an additional period. . . ."

[144] *Id*., Article 48.

MAP 10.6

West Germany and Italy (1991)

Judgment

The sales contract entered into by the parties in January 1991 is governed by the *United Nations Convention on Contracts for the International Sale of Goods* (Convention or CISG) pursuant to Articles 1 and 100(2) of that Convention. Both Italy and Germany were then, and are now, parties to the CISG, the CISG having come into force in Germany on January 1, 1991, and in Italy on January 1, 1988.

The plaintiff's claim in this case is based upon two unpaid invoices . . . relating to the sale of women's shoes. The plaintiff seeks to recover from the defendant . . . the unpaid balance due on those invoices. The defendant does not contest the making of the contract, her acceptance of delivery of the shoes, or the amount of the purchase price.

A buyer is excused from paying the purchase price for goods if the buyer can avoid the contract[145] and, except for the obligation to pay any damages that may be due, the avoidance of a contract releases both parties from their contractual obligations.[146]

The defendant's contention that she may avoid the contract because the plaintiff was late in delivering the goods is not by itself a sufficient basis for her to avoid the contract. Avoidance in such a case is only allowed after a buyer [gives a seller a *Nachfrist* notice and] defines an additional fixed period of time in which the seller may make delivery.[147] Because the defendant did not do so, she may not avoid the contract on this basis.

[145]United Nations Convention on Contracts for the International Sale of Goods (1980), Article 49.

[146]*Id*., Article 81(1).

[147]*Id*., Articles 49(1)(b) and 47(1).

The defendant's contention that she may avoid the contract because the goods were predominantly nonconforming is also lacking in merit. According to the Convention, the tender of nonconforming goods does not amount to a failure to make delivery; it is only a breach of contract. Such a breach, moreover, may or may not be fundamental, and only in those cases in which the seller commits a fundamental breach of contract is the buyer entitled to use the remedy of avoidance.[148]

Germany's national sales law allows a buyer (with minor exceptions) to avoid a contract if the goods the seller delivers are defective. This is not so under the CISG. The CISG expects a buyer to accept deliveries of nonconforming goods [unless they are fundamentally nonconforming] and to invoke remedies other than avoidance (such as reduction of the price and damages) as compensation for the defects. For example, there would be no fundamental breach of contract [and no right to avoid the contract] in cases where the buyer is able to use some of the goods.[149]

Thus, if a buyer contends that there is a fundamental breach of contract because the goods delivered do not conform to the original sample the parties relied on in making their contract, the buyer must introduce evidence that (1) describes the exact nature of the defects and (2) shows that the goods cannot be used in any way. If a buyer does not do this, the court will be unable to determine if there was a fundamental breach.

In this case, the defendant only testified that . . . "[the shoes] were defectively made." She said that the materials had "defects," that the manufacture was "not uniform," that some of the shoes were "stitched together" while others were merely "folded," and overall that the shoes did not correspond to the original sample she had been shown. From this testimony it is not possible to determine the precise nature of the defects. More importantly, the defendant's evidence about how the shoes were different from the sample does not help us ascertain whether or not she could reasonably be expected to use the shoes.

In her allegations, the defendant . . . also complained that the shoes were made from a material called "S. Oro" rather than "Metallic Gold Leather" and that this caused the shoes to have heavy wrinkles rather than a smooth finish. Again, however, these allegations do not allow us to determine if the shoes—apart from their being made of different material and having a different appearance—were defective or unfit for use.

***

The Court of Appeals affirmed the decision in favor of the plaintiff.

Casepoint

Here the parties had a contract for a delivery of shoes from an Italian seller to a German buyer. Claiming that some of the shoes were defective, the buyer did not pay for two invoices, and the seller sued. The legal question was whether, under the CISG, the buyer had grounds to avoid the contract. The court stated that in order to use the CISG avoidance remedy, either (1) the buyer must have sent a *Nachfrist* notice giving the seller more time to perform or (2) the seller must have committed a fundamental breach of contract. Since neither of these tests were met here, the court ruled in favor of the plaintiff.

reduction in price Remedy that allows a buyer to pay less for nonconforming goods in those cases where the buyer is not entitled to damages.

Reduction in Price If a buyer is not entitled to damages when a seller delivers nonconforming goods, the buyer will be entitled to a **reduction in price**.[150] This remedy has its origins in the Roman law remedy of *actio quanti minoris*,[151] a remedy commonplace in civil law countries but generally unknown in the common law world. At the proceedings leading up to the adoption of CISG, many delegates argued that the price reduction remedy is little different from damages and therefore served no real purpose. Nevertheless, most representatives from the civil law countries felt that it was different, and eventually it was incorporated in the convention.

[148] *Id.*, Article 49(1)(a).

[149] Ernst von Caemmerer and Peter Schlechtriem, eds., *Commentary on the Uniform UN Law of Sales—CISG*, Article 46, no. 64, Article 49, no. 27 (1990); Piltz, *International Sales Law*, §5, no. 247 (1993).

[150] UN Convention on Contracts for the International Sale of Goods, Article 50 (1980).

[151] From Latin: "action to determine the extent of a reduction."

The price reduction remedy is different from damages because it applies to a very special situation. First, the buyer must have accepted goods that are nonconforming. Second, the seller must not be responsible for the nonconformity. An example of such a case is one where the goods were damaged by *force majeure*[152] or an act of nature. Consider the following situation. A seller in New Orleans agrees to deliver grade No. 1 corn to a buyer at the buyer's mill in Karachi for a price of $80,000. While the corn is in transit on the SS *Skipper*, a war breaks out and the ship is detained by one of the warring countries for three months. When the SS *Skipper* arrives in Karachi, the corn is moldy and graded only as No. 3. The buyer is happy to have the corn, even though it is moldy, because the war has interrupted all of its orders. Under the damage provisions of CISG, the buyer is not entitled to damages.[153] The buyer is, however, entitled to a price reduction.

The amount of the reduction is determined by a formula that considers the relative price of conforming and nonconforming goods at the time of delivery. That is, "the buyer may reduce the price in the same proportion as the value that the goods actually delivered had at the time of delivery bears to the value that conforming goods would have had at that time."[154] In other words,

$$\text{Price Reduction} = [\text{Price}] - \left[\frac{\text{Price} \times \text{Value of goods as delivered}}{\text{Value of conforming goods at the time of delivery}}\right]$$

In our example, let us assume that the price for 25,000 bushels of No. 3 corn in Karachi at the time of delivery is $75,000 and the price for the same amount of No. 1 corn is $100,000. The original price ($80,000) will therefore be reduced by the ratio of the price of the No. 3 to the price of the No. 1 corn. Accordingly, the reduction will be $20,000 and the buyer will pay only $60,000.

Refusing Early Delivery and Excess Quantity If the seller delivers early, the buyer is under no obligation to take delivery.[155] If the seller delivers more than the amount agreed upon, the buyer may also accept or reject the excess part. However, if the buyer does accept, he must pay for the excess goods at the contract rate.[156]

The Effect of Nonconformity in a Part of the Goods Assume the following facts: A seller agrees to sell a buyer 1,000 bags of flour. At the time of delivery, 100 bags are vermin infested and totally unusable. May the buyer reject the 100 bags and accept the balance? May the buyer reject the entire contract?

As to the defective part, CISG provides that the buyer may seek specific performance, obtain a price reduction, or avoid that part of the contract. In doing so, however, he must comply with CISG's rules for those particular remedies.[157] As for avoiding the whole contract, a buyer may do so only if the partial delivery amounts to a fundamental breach of the whole.[158]

Seller's Remedies

The seller's remedies in CISG mirror those of the buyer. Like the buyer's remedies, the seller's remedies are both cumulative and immediate. That is, the right to recover damages is not lost if a seller exercises any other available remedy, and courts will not grant the buyer a grace period in which to perform.[159]

The remedies that are unique to the seller are (1) to compel specific performance, (2) to avoid the contract for a fundamental breach or failure to cure a defect, and (3) to obtain missing specifications. Again, each of these remedies is meant to mirror the buyer's remedies.

---

[152]From French: "superior force." An event or effect that cannot be reasonably anticipated or controlled.

[153]UN Convention on Contracts for the International Sale of Goods, Article 79 (1980).

[154]*Id.*, Article 50.

[155]*Id.*, Article 52(1). The buyer, however, may have an obligation under Article 86 to take possession of the goods on behalf of the seller to prevent the seller from suffering injury.

[156]*Id.*, Article 52(2).

[157]*Id.*, Article 51(1).

[158]*Id.*, Article 51(2).

[159]*Id.*, Article 61.

Specific Performance Assuming that a decree of specific performance is available under local law, a seller may require a buyer to (1) take delivery and pay the contract price or (2) perform any other obligation required by the contract.[160]

This rather unusual remedy is included in the convention primarily for symmetry, as a balance to the buyer's specific performance remedy. Its inclusion stresses the fact that CISG requires both parties to perform their obligations. However, because Article 28 of the convention limits the availability of specific performance decrees to cases where the domestic court has powers to grant a similar decree, the likelihood that it will be used very often is small.

In common law countries, a suit to recover the full price from the buyer is not a form of specific performance. Historically, specific performance was a decree issued by a court of equity. A suit to recover the price, normally called an action in *debt*, was obtained from a different court, a court of law. An action in debt, moreover, was available only on a *quid pro quo*[161] basis. The seller could recover the price only for the things actually received by the buyer, and the buyer (at least in a court of law) could not be compelled to take delivery of the goods. This tradition survives in both the U.K. Sale of Goods Act of 1893 (§49) and the U.S. Uniform Commercial Code (§2–709), as well as in the statutes of other common law countries. The seller may recover the price, but only after "the property in the goods has passed to the buyer."[162]

Unlike the common law countries, the sales codes in civil law countries do have provisions that can require the buyer to take delivery and pay the full price. As a practical matter, however, they are seldom used.[163] Rather, when a buyer refuses to take delivery, the seller commonly resells the goods on the buyer's account and brings an action to recover any deficiency. Such a remedy for damages is also allowed under the convention.[164]

Avoidance The seller's avoidance remedy truly is the mirror image of the buyer's remedy. Like the buyer, the seller may avoid the contract only if there has been a fundamental breach or, following a *Nachfrist* notice, the buyer refuses to cure any defect in his performance.[165] The rules applying to fundamental breach and the *Nachfrist* notice, discussed earlier, apply here as well.

missing specifications
Remedy that allows a seller to ascertain specifications himself when the buyer fails to supply them as required by the contract or within a reasonable time after the seller requests them.

Missing Specifications The **missing specifications** remedy applies to a special problem that can face sellers: obtaining specifications for goods that the buyer fails to supply. If the buyer does not produce the measurements that the seller needs by the date specified in the contract or within a reasonable time after the seller asks for them, CISG allows the seller to ascertain them himself "in accordance with the requirements of the buyer that may be known to him."[166] The seller must then inform the buyer of what he has done and set a reasonable time period for the buyer to supply different specifications. However, if the buyer does not respond, the seller's specifications become "binding."[167]

Remedies Available to Both Buyers and Sellers

The remedies available to both buyers and sellers are (1) suspension of performance, (2) avoidance in anticipation of a fundamental breach, (3) avoidance of an installment contract, and (4) damages.

suspension of performance
Remedy available to either party when it becomes clear that the other party will not perform a substantial part of his obligation because of a serious deficiency in his ability to perform, his creditworthiness, his preparations for performing, or his performance.

Suspension of Performance CISG, Article 71, describes the remedy of **suspension of performance** as follows:

1. A party may suspend the performance of his obligations if, after the conclusion of the contract, it becomes apparent that the other party will not perform a substantial part of his obligations as a result of: (a) a serious deficiency in his ability to perform or his creditworthiness; or (b) his conduct in preparing to perform or in performing the contract.

---

[160] *Id.*, Article 62.

[161] From Latin: "something for something." One thing in return for another. In the traditional English common law, the giving of one valuable thing for another—called *mutual consideration*—was a necessary requirement for a contract to be valid.

[162] United Kingdom, Sale of Goods Act, § 49 (1893).

[163] See John Philip Dawson, "Specific Performance in France and Germany," *Michigan Law Review*, vol. 57, p. 495 (1959); and G. H. Treitel, "Remedies for Breach of Contract," in *International Encyclopedia of Comparative Law*, vol. 7, chap. 16, §§10–29 (1976).

[164] UN Convention on Contracts for the International Sale of Goods, Article 75 (1980).

[165] *Id.*, Article 64.

[166] *Id.*, Article 65(1).

[167] *Id.*, Article 65(2).

2. If the seller has already dispatched the goods before the grounds described in the preceding paragraph become evident, he may prevent the handing over of the goods to the buyer even though the buyer holds a document which entitles him to obtain them. The present paragraph relates only to the rights in the goods as between the buyer and the seller.
3. A party suspending performance, whether before or after dispatch of the goods, must immediately give notice of the suspension to the other party and must continue with performance if the other party provides adequate assurance of his performance.

Paragraph (1) applies to threats of nonperformance, paragraph (2) applies to threats of nonpayment discovered after the goods are in transit, and paragraph (3) requires a suspending party to give notice and to resume his obligations under the contract if the other party provides adequate assurances of his capability to perform.

Paragraph (2) applies to a special set of circumstances. The threat that the buyer will not pay must be discovered after the goods are shipped but before they are handed over by the carrier, and the seller must not have retained control over the goods (e.g., he may have turned over a negotiable bill of lading to the buyer).[168] In this situation, the seller can prevent the carrier from delivering the goods to the buyer. This right, however, "relates only to the rights in the goods as between the buyer and the seller." Should a third person acquire legal rights in the goods (e.g., as the holder in due course of a negotiable bill of lading), CISG will not apply.[169] Instead, the matter is left to domestic law; and, in most cases, the third party's right will prevail.

Anticipatory Avoidance **Anticipatory avoidance** is different from the avoidance remedies that apply specifically to buyers and sellers. Those remedies apply only after an offending party has committed a fundamental breach. The remedy provided in Article 72 arises as soon as "it is clear" that the other party "will commit a fundamental breach."

anticipatory avoidance Remedy available to either party when it becomes clear that the other party will commit a fundamental breach.

There seem to be only a few cases where this remedy can be invoked. These include (1) the specific goods promised to the buyer are wrongfully sold to a third party; (2) the seller's only employee capable of producing the goods dies or is fired; and (3) the seller's manufacturing plant is sold.[170] In most other cases the breach will already have occurred, or the circumstances will be such that a suspension of performance is the appropriate remedy.

If a party opts to anticipatorily avoid, CISG requires him, "if time allows," to notify the other party so that the latter can "provide adequate assurance of his performance."[171] In practice, this is worth doing, both to comply with the convention's general requirement of "good faith" and to minimize any challenges to the use of the remedy.[172]

Avoidance of Installment Contracts CISG's rule for avoiding installment contracts uses the same logic found in its other avoidance provisions. First, as to a particular installment, if there was a "fundamental breach with respect to that installment," then "the other party may declare the contract avoided with respect to that installment."[173] Second, if the breach of one installment gives a party "good grounds" to believe that a fundamental breach of later installments "will occur," then those later installments may be anticipatorily avoided.[174] Finally, if the installments are interdependent, a fundamental breach of one installment will allow a party to avoid the entire contract (past and future installments included).[175]

---

[168]Similar provisions can be found in many domestic codes: e.g., United States, Uniform Commercial Code, §2–704; Sweden, Sales Act, §39; and United Kingdom, Sale of Goods Act, §§44–46 (1893 as amended in 1979).

[169]UN Convention on Contracts for the International Sale of Goods, Article 4(b) (1980).

[170]See James C. Gulotta Jr., "Anticipatory Breach—A Comparative Analysis," *Tulane Law Review*, vol. 50, p. 932 (1976).

[171]UN Convention on Contracts for the International Sale of Goods, Article 72(2) (1980).

[172]See John Honnold and Harry M. Flechtner, *Uniform Law for International Sales Under the 1980 United Nations Convention* (2009).

[173]UN Convention on Contracts for the International Sale of Goods, Article 73(1) (1980).

[174]*Id.*, Article 73(2).

[175]*Id.*, Article 73(3).

Damages The basic rule on damages in CISG is common to both the civil law and common law worlds. Article 74 states:

> Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters of which he then knew or ought to have known, as possible consequence of the breach of contract.

This rule, that a breaching party is liable for any foreseeable damages, is derived from Section 1150 of the French Civil Code, which limits damages to those "which were foreseen or which could have been foreseen at the time of the contract." In England, the French law was referred to with favor in the landmark 1854 case of *Hadley v. Baxendale*, which established the **foreseeability** or improbability test as a common law rule.[176] A similar but slightly different test is followed in Germany and the Scandinavian countries. To calculate the damages, the convention uses two different rules. First, if an avoiding party has entered into a good-faith substitute transaction—the buyer obtaining substitute goods or the seller reselling the goods to another party—then damages are measured by the difference between the contract price and the price received in the substitute transaction.[177]

foreseeability test
A breaching party is liable only for those damages that he foresaw or ought to have foreseen.

Alternatively, if the avoiding party did not enter into a substitute transaction, then the damages are calculated by taking the difference between the contract price and the current price at the time of avoidance.[178] The current price is defined as "the price prevailing at the place where delivery of the goods should have been made or, if there is not current price at that place, the price at such other places as serves as a reasonable substitute."[179]

No matter which of the two CISG damage rules applies, the party claiming damages is under an obligation to take reasonable measures "to **mitigate** the loss." If the claiming party fails to take such action, the other may seek a proportionate reduction in the damages.[180]

mitigation
Obligation of a party claiming damages to keep the damages to a minimum.

L. Excuses for Nonperformance

Two excuses are provided in CISG for a party's failure to perform. One is *force majeure*; the other is *dirty hands*.

Force Majeure

A party is not liable for any damages resulting from his failure to perform if he can show (1) that his failure was "due to an impediment beyond his control," (2) that the impediment was not something he could have reasonably taken into account at the time of contracting, and (3) that he remains unable to overcome the impediment or its consequences.[181]

[176] *English Reports*, vol. 156, p. 145. The English rule was codified in the Sale of Goods Act, §§50(2), 51(2), and 53(2) (1893); however, the phrase "loss directly and naturally resulting in the ordinary course of events" is used rather than the word *foreseeable*. The U.S. Uniform Commercial Code, § 2–715(2), speaks of "any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know."

[177] UN Convention on Contracts for the International Sale of Goods, Article 75 (1980).

[178] *Id*., Article 76(1).

[179] *Id*., Article 76(2).

[180] *Id*., Article 77. Related to the requirement of mitigation of damages is the requirement to preserve goods. Thus, a seller must preserve goods in his possession if the buyer is late taking delivery (Article 85), and a buyer must preserve goods in his possession if he intends to reject them (Article 86). In doing so, the goods can either be deposited in a warehouse at the expense of the other party (Article 87) or sold when the other party has unreasonably delayed in reclaiming them (Article 88).

[181] UN Convention on Contracts for the International Sale of Goods, Article 79(1) (1980).

This excuse, commonly known as ***force majeure***, is not only narrowly defined, it is also limited in its application.[182] It applies to situations—such as natural disasters, war, embargoes, strikes, breakdowns, and the bankruptcy of a supplier—that frustrate both the party attempting to perform and the party expecting performance. Because neither party is really at fault, the breaching party is excused from paying damages. He is not, however, exempted from the application of any other appropriate remedy (such as suspension of performance or avoidance).

force majeure From French: "superior force." An event or effect that cannot be reasonably anticipated or controlled.

A party seeking to use CISG's excuse of *force majeure* is under some additional limitations. First, he/she has a duty to promptly notify the other party of "the impediment and its effect on his ability to perform."[183] Second, if his/her claim is based on the failure of a third person to perform (such as a supplier), the third party must itself be able to claim the excuse.[184] Finally, the excuse may be used only as long as the underlying impediment continues in existence.[185]

Dirty Hands

The **dirty hands** excuse is based on a very simple premise, succinctly stated in CISG, Article 80:

dirty hands Maxim that a party whose actions cause the other party to breach may not complain.

> A party may not rely on a failure of the other party to perform, to the extent that such failure was caused by the first party's act or omission.

For example, if a seller agrees to deliver goods to a buyer at the buyer's warehouse, but the buyer's warehouse is locked and inaccessible at the time that the seller is supposed to make delivery, the buyer cannot complain that the seller failed to deliver on time.

Chapter Questions

Application of the CISG

1. Buyer and Seller are citizens of the United States and France respectively. Both countries have adopted the CISG. However, as the performance of the contract is going to take place in the United States, they decide that the United States would have jurisdiction to hear disputes and the applicable law shall be that of the United States. When a dispute arises, Seller claims that given the different legal traditions followed, the applicable law should be the CISG. Buyer argues that the law of the United States has been specifically mentioned in the contract, and hence the CISG cannot be applied to in the settlement of disputes. Whom do you think is correct? Discuss.

Various Provisions of the CISG

2. Retailer in State A decides to go into the catalog sales business in State B. Both countries are parties to the CISG. Retailer purchases a mailing list from Ace Credit Card Company. The list has the names and addresses of 500,000 persons owning Ace credit cards in State B, and Retailer uses this to prepare mailing labels. John Q. Public receives a catalog addressed to him personally from Retailer. The catalog describes various types of widgets and gives prices for each one. Has the retailer made an offer to sell the widgets? If John accepts, will there be a binding contract under the CISG?
3. On January 1, Seller sent a letter to Buyer offering to sell to Buyer 5,000 widgets for $25 apiece. The letter also stated: "This offer is binding and irrevocable until February 1." On January 5, prior to Buyer's receipt of the letter, Seller called Buyer on the telephone and left the following message on the answering machine at Buyer's place of business: "Ignore my letter of January 1. I have decided to withdraw the offer contained in it." On January 7, after listening to her answering machine and reading the letter that arrived that same day, Buyer sent Seller the following telegram: "I accept your offer of January 1." Is there a contract under the CISG?

Rejection Under the CISG

4. On December 1, Seller sent Buyer an offer to sell 5,000 widgets to Buyer for $25 apiece. The offer stated: "The offer will remain open until December 31." On December 10, Buyer answered: "The price is too high; I don't accept your offer." Then, on December 15, Buyer changed his mind and sent a telegram stating: "I accept your December 1 offer after all." Seller replied: "Your acceptance is too late, since you already rejected the offer." In turn, Buyer answered: "The acceptance is good, you promised to keep your offer open until December 31." Is there a contract under the CISG?

Is Silence Acceptance Under the CISG?

5. Buyer received a letter in her mail on January 1 offering to sell Buyer 5,000 widgets for $20 apiece. Seller's letter closed with the following statement: "I know that this offer is so attractive that I

[182]The CISG rule, based on civil law practice, is much broader, however, than the rule followed in common law countries. For example, in the United States, the Uniform Commercial Code, §2–615, applies only to a seller and only in respect to two aspects of his performance: delay in delivery and nondelivery.

[183]UN Convention on Contracts for the International Sale of Goods, Article 79(4) (1980).

[184]*Id.*, Article 79(2).

[185]*Id.*, Article 79(3).

will assume that you accept it unless I hear otherwise by January 31." Buyer did not reply. Seller shipped the widgets on February 1. What are Buyer's responsibilities under the CISG?

Modification of Contract and Reliance Under the CISG

6. Seller and Buyer entered into a written contract for the manufacture by Seller of 10,000 widgets of a design specified by Buyer and set out in the contract. The contract also provided: "This contract may only be modified in a writing signed by both parties." Before Seller began work on the widgets, Buyer and Seller agreed by telephone to a change in the specifications for 2,500 of the widgets. Seller then produced and delivered the 2,500 widgets as specified. Buyer refused to accept them because they did not conform to the specifications in the original contract. Assuming the CISG applies, who breached?

What Are the Requirements of a *Nachfrist* Notice?

7. Buyer and Seller entered into a contract governed by the CISG for Seller to deliver a sophisticated computer to Buyer by January 1. Seller was late in delivering the machine, so Buyer wired Seller on January 2: "Anxious to take delivery of the computer. Hope that it arrives by February 1." Seller delivers the computer on February 5, but Buyer refuses to accept it and declares that the contract is avoided because Seller failed to hand over the computer before the February 1 date specified in the January 2 telegram. Both Buyer and Seller agree that there has not been a fundamental breach. Is Buyer able to avoid the contract under these circumstances?

Risk of Loss Under the CISG

8. Buyer and Seller are located in different countries that have adopted the CISG. Buyer purchases a software package online that immediately downloads and renders a particular hardware operational (but has no express warranty). After the software is completely downloaded, the program does not function correctly (due to incompatibility with Buyer's computer configuration). Buyer alleges that it was Seller's responsibility to specify the required configuration for the program to work. Seller alleges that it was Buyer's responsibility to check whether his computer was correctly configured for the program. Who do you think is correct? Discuss.

Avoidance of Installment Contracts Under the CISG

9. Seller agreed to deliver three software programs to Buyer that are specially designed for Buyer's business. The first was to be delivered in January, the second in February, and the third in March. The program delivered in January worked fine, but the one delivered in February was defective. It not only failed to function properly, it also made the other two programs effectively worthless. Seller was unable to correct the defect, and no suitable replacement could be found from another supplier. What CISG remedies are available to Buyer?

Damages for Breach of Contract Under the CISG

10. Seller contracted to deliver 1,000 barrels of oil to Buyer for $14,000. When the oil arrived, 975 barrels complied fully with the contract description. Twenty-five were contaminated and unacceptable. Oil in comparable barrels was available in the local market for a price of $18 a barrel in 25-barrel lots. Seller offered not to charge Buyer for the barrels. Is there a contract under the CISG? If so, what payment is due to the Seller?

CHAPTER 11

Transportation

Chapter Outline

A. Trade Terms
  A Note on the Incoterms
  "Free" Terms
  FOB—Free on Board
  FAS—Free Alongside Ship
  CIF—Cost, Insurance, and Freight
  CFR—Cost and Freight
  FCA—Free Carrier
  EXW—Ex Works
B. Transportation
C. Inland Carriage
D. Carriage of Goods by Sea
  Common Carriage
  The Bill of Lading
  Carrier's Duties Under a Bill of Lading
  Carrier's Immunities
  Liability Limits
  Time Limitations
  Third-Party Rights (Himalaya Clause)
E. Charterparties
  Voyage Charterparties
  Time Charterparties
  Charterparties and Bills of Lading
F. Maritime Liens
G. Maritime Insurance
  Perils
  Average Clauses
H. Carriage of Goods by Air
Chapter Questions

A. Trade Terms

Sales contracts involving transportation customarily contain abbreviated terms describing the time and place where the buyer is to take delivery. These **trade terms,** such as *free on board* (*FOB*) and *cost, insurance, and freight* (*CIF*), may also define a variety of other matters, including the time and place of payment, the price, the time when the risk of loss shifts from the seller to the buyer, and the costs of freight and insurance.

trade terms
Standardized terms used in sales contracts that describe the time, place, and manner for the transfer of goods from the seller to the buyer.

Incoterms
Trade terms published by the International Chamber of Commerce.

The same trade abbreviations are widely used in both domestic and international transactions. Unfortunately, they have different meanings, depending on the governing law.[1] In the United States, for example, the Uniform Commercial Code defines trade terms for domestic and export sales. In the United Kingdom, the terms are defined by reference to case law.[2] Virtually all domestic laws, however, allow the parties to define the terms themselves, or to incorporate definitions from foreign legislation or from a specific set of private rules. The United Nations Convention on Contracts for the International Sale of Goods similarly allows parties to incorporate trade terms of their choosing as was discussed in Chapter 10.[3]

The most widely used private trade terms are those published by the International Chamber of Commerce (ICC). Called **Incoterms,** they are well known throughout the world, and their use in international sales is encouraged by trade councils, courts, and international lawyers.[4] First published in 1936, they are revised every 10 years—the current version is *Incoterms 2010*.[5] Parties who adopt the Incoterms, or any other trade terms, should make sure they express their desire clearly. For example, a contract might refer to "FOB (Incoterms 2010)" or "CIF (U.S. Uniform Commercial Code)." Courts will otherwise apply the definitions used in their own jurisdictions.[6] Parties should also refrain from casually adopting any particular set of terms. The ICC's Incoterms, which are possibly the most complete of all such rules, are lengthy and deserve careful study. Finally, parties should be wary about making additions or varying the meaning of any particular term, except to the extent that it is allowed by the rules they adopt or by judicial decision. Courts are as apt to ignore a variation, or hold that the entire term is ineffective, as they are to apply it.[7]

The Incoterms Web site is
www.iccwbo.org/incoterms/.

The parties' failure to use any trade term at all can also produce unexpected results. Courts are then left to divine the parties' intent and to decide the case based on local commercial practice. Such a problem arose in Case 11-1.

CASE 11-1 St. Paul Guardian Insurance Company v. Neuromed Medical Systems & Support, GmbH

United States District Court for the Southern District of New York
LEXIS United States District Court Cases, no. 5096 (2002)

District Judge Sidney H. Stein

Plaintiffs St. Paul Guardian Insurance Company and Travelers Property Casualty Insurance Company have brought this action as subrogees[8] of Shared Imaging, Inc., to recover $285,000 they paid to Shared Imaging for damage to a mobile magnetic resonance imaging system ("MRI")

[1] See Trade Terms, an International Chamber of Commerce publication (Document No. 16, issued in 1955), which describes how 10 major trade terms are defined in 18 countries. Not all countries use trade terms, however. Japan, for example, has no established set of domestic trade terms.

[2] See D. Michael Day, *The Law of International Trade*, pp. 40–80 (1981).

[3] UN Convention on the International Sale of Goods, Article 6 (1980), provides: "The parties may exclude the application of this Convention, or . . . derogate from or vary the effect of any of its provisions."

[4] The National Foreign Trade Council in New York, which issued its own definitions, the Revised American Foreign Trade Definitions, in 1941, has since 1980 encouraged traders to use the Incoterms instead. See Paul H. Vishny, *Guide to International Commerce Law*, §2–36 (1998).

[5] International Chamber of Commerce, *Incoterms 2010* (Pub. No. 715, 2010). The Incoterms are currently revised every 10 years.

[6] Frederic Eisemann, "Incoterms and the British Export Trade," *Journal of Business Law*, vol. 1965, p. 119 (1965), doubts that Incoterms have become sufficiently accepted to constitute trade usage or custom.

[7] Paul H. Vishny, *Guide to International Commerce Law*, §2–37 (1998).

[8] Subrogees are persons who have been subrogated to the legal claim of another; that is, persons who have assumed the legal right to collect another's debt or damages—often insurance companies that have paid claims, as in this case and they then acquire the rights of the insured party.

MAP 11.1

Germany and the United States (2002)

purchased by Shared Imaging from defendant Neuromed Medical Systems & Support GmbH ("Neuromed"). Neuromed has moved to dismiss the complaint. . . . [It contends that] the complaint fails to state a claim for relief. . . .

The crux of Neuromed's argument is that it had no further obligations regarding the risk of loss once it delivered the MRI to the vessel at the port of shipment due to a "CIF" clause included in the underlying contract. Plaintiffs respond that . . . the generally understood definition of the "CIF" term as defined by the International Chamber of Commerce's publication, INCOTERMS 1990, is inapplicable here . . .

Pursuant to the applicable German law—the U.N. Convention on Contracts for the International Sale of Goods (CISG)—the "CIF" term in the contract operated to pass the risk of loss to Shared Imaging at the port of shipment, at which time, the parties agree, the MRI was undamaged and in good working order. Accordingly, Neuromed's motion to dismiss the complaint should be granted and the complaint dismissed.

Background

Shared Imaging, an American corporation, and Neuromed, a German corporation, entered into a contract of sale for a Siemens Harmony 1.0 Tesla mobile MRI. Thereafter, both parties engaged various entities to transport, insure, and provide customs entry service for the MRI. Plaintiffs originally named those entities as defendants, but the action has been discontinued against them by agreement of the parties. Neuromed is the sole remaining defendant.

According to the complaint, the MRI was loaded aboard the vessel "Atlantic Carrier" undamaged and in good working order. When it reached its destination of Calmut City, Illinois, it had been damaged and was in need of extensive repair, which led plaintiffs to conclude that the MRI had been damaged in transit.

The one-page contract of sale contains nine headings, including: "Product," "Delivery Terms," "Payment Terms," "Disclaimer," and "Applicable Law." Under "Product" the contract provides, the "system will be delivered cold and fully functional." Under "Delivery Terms" it provides, "CIF New York Seaport, the buyer will arrange and pay for customs clearance as well as transport to Calmut City."

Under "Payment Terms" it states, "By money transfer to one of our accounts, with following payment terms: U.S. $93,000—downpayment to secure the system; U.S. $744,000—prior to shipping; U.S. $93,000—upon acceptance by Siemens of the MRI system within three business days after arrival in Calmut City." In addition, under "Disclaimer" it states, "system including all accessories and options remain the property of Neuromed till complete payment has been received." Preceding this clause is a handwritten note, allegedly initialed by Raymond Stachowiak of Shared Imaging, stating, "Acceptance subject to Inspection."

Discussion

Neuromed contends that because the delivery terms were "CIF New York Seaport," its contractual obligation, with regard to risk of loss or damage, ended when it delivered the MRI to the vessel at the port of shipment and therefore the action must be dismissed because plaintiffs have failed to state a claim for which relief can be granted. Plaintiffs respond that the generally

accepted definition of the "CIF" term, as defined in INCOTERMS 1990, is inapplicable. Moreover, plaintiffs suggest that other provisions of the contract are inconsistent with the "CIF" term because Neuromed, pursuant to the contract, retained title subsequent to delivery to the vessel at the port of shipment and thus, Neuromed manifestly retained the risk of loss.

***

B. Applicable Law

***

The parties have each submitted relevant opinions of German legal experts and the Court has independently researched the applicable foreign law. On the basis of those submissions and analysis, the Court finds the expert opinion of Karl-Ulrich Werkmeister for the defendants to be an accurate statement of German law.

2. Applicable German Law

The parties concede that pursuant to German law, the UN Convention on Contracts for the International Sale of Goods ("CISG") governs this transaction because (1) both the U.S. and Germany are Contracting States to that Convention, and (2) neither party chose, by express provision in the contract, to opt out of the application of the CISG.[9]

The CISG aims to bring uniformity to international business transactions, using simple, non-nation specific language. To that end, it is comprised of rules applicable to the conclusion of contracts of sale of international goods. In its application regard is to be paid to comity and interpretations grounded in its underlying principles rather than in specific national conventions.[10]

Germany has been a Contracting State since 1991, and the CISG is an integral part of German law. Where parties, as here, designate a choice of law clause in their contract—selecting the law of a Contracting State without expressly excluding application of the CISG—German courts uphold application of the Convention as the law of the designated Contracting state. To hold otherwise would undermine the objectives of the Convention which Germany has agreed to uphold.

C. Cisg, Incoterms and "CIF"

"CIF," which stands for "cost, insurance and freight," is a commercial trade term that is defined in INCOTERMS 1990, published by the International Chamber of Commerce ("ICC"). The aim of INCOTERMS, which stands for international commercial terms, is "to provide a set of international rules for the interpretation of the most commonly used trade terms in foreign trade." These "trade terms are used to allocate the costs of freight and insurance" in addition to designating the point in time when the risk of loss passes to the purchaser. INCOTERMS are incorporated into the CISG through Article 9(2) which provides that,

> The parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract or its formation a usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned.

At the time the contract was entered into, INCOTERMS 1990 was applicable. INCOTERMS define "CIF" (named port of destination) to mean [that] the seller delivers when the goods pass "the ship's rail in the port of shipment." The seller is responsible for paying the cost, freight and insurance coverage necessary to bring the goods to the named port of destination, but the risk of loss or damage to the goods passes from seller to buyer upon delivery to the port of shipment. Further, "CIF" requires the seller to obtain insurance only on minimum cover.

---

[9] See CISG, Article 1(1)(a). . . .

[10] See CISG Article 7(1), (2). . . .

Plaintiffs' legal expert contends that INCOTERMS are inapplicable here because the contract fails to specifically incorporate them. Nonetheless, he cites and acknowledges that the German Supreme Court—the court of last resort in the Federal Republic of Germany for civil matters—concluded that a clause "fob" without specific reference to INCOTERMS was to be interpreted according to INCOTERMS "simply because the [INCOTERMS] include a clause 'fob.'"

Conceding that commercial practice attains the force of law under section 346 of the German Commercial Code, plaintiffs' expert concludes that the opinion of the BGH "amounts to saying that the [INCOTERMS] definitions in Germany have the force of law as trade custom." As encapsulated by defendant's legal expert, "It is accepted under German law that in case a contract refers to CIF-delivery, the parties refer to the INCOTERMS rules. . . ."

The use of the "CIF" term in the contract demonstrates that the parties "agreed to the detailed oriented [INCOTERMS] in order to enhance the Convention."[11] Thus, pursuant to CISG art. 9(2), INCOTERMS definitions should be applied to the contract despite the lack of an explicit INCOTERMS reference in the contract.

D. Incoterms, the CISG and the Passage of Risk of Loss and Title

Plaintiffs argue that Neuromed's explicit retention of title in the contract to the MRI machine modified the "CIF" term, such that Neuromed retained title and assumed the risk of loss. INCOTERMS, however, only address passage of risk, not transfer of title. Under the CISG, the passage of risk is likewise independent of the transfer of title.[12] Plaintiffs' legal expert mistakenly asserts that the moment of "passing of risk" has not been defined in the CISG. Chapter IV of that Convention, entitled "Passing of Risk," explicitly defines the time at which risk passes from seller to buyer pursuant to Article 67(1),

> If the contract of sale involves carriage of the goods and seller is not bound to hand them over at a particular place, the risk passes to the buyer when the goods are handed over to the first carrier for transmission to the buyer in accordance with the contract of sale. If the seller is bound to hand the goods over to a carrier at a particular place, the risk does not pass to the buyer until the goods are handed over to the carrier at that place.

Pursuant to the CISG, "the risk passes without taking into account who owns the goods. The passing of ownership is not regulated by the CISG according to art. 4(b)."[13] Article 4(b) provides that the Convention is not concerned with "the effect which the contract may have on the property in the goods sold."[14] Moreover, according to Article 67(1), the passage of risk and transfer of title need not occur at the same time, as the seller's retention of "documents controlling the disposition of the goods does not affect the passage of risk."

Had the CISG been silent, as plaintiffs' expert claimed, the Court would have been required to turn to German law as a "gap filler." There again, plaintiffs' assertions falter. German law also recognizes passage of risk and transfer of title as two independent legal acts. In fact, it is standard "practice under German law to agree that the transfer of title will only occur upon payment of the entire purchase price, well after the date of passing of risk and after receipt of the goods by the buyer."[15] Support for this proposition of German law is cited by both experts. They each refer to section 447 of the German Civil Code, a provision dealing with long distance sales, providing in part—as translated by plaintiff's expert—that "the risk of loss passes to the buyer at the moment when the seller has handed the matter to the forwarder, the carrier or to the otherwise determined person or institution for the transport."[16]

---

[11]Neil Gary Oberman, "Transfer of Risk from Seller to Buyer in International Commercial Contracts: A Comparative Analysis of Risk Allocation Under CISG, UCC and INCOTERMS," at www.cisg.law.pace.edu/cisg/thesis/Oberman.html.

[12]See CISG Article 67(1).

[13]Annemieke Romein, "The Passing of Risk: A Comparison Between the Passing of Risk under the CISG and German Law" (Heidelberg, June 1999), at www.cisg.law.pace.edu/cisg/biblio/romein.html.

[14]CISG Article 4(b).

[15]Werkmeister's Reply Opinion at p. 7.

[16]Strube's Opinion at p. 5.

Accordingly, pursuant to INCOTERMS, the CISG and specific German law, Neuromed's retention of title did not thereby implicate retention of the risk of loss or damage.

***

Conclusion

For the foregoing reasons, Neuromed's motion to dismiss for failure to state a claim is granted and the complaint is dismissed.

Casepoint

This case involves the sale of an expensive piece of medical equipment (an MRI scanner) by a seller in Germany to a buyer in the United States. The scanner was damaged when it arrived at the buyer's place of business. It was thus important to determine when the risk of loss passed. The contract shipping terms were "CIF, New York Seaport." The court stated that the CISG incorporated the relevent Incoterms, unless the parties had specified otherwise, and found that the term "CIF, New York" meant that the risk of loss effectively moved from seller to buyer when the goods were loaded onto the carrier in Germany for the trip to New York. The Incoterms regarding risk of loss are not tied to the passage of title, as the buyer claimed, so here the loss must fall upon the buyer.

A Note on the Incoterms

Because the ICC's Incoterms are the most commonly used trade terms, most of this discussion of trade terms focuses on them.

The 2010 revision makes several changes from the previous revisions, *Incoterms 1990 and Incoterms 2000*.[17] The 1990 revision made several significant modifications to the earlier terms, reflecting changes both in technology and in shipping practices that occurred during the 1980s. According to the ICC, "The main reason for the 1990 revision of *Incoterms* was the desire to adapt terms to the increasing use of electronic data interchange (EDI)." The terms, accordingly, allow parties to transmit documents electronically, including negotiable bills of lading, so long as their contract specifically allows them to do so. The second major reason for the revision stemmed "from transportation techniques, particularly the unitization of cargo in containers, multimodal transport, and roll-on roll-off traffic with road vehicles and railway wagons in 'short sea' maritime transport." Older terms that applied to peculiar modes of land and air transport—such as *free on rail* (*FOR*), *free on truck* (*FOT*), and *FOB airport*—were eliminated and the **free carrier** term was expanded.

free carrier
The seller fulfills his obligations to deliver by handing over the goods, cleared for export, to a carrier named by the buyer.

The Incoterms were formerly classified into four groups arranged according to the parties' obligations; however, Incoterms 2010 is classified into only two groups (see Figure 11.1). The first group can be applied to any mode(s) of transportation and includes Ex Works (EXW), Free Carrier (FCA), Carriage Paid To (CPT), Carriage and Insurance Paid (CIP), Delivered at Terminal (DAT), Delivered at Place (DAP), and Delivered Duty Paid (DDP). These last are especially important when several different forms of transport (i.e., *multimodal* transport) are used to get goods to their destination. The second group can only be applied to sea and inland waterway transportation and includes Free Alongside Ship (FAS), Free On Board (FOB), Cost and Freight (CFR), and Cost, Insurance and Freight (CIF). Incoterms 2010 eliminated four terms from the 2000 revision—Delivered at Frontier (DAF), Delivered Ex-Ship (DES), Delivered Ex-Quay (DEQ), and Delivered Duty Unpaid (DDU). Incoterms 2010 also added two new terms—Delivered at Terminal (DAT) and Delivered at Place (DAP). The most important Incoterms are discussed later in the text.

Incoterms 2010 also formally defined *delivery*. Before this revision, the term had always been defined informally. This revision defines *delivery* as the point in the transaction where the risk of loss or damage to the goods is transferred from the seller to the buyer.

[17]International Chamber of Commerce, pub. no. 715.

Any mode of transportation
- Ex Works (EXW)
- Free Carrier (FCA)
- Carriage Paid To (CPT)
- Carriage and Insurance Paid (CIP)
- Delivered at Terminal (DAT)
- Delivered at Place (DAP)
- Delivered Duty Paid (DDP)

Sea and inland waterway transportation only
- Free Alongside Ship (FAS)
- Free On Board (FOB)
- Cost and Freight (CFR)
- Cost, Insurance and Freight (CIF)

FIGURE 11.1

The Two Groups of Terms Classified by Incoterms 2010

"Free" Terms

Several of the common trade terms begin with the word **free** (e.g., *free on board*, *free alongside ship*, *free carrier*). *Free* means that the seller has an obligation to deliver the goods to a named place for transfer to a carrier. National laws sometimes treat the "free" terms as interchangeable, so it is important for contracting parties to identify not only the term but also the set of rules that applies to their particular transaction.[18]

free
When used in a trade term, it means that the seller has an obligation to deliver goods to a named place for transfer to a carrier.

FOB—Free on Board

Historically, **free on board,** as its name suggests, is a maritime trade term, and in most of the world its use remains limited to seaborne commerce. The ICC's Incoterms 2010, accordingly, uses it only in connection with the carriage of goods by sea. In common law countries, however, it is also used for inland carriage aboard any "vessel, car or other vehicle."[19]

free on board
Seller fulfills his obligations to deliver when the goods have passed over the ship's rail at the named port of shipment.

The FOB (port of shipment) contract requires a seller to deliver goods on board a vessel that is to be designated by the buyer in a manner customary at the particular port. For example, *FOB Singapore* requires the buyer to name the ship that will accept delivery in Singapore, and the seller must deliver the goods on board the ship as required by the port rules in Singapore.

The essence of an FOB contract is the notion that a seller is responsible for getting goods on board a ship designated by a buyer. What is meant by *on board* has been the issue in many cases and is described in detail in the Incoterms. Traditionally (and according to the Incoterms), goods are on board a ship the moment they cross its rail. A seller's responsibility, however, does not end at that point unless the goods are also "appropriated to the contract"—that is, they are "clearly set aside or otherwise identified as the contract goods." Thus, the seller continues to be responsible for the goods even after the buyer's chosen ship takes control of the goods at the end of its cargo boom and begins to hoist the goods off the dock. Moreover, the seller may remain

[18]In France, for example, the distinction between FOB and FAS is sometimes blurred. Frederic Eisemann, *Usages de la Vente Commerciale Internationale*, p. 83 (1972).

[19]United States, Uniform Commercial Code, §2–319(1)(c). For the practice in the United Kingdom, see D. Michael Day, *The Law of International Trade*, p. 42 (1981).

responsible for the goods even after they are loaded onto the ship if they remain unidentified to the buyer's contract.

FAS—Free Alongside Ship

free alongside ship
The seller fulfills his obligations to deliver when the goods have been placed alongside the vessel on the quay or in lighters at the named port of shipment.

The term **free alongside** or **free alongside ship** requires the seller to deliver goods to a named port alongside a vessel to be designated by the buyer and in a manner customary to the particular port.[20] *Alongside* has traditionally meant that the goods must be within reach of a ship's lifting tackle. This may, as a consequence, require that the seller hire lighters to take the goods out to a ship in ports where this is the practice. In other respects, the requirements of an FAS term are the same as those of an FOB contract. The seller's responsibilities end upon delivery of the goods alongside.

CIF—Cost, Insurance, and Freight

cost, insurance, and freight
The seller must pay the costs and freight necessary to bring the goods to a named port of destination and must procure marine insurance against the buyer's risk of loss to the goods during the carriage.

The most important and most commonly used shipping term is **cost, insurance, and freight.** The CIF term is preferred by buyers because it means that they have little to do with the goods until the goods arrive at a port of destination in their country. A CIF price quote also allows buyers to compare prices from suppliers around the world without having to take into consideration differing freight rates, since the seller pays the freight and insurance. Export-sellers are often under pressure from their governments to use domestic carriers and insurers, so they too like the term. On the other hand, sellers may not be able to find domestic carriers or insurers; and buyers, under pressure from governments that are also concerned about employing national carriers and insurers, may settle for an FOB contract.

In short, a CIF contract requires the seller to arrange for the carriage of goods by sea to a port of destination and to turn over to the buyer the documents necessary to obtain the goods from the carrier or to assert a claim against an insurer if the goods are lost or damaged. The three documents that the seller (as a minimum) has to provide—the invoice, the insurance policy, and the bill of lading—represent the three elements of the contract: cost, insurance, and freight. The seller's obligations are complete when the documents are tendered to the buyer. At that time, the buyer is obliged to pay the agreed-upon price.

CFR—Cost and Freight

cost and freight (port of destination)
The seller must pay the cost and freight necessary to bring the goods to the named port of destination.

The **cost and freight (port of destination)** term is the same as the CIF term except that the seller does not have to procure marine insurance against the risk of loss or damage to the goods during transit. Because the insurance required under a CIF contract only has to cover minimum conditions (the so-called FPA or *free from particular average* conditions), buyers wishing to purchase more extensive policies will want to use a CFR contract. The buyer's responsibilities under a CFR contract (known also as a *C & F contract*) are considered in Case 11-2.

CASE 11-2 Phillips Puerto Rico Core, Inc. v. Tradax Petroleum, Ltd.

United States, Court of Appeals, Second Circuit, 1985
Federal Reporter, Second Series, vol. 782, p. 314 (1985)

Circuit Judge Mansfield . . .

This convoluted maritime controversy had its origins in early September 1981 when Phillips, a corporation organized under Delaware law with its principal place of business in Puerto Rico, agreed to buy 25–30,000 metric tons of naphtha from Tradax, a corporation organized under Bermuda law, with its principal place of business in Switzerland. Tradax had just purchased the naphtha from another firm, Schlubach & Co., and the naphtha was located in Skikda, Algeria.

[20] Incoterms 2010 (International Chamber of Commerce, pub. no. 715).

MAP 11.2

Algeria and Gibraltar (1981)

The Tradax-Phillips contract, which was made by telephone and then confirmed by telex on September 3, 1981, specified that the sale was to be "C & F" (cost and freight) Guayama, Puerto Rico and that shipment was to be made between September 20–28, 1981. No dates for delivery were specified. The agreement incorporated the International Chamber of Commerce 1980 *Incoterms*, a set of standardized terms for international commercial contracts, which define a "C & F" contract as one in which the seller arranges and pays for the transport of the goods, but the buyer assumes title and risk of loss at the time of shipment. The contract was also to include Tradax's standard contract provisions "subject to [Phillips'] review and acceptance." These standard terms, including a *force majeure*[21] clause and an arbitration clause, were not recited in the telex but were subsequently mailed by Tradax to Phillips with a confirming letter and arrived several weeks later.

Soon after the original contract was entered into on September 8, 1981, a telex from Phillips to Tradax provided documentation and delivery instructions giving the destination in Puerto Rico and listing Phillips as consignee. The telex confirmed that "title and risk of loss to products shall pass to buyer at the time product reaches the vessel[']s flange at the load port." On September 16, Tradax nominated the Oxy Trader, an integrated tug barge, as the vessel for the journey, and after determining that the Trader would fit in the Puerto Rico berth and was available at the correct times, Phillips accepted the nomination.

The Trader arrived at Skikda for loading on the afternoon of September 20, 1981, and loading commenced the following day. The naphtha was completely loaded by the early morning of September 24 and at 1030 hours that morning the ship embarked. . . .

The Trader's voyage was cut short . . . when the ship was detained by the Coast Guard at Gibraltar for an inspection. Tradax relayed word of the delay to Phillips, which telexed back on October 1 that October 15 was the last acceptable delivery date. . . .

[21]From French: "superior force." An event or effect that cannot be reasonably anticipated or controlled.

On October 7, Tradax received word that the Trader might have a latent defect . . . that the authorities were not letting the Trader proceed, and that the naphtha cargo would have to be transshipped. Tradax relayed this message to Phillips.

On October 9, Phillips telexed Tradax stating that it was "declar[ing] *force majeure*," that it would "not make any payments under the contract until the event of *force majeure* abates," and that it was reserving the right to cancel the contract if delivery did not occur within 30 days. Tradax responded, reiterating its claim that its responsibility ended at the time of shipment and notifying Phillips that it would present the shipping documents for payment of the contract price the following day. Phillips again instructed its Puerto Rico office not to make payment if Tradax tendered the documents.

On October 13, a Tradax representative presented the shipping documents for payment at Phillips' Puerto Rico office. A Phillips employee examined the documents briefly—about 30 seconds according to Tradax's witness—and stated that they seemed to be in order but that he had been instructed not to pay. A telex back to Tradax that day reaffirmed Phillips' unwillingness to pay until the abatement of the claimed force majeure.

. . . [O]n November 9, Phillips informed Tradax that it was terminating the contract due to the "unseaworthiness" of the Trader, "discrepancies in the documents," and an "unreasonable delay" in performance. Although Phillips and Tradax representatives tried to negotiate a new contract by which Phillips would buy the naphtha on "delivery" terms, negotiations fell through when Tradax's management refused to accept that deal. The transshipment then began on November 13, with a bill of lading which left open the destination port. On November 19, Tradax informed Phillips that it would try to sell the naphtha on the open market and would hold Phillips liable for any damages. Tradax then sold the naphtha to a third party for $.88 per gallon, after first offering it to Phillips on condition that Tradax retain its right to claim in arbitration the difference between that price and the contract price. Tradax's total loss on the naphtha, compared to the contract price, was $911,710.31, plus incidental damages.

. . . On August 1, 1984, Judge Carter filed his decision in the case, finding Phillips liable to Tradax for $1,039,330.99 plus prejudgment interest from October 13, 1981. The court held that Phillips had anticipatorily breached the contract by declaring its unwillingness to pay because of *force majeure*. . . .

From this judgment Phillips appeals.

Discussion

The 1980 *Incoterms* define a "C & F" contract as one in which:

> [t]he seller must pay the costs and freight necessary to bring the goods to the named destination but the risk of loss of or damage to the goods, as well as of any cost increases, is transferred from the seller to the buyer when the goods pass the ship's rail in the port of shipment.

. . . As a "C & F" seller Tradax had two duties that are relevant here: to deliver the naphtha to an appropriate carrier with which it had contracted for shipment and to tender proper documents to Phillips. Phillips in return was contractually obliged to pay for the naphtha when presented with the shipping documents by Tradax. It is undisputed that after Tradax loaded the naphtha on the Oxy Trader and presented Phillips with the shipping documents on October 13, 1981, Phillips refused to pay for the cargo. If Tradax had adequately performed its contractual duties, Phillips' refusal to pay for the naphtha constituted a breach of the contract as of October 13, unless it was somehow excused from performing.

Phillips asserts several grounds for its failure to pay Tradax on October 13: (1) the existence of a "*force majeure*," (2) unreasonable delay in Tradax's performance, (3) discrepancies in Tradax's shipping documents, and (4) unsuitability (unseaworthiness) of the Oxy Trader. On the undisputed circumstances of this case, however, none of these theories suffice to excuse Phillips' failure to pay on Tradax's presentation of the documents.

Force Majeure

Phillips first relies on the *force majeure* clause among Tradax's standard contract terms, which were to be included in the contract "subject to [Phillips'] review and acceptance"; the contract, however,

did not actually arrive at Phillips' office for review untilt after the Oxy Trader left port. The standard *force majeure* clause reads:

> FORCE MAJEURE: In the event of any strike, fire or other event . . . preventing or delaying shipment or delivery of the goods by the seller . . . the unaffected party may cancel the unfulfilled balance of the contract . . .

. . . We . . . look to the basic purpose of *force majeure* clauses, which is in general to relieve a party from its contractual duties when its performance has been prevented by a force beyond its control or when the purpose of the contract has been frustrated. . . . The burden of demonstrating *force majeure* is on the party seeking to have its performance excused, . . . and, as Judge Carter pointed out, the nonperforming party must demonstrate its efforts to perform its contractual duties despite the occurrence of the event that it claims constituted *force majeure*. . . .

With these principles in mind, we cannot agree that Phillips' performance was excused by its invocation of *force majeure*. Even if the detention of the ship by the Coast Guard constituted *force majeure*, and we are inclined to agree with Judge Carter that it did not, that detention did not frustrate the purpose of the contract or prevent Phillips from carrying out its obligation under the terms of the parties' contract to make payment. Indeed, to hold that the *force majeure* clause may be interpreted to excuse the buyer from that obligation, as Phillips urges, would be to wholly overturn the allocation of duties provided for in "C & F" sales. We do not find any evidence that the parties intended such a result.

. . . The *force majeure* clause thus did not alter the design of the "C & F" contract by requiring Tradax to assure delivery of the naphtha at the ultimate destination in Puerto Rico before it would be entitled to payment. The authorities Phillips cites in support of its contention that a "C & F" seller retains responsibility for events after the time of shipment are plainly distinguishable. The court in *Gatoil International Inc. v. Tradax Petroleum, Ltd.*[22] stated "tentative[ly]" that a "C & F" seller could be liable for having "wrongfully delay[ed] the actual delivery of the goods," in that case by instructing a ship to wait outside the harbor at the port of discharge. Here, in contrast, the absence of any such wrongful conduct on Tradax's part makes such deviation from the standard "C & F" division of responsibility inappropriate.

***

Defects in the Documents

There is equally little merit in Phillips' claim that it was excused from payment under the contract because Tradax tendered defective shipping documents. While it is true that in a sale by documents the seller's tender of the documents is judged very strictly, Phillips' objection to the documents here, as Judge Carter noted, "is an afterthought and must fail." Without having seen the shipping documents, Phillips twice instructed its agents that because of *force majeure*, they were not to pay Tradax when the latter presented the papers for payment. When Tradax presented the papers in Puerto Rico, a Phillips employee chose to give them only a cursory examination before stating that they seemed "okay," but that he had been instructed not to pay.

***

The Suitability of the Oxy Trader

Phillips was not relieved of its contractual obligation because of Tradax's selection of the Oxy Trader. The relevant provision in the 1980 *Incoterms* requires that a "C & F" seller contract for the carriage of the goods "in a seagoing vessel . . . of the type normally used for the transport of goods of the contract description." Although the Oxy Trader, an integrated tug barge, was of novel design in that the tug and the barge were married together, this feature did not disqualify the Trader as a ship that might "normally" be used for transport. A new design would not carry with it such a disqualification. Indeed, the status of the Trader as a ship normally used for transport was confirmed by the United States Coast Guard's certification of it for ocean transport and for carriage of comparable cargoes and by Phillips' own approval of the choice of the ship. Moreover, the Oxy Trader had safely sailed on transatlantic trips.

[22]Commercial Ct., Queen's Bench Division, Slip Opinion at p. 24 (July 31, 1984); *Lloyd's Law Reports, Queen's Bench*, vol. 1985, pt. 1, p. 350 (1985).

. . . The remaining claims raised on appeal need little discussion. . . . The judgment of the district court is affirmed.

Casepoint

In this case, a shipment of naphtha was delayed after the goods had been loaded onto a ship for transport to the buyer. The contract shipping terms were C & F, which meant, under Incoterms, that the risk of loss passed to the buyer when the goods were properly loaded aboard the carrier ship. After the ship was detained for some time, the buyer stated that it was refusing to take delivery and refused to pay the price of the goods, which were eventually sold by the seller for much less than the contract price. The court held that the buyer had assumed the risk of loss when the goods "passed the rail" under the Incoterms and, when the shipping documents were properly presented, the buyer was responsible to pay the contract price.

FCA—Free Carrier

The FCA term, which applies to any form of transport—maritime, inland waterways, air, rail, or truck—requires the seller to deliver goods to a particular carrier at a named terminal, depot, airport, or other place where the carrier operates. The costs of transportation and the risks for loss shift to the buyer at that time.[23]

EXW—Ex Works

ex works
The seller fulfills his obligations to deliver by making the goods available at his premises.

Under an **ex works** contract, a seller is obliged only to deliver the goods at his own place of business. All the costs connected with transportation are the responsibility of the buyer.

B. Transportation

The following is a typical example of how goods are transported by sea from a seller in Country A to a buyer in Country B. Goods are picked up at the seller's place of business by an inland carrier and transported to a seaport for carriage abroad. The inland carrier will deposit the goods in a warehouse or port depository for examination by customs officials and for consolidation with other goods if the load is not large enough to occupy a ship by itself. A stevedore company or the ship's crew will load the goods. The crew will then stow the goods aboard ship, mark the goods with *leading* marks, and issue a bill of lading to the shipper. At a seaport in Country B, the ship will be directed by port authorities to tie up at a pier or to anchor at a moorage in the harbor. When the buyer produces the bill of lading, the ship's crew will unload the goods onto the dock or, if the ship is anchored out, into a lighter for transfer ashore. The crew or a stevedoring company will then deliver the goods to a customhouse or a bonded warehouse for inspection. Once customs has inspected the goods and their related documents, and collected any import taxes or duties, the goods will be released for entry into Country B. A local inland carrier will then transport the goods to the buyer's place of business.

When goods are transported by air, rail, or truck, much the same procedure is followed, except that the carrier will issue an air waybill or similar non-negotiable receipt instead of a bill of lading, and the transfer of goods will more commonly be done by the carriers without the assistance of stevedores or other intermediaries.

freight forwarder
A firm that makes or assists in the making of shipping arrangements.

In making arrangements for the transportation of goods, the buyer and seller will deal with a variety of intermediaries, such as **freight forwarders,** warehousemen, port authorities, stevedores, and customhouse brokers. The most important of these agents for most shippers is the freight forwarder, or confirming house.[24] Unless a merchant has a large staff dedicated to making shipping

[23]The 1990 revision of Incoterms expanded the coverage of the free carrier term, eliminating older terms, such as FOB airport, free on rail (FOR), and free on truck (FOT). FOR contracts required a seller to deliver goods to a railway carrier and pay all expenses up to that time, including the cost of packaging the goods for rail carriage. FOT contracts were the same as FOR contracts, except that the seller also had to pay for loading the goods on the railway's cars (or "trucks").

[24]The term "freight forwarder" is used in North America, while the terms "confirming house" or "export house" are used in the United Kingdom.

arrangements, the use of a freight forwarder will save time and expense. Freight forwarders, for example, arrange three out of every four shipments moved across the New York docks.[25]

Freight forwarders are companies with specialized knowledge of international markets, finance, transport, customs, sales law, and other related matters. In most countries they are licensed by the government. In the United States, for example, export freight forwarders are licensed by the International Air Transport Association (IATA) to handle air freight and the Federal Maritime Commission to handle ocean freight.[26] Unlicensed brokers and agents also are commonly available who perform much more limited services (such as the booking of ocean freight or the handling of air cargo). A full-service freight forwarder can help with or perform the following:

- Obtaining quotations on CIF and C & F contracts
- Determining the availability of ships and port facilities
- Estimating costs based on gross weight, cubic feet, value, description of the goods, and the port of destination
- Booking space
- Procuring export licenses
- Reviewing letter of credit terms
- Tracing inland shipments
- Preparing shipping documents, including export declarations
- Preparing and authenticating consular invoices
- Procuring certificates of origin from local Chambers of Commerce
- Purchasing insurance
- Presenting banking drafts and collecting payment

C. Inland Carriage

The first stage of transporting goods overseas almost always involves an inland carrier, either a trucking or rail company, which moves the seller's goods from the seller's place of business to a seaport or airport. Except for *ex works* contracts, it is common for the seller to arrange for inland carriage, with the inland carrier transferring the goods to a freight forwarder at a seaport or airport for the latter to arrange and oversee the shipment of the goods abroad (see Figure 11.2).

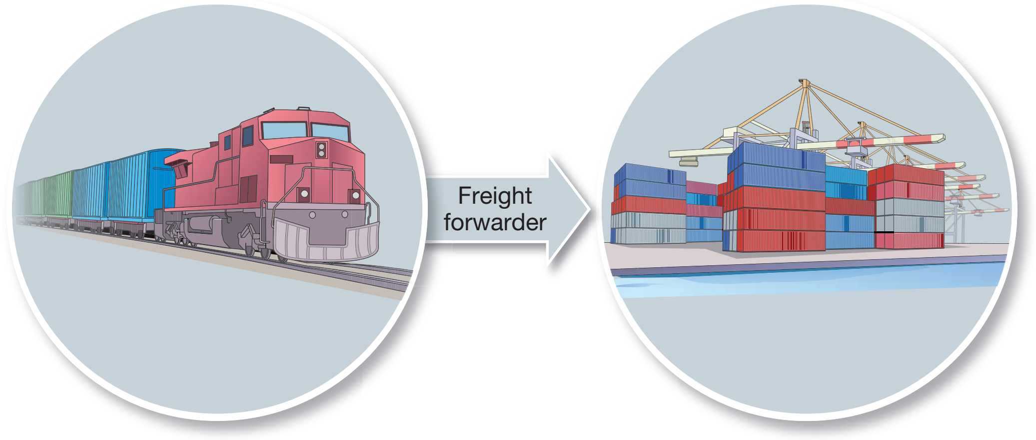


FIGURE 11.2

The Common Way for Goods to Be Shipped Abroad

[25]Gerald H. Ullman, *The Ocean Freight Forwarder, the Exporter and the Law*, p. 2 (1967).

[26]See "What Is a Freight Forwarder?" at the federal government's Web site. "An international freight forwarder is an agent for the exporter in moving cargo to an overseas destination. These agents are familiar with the import rules and regulations of foreign countries, the export regulations of the U.S. government, the methods of shipping, and the documents related to foreign trade. Export freight forwarders are licensed by the International Air Transport Association (IATA) to handle air freight and the Federal Maritime Commission to handle ocean freight." http://export.gov/logistics/eg_main_018115.asp.

In the absence of universal conventions, several regional agreements regulate transport by road and rail. In Europe, road transport is regulated by the 1956 Convention on the Contract for the International Carriage of Goods by Road (*Convention relative au contrat de transport international de merchandises par route*, or *CMR*)[27] and rail transport is governed by the 1980 Convention Concerning International Carriage by Rail (*Convention relative aux transports international ferroviares*, or *COTIF*).[28] Similar agreements exist in other parts of the world, with the significant exception of North America.[29]

The *CMR* is representative of the conventions governing road transport. It applies whenever goods are shipped between two countries, at least one of which is a signatory of the convention. The convention requires a carrier to issue a consignment note. Unlike a bill of lading (including the bill of lading issued by inland carriers in the United States), the *CMR* consignment note is not a negotiable instrument. It is, nonetheless, *prima facie* evidence of the making of a transport contract and of the receipt and the condition of the goods. The convention also grants the consignee the right to demand delivery of the goods in exchange for a receipt and to sue the carrier in his own name for any loss, damage, or delay for which the carrier is responsible. However, up to the time that the goods are turned over to the consignee, the shipper (consignor) has the right to order the carrier to stop them in transit, to change the place for delivery, or to order them delivered to a different consignee.

If a road carriage contract involves the use of multiple carriers, each carrier is treated as a party to the contract, and each is responsible for the entire transaction. Suits can be brought against the first or last carrier or the carrier in possession at the time of the loss.

Carriers are liable for loss, damage, or delay up to the liability limit set by the convention, so long as the consignment note states that carriage is governed by the *CMR*. The liability limit is 8.33 Special Drawing Rights (SDRs) per kilogram unless the consignor declares a higher value and pays a surcharge. If the consignment note fails to include a reference to the *CMR*, the carrier will be liable for any resulting injury. In either case, the burden of proof rests on the carrier, which will be liable unless it can show that the loss, damage, or delay was caused by the consignor or the consignee, by an inherent defect in the goods, or "through circumstances which the carrier could not avoid and the consequences of which he was unable to prevent."[30] A consignee has to notify the carrier within seven days of delivery to assert a claim for loss or damages, and within 21 days to make a claim for losses resulting from delay.

The *COTIF*, which governs rail transport, contains in most respects the same provisions as the *CMR*. The carrier's liability for losses, however, is 17 SDRs per kilogram.[31]

D. Carriage of Goods by Sea

Most goods are transported by a common carrier, that is, a carrier holding itself out as available to carry goods for more than one party. Only a few shipments are large enough to require the shipper to hire an entire vessel. The contract to employ an entire vessel is known as a *charterparty*. We return to charterparties after discussing common carriage.

[27]The text of the CMR is posted at www.afsl.es/downloads/conveniocmreningles.pdf. The CMR's member states as of January 2012 were Albania, Andorra, Austria, Azerbaijan, Belarus, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Georgia, Germany, Greece, Hungary, Iran, Ireland, Israel, Italy, Jordan, Kazakhstan, Kyrgyzstan, Latvia, Lebanon, Lithuania, Luxembourg, Malta, Moldova, Mongolia, Montenegro, Morocco, the Netherlands, Norway, Poland, Portugal, Romania, the Russian Federation, Serbia, Slovakia, Slovenia, Spain, Sweden, Switzerland, Syria, Tajikistan, the Former Yugoslav Republic of Macedonia, Tunisia, Turkey, Turkmenistan, Ukraine, the United Kingdom, and Uzbekistan.

[28]The member states of the COTIF as of January 2012 were Albania, Algeria, Armenia, Austria, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iran, Iraq, Ireland, Italy, Latvia, Lebanon, Liechtenstein, Lithuania, Luxembourg, the Former Yugoslav Republic of Macedonia, Monaco, Montenegro, Morocco, the Netherlands, Norway, Poland, Portugal, Romania, Russia, Serbia, Slovakia, Slovenia, Spain, Sweden, Switzerland, Syria, Tunisia, Turkey, Ukraine, and the United Kingdom. The nation of Jordan is an associate member. See www.otif.org/en/about-otif/list-of-member-states.html.

[29]Paul H. Vishny, *Guide to International Commerce Law*, §2–34 (1998).

[30]CMR, Article 17.2.

[31]The liability limit for personal injury to a passenger is 70,000 SDRs.

Common Carriage

Where the owner or operator of a vessel is willing to carry goods for more than one person, the vessel is known as a *general ship* or **common carrier**.[32] Unlike private carriers, common carriers are the subject of extensive municipal legislation and international conventions.

Merchants who employ common carriers will find that there are three sorts. A **conference line** is an association of seagoing carriers that have joined together to offer common freight rates. **Independent lines** have their own rate schedules. **Tramp vessels** also have their own rate schedules, but unlike conference and independent lines, they do not operate on established schedules.

Exporters who agree to ship all or a large share of their cargoes with a conference line receive a discounted rate.[33] Independent lines, however, generally offer lower rates than a conference line's nondiscounted rates. In most countries, the tariffs of ocean carriers are not regulated, and both conference and independent lines commonly offer regular shippers substantial rebates. In the United States, however, ocean carriers have to file their tariffs with the Federal Maritime Commission, and American law forbids rebates.[34]

common carrier
A ship that carries goods for all persons who choose to employ it so long as there is room.

conference line
An association of seagoing common carriers operating on established routes that have joined together to offer common freight rates.

independent line
A seagoing common carrier operating over established routes with a stated rate schedule.

tramp vessel
A seagoing common carrier operating with a stated rate schedule but without established routes.

The Bill of Lading

A **bill of lading** is an instrument issued by an ocean carrier to a shipper with whom the carrier has entered into a contract for the carriage of goods.[35] The multilateral treaty governing bills of lading is the International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading.[36] This treaty is known both as the 1921 Hague Rules—because they were originally proposed by the International Law Association at a meeting at The Hague in 1921—and the Brussels Convention of 1924—because they were recommended for adoption at a diplomatic conference held in Brussels in 1924. The Hague Rules were extensively revised in 1968 by a Brussels Protocol, and the amended 1968 version is known as the Hague-Visby Rules.[37] Most countries, including the United States, are parties to the 1921 Hague Rules.[38] A few, including France and the United Kingdom, have adopted the Hague-Visby amendments.[39] The domestic

bill of lading
An instrument issued by an ocean carrier to a shipper that serves as a receipt for goods shipped, as evidence of the contract of carriage, and as a document of title for the goods.

[32]The definition of common carrier has been the subject of much litigation. See Yung F. Chiang, "The Characterization of a Vessel as a Common or Private Carrier," *Tulane Law Review*, vol. 48, p. 299 (1974).

[33]Conference lines offer their regular customer rebates in two ways: (1) by a contract system in which the shipper signs a contract to use only conference ships and (2) by a system of deferred rebates of varying amounts that require the shipper to not use nonconference ships to send goods to the area in question for a period of time (commonly three or six months). Under the first of these arrangements the shipper is entitled to an immediate discount; under the second, the rebate is retained by the carrier until the shipper has met the condition of not using nonconference ships. Clive M. Schmitthoff, *Schmitthoff's Export Trade: The Law and Practice of International Trade*, p. 548 (8th ed., 1990).

[34]United States Code, Title 46, Appendix, §1709, paras. (b)(1) and (b)(2).

[35]In the United States, a bill of lading is also issued by inland carriers. See Uniform Commercial Code, §§2–319 and 2–320.

[36]The text of the Hague Rules is posted at www.austlii.edu.au/au/other/dfat/treaties/19560002.html.

[37]The text of the Hague Rules as modified by the Brussels Protocol (the Hague-Visby Rules) is posted at www.jus.uio.no/lm/sea.carriage.hague.visby.rules.1968/doc.html and at www.admiraltylaw.com/statutes/hague.html. The Brussels Protocol itself is posted at www.austlii.edu.au/au/other/dfat/treaties/1993/23.html. A United Nations Convention on the Carriage of Goods by Sea, drafted and signed in 1978 (the Hamburg Rules), came into force among 20 developing states in November 1992. As to those states, it modifies the Hague-Visby rules by establishing a single basis of liability for a carrier's breach of duty and it also governs "through transport," that is, shipments from the point of departure ashore through their final delivery inland via truck, rail, or plane. Because these rules also increase the liability of carriers, they have been ignored by all of the major maritime states. The text of the Hamburg Rules is posted at www.uncitral.org/english/texts/transport/hamburg.htm. As of December 2011, there were 34 states parties to the Hamburg Rules. Multilateral Treaties Deposited with the Secretary-General, see http://treaties.un.org/pages/ViewDetails.aspx?src=TREATY&mtdsg_no=XI-D-3&chapter=11&lang=en.

[38]The member states of the Hague Rules as of January 2012 were Algeria, Angola, Anguilla, Antigua and Barbuda, Argentina, Australia, Norfolk, the Bahamas, Barbados, Belize, Bolivia, Bosnia, Congo, Croatia, Cuba, Cyprus, Fiji, France, Gambia, Ghana, Grenada, Guyana, Iran, Ireland, Israel, Ivory Coast, Jamaica, Kenya, Kiribati, Kuwait, Macedonia, Madagascar, Malaysia, Mauritius, Monaco, Mozambique, Nauru, Netherlands, Nigeria, Papua New Guinea, Paraguay, Peru, Portugal, St. Kitts-Nevis, Sao Tomé and Principe, Sarawak, Senegal, Seychelles, Sierra-Leone, Singapore, Slovenia, S. Lucia, St. Vincent, the Solomon Islands, Seychelles, Slovenia, Somalia, Trinidad and Tobago, Turkey, Tuvalu, the United Kingdom, the United States, and Yugoslavia. See www.informare.it/dbase/convuk.htm.

[39]The member states of the Hague-Visby Rules as of January 2012 were Australia, Belgium, Canada, Denmark, Ecuador, Finland, France, Greece, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Singapore, Spain, Sri-Lanka, Sweden, Switzerland, Syria, Tonga, and the United Kingdom. See www.informare.it/dbase/convuk.htm.

laws implementing these conventions are typically called Carriage of Goods by Sea acts.[40] In addition, many states have supplementary legislation that also governs bills of lading in both municipal and international settings.[41]

A bill of lading serves three purposes. First, it is a carrier's receipt for goods. Second, it is evidence of a contract of carriage. Finally, it is a document of title; that is, the person rightfully in possession of the bill is entitled to possess, use, and dispose of the goods that the bill represents.[42] A bill of lading and samples of the documents that a carrier collects in order to prepare a bill of lading are shown in Figures 11.3–11.6.

Receipt for Goods A bill of lading describes the goods put on board a carrier, states the quantity, and describes their condition. The form itself is normally filled out in advance by the shipper; then, as the goods are loaded aboard the ship, the carrier's tally clerk will check to see that the goods loaded comply with the goods listed. The carrier, however, is responsible only to check for outward compliance—that is, that the labels comply and that the packages are not damaged. If all appears proper, the appropriate agent of the carrier will sign the bill and return it to the shipper.[43] Bills certifying that the goods have been properly loaded on board are known as *on board bills of lading* or **clean bills of lading.**

clean bill of lading A bill of lading indicating that the goods have been properly loaded on board the carrier's ship.

Should there be a discrepancy between the goods loaded and the goods listed, the statement on the bill is considered *prima facie* evidence that the goods were received in the condition shown in any dispute between the shipper and the carrier.[44] Nevertheless, the carrier can, if it is able, introduce evidence to rebut this evidence. However, once the bill is endorsed and negotiated to a third party, this is no longer the case. An endorsee's knowledge of the goods is limited to what is on the bill of lading. For this reason, the Hague and Hague-Visby Rules hold that the bill is conclusive evidence as to the goods loaded once the bill has been negotiated in good faith to a third party. The carrier is then barred from introducing evidence to contradict the bill of lading.

If, at the time the goods are being loaded, the carrier's tally clerk notes a discrepancy, a notation to this effect may be added to the bill of lading. Called a **claused bill of lading,** such bills are normally unacceptable to third parties, including a buyer of the goods under a CIF contract or a bank that has agreed to pay the seller under a documentary credit on receipt of the bill of lading and other documents. Such a notation, however, may be made on the bill only at the time the goods are loaded. Later notations will have no effect, and the bill will be treated as if it were "clean." The significance of clean and claused bills of lading is discussed in Case 11-3.

claused bill of lading A bill of lading indicating that some discrepancy exists between the goods loaded and the goods listed on the bill.

---

[40]The United Kingdom's statute is the Carriage of Goods by Sea Act (1971) in Statutes, vol. 41, chap. 1312. The United States Carriage of Goods by Sea Act is codified in the United States Code, Title 46, §1300 et seq.

[41]In the United States, the two other important acts are the Bill of Lading Act (Interstate and Foreign Commerce), in United States Code, Title 46, §14306, and the Harter Act, in United States Code, Title 46, §§190–196. In the United Kingdom, the Bill of Lading Act (1855) in Statutes, vol. 31, Chap. 44 also applies.

[42]In re Marine Sulphur Queen, *Federal Reporter, Second Series*, vol. 460, p. 89 at p. 103 (Second Circuit Ct. of Appeals, 1972).

[43]The United States Carriage of Goods by Sea Act, United States Code, Title 46, §1303(3), provides: After receiving the goods into his charge the carrier, or the master or agent of the carrier, shall, on demand of the shipper, issue to the shipper a bill of lading showing among other things—
(a) The leading marks necessary for identification of the goods as the same are furnished in writing by the shipper before the loading of such goods starts, provided such marks are stamped or otherwise shown clearly upon the goods if uncovered, or on the cases or coverings in which such goods are contained, in such manner as should ordinarily remain legible until the end of the voyage.
(b) Either the number of packages or pieces, or the quantity or weight, as the case may be, as furnished in writing by the shipper.
(c) The apparent order and condition of the goods: Provided, that no carrier, master, or agent of the carrier, shall be bound to state or show in the bill of lading any marks, number, quantity, or weight which he has reasonable grounds for suspecting not accurately to represent the goods actually received, or which he has had no reasonable means of checking.

[44]Id., §1303(4), provides: "Such a bill of lading shall be prima facie evidence of the receipt by the carrier of the goods as described in accordance with paragraphs (3)(a), (b) and (c), of [§1303]. . . ."

FIGURE 11.3

A Commercial Invoice

International Sales Company
1234 Main Street
Pullman, Washington 99163
U.S.A.

INVOICE

Date: July 1, 2012	Invoice No. 030701
	Order No. 080202
To: Compañía Mundial, S.A. 567 Avenida de Mayo Buenos Aires 1103 Argentina	Shipped: via M/V La Plata from Seattle, WA to Buenos Aires, Arg. on July 1, 2012
	Payment: L/C #099762 dated July 1, 2012 Banco del Sur, Buenos Aires, Arg.

Identifying Marks & Numbers	Quantity	Description	Unit Price	Amount
			US $	US $
Cía Mundial	432 ea	Type "A" Widgets	1.23	531.36
Buenos	288 ea	Type "B" Widgets	4.56	1313.28
Aires	144 ea	Type "C" Widgets	7.89	1136.16
ARGENTINA		TOTAL FOB PORT OF SEATTLE		2980.80
Made in USA				

International Sales Company

Jane Doe

Jane Doe, Pres.

FIGURE 11.4

A Packing List

International Sales Company
1234 Main Street
Pullman, Washington 99163
U.S.A.

PACKING LIST

Date: July 1, 2012

Invoice No. 030701

Order No. 080202

To: Compañía Mundial, S.A.
567 Avenida de Mayo
Buenos Aires
1103 Argentina

Notify:
Agencia Rosas
987 Calle de los Marineros
Buenos Aires
1117 Argentina

Shipped: via M/V La Plata from Seattle, WA to Buenos Aires, Arg. on July 1, 2012

Payment: L/C #099762 dated July 1, 2012 Banco del Sur, Buenos Aires, Arg.

Identifying Marks & Numbers	Quantity	Description	Net Weight	Gross Weight	Measurement Cu. Meters
Cía. Mundial Buenos Aires ARGENTINA Made in USA					
No. 1-3	432 ea	Type "A" Widgets			.006m^3
Ditto No. 4-5	288 ea	Type "B" Widgets			.004m^3
Ditto No. 6	144 ea	Type "C" Widgets			.002m^3
6 ctns					.012m^3

International Sales Company

Jane Doe

Jane Doe, Pres.

FIGURE 11.5

A Dock Receipt

Seagoing Carrier Company
665 Dockside Drive
Seattle, Washington 98203
U.S.A.

DOCK RECEIPT
NOT NEGOTIABLE

Shipper: **International Sales Co. 1234 Main St, Pullman, WA 99163**

Vessel	Voyage Number	Flag	Port of Loading	Pier
La Plata	**03 W**	**Panama**	**Seattle**	**18**

PORT OF DISCHARGE (Where goods are to be delivered to consignee or on carrier)

Buenos Aires

For TRANSSHIPMENT (If goods are to be transshipped or forwarded at port of discharge)

PARTICULARS FURNISHED BY SHIPPER OF GOODS

Identifying Marks & Numbers	Number of Packages	Description	Gross Weight	Measurement Cu. Meters
Cía. Mundial Buenos Aires ARGENTINA Made in USA	**6**	**Widgets - Type "A", "B" and "C"**	**84 kg**	**0.12m³**
		ATTN: RECEIVING CLERK ONLY CLEAN DOCK RECEIPT ACCEPTED		

DIMENSIONS AND WEIGHT OF PACKAGES TO BE SHOWN ON REVERSE SIDE

RECEIVED THE ABOVE-DESCRIBED MERCHANDISE FOR SHIPMENT AS INDICATED HEREON, SUBJECT TO ALL CONDITIONS OF THE UNDERSIGNED'S USUAL FORM OF DOCK RECEIPT AND BILL OF LADING. COPIES OF THE UNDERSIGNED'S USUAL FORM OF DOCK RECEIPT AND BILL OF LADING MAY BE OBTAINED FROM THE MASTER OF THE VESSEL OR THE VESSEL'S AGENT.

LIGHTER TRUCK ______

ARRIVED Date ______ Time ______

UNLOADED Date ______ Time ______

CHECKED BY ______

PLACED [ ] IN SHIP [ ] ON DOCK

LOCATION ______

Agent for Master

BY ______
Receiving Clerk

Date ______

FIGURE 11.6

A Bill of Lading

Seagoing Carrier Company
665 Dockside Drive
Seattle, Washington 98203
U.S.A.

BILL OF LADING
NOT NEGOTIABLE UNLESS CONSIGNED TO ORDER

Shipper: **International Sales Co. 1234 Main St, Pullman, WA 99163**

Consignee: **To Order Banco del Sur, 17 Ave. Evita, Buenos Aires**

Address Arrival Notice to:	Also Notify:
Agencia Rosas **987 Calle Marineros** **Buenos Aires** **1117 Argentina**	**Compañia Mundial, S.A.** **567 Avenida de Mayo** **Buenos Avenida** **1103 Argentina**

Vessel	Voyage No.	Flag	Port of Loading
La Plata	**03 W**	**Panama**	**Seattle**

PARTICULARS FURNISHED BY SHIPPER OF GOODS

Identifying Marks & Numbers	Number of Packages	Description	Gross Weight	Measurement Cu. Meters
Cía. Mundial **Buenos Aires** **ARGENTINA** **Made in USA**		FINAL DESTINATION OF GOODS **BUENOS AIRES**		
	6	**Widgets - Type "A", "B" and "C"** **FREIGHT COLLECT** **LADEN ABOARD**	**84 kg**	**$0.12m^3$**

THESE COMMODITIES LICENSED BY U.S. FOR ULTIMATE DESTINATION. DIVERSION CONTRARY TO U.S. LAW PROHIBITED.

Freight Payable at: **Buenos Aires**

Gross Weight	Measurements Cu. Meters	Rate	Ocean Freight	Receiving Charge	Delivery Charge	Total Charge	Total Prepaid	Total Collect
84 Kg	**$0.12m^3$**	**2.70**	**226.80**	**15.87**	**27.22**	**$269.89**		**$269.89**

Bill of Lading No. **582 63409** Issued at **Seattle** Date **July. 1, 2012**

WHEN VALIDATED, CARGO LADEN ON BOARD ON THE DATE APPEARING HEREON

DATED AT PORT OF LOADING SHOWN ABOVE
Seagoing Carrier Company

Validation:

By ______________________
Agent - For the Master

CASE 11-3 M. Golodetz & Co., Inc. v. Czarnikow-Rionda Co., Inc. (The Galitia)

England, Queen Bench's Division (1978)
All England Law Reports, vol. 1979, pt. 2, p. 726 (1979)

MAP 11.3

Iran and India (1978)[45]

The sellers contracted to sell to the buyers between 12,000 and 13,200 tons of sugar, C & F Bandarshapur, Iran. The contract provided, among other things, that payment was to be made against a complete set of clean "on board" bills of lading evidencing that freight had been paid. After part of the consignment of sugar had been loaded, a fire broke out on the ship, as a result of which 200 tons of sugar were damaged and had to be discharged. The remainder of the consignment was loaded and carried to its destination. The sellers tendered two bills of lading to the buyers. The first was in respect to the 200 tons of sugar that had been lost and the second was in respect to the balance of the consignment. The first bill in its printed clauses acknowledged shipment of the goods in apparent good order and condition. In addition, however, it bore a typewritten note stating that the cargo covered by the bill had been discharged because it had been damaged by fire and/or water. The second bill was taken up and paid for by the buyers, but the first bill was rejected by them on the ground that it was not a clean bill of lading. The sellers claimed that the typewritten note did not prevent it from being a clean bill of lading and that they were entitled to be paid the price of the 200 tons of sugar that had been lost.

Opinion by Judge Donaldson

* * *

The Dispute

The parties to this dispute are household names in the world trade in sugar. Both are based in New York. The sugar concerned was to be shipped from Kandla in India to Iran. The reason why the matter comes to the English Commercial Court is that the contract incorporated the rule of the Refined Sugar Association and provided for arbitration in London.

. . . The question at issue is, of course, who is to stand the loss in respect of the 200 tons of sugar which was destroyed by or as a consequence of the fire? The board of appeal of the Refined Sugar Association has held that the loss must fall on the sellers. The sellers now appeal.

The Sellers' Claim to the Price

Under the terms of the contract, the sellers are entitled to be paid the price on tender of "clean 'On Board' bills of lading evidencing freight having been paid." Counsel for the sellers submitted that this bill of lading qualified for this description, notwithstanding the notation recording that

[45] Affirmed by the Court of Appeal, Civil Division, *All England Law Reports*, vol. 1980, pt. 1, p. 501 (1980). The statement of facts is from the appellate report.

the sugar had been discharged fire damaged. . . . In his submission, the sellers, having tendered this bill of lading, were entitled to be paid the price. Alternatively, the sugar was at the risk of the buyers when it was destroyed and, that being so, the sellers were entitled to be paid the price whether or not they tendered this or any other bill of lading.

Counsel for the buyers challenged these submissions root and branch. In his submission, there were no less than eight reasons why the sellers were not entitled to be paid the price. It is, of course, for the sellers to make out their case, but in all the circumstances, it is convenient to consider whether they have done so in the context of counsel's objections.

(a) That the Bill of Lading Was Not "Clean"

(i) The Practical Test Counsel for the buyers submits that there are two possible tests to be applied, the practical and the legal. The practical test is whether a bill of lading in this form is acceptable to banks generally as being a "clean" bill of lading. Since 1962, virtually all banks have accepted the international rules set out in a document issued by the International Chamber of Commerce entitled *Uniform Customs and Practices for Documentary Credits* ("UCP Rules"). Rule 16 provides as follows:

> A clean shipping document is one which bears no superimposed clause or notation which expressly declares a defective condition of the goods and/or the packaging. Banks will refuse documents bearing such clauses or notations unless the credit expressly states clauses or notations which may be accepted.

This definition fails to specify the time with respect to which the notation speaks. The bill of lading and any notation speak at the date of issue, but they may speak about a state of affairs which then exist or about an earlier state of affairs or both. If the rule refers to notations about the state of affairs at the time of the issue of the bill of lading or, indeed, at any time after shipment of the 200 tons was completed, the bill of lading is not "clean" within the meaning of that word in the rule, for the notation clearly draws attention to the cargo being damaged. If, however, it refers to notations about the state of affairs on completion of shipment, the bill of lading is equally clearly clean, for it shows that the goods were in apparent good order and condition on shipment and suggests only that they were damaged after shipment.

Counsel for the buyers draws attention to the fact that this bill of lading was rejected by two different banks. The first rejection was by the sellers' own bank when the bill of lading was tendered by the shippers under the FOB supply contract. The second rejection was by the buyers' subpurchasers' bank when it was tendered to them by the buyers without prejudice to the rights of the parties as between sellers and buyers. On these facts, counsel for the buyers invites me to hold that this bill of lading is not a "clean" bill in commercial or practical terms.

Let me consider this "practical" test. The information as to what prompted the banks' action is somewhat sparse. . . .

. . . There is no contemporary note of why the banks refused to accept the documents, but there is a letter dated March 24, 1976, reading:

> Your draft and documents valued $183,732.00, payment for which was not effected because Bills of Lading showing the following clause Quote "Cargo covered by this Bill of Lading has been discharged at Kandla View damaged by fire and/or water used to extinguish fire for which general average declared" Unquote, whereas credit class of clean (unclaused) Bills of Lading.

It is not uninteresting that it was not the buyers' bank which rejected the documents, but the buyers themselves (by a letter of April 22nd, 1975, referred to in the [arbitration] award). Furthermore, although they gave as a reason the fact that the clause prejudiced their ability to negotiate the documents with their buyers, the letter of 24th March 1976 set out above suggests that the documents were only rejected by the subbuyers' bank some weeks later on May 13th, 1975. However, there may have been more than one rejection.

It is clear that the subbuyers' bank thought that a letter of credit incorporating the UCP rules and calling for "clean" bills of lading was only satisfied if the bills were wholly unclaused. This goes further than the UCP rules justify since they appear to take exception only to a "superimposed clause or notation which expressly declares a defective condition of the goods and/or the packaging," whatever that may mean.

There is, I think, more than one answer to this "practical test" objection. First, the contract . . . does not provide that the documents shall be such as to satisfy the UCP rules as to "clean" bills of lading. . . . Furthermore, if there is ambiguity as to the meaning of those rules, that ambiguity should, if possible, be resolved in a way which will result in the rules reflecting the position under general maritime and commercial law. So construed they add nothing to the legal test which I consider hereafter.

Second, the evidence does not disclose that banks generally would reject such a bill of lading as that relating to the 200 tons as not being a "clean" bill of lading or that, if they would do so, it would be for any better reason than that they were applying what they though the UCP rules required.

Third, I am not satisfied that it is right to apply a practical test. . . . What is really being said here is that the very fact that the buyers and two banks rejected these documents proves that they are not "clean." This is a proposition which I decline to accept.

(ii) *The Legal Test* I, therefore, proceed to apply the legal test. As Judge Salmon remarked in *British Imex Industries, Ltd., v. Midland Bank, Ltd.*,[46] a "clean bill of lading" has never been exhaustively defined. I have been referred to a number of textbooks and authorities which support the proposition that a "clean" bill of lading is one in which there is nothing to qualify the admission that the goods were in apparent good order and condition and that the seller has no claim against the goods except in relation to freight. Some clearly regard the relevant time as being that of shipment. Some are silent as to what is the relevant time. None refers expressly to any time subsequent to shipment.

As between the shipowner and the shipper (including those claiming through the shippers as holders of the bill of lading) the crucial time is shipment. The shipowner's prime obligation is to deliver the goods at the contractual destination in the like good order and condition as when shipped. The cleanliness of the bill of lading may give rise to an estoppel and the terms of the bill of lading contract may exempt the shipowner from a breach of this obligation, but everything stems from the state of the goods as shipped. As between seller and CIF or C&F buyer, the property and risk normally pass on the negotiation of the bill of lading, but do so as from shipment. Thus, the fact that the ship and goods have been lost after shipment or that a liability to contribute in general average or salvage has arisen is no reason for refusing to take up and pay for the documents.

In these circumstances, it is not surprising that there appears to be no case in which the courts or the textbook writers have had to consider a bill of lading which records the fate of the goods subsequent to shipment and, indeed, I have never seen or heard of a bill of lading like that in the present case. Nor is it surprising that some of the judgments and textbooks do not in terms say that when reference is made to the condition of the goods what is meant is their condition on shipment.

However, I have no doubt that this is the position. The bill of lading with which I am concerned casts no doubt whatsoever on the condition of the goods at that time and does not assert that at that time the shipowner had any claim whatsoever against the goods. It follows that in my judgment this bill of lading, unusual though it is, passes the legal test of cleanliness.

(b) The Bill of Lading Was Rightly Rejected as Being Unmerchantable—Counsel for the buyers submits that documents tendered under a C & F contract must be merchantable and that, in the context of a bill of lading, this may be a factor of cleanliness or an independent quality which is required. He seeks to support this proposition by reference to *Hansson v. Hamel & Horley, Ltd*.[47] in which Lord Sumner said:

> When documents are to be taken up the buyer is entitled to documents which substantially confer protective rights throughout. He is not buying a litigation, as Lord Trevethin (then Judge A. T. Lawrence) says in the *General Trade Co.'s Case*.[48] These documents have to be handled by banks, they have to be taken up or rejected promptly and without any opportunity for prolonged inquiry, they have to be such as can be re-tendered to subpurchasers, and it is essential that they should so conform to the accustomed shipping documents as to be reasonable and readily fit to pass current in commerce.

[46] *All England Law Reports*, vol. 1958, pt. 1, p. 264 (Queen's Bench, 1958).

[47] *All England Law Reports*, vol. 1922, p. 237 at p. 241 (Ct. of Appeal, 1922).

[48] Re General Trading Co. & Van Stolk's Commissiehandel, *Commercial Cases*, vol. 16, p. 95 (1911).

I need hardly say that I accept this proposition unreservedly. A tender of documents which, properly read and understood, calls for further enquiry or are such as to invite litigation is clearly a bad tender. But the operative words are "properly read and understood." I fully accept that the clause on this bill of lading makes it unusual, but properly read and understood it calls for no inquiry and it casts no doubt at all on the fact that the goods were shipped in apparent good order and condition or on the protection which anyone is entitled to expect when taking up such a document whether as a purchaser or as a lender on the security of the bill. . . .

The only ground for holding that the bill of lading was not "reasonably and readily fit to pass current in commerce" is that the form is unusual and that two banks and the buyers rejected it. If the buyers wanted bills of lading which were not only "clean," but also in "usual form," they should have contracted accordingly. They did not do so and I am not prepared to hold that the bill was unmerchantable. . . .

Conclusion

For the reasons which I have sought to express, I consider that this was a "clean" bill of lading and that the buyers should have accepted it and paid the price. In reaching this conclusion, I have, regretfully, to disagree with the decision of the board of appeal [of the Refined Sugar Association]. That decision seems to me to have been based solely on considerations of law. Had it been a conclusion based on trade practice and included, for example, a finding that a bill in this form was not acceptable in the trade, my decision would, of course, have been different.

. . . Accordingly, for the reasons which I have expressed, I answer the questions of law in favor of the sellers.

Order accordingly. Leave to appeal to the Court of Appeal.

Casepoint

The decision turned on whether the bill of lading here was clean and merchantable. The goods were apparently delivered to the ship in good condition, and then 200 tons of the sugar were destroyed by fire and water. Two bills of lading were then issued, one covering the 200 tons, which noted that this portion of the goods was destroyed, and a second bill of lading covering the balance of the shipment. The second bill of lading was paid without problem, but the buyers refused to pay the first. The court thoroughly examined both a "practical test" and a "legal test" and concluded that the key point of time was when the goods were "shipped" by the seller (loaded on the ship). Since the bill of lading did not note any problems with the goods "when shipped," the document was therefore clean under applicable law, despite the notation.

straight bill of lading A bill of lading issued to a named consignee that is not negotiable.

order bill of lading A bill of lading that is negotiable.

Contract of Carriage Between the shipper and the carrier, the bill of lading is evidence of their contract of carriage. Either may rebut this by producing evidence of other terms. However, as is the case where the bill functions as a receipt, the bill becomes conclusive evidence of the terms of the contract of carriage once it is negotiated to a good-faith third party. Again, this is because the endorsee's knowledge of the terms of the contract of carriage is limited to what appears on the bill of lading.[49]

Document of Title Two kinds of bills of lading need to be distinguished: the straight bill and the order bill. A straight bill is issued to a named consignee and is non-negotiable. The transfer of a **straight bill** gives the transferee no greater rights than those of his transferor. An **order bill,** on the other hand, is negotiable and conveys greater rights. The holder of an order bill of lading, provided he has received it in good faith through due negotiation, has a claim to title and, by surrendering the bill, to delivery of the goods. In 1883, Lord Justice Bowen wrote what has become the time-honored definition of the order bill of lading:[50]

[49]In the *Emilien Marie Case*, *Law Journal Reports, Admiralty*, vol. 44, p. 9 (1875), the carrier issued three bills of lading to the shipper with the understanding that the last would apply only if there was enough of the perishable cargo left at the port of destination. The shipper nonetheless negotiated the bill to a third party who was unaware of the understanding. The court held that the endorsee was entitled to demand the full quantity.

[50]*Sanders v. Maclean & Co.*, *Law Reports, Queen's Bench Division*, vol. 11, p. 327 at p. 341 (1883).

> A cargo at sea while in the hands of the carrier is necessarily incapable of physical delivery. During this period of transit and voyage, the bill of lading by the law merchant is universally recognized as its symbol, and the endorsement and delivery of the bill of lading operates as a symbolical delivery of the cargo. Property in the goods passes by such endorsement and delivery of the bill of lading, whenever it is the intention of the parties that the property should pass, just as under similar circumstances the property would pass by an actual delivery of the goods. And for the purpose of passing such property in the goods and completing the title of the endorsee to full possession thereof, the bill of lading, until complete delivery of the cargo has been made on shore to someone rightfully claiming under it, remains in force as a symbol, and carries with it not only the full ownership of the goods, but also all rights created by the contract of carriage between the shipper and the shipowner. It is a key which in the hands of the rightful owner is intended to unlock the door of the warehouse, floating or fixed, in which the goods may chance to be.

Order bills, although they are negotiable instruments, should not be confused with bills of exchange (such as checks or trade acceptances). Maritime commercial practice is less developed than the law of commercial paper, and though both classes of instruments are related, they are also distinct.

Like bills of exchange, order bills of lading may be made out *to bearer* or *to the order* of a named party. Bearer instruments are transferred by delivery; order instruments by negotiation, that is, by endorsement and delivery. In practice, bills of lading are seldom made out to bearer, as they are documents of title that serve as the symbol or token of the goods described in the bill.

The negotiation of an order bill transfers title in the goods. This is what makes the bill valuable. Because the bill is *negotiable*, so too are the goods. This enables the person named on the bill to transfer the goods while a ship is in transit. In other words, possession of the order bill is in most respects the same as possession of the goods.

Unlike transferees of bills of exchange (as discussed in Chapter 12), a transferee who obtains an order bill of lading in good faith and for value paid is not a holder in due course who is entitled to claim the goods from the carrier *free of equities* or *free of personal defenses*.[51] This is a significant difference. In practice, it means that should an order bill of lading be obtained by fraud and endorsed to a bona fide purchaser for value, the recipient will not acquire title to the goods described in the bill. On the other hand, if the same thing were to happen with a bill of exchange (such as a draft, check, or note) that was neither overdue nor dishonored, the recipient (who would be a holder in due course) would be entitled to the money or property described in that bill. Because of this difference, an order bill of lading is sometimes described as only a *quasi-negotiable* instrument.[52]

The definitional basis for this difference between bills of exchange and order bills of lading can be found in Lord Justice Bowen's description, quoted earlier. Even when a bill of lading is properly endorsed and delivered, title to the goods will pass only when the bill of lading is negotiated with the intention of transferring the goods. For example, a seller may endorse a bill of lading to his agent in the port where the goods are to be discharged so that the agent can deal directly with a particular buyer. Because the seller did not intend to pass title to the agent by his endorsement, title would not pass. If the agent were to fraudulently sell the bill to a third party, the third party would also not have title. In such a circumstance, the seller could order the carrier to deliver the goods only to the intended buyer, or if delivery had already been made to the third party, the seller could sue that person for conversion. This is so because the transferee of an order bill of lading acquires both the rights and the liabilities of his transferor.[53]

---

[51]British practice uses the phrase "free of equities"; American practice uses "free of personal defenses." Both refer to a class of adverse claims that the person obliged to perform may assert against a holder, but not a holder in due course. Such equities or personal defenses include breach of contract, lack or failure of consideration, fraud in the inducement, some forms of illegality, mental incapacity, ordinary duress, discharge by payment or cancellation, and nondelivery.

[52]Leo D'Arcy, *Schmitthoff's Export Trade: The Law and Practice of International Trade*, p. 276 (10th ed., 2000).

[53]The rule was applied in a more roundabout way in Sewell v. Burdick, *Law Reports, Appeal Cases*, vol. 10, p. 74 (1884). There, a bank that was the holder of the bill of lading argued that it was not obligated to pay the cost for storing the goods after they were discharged from the carrier because the shipper had not intended to transfer title to it. The court agreed, noting that the shipper had given the bill of lading to the bank only as a pledge for a loan.

Bills of lading are also distinct from bills of exchange because they additionally represent a contract for carriage. Negotiation of an order bill of lading produces the unique result of a transfer of the right to enforce the underlying transportation agreement. For example, in the case of *The Albazero*, cargo was lost due to the alleged negligence of the carrier. The holders of the bill of lading were unable to sue because the statute of limitation set by the Hague Rules had run. Accordingly, the charterers, who were business affiliates of the holders, attempted to sue under the charterparty, which was not subject to the same statutory time limits. The British House of Lords held that the charterers could not sue. By endorsing the bill of lading, which also represented the contract of carriage, they had transferred all of their contractual rights to the transferee.[54]

Carrier's Duties Under a Bill of Lading

A carrier transporting goods under a bill of lading is required by the Hague and Hague-Visby Rules to exercise "due diligence" in:[55]

a. Making the ship seaworthy.
b. Properly manning, equipping, and supplying the ship.
c. Making the holds, refrigerating, and cool chambers, and all other parts of the ship in which goods are carried, fit and safe for their reception, carriage, and preservation.
d. Properly and carefully loading, handling, stowing, carrying, keeping, caring for, and discharging the goods carried.

Most courts strictly enforce this obligation. For example, in *Riverstone Meat Co. Pty., Ltd. v. Lancashire Shipping Co., Ltd.*, cargo was damaged by water due to the negligent work of a shipfitter employed by a ship repair company. The court held that the carrier had failed to use due diligence in making the ship seaworthy.[56]

Carrier's Immunities

Both the Hague and Hague-Visby Rules exempt carriers from liability from damages that arise from any[57]

a. Act, neglect, or default of the master, mariner, pilot, or the servants of the carrier in the navigation or in the management of the ship;
b. Fire, unless caused by the actual fault or privity of the carrier;
c. Perils, dangers, and accidents of the sea or other navigable water;
d. Act of God;
e. Act of war;
f. Act of public enemies;
g. Arrest or restraint of princes, rulers, or people, or seizure under legal process;
h. Quarantine restrictions;
i. Act or omission of the shipper or owner of the goods, or his agent or representative;
j. Strikes or lockouts or stoppage or restraint of labor from whatever cause, whether partial or general; provided that nothing herein contained shall be construed to relieve a carrier from responsibility for the carrier's own acts;
k. Riots and civil commotions;
l. Saving or attempting to save life or property at sea;
m. Wastage in bulk or weight or any other loss or damage arising from inherent defect, quality, or vice of the goods;

---

[54] *All England Law Reports*, vol. 1976, pt. 3, p. 129 (House of Lords, 1976).

[55] International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading, Article 3 (1924) (the 1921 Hague Rules); Brussels Protocol, Article 3 (1968) (the Hague-Visby Rules).

[56] *All England Law Reports*, vol. 1961, pt. 1, p. 495 (1961).

[57] International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading, Article 4 (1924) (the 1921 Hague Rules); Brussels Protocol, Article 4 (1968) (the Hague-Visby Rules).

n. Insufficiency of packing;
o. Insufficiency or inadequacy of marks;
p. Latent defects not discoverable by due diligence; and
q. Any other cause arising without the actual fault and privity of the carrier and without the fault or negligence of the agents or servants of the carrier, but the burden of proof shall be on the person claiming the benefit of this exception to show that neither the actual fault or privity of the carrier nor the fault or neglect of the agents or servants of the carrier contributed to the loss or damage.

These immunities are narrowly construed. If cargo is injured and the injury falls within one of the exemptions, the carrier will nonetheless be responsible if the underlying cause was the result of the carrier's failure to exercise due diligence in carrying out its fundamental duties. This point is illustrated in Case 11-4.

CASE 11-4 Great China Metal Industries Co. Ltd. v. Malaysian International Shipping Corp.

High Court of Australia
High Court of Australia Reports, vol. 1998, no. 65 (1998)

MAP 11.4

Australia and Taiwan (1998)

Opinion by Justices Gaudron, Gummow and Hayne

In 1989, 40 cases of aluminum can body stock in coils were consigned from Sydney to Keelung, Taiwan. The respondent issued a bill of lading dated 5 October 1989, acknowledging receipt of the goods in apparent good order and condition. The vessel named in the bill as the intended vessel was the MV *Bunga Seroja*.

The shipper named in the bill was Strang International Pty. Ltd. ("Strang") as agent for Comalco Aluminium Ltd. Strang packed the containers in which the cargo was shipped. The appellant was named in the bill as "the notify party" and property in the goods duly passed to it.

The bill provided that it should have effect subject to legislation giving effect to the Hague Rules. By the *Sea-Carriage of Goods Act 1924* (Commonwealth),[58] the Hague Rules applied to the carriage of the goods. The parties to the bill of lading were deemed by §§4(1) and 9(1) of that statute to have intended to contract according to the Hague Rules.

In the course of its passage across the Great Australian Bight, the vessel encountered heavy weather. That weather had been forecast before the vessel left port. Some of the goods were damaged.

Although, as will appear, it is not determinative of the outcome of the appeal, the question to which submissions primarily were directed is the meaning and effect of Art. IV rule 2(c) of the Hague Rules that:

> "Neither the carrier nor the ship shall be responsible for loss or damage arising or resulting from—
>
> ***
>
> (c) perils, dangers, and accidents of the sea or other navigable waters . . ."

The appellant contended that:

- this exception (the "perils of the sea" exception) does not apply if damage to cargo results from sea and weather conditions which could reasonably be foreseen and guarded against;
- the weather encountered by the Bunga Seroja was foreseen; and
- the statement of Judges Mason and Wilson in *Shipping Corporation of India Ltd. v Gamlen Chemical Co (A/Asia) Pty Ltd*.[59] that "sea and weather conditions which may reasonably be foreseen and guarded against may constitute a peril of the sea" is wrong and should not be followed.

The appellant pleaded that the respondent had failed to meet its responsibility under Art. III rule 1 of the Hague Rules to exercise, before and at the beginning of the voyage, due diligence to make the ship seaworthy; to properly man, equip, and supply the ship; and to make the holds and all other parts of the ship in which the goods were carried fit and safe for their reception, carriage, and preservation. It also pleaded failure by the respondent to properly and carefully load, handle, stow, carry, keep, care for, and discharge the goods carried (Art. III rule 2). By its defense, the respondent relied upon various immunities specified in Art. IV rule 2. In particular, the respondent pleaded that it was not responsible for any loss or damage to the goods arising or resulting from perils of the sea and that any damage to the goods resulted or occurred by reason of that matter.

The trial judge (Judge Carruthers) entered judgment for the respondent. His Honor concluded:

> "In my view, the [respondent] has established to the requisite degree that the damage to the subject cargo was occasioned by perils of the sea. . . . In summary, the evidence satisfies me that, bearing in mind the anticipated weather conditions: (i) when the *Bunga Seroja* sailed from Burnie she was fit in all respects for the voyage; (ii) the [respondent] properly and carefully loaded, handled, stowed, carried, kept, and cared for the subject cargo; and (iii) there was no neglect or default of the master or other servants of the [respondent] in the management of the ship or cargo.
>
> I am satisfied that the damage to the subject cargo was occasioned by perils of the sea, in that, the pounding of the ship by reason of the heavy weather caused the coils within the container to be dislodged and thereby sustain damage."

The New South Wales Court of Appeal dismissed an appeal. The appeal to this Court also should be dismissed.

***

[58]Section 4(1). This has now been replaced by the Carriage of Goods by Sea Act 1991 (Commonwealth), which incorporates the Hague-Visby Rules.

[59]*Commonwealth Law Reports*, vol. 147, p. 142 at p. 166 (1980).

In understanding the operation of the Hague Rules, there are three important considerations. The rules must be read as a whole, they must be read in the light of the history behind them, and they must be read as a set of rules devised by international agreement for use in contracts that could be governed by any of several different, sometimes radically different, legal systems. It is convenient to begin by touching upon some matters of history.

Uniform Construction

Because the Hague Rules are intended to apply widely in international trade, it is self-evidently desirable to strive for uniform construction of them. As has been said earlier, the rules seek to allocate risks between cargo and carrier interests and it follows that the allocation of those risks that is made when the rules are construed by national courts should, as far as possible, be uniform. Only then can insurance markets set premiums efficiently and the cost of double insurance be avoided.

In *Gamlen*, Judges Mason and Wilson note that:[60]

> [t]here is a difference between the Anglo-Australian conception of "perils of the sea" and the United States-Canadian conception. According to the latter, "perils of the sea" include losses to goods on board which are peculiar to the sea and "are of an extraordinary nature or arise from irresistible force or overwhelming power, and which cannot be guarded against by the ordinary exertions of human skill and prudence."[61] In the United Kingdom and Australia it is not necessary that the losses or the cause of the losses should be "extraordinary."[62] Consequently sea and weather conditions which may reasonably be foreseen and guarded against may constitute a peril of the sea.

When reference is made to occurrences identified as "extraordinary," the question arises as to the nature of the relativity which is contemplated. Thus it has been said that the events which occurred "may be considered extraordinary as compared with an even voyage upon a placid sea; and yet [they] may be an entirely ordinary occurrence as compared with transportation by sea generally."[63]

It may be that the difference between Anglo-Australian and American-Canadian construction of the "perils of the sea" exception is less than might appear from reference to cases such as *The Giulia*[64] or *The Rosalia*[65]—both decisions of the [United States] Second Circuit Court of Appeals. In *The Rosalia* a peril of the sea was described as "something so catastrophic as to triumph over those safeguards by which skillful and vigilant seamen usually bring ship and cargo to port in safety." More recent authority in the United States has, perhaps, placed less emphasis on whether what happened was extraordinary and catastrophic. But whether or not that is an accurate reflection of more recent developments, there is great force in what Judge Learned Hand said in *Philippine Sugar Centrals Agency v. Kokusai Kisen Kabushiki Kaisha:*[66]

> The phrase, "perils of the sea," has at times been treated as though its meaning were esoteric: Judge Hough's vivid language in *The Rosalia* . . . has perhaps given currency to the notion. That meant nothing more, however, than that the weather encountered must be too much for a well-found vessel to withstand. . . . The standard of seaworthiness, like so many other legal standards, must always be

[60]*Id*., at pp. 165–166.

[61]*The Giulia*, *Federal Reporter*, vol. 218, p. 744 (U.S. 2nd Circuit Ct. of Appeals, 1914), adopting Joseph Story, *Commentaries on the Law of Bailments: with Illustrations from the Civil and the Foreign Law*, §512(a) (9th ed., 1878).

[62]Thomas G. Carver, *Carriage by Sea*, vol. 1, §161, (12th ed., 1971); Skandia Insurance Co. Ltd. v. Skoljarev, *Commonwealth Law Reports*, vol. 142, p. 375 at pp. 386–387 (1979). . . .

[63]*Clinchfield Fuel Co. v. Aetna Insurance Co*., *South Eastern Reporter*, vol. 114, p. 543 at p. 546 (Supreme Ct. of South Carolina, 1922).

[64]*Federal Reporter*, vol. 218, p. 744 (U.S. 2nd Circuit Ct. of Appeals, 1914).

[65]*Id*., vol. 264, p. 285 (U.S. 2nd Circuit Ct. of Appeals, 1920).

[66]*Id*., vol. 106, p. 32 at pp. 34–35 (U.S. 2nd Circuit Ct. of Appeals, 1939).

> uncertain, for the law cannot fix in advance those precautions in hull and gear which will be necessary to meet the manifold dangers of the sea. That Judge Hough meant no more than this in *The Rosalia* . . . is shown by his reference to the definition in *The Warren Adams*[67] . . . as the equivalent of what he said. That definition was as follows: "That term may be defined as denoting 'all marine casualties resulting from the violent action of the elements, as distinguished from their natural, silent influence."' It would be too much to hope that *The Rosalia* . . . will not continue to be cited for more than this, but it would be gratifying if it were not.

***

Thus there are statements to be found in the United States authorities that a "perils of the sea" exception may apply even if the weather encountered was no more than expected.

Nor should statements made in the many English cases dealing with perils of the sea be read divorced from their context. Some can, we think, be seen as no more than decisions about particular facts. Others examine questions of onus of proof and concurrent causation, which do not arise in this case. [For example, in the "*Xantho*"[68] Lord Herschell drew a distinction] between perils of the sea and other losses of which the sea is the immediate cause. He said:

> I think it clear that the term "perils of the sea" does not cover every accident or casualty which may happen to the subject-matter of the insurance on the sea. It must be a peril "of" the sea. Again, it is well settled that it is not every loss or damage of which the sea is the immediate cause that is covered by these words. They do not protect, for example, against that natural and inevitable action of the winds and waves, which results in what may be described as wear and tear. There must be some casualty, something which could not be foreseen as one of the necessary incidents of the adventure.

The distinction drawn by his Lordship is important and must be borne in mind when considering the operation of the "perils of the sea" exception. . . .

Many other cases were mentioned in argument or can be found in the books. We think it desirable to touch briefly on only three other streams of authority. First, it seems that in German law, a peril of the sea need not be an extraordinary event and that a storm of a certain force is regarded as a peril of the sea.[69] Similarly, in French law a peril of the sea need not be "unforeseeable and insurmountable."[70] Finally, the Supreme Court of Canada held in *Goodfellow Lumber Sales v. Verreault*[71] that:

> . . . even if the loss is occasioned by Perils of the sea, the ship owner is nevertheless liable if he failed to exercise due diligence to make the ship seaworthy at the beginning of the voyage and that unseaworthiness was a decisive cause of the loss.

How then are these disparate streams of authority to be brought together? In our view one must begin by recognizing that the inquiry is, in large part, a factual inquiry—is the carrier immune in respect of what otherwise would be its failure to discharge its responsibilities under Art. III because the loss or damage to the goods arose or resulted from a cause which brings the carrier within the immunity conferred by Art. IV, rule 2?

If cargo has been lost or damaged and if the vessel was seaworthy, properly manned, equipped, and supplied, what led to the loss or damage? Did it arise or result from want

---

[67] *Id.*, vol. 74, p. 413 at p. 415 (U.S. 2nd Circuit Ct. of Appeals, 1896).

[68] *Law Reports, Appellate Cases*, vol. 12, p. 503 (1887).

[69] *General Motors Overseas Operation v SS Goettingen*, *Federal Supplement*, vol. 225, p. 902 at pp. 904–905 (U.S. Dist. Ct. S. Dist. of N.Y., 1964).

[70] William Tetley, *Marine Cargo Claims*, p. 441 (3rd ed., 1988).

[71] *Supreme Court Reports*, vol. 1971 p. 522 at p. 528 (1971).

of proper stowing (Art. III, rule 2)? Did it arise from the "act, neglect or default of the master . . . or the servants of the carrier in the navigation, or in the management of the ship" (Art. IV, rule 2(a))? Or, did it result from some other cause peculiar to the sea? The last is a peril of the sea.

In *Gamlen*, Judges Mason and Wilson said that "sea and weather conditions which may reasonably be foreseen and guarded against may constitute a peril of the sea." The fact that the sea and weather conditions that were encountered could reasonably be foreseen, or were actually forecast, may be important in deciding issues like an issue of alleged want of seaworthiness of the vessel, an alleged default of the master in navigation or management, or an alleged want of proper stowage. . . . But if it is necessary to consider the "perils of the sea" exception, the fact that the conditions that were encountered could reasonably be expected or were forecast should not be taken to conclude that question. . . . Such an approach, even if it is different from the American and Canadian approach, better reflects the history of the rules, their international origins, and is the better construction of the rules as a whole.

The Present Appeal

In the present case, the trial judge held that there was no breach of Art. III, rule 1 or rule 2. That is, the trial judge rejected the contentions that due diligence had not been exercised to make the ship seaworthy, to properly man, equip, and supply the ship and to "make the holds . . . and all other parts of the ship in which goods are carried, fit and safe for their reception, carriage and preservation." Indeed the trial judge found that in fact the vessel was fit in all respects for the voyage when it left port, [and that the goods had been properly stowed. . . .]

It was submitted by the appellant that the master should not have left port or should have diverted so as to avoid the weather which was forecast. The former contention appears not to have been made at trial. The latter was, but was rejected. The trial judge, having heard the evidence of experts called by both parties, said that he was "unable to conclude that any deficiencies in the conduct of the ship and her cargo by [the ship's master] have been demonstrated." There is no basis for departing from that finding. Once it was made, the trial judge's conclusion that there was no neglect or default of the master or other servants of the carrier in the management of the ship or cargo was inevitable. To the extent that the appellant now seeks to expand its contention to include the proposition that the vessel should not have left port, it is enough to say that, if the judge's finding does not meet the contention, it is a contention that could be made only with evidence to support it and there was none.

***

The failure of the submissions by the appellant makes it unnecessary to consider grounds urged in support of the decision of the Court of Appeal by the respondent in its Notice of Contention.

The appeal should be dismissed with costs.

Casepoint

This case turned on the interpretation of the phrase "perils of the sea." This term is one of the exceptions mentioned in the Hague Rules, which protect the carrier from liability when goods are damaged because of perils of the sea. The court noted that there was some difference in interpretation of this phrase in England and Australia compared to interpretations in the United States and Canada (which appear to require that the peril be something *extraordinary*). However, the court found that the differences were not as large as some had argued, that Germany and France had viewed the phrase in the same way as England and Australia, and that the need to interpret the phrase in a uniform way was important. In conclusion, the court ruled that where there was no negligence on the part of the carrier and the goods had been properly loaded and stowed, that the damage caused by the rough voyage was one of the perils of the sea.

Liability Limits

Carriers have long attempted to set monetary limits on their liability in the event that they are found liable for loss of or damage to a cargo. The permissible limits are now established by convention. The Hague Rules of 1921 limit a carrier's liability to (1) UK £100 per package or (2) UK £100 per unit when shipped in "customary freight units."[72]

One reason many nations had a strong interest in amending the Hague Rules in the 1960s was the belief that its monetary limits were inadequate. The limits were dramatically raised in the Hague-Visby Rules. Those rules set the limits at "10,000 gold francs per package or unit, or thirty gold francs per kilo of the gross weight of the goods lost or damaged, whichever is the higher."[73] This gold or *Poincaré* franc is not a unit of currency but rather an amount of gold. At current conversion rates, it is equivalent today to approximately U.S. $1 or U.K. £0.64 or 0.75 Euros.

The limits do not apply if the parties agree to higher amounts. They also do not apply if the carrier acted either (1) "with intent to cause damage" or (2) "recklessly and with knowledge that damage would probably result."[74]

The low limits set in the Hague Rules—which remain in effect in the United States—have forced shippers suing in American courts to suggest creative definitions for the terms *package* and *customary freight unit* as a way to obtain a respectable recovery. Courts, not unsympathetic to their plight, have sometimes adopted these suggestions. One such court produced the opinion in Case 11-5. This decision is a rare case where the Judge injects a sense of humor into his opinion.

CASE 11-5 Croft & Scully Co. v. M/V Skulptor Vuchetich et al.

United States, Court of Appeals, Fifth Circuit, 1982
Federal Reporter, Second Series, vol. 664, p. 1277 (1982)

MAP 11.5

Texas (1982)

---

[72]International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading, Article 4, §5 (1924) (the 1921 Hague Rules). Article 9 provides: "Those contracting states in which the pound sterling is not a monetary unit reserve to themselves the right of translating the sums indicated in this convention in terms of pounds sterling into terms of their own monetary system in round figures."

[73]*Id.*, Article 4, §5.

[74]*Id.* and Brussels Protocol, Article 4, §5 (1968) (the Hague-Visby Rules).

Circuit Judge John R. Brown

Appellant Croft & Scully Co. appeals from a decision by the District Court limiting to $500 its recovery in an incident where the parties stipulated negligence. . . .

Things Go Better with Coke

Croft & Scully contracted to ship 1755 cases of soft drink from Houston, Texas, to Kuwait. Apparently, Kuwaitis would like to be Peppers, too. Croft & Scully arranged to ship the soft drinks on board M/V *Skulptor Vuchetich*, which arrived in Houston December 8, 1977. Baltic Shipping Co., owner of *Skulptor*, dispatched a 20-foot steel container to Croft & Scully's warehouse in Wharton, Texas. Employees of the supplier loaded the 1755 cases, each containing four "6-packs" or 24 cartons, into the container, closed, and sealed it. The supplier then trucked the container to Goodpasture's yard, near the Houston Ship Channel, which Baltic had selected as convenient storage facility pending arrival of *Skulptor*.

During the Refreshing Pause between arrival of the container and arrival of *Skulptor*, the vessel's agent prepared a Bill of Lading, and hired Shippers Stevedoring, Inc ., to load the soft drink container on board *Skulptor*.

Pepsi Cola Hits the Spot—On the Pavement

As one of the Stevedore's employees was lifting the container, with the use of a forklift, he negligently dropped it. By our calculations, 42,120 cans of soft drinks crashed to the ground, never a thirst to quench. In the Crush, the cans were damaged. The stevedore, no doubt, was in no mood to have a Coke and a smile.

Dr. Pepper at 10, 2, and § 1304

Croft & Scully sued Goodpasture, Shippers Stevedoring, and *Skulptor* and her owners to pick up the Tab for its damages. The District Court dismissed the suit as to Goodpasture because it had no agency relationship with Shippers Stevedoring. Relying upon a so-called Himalaya Clause in the Bill of Lading, it granted the remaining defendants' motion for summary judgment and, finding that the container constituted a "package" within the meaning of §4(5) of [the *Carriage of Goods by Sea Act* (COGSA), which implements the Hague Rules in the United States,] limited Shippers Stevedoring's liability to $500. Croft & Scully appeals. Things Go Better on appeal, and we reverse and remand.

A Peek at the Himalaya Clause

Croft & Scully asserts that the Himalaya Clause limiting recovery to $500 violates public policy. That claim fails to make the grade, given our decision in *Brown & Root v. M/V Peisander*[75] upholding such a clause. Indeed, the conflict which we surmounted there does not even arise in this case. Clause 17 of the Bill of Lading makes clear provision for an increased valuation at a higher freight rate. A more unequivocal declaration, in fact, one could not find. As Croft & Scully could have availed itself of extra loss or damage protection, but chose not to, the District Court ruled that the Himalaya Clause applied.

Don't Judge the Package by Its Appearance

Even if liability is limited to $500 per package, Croft & Scully argues, the cardboard cases of soft drinks rather than the 20-foot container should constitute the relevant "package." Shippers Stevedoring responds with equal fervor that the container is the "package." Their argument, we think, given the recent decision in *Allstate Insurance Co. v. Inversiones Navieras Imparca*,[76] holds no water, carbonated or otherwise.

We begin by pointing out that COGSA does not apply by its own force and effect, since the incident occurred in the yard and not on the vessel. Rather the Bill of Lading incorporates COGSA. Thus, its provisions are merely terms of the contract of carriage which, like any other contractual terms, call out for judicial interpretation in case of dispute. . . .

---

[75] *Federal Reporter, Second Series*, vol. 648, p. 415 (Fifth Circuit Ct. of Appeals, 1981).

[76] *Id.*, vol. 646, p. 169 (Fifth Circuit Ct. of Appeals, 1981).

The District Court further observed that the Fifth Circuit had not established a test to determine what constitutes a "package" under COGSA. Since the date of its order, this Court has formulated such a test in whose good hands the parties—and the District Court—must rest.

Allstate involved the loss of 341 cartons of stereo equipment. The shipper loaded the cartons inside a container, sealed it, and had its agent deliver it to the carrier. The carrier issued a Bill of Lading which described the contents both in number and in kind. When the container arrived in Venezuela, it was as empty as a can of soda on a hot summer day. The shipper sought recovery for its full damages, but the carrier, relying on COGSA, sought shelter in the $500 limitation. Although the District Court concluded that the container was the COGSA package, the winds of judicial change Schwepped away the $500 shelter and exposed the carrier to full liability.

Judge Anderson, writing for the Court, after reviewing the history of COGSA and decisions in other Circuits, found that each stereo carton was a discrete "package." He based his decision on a case in the Second Circuit, *Mitsui & Co. v. American Export Lines*.[77] There Judge Friendly expressly rejected as unworkable and unsound the old "functional economics" test.[78] . . . Instead, relying on dicta in *Leather's Best, Inc. v. S.S. Mormaclynx*[79] he looked to see whether the carrier had clear, unequivocal notice of the container's contents:

> Clearly the goal of international uniformity is better served by the approach in *Leather's Best* that generally a container supplied by the carrier is not a COGSA package if its contents and the number of packages or units are disclosed. . . .

We find nothing in the Bill of Lading to indicate that the contracting parties intended some special meaning of the term "package." Since Croft & Scully included information about the contents of the container and their number, *Allstate* governs. Therefore, the District Court erred in granting summary judgment on the "package" issue.

Customary Freight Unit

Even if the container was not a COGSA "package," Shippers Stevedoring contends, the Court should uphold the $500 award because the container was a "customary freight unit" within the ambit of § 4(5) of COGSA, and thus the Himalaya Clause still applies. . . .

Caterpillar Americas Co. v. S/S Sea Roads[80] held that the "customary freight unit" was a tractor and its parts rather than hundredweight units, "regardless of the harshness or seemingly illogic of such result":

> With respect to the words "customary freight unit," the authorities are conclusive that this phrase refers to the *unit upon which the charge for freight is computed* and not to the physical shipping unit. As thus construed, the statute gives the court the task of determining what unit was actually used by the carrier for computing the freight charge on the shipment in question. Under the statute the freight unit, if one exists, will control the question of limitation of liability, unless the freight unit employed was a mere sham, and, therefore not a "customary" unit within the meaning of the statute. . . .

From these cases, we deduce that "customary freight unit" is a question of fact that will vary from contract to contract. Of particular importance in this as in any contractual dispute, then, is the parties' intent, as expressed in the Bill of Lading, applicable tariff, and perhaps elsewhere. . . .

Although Croft & Scully admitted that the freight charge was $2200, calculated on a "flat container rate," we do not know how the parties arrived at that rate. Does it depend upon the contents, weight, value, custom of the trade, applicable tariffs, if any, or other factors? The District Court must consider these questions on remand. If it finds that the container was a "customary freight unit," then the Court should reinstate the $500 limitation of liability. If not,

---

[77]*Id.*, vol. 636, p. 807 (Second Circuit Ct. of Appeals, 1981).

[78]That test, which lingered beyond its time as a Sprite disrupting the admiralty for some years, looks to see whether the goods as packaged prior to shipping were "functional," i.e., fit for shipping and transport individually as packed. It necessitated much judicial guessing work, and we are well rid of it.

[79]*Federal Reporter, Second Series*, vol. 800, p. 815 (Second Circuit Ct. of Appeals, 1971).

[80]*Federal Supplement*, vol. 231, p. 647 (Dist. Ct. S. Dist. of Florida, 1964), affirmed, *Federal Reporter, Second Series*, vol. 364, p. 829 (Fifth Circuit Ct. of Appeals, 1966).

then it should hold further proceedings to determine the amount of damages. We, of course, express no opinion concerning the outcome.

Recap

We affirm the District Court's dismissal of Goodpasture and its conclusion that the Himalaya Clause applies. We reverse its grant of summary judgment for Shippers Stevedoring and its finding that the steel container was a COGSA package. As the District Judge never reached the important factual question whether the container of soft drink cartons was a "customary freight unit," we remand for further inquiry into the facts and for consideration of the parties' intent, factors that will guide the trial Court in determining the meaning of that COGSA clause.

Affirmed in part, reversed in part and remanded.

Casepoint

In this humorous opinion, Judge Brown of the U.S. Fifth Circuit Court of Appeals discusses what is a *customary freight unit (CFU)* in connection with the loss of 42,120 cans of soft drinks during loading onto a ship. A so-called Himalaya Clause in the bill of lading, allowed by the Hague Rules, limited the liability of the carrier and that of the stevedore to $500 per CFU. So, the question was whether the CFU was the 20-foot steel container holding the 1,755 cases of soft drinks or the 1,755 cases (each containing four six-packs of drinks). The district court had held that there was only one package (CFU) and limited the liability to $500. But on appeal, the court held that additional inquiry into this factual issue was necessary, specifically as to the type of packing unit upon which the shipping charges are based. This case was sent back to the lower court for further hearings on that issue. So it is possible that the damages will be increased by 1,755 times over the original award.

Time Limitations

A claim for loss or damages must be instituted within one year after the goods were or should have been delivered.[81] The claim may be initiated by filing suit or commencing an arbitration proceeding.[82]

Recent International Developments

Piracy on the Seas

Some people may think that pirates died long ago with wooden ships and swords, or that they only exist today in movies. However, that is far from the truth. In fact, pirates never really disappeared. Recently, they have become more than a small blip on the world's sea transportation radar with frequent highjackings of ships and payment of ransoms.

Modern-day pirates do not use swords and wear hats with feathers on them, but instead have been known to use heavy-duty firepower such as AK 47s and cellphones in their hijackings. In mid-November and early-December 2011, countries began to discuss ways to further protect ships transporting goods. The Seychelles invited China to set up an anti-piracy base in the islands to help fight the regular piracy attacks that occur there (see Figure 11.7). China has economic interests in the islands and is considering the proposition.

The United States is taking a slightly different stance. The U.S. wants to arm merchant vessels with heavily armed security teams. There is a controversy involved with this stance, but from a liability standpoint, the security teams look like a solid option. If a civil lawsuit were brought against the captain of a ship by a crew member as a result of a pirate attack, U.S. maritime law would apply. Under U.S. maritime law, there are two arguments that the crewmember could use. The first is found under the Jones Act, which allows crewmembers to sue the shipowner for negligence. The second is considered a breach of the warranty of seaworthiness, meaning that the shipowner failed to furnish a fit vessel. Both of these arguments have held up in court and therefore arming merchant ships seems to be a valid stance.

Sources: www.maritime-executive.com/article/fighting-fire-with-fire-the-debate-over-arming-merchant-vessels; www.terradaily.com/reports/Seychelles_invites_China_to_set_up_anti-piracy_base_999.html; www.criminaljusticeusa.com/blog/2009/10-shocking-facts-about-modern-day-pirates/.

---

[81]International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading, Article 3, §6 (1924) (the 1921 Hague Rules); Brussels Protocol, Article 3, §6 (1968) (the Hague-Visby Rules).

[82]*The Merak*, *All England Law Reports*, vol. 1965, pt. 1, p. 230 (1965).

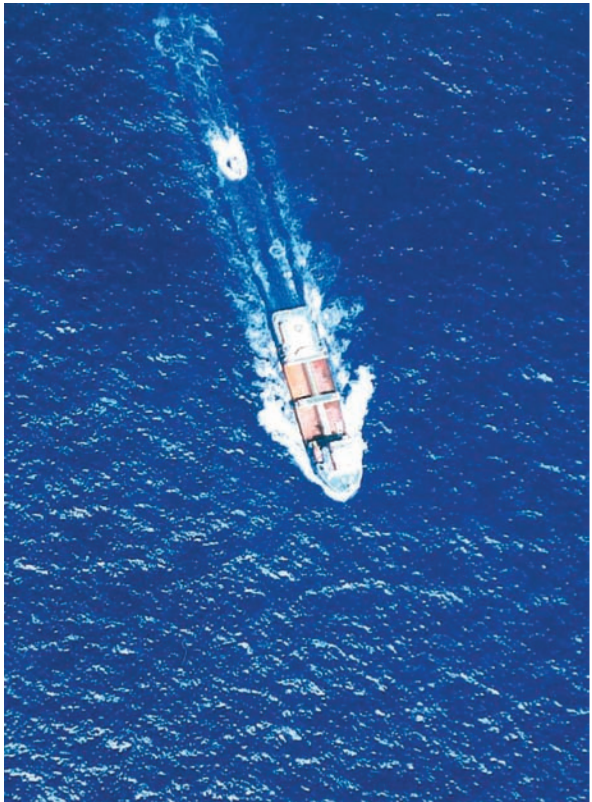


FIGURE 11.7

A Belgian Ship Being Attacked on its Way to the Seychelles.

Source: Belgian Government/AP Images

The Economic Cost of Maritime Piracy

At the end of 2010, around 600 seafarers from more than 18 countries were being held hostage by pirates. Piracy clearly affects the world's largest trade transport industry, but how much is it costing the world? The One Earth Future (OEF) Foundation has conducted a large-scale study to quantify the cost of piracy as part of its Oceans Beyond Piracy project. Based on its calculations, maritime piracy costs the international economy between $7 and $12 billion per year.

The project focused on direct (first) order costs, but also included some estimates of secondary (macroeconomic) costs, where data was available. It concentrated on the supply-side costs to both industry and governments. The study set out to analyze the cost of piracy to the Horn of Africa, Nigeria and the Gulf of Guinea, and the Malacca Straits. The focus was inevitably on the costs of Somali piracy because this is the region where contemporary piracy is most highly concentrated, and is the greatest source of current data and information.

The full report may be accessed at http://oceansbeyondpiracy.org/sites/default/files/documents_old/The_Economic_Cost_of_Piracy.

Third-Party Rights (Himalaya Clause)

The Hague and Hague-Visby Rules apply only to the carrier and the party or parties shipping goods under a bill of lading. Third parties who help in the transport of the goods but who are not parties to the carriage-of-goods contract contained in the bill of lading have no contractual right to claim the liability limits established by the conventions. Thus, officers, crew members, agents, and brokers who work for a carrier, as well as stevedores who commonly work for a unit of a shipping line, can be sued under local laws of tort without the convention-imposed cap.

Himalaya Clause A term in a bill of lading that purports to extend to third parties the carrier's liability limits established by the Hague and Hague-Visby Rules.

To extend the liability limits of the conventions to their employees, agents, and even independent contractors (such as stevedores), carriers have added a clause to their bills of lading, known as a **Himalaya Clause,** which entitles them to claim the protection of the Hague or the Hague-Visby Rules. These clauses are valid in the United States but are generally unenforceable in the United Kingdom. Most U.K. courts refuse to enforce the Himalaya Clause because of a

Reading 11-1 Cargo Theft Is Big Business

Based on "How a Memphis Task Force Combats a Costly Problem," FBI NEWS, January 2012 (accessed at http://www.fbi.gov/news/stories/2012/january/cargo_012712; "Cargo Theft: The New Highway Robbery," BUSINESS WEEK, May 26, 2011; THE FBI THIS WEEK (audio file), January 26, 2012; "Mexico Cargo Theft Increased 13% Year-Over-Year, Lower Than Normal," TRUCKINGINFO MAGAZINE, February 10, 2012; and "Cargo Theft and Terrorism," JOURNAL OF COMMERCE, January 23, 2006.

Cargo theft is a multi-billion dollar criminal enterprise, which is increasing every year. Freight Watch, an industry group, estimates a 30% increase in thefts since 2007. Some FBI employees estimate that thieves could be stealing between $10 billion and $30 billion per year. There are more than 2 million trucks on the road in the U.S., and some 63 percent of all freight travels in trailers. Thieves know how to find and exploit the weak links in the supply chain, including poorly-guarded warehouses and truckers who ignore shipping rules.

In response to this problem, the FBI has established seven task forces located around the country. For example, Memphis, Tennessee, which is located along major interstate highways and home to several product distribution centers, has experienced considerable cargo theft. The thieves steal whole trucks with trailers or just the trailers and their contents, and goods are also stolen from distribution center warehouses and even from moving rail cars. Special Agent Conrad Straube, coordinator of the FBI task force in Memphis says "there is an average of one cargo theft every day of the year."

One example occurred in the evening of June 2009, when truck driver Ricky McNew pulled his big rig into a truck stop in Denmark, Tenn. McNew had been driving all afternoon and was hauling $10 million in pharmaceuticals. He filled his gas tank and went inside to take a shower, and when he returned, his truck was gone. There were no witnesses and he had left his cell phone and extra key in the truck, so he had to have the truck stop dispatcher call his company. This theft of sensitive drugs caused many serious effects including the alerting—later that evening—of all wholesalers and hospitals in the supply chain, the subsequent recall of all drugs on the marketplace from the same lots as the stolen load and other expensive protective measures. The total cost to the pharmaceutical company was near $47 million.

Cargo theft is difficult to prevent and presents problems for law enforcement. City police departments are geared to respond to local crime, and there is often a lack of coordination across jurisdictions when cargo theft occurs—and the truck may be out of the country by the time an investigation begins. Handling a simple theft can fall over several jurisdictional boundaries, making it difficult for any one agency to take ownership of the investigation. The seven FBI task forces are a fairly recent attempt to strengthen and coordinate the law enforcement response.

Cargo is not only stolen from trucks, but also from rail cars, ships, planes and from warehouses. One study done some 10 years ago indicated that the average air cargo shipment is handled 16 to 32 times from the shipper to the consignee. Suppose that a shipment starts in Toronto, is trucked through New York to JFK Airport and then flown to London, and when it arrives, much of the cargo is missing. The Toronto Police, Canadian Customs, U.S. Customs, New York State Police, New York City Police, JFK Airport Police, the FBI, British Customs and finally Scotland Yard may all have a role in the investigation

Barry Clark, a member of a county sheriff's enforcement task force has said that some of the theft crews are so organized that each member has his own specialty, from the break-in artist who can steal a rig in seconds, to professional drivers, surveillance experts, and people who know how to defeat the specialized devices that lock trailers carrying extremely valuable loads. "This is their business," Clark said, "and they are good at it."

In Mexico, cargo theft is a growing problem as well, with one study indicating that cargo theft increased 13% in 2011, after increases of 20–40% the previous 5 years. Food and drink products were most targeted by thieves in 2011, with 24% of all theft incidents. Building and industrial products accounted for 22% of the total. The slower rate of increase may be a result of more companies adopting security measures and purchasing additional security technology. The data did show, however, a sharp rise in rail theft, which increased by 120% over the previous year. According to FreightWatch International, more than 10,000 hijackings occur each year in Mexico with losses estimated at $9 billion USD.

doctrine known as *privity of contract*, which says that only persons who are a party to a contract may enforce its provisions.[83]

In the United States, on the other hand, the doctrine of privity is, at best, haphazardly enforced. As a consequence, most American courts allow the persons named in a Himalaya Clause to claim the rights it grants as third-party beneficiaries, as Case 11-5 (*Croft & Scully*) demonstrated. In addition to piracy, there is a considerable risk of theft as goods are handled by many different parties while being transported from seller to buyer.[84]

E. Charterparties

A **charterparty** is a contract for the hire of an entire ship for a particular voyage or a set period of time. Oil, sugar, grain, ores, coal, and other bulk commodities are almost always shipped under such contracts.

charterparty
A contract to hire an entire ship for a particular voyage or for a particular period of time.

[83]In 1962, the Court of Appeal refused to enforce a Himalaya Clause in *Scruttons, Ltd. v. Midland Silicones, Ltd.*, *All England Law Reports*, vol. 1962, pt. 1, p. 1 (1962). In 1975, the House of Lords in the case of *New Zealand Shipping Co., Ltd. v. Satterthwaite*, *All England Law Reports*, vol. 1974, pt. 1, p. 1015 (1974), said that there might be circumstances where stevedores could be treated as parties to a contract containing a Himalaya Clause. However, in 1980 the Privy Council reapplied the doctrine of privity and found the Himalaya Clause unenforceable in Port Jackson Stevedoring, *Pty. Ltd. v. Salmond and Spraggon (Australia) Pty.*, *All England Law Reports*, vol. 1980, pt. 3, p. 257 (1980).

[84]*Brown & Root v. M/V Peisander*, *Federal Reporter, Second Series*, vol. 648, p. 415 (Fifth Circuit Ct. of Appeals, 1981).

The Hague and Hague-Visby Rules do not apply to charterparties unless a bill of lading issued by the shipowner comes into the hands of a third party. The charterer and the owner are free to set the terms of their contract, and commonly they use standardized contracts drafted at various conferences and known by such code names as Baltime and Gencon. Interpretations and legal obligations vary from country to country, so a forum selection clause and a choice-of-law clause are common, and important, provisions.[85]

Voyage Charterparties

voyage charterparty A contract to hire an entire ship for a particular voyage.

When a charterer employs a ship and its crew for the carriage of goods from one place to another, the charterer and shipowner have entered into a **voyage charterparty.** Under the terms most commonly used in such a contract, the owner agrees to provide the ship at a named port at a specified time and to carry the goods to the contract destination. The charterer agrees to provide a full cargo and to arrange for its loading at an agreed-upon time. If less than a full load is provided, the shipowner is entitled to charge **dead freight** for the amount of the deficiency. This dead-freight charge will be noted on the bill of lading issued by the shipowner, and a holder who acquires the bill will be obliged to pay the charge before the ship will turn over the cargo.

dead freight A charge imposed on a charterer when a chartered ship has less than a full load.

If the shipowner fails to arrive at the original port for loading at the specified time, the charterer will commonly be able to terminate the contract by virtue of a cancellation clause. The charterparty will also describe the number of **lay days** that the ship may be idle while goods are loaded or discharged. Because modern cargo ships are expensive and have a short working life, the charterparty will additionally describe damages, known as **demurrage,** that the shipowner can charge for every idle day that exceeds the agreed-upon number of lay days. The obligation to pay the demurrage will be secured by a lien on the cargo, which any holder of the corresponding bill of lading will have to pay off before taking delivery.

lay days The number of days that a charterer may keep a chartered ship idle for the loading of goods.

Time Charterparties

Under a **time charterparty** the charterer engages the use of a vessel for a stated period of time. The charterer normally pays *hire* monthly, and the shipowner is entitled to withdraw the ship from the charterer's use if a monthly installment is not paid promptly. Questions of demurrage and dead freight do not arise because the shipowner receives hire while the ship is loading and unloading and whether or not it is carrying a cargo.

demurrage A charge made by a shipowner when a charterer keeps a ship idle for more than the agreed-upon number of lay days.

The charterer has the right to direct the ship to proceed to wherever it is needed. Ordinarily, the only limitation on this right is the charterer's promise to engage only in lawful trades, to carry only lawful goods, and to direct the vessel only to safe ports. If the shipowner attempts to interfere with the charterer's use of the vessel, he will be in breach of the charterparty.

time charterparty A contract to hire an entire ship for a particular period of time.

Recent International Developments

English Case Involving Charter parties

In August 2011 the Commercial Court in England handed down judgment on a claim brought by Star Reefers Pool Inc. against JFC Group Co. Ltd. under two contracts of guarantee. The guarantees were in respect of a charterer's obligations under two long-term time charterparties, which were repudiated in September 2010, at which point they had more than a year left to run. The case raised an important question as to the assessment of the owners' damages following the charterer's repudiation of the charterparties. On the facts of the case, at the date of the termination of the charterparties there was an available market for substitute fixtures on similar terms to the charterparties for the remaining periods. However, the owners chose not to enter into that market, but instead traded the vessels for the remaining periods on the spot market, and earned higher rates of income than they would have done had they entered into the available market at the date of the breach. The question was whether the owners were entitled to claim damages by reference to the market rates at the date of the repudiation, or whether the actual income received by the owners had to be taken into account in the assessment of damages. It was held, following the decision of Judge Goff in The Elena d'Amico [1980] 1 LLR 75, that the owners' damages were to be assessed by reference to the available market at the date of the breach, and it was irrelevant that the owners had not in fact entered into the market. [Star Reefers Pool Inc. v JFC Group Co. Ltd. [2011] EWHC 2004 (Comm)].

---

[85]The law of charterparties is vast and its terminology peculiar. Reference to one of the standard texts on the subject is vital for a complete understanding. See, for example, J. Bes, *Chartering and Shipping Terms* (10th ed., 1977); Michael Wilford, Terrance Coghlin, and Nicholas Healy, *Time Charters* (2nd ed., 1982); Wharton Poor, *American Law of Charter Parties and Ocean Bills of Lading* (5th ed. supp. by R. Bauer, 1974); and Stewart C. Boyd, Andrew S. Burrows, and David Foxton, *Scrutton on Charterparties and Bills of Lading* (20th ed., 1996).

Charterparties and Bills of Lading

The contract of carriage between a charterer and a shipowner is the charterparty. The shipowner will commonly issue the charterer a bill of lading when goods are loaded on board; however, between the two of them, the bill will be only a receipt for goods and a document of title. Should the charterer transfer the bill, the position of the third-party endorsee will be different. The Hague or Hague-Visby Rules will apply, and the contract between the shipowner and the endorsee will be governed by the bill of lading. Of course, the bill of lading may incorporate the terms of the charterparty. In that case, the endorsee will be governed by its terms. To incorporate the terms of the charterparty, the bill of lading must do so clearly and unambiguously, and the terms of the charterparty must not conflict with any express terms of the bill of lading or (if they apply) the Hague or Hague-Visby Rules.

F. Maritime Liens

A lien is a charge or claim against property that exists to satisfy some debt or obligation. A **maritime lien** is a charge or claim against a vessel, its freight, or its cargo.[86] The main purpose of maritime liens is to ensure that a vessel can adequately obtain credit to properly outfit itself for a voyage.

maritime lien
A charge or claim against a vessel or its cargo.

In common law countries, a vessel is regarded as a juridical person separate and apart from its owner. Thus, a ship itself may be liable for the shipowner's breach of contract or for the crew's negligence, or even for damages caused without the shipowner's or crew's fault, as when port regulations require the ship to use a pilot and the pilot causes the injury. In sum, the owner is not essential to the existence of a lien against a ship. In civil law countries, on the other hand, a maritime lien (or *privilege*) is a right in property, but the property is not independent of the owner. The lien, in essence, exists against the owner as a debtor.

The distinctive characteristic of maritime liens, whether defined by the common or the civil law, is that they do not require possession. They attach to the ***res*** (i.e., the vessel, freight, or cargo) and travel with it. They are also secret.[87] If a vessel is sold, the lien "goes with the ship," even if the new owner is unaware of its existence. In common law countries, the foreclosure of a maritime lien follows a peculiar procedure. The *res* is seized (if it is a vessel, it is *arrested*) without prior notice to the owner. An admiralty court takes custody, and a suit proceeds against the thing. If the lien-holder's claim succeeds, the *res* is sold, the proceeds are distributed among the various lien-holders, and the title to the property is transferred to the purchaser of the *res* free of all claims. In civil law countries, by comparison, the *res* is not regarded as something distinct from its owner. A foreclosure suit is initiated against the owner, and the *res* is then seized as a way to compel the owner to appear and furnish security before the *res* can be released.

res
From Latin: "a thing." The vessel or cargo to which a maritime lien attaches.

When there are multiple lien-holders, the various claims must be ranked. A multilateral treaty, the 1926 International Convention for the Unification of Certain Rules Relating to Maritime Liens and Mortgages (known as the Brussels Convention), establishes a hierarchy among lien claims.[88] Although the convention has not been widely adopted, its ranking of liens is representative of most municipal schemes.[89] Under the convention, claims are ranked as follows:

1. Judicial costs and other expenses
2. Seaman's wages
3. Salvage and general average

[86] A vessel is practically any floating object capable of being propelled for the purpose of carrying goods, including any equipment or appurtenances on board. Cargo is the goods carried aboard a vessel. Freight is the sum of money paid for the carriage of cargo. Geoffrey H. Longnecker, "Development of the Law of Maritime Liens," *Tulane Law Review*, vol. 45, p. 574 (1971).

[87] In some civil law countries, however, shipbuilding liens (known as maritime mortgages) must be recorded with a government agency. Ivon d'Almeida Pires-Filho, "Priority of Maritime Liens in the Western Hemisphere: How Secure Is Your Claim?" *University of Miami Inter-American Law Review*, vol. 16, p. 507 (1985). The same is technically true in common law countries, because shipbuilding liens are not considered to be maritime transactions. See *North Pacific S.S. Co. v. Hall Bros. Co*., *United States Reports*, vol. 249, p. 119 (Supreme Ct., 1919).

[88] *League of Nations Treaty Series*, vol. 120, p. 187. The 1926 convention was revised and updated in 1967. The text of the 1967 convention is posted at www.admiraltylawguide.com/conven/liens1967.html.

[89] For a comparison of the 1926 Brussels Convention with the maritime lien laws of North and South America, see Ivon d'Almeida Pires-Filho, "Priority of Maritime Liens in the Western Hemisphere: How Secure Is Your Claim?" *University of Miami Inter-American Law Review*, vol. 16, p. 507 (1985).

4. Tort claims
5. Repairs, supplies, and necessaries
6. Ship mortgages

Case 11-6 illustrates how courts go about applying this ranking.

CASE 11-6 The Chinese Seamen's Foreign Technical Services Co. v. Soto Grande Shipping Corp., Sa

People's Republic of China, Shanghai Maritime Court, 1987

MAP 11.6

China (1987)

The Facts

The plaintiff in this action was engaged in the provision of crewing services for vessels in maritime commerce. The defendant was the owner of the Panamanian M/V *Pomona*. The plaintiff and the defendant shipowner executed a crewing services contract on December 17, 1984, in Shanghai (see Figure 11.8). The contract required the plaintiff to provide 25 seamen, including a master, officers, and crew, to serve for one year aboard the *Pomona*. The defendant was to pay monthly wages of $20,833 to the plaintiff. On January 14, 1985, the plaintiff dispatched the 25 seamen to the vessel. By September 16, 1985, the plaintiff had received only two payments, totaling $21,455 for wages and $840.80 for ship's stores. The plaintiff claimed $225,283.05 in wage payments from the defendant shipowner.

FIGURE 11.8

Shanghai, China, Waterfront and the Huangpu River (2008)

Source: Courtesy of Michael Bixby

The Seizure and Sale

On September 16, 1985, the plaintiff submitted to the Shanghai Maritime Court a petition for the seizure of the *Pomona*. The petition prayed for an order directing the shipowner to post security in the amount of U.S. $200,000, or alternatively, for an order directing the sale of the vessel. The court found that the petition was procedurally correct, that it alleged a claim for which seizure of foreign flag vessels is allowed under Chinese law, and that it set forth a reasonable basis for seizure. On September 28, the court therefore ordered the vessel's seizure.

Due to the failure of the shipowner to furnish security, the court ordered the sale of the *Pomona* in accordance with Article 93, clause 3 of the Law of Civil Procedure (For Trial Implementation) of the People's Republic of China.

Clause 3 . . . provides that if the property under legal custody cannot be held and maintained for a long period, the People's Court may compel a sale and deposit the proceeds in the court's registry. The *Pomona* was sold at public auction on October 18, 1985, and sales proceeds of $430,000 were generated and deposited in the court's registry. Simultaneously, the court published an official announcement that all creditors of the vessel should apply to register their claims within 30 days.

The Suit

On October 3, 1985, the plaintiff commenced suit in the Shanghai Maritime Court and sought, in addition to the above-mentioned back wages of the seamen, the fuel expenses which it had covered for the vessel, the cost of the vessel arrest, its legal fees, liquidated damages for breach of contract, and interest. The total amount of plaintiff's claim was $259,636.03.

The shipowner failed to file answering papers within the time limit prescribed by law. Although twice formally summoned by the court, the shipowner consistently failed to submit any legitimate reasons for its refusal to enter a formal appearance in the action. Having given the defendant the requisite opportunity to be heard, the court conducted a trial of the action in the shipowner's absence.

The Rulings

The court ruled that the shipowner had breached the terms of the contract and should bear full responsibility for the consequences of its unfulfilled obligations. Following international custom and practice as well as Chinese law, the court ruled as follows:

1. The shipowner was required to compensate the plaintiff for crew wages in the amount of $190,149.24;
2. The shipowner was required to compensate the plaintiff for fuel expenses in the amount of $3,500.00;
3. The plaintiff's claims for other expenses were denied;
4. The shipowner was required to bear certain costs of litigation, including the filing fee ($1,176.87), the application fee for seizure of the vessel ($625), and miscellaneous litigation expenses ($139.90), totaling $1,941.77. Those expenses were to be deducted from the sales proceeds after the effective date of the ruling.

The Preliminary Distribution of The Sales Proceeds

The order took effect after it was served upon the parties and the time for appeal had expired. In accordance with a recent Supreme People's Court directive entitled "Special Rules on the Payment of Claims Against Vessels Sold by Court Order," the court directed the convening of a meeting of creditors to engage in the liquidation of the debts arising out of this case. It publicly verified the sum of money available for distribution, the priority of claims, the nature and extent of each creditor's claim, and the methods of negotiating the creditors' claims. After marshalling the creditors' evidence and examining the value of the claims, the court certified four creditors' claims in addition to the plaintiff's judgment for crew wages. The additional claims certified by the court were the following:

1. A claim for seamen's wages in the sum of $171,840.26 put forward by the Chinese Seamen's Foreign Technical Services Company (CSFTSC) of the Shanghai Maritime Transport Bureau;

2. Claims totaling $23,292.18 for harbor usage, ship's stores and other items put forward by the Ningpo Branch of the China Ocean Shipping Agency (COSA);
3. A ship mortgage in the amount of $1,931,530.34 held by the National Westminster Bank, USA.
4. A claim asserted by the Repair Center of the Shanghai Shipbuilding Industry Corporation (SSIC) for repairs totaling $39,000.

The *Pomona* sales proceeds were applied first to litigation costs and certain . . . *custodia legis*[90] expenses. The costs and expenses paid in this manner consisted of the $1,941.77 in costs awarded to the plaintiff, $25,185.88 in claims and expenses arising from the sale of the vessel, and $3,500 for the diesel oil and lighterage expenses incurred by the plaintiff during the period of seizure. The remaining amount of U.S. $399,372.35 was augmented by $17,921.67 in interest earned while the sales proceeds were held in legal custody at the Bank of China. The fund available to creditors was thereby raised to U.S. $417,294.02.

The priority rules established by the aforementioned directive rank seamen's wages in the first priority class. The plaintiff's judgment for seamen's wages and the wage claim of the Shanghai CSFTSC, which together amounted to $361,989.50, were therefore paid first out of the remaining sales proceeds.

The second priority class established by the directive includes national taxes, harbor usage fees and other port expenses. The claim of the Ningpo COSA included items totalling $9,574.29, which fell within the second class. Those items were accordingly paid next.

There were no other claims in the first three priority classes established by the directive. The next highest claim was the mortgage held by the National Westminster Bank, which was listed between the fourth and fifth priority classes. The remaining claims of the Ningpo COSA, including claims for fuel and water supplied to the vessel, and the repair costs claimed by the Repair Center of SSIC, were deemed "other registered claims" within the meaning of the directive. They fell within the fifth priority class, below the mortgage. The balance of the sales proceeds, totalling $45,730.23, was therefore distributed to the mortgagee, and the remaining claims were left unpaid.

The Final Distribution of Sales Proceeds

After another step in the deliberations, the Shanghai CSFTSC "reconsidered" the effect of the plaintiff's lead in this case and agreed to transfer $12,400.26 to the plaintiff from its own portion of the preliminary distribution. The Shanghai CSFTSC and the National Westminster Bank then "reconsidered" the actual losses of the Repair Center of SSIC Corporation and the Ningpo Branch of COSA, and agreed to allow them, from their portions of the preliminary distribution, "suitable amounts" to remedy their losses. In this way, the five claimants arrived at the following final distribution of payments:

- The plaintiff received $202,549.50;
- The Shanghai CSFTSC received $150,000;
- The Ningpo Branch of COSA received $15,274.29;
- The National Westminster Bank USA received $44,970.23;
- The Repair Center for SSIC Corporation received $4,500.00.

Casepoint

In this case, a shipowner had contracted for a crew of 25 seamen for a one-year period, but nine months after the crew started work, only a small portion of the wages had been paid. Thus, the law in China (as elsewhere) allowed the seizure and sale of the ship to satisfy the wage and other claims. The owner was notified but did not answer the court petition, so judgment was entered for the plaintiff and the ship was sold at auction. The court then decided how to distribute the proceeds of the sale.

G. Maritime Insurance

The trade terms the parties choose in their sales contract determine who is responsible for purchasing maritime insurance and who benefits from it. However, even when the risk of loss shifts from the seller to the buyer, the seller continues to have an interest in seeing that the goods are insured. If the

[90] From Latin: "in the custody of the law." Refers to property held in the custody of a court.

goods are lost and the buyer is either bankrupt or unwilling to pay, insurance may be the only basis for recovery available to the seller.

Should a party who is required to purchase insurance be involved in an isolated sale, he can purchase a special cargo policy covering the single sale. It is more common, however, for cargo to be covered by an open cargo policy. Such a policy is an open-ended contract that insures all the cargo of an exporter during a particular time period. All of the exporter's shipments, whether by truck, rail, air, or vessel, are covered. Parties involved in an isolated sale often arrange to have their goods covered by the open cargo policy of a freight forwarder or customhouse broker.

Perils

The perils covered by special and open cargo policies commonly include the following:

1. Loss or damage from the sea (e.g., weather, collision, stranding, sinking)
2. Fire
3. Jettison (i.e., the dumping of cargo in order to protect other property)
4. Forcible taking of the ship
5. Barratry (i.e., the fraudulent, criminal, or wrongful conduct of the captain or crew)
6. Explosion
7. Fumigation damage
8. Damage from loading, discharging, or transshipping cargo

The coverage of maritime insurance policies is examined in Case 11-7.

CASE 11-7 Assicurazioni Generali (Underwriters) v. Black & Veatch

United States Court of Appeals, Eighth Circuit, 2004

MAP 11.7

Japan and the United States

MEP Pleasant Hill contracted with Black & Veatch to design, procure equipment for, and build a combined-cycle electricity generating facility in Missouri—this was known as the Aries Project. Black & Veatch then contracted with Toshiba to manufacture Heat Recovery Steam Generators (HRSGs) for the new facility. HRSGs are boilers that turn waste heat produced by gas turbines into processed steam, which is used for combined-cycle electrical generation. The HRSG components were to be shipped from Japan to the United States.

Black & Veatch used a broker to procure a policy for marine cargo insurance from "Underwriters." The policy had two sections of coverage. The first section provided physical loss coverage for the transport of "equipment, machinery, supplies and materials," among other things. The second section provided coverage for "delay-in-start-up" losses and for expenditures incurred to avoid or diminish such losses.

Both of the parties agree that the policy did not cover specific projects, but instead the risk for a project could be added to the facility through a declaration (or endorsement). Consequential loss

coverage in Section 2 only applied for projects listed under Section 1, and only if the Underwriters specifically agreed to accept the risk on a project-by-project basis. Section 2 also stated that certain "critical items" (seemingly cargo) must be surveyed either by London Salvage Association (LSA) or surveyors approved by Underwriters. The following "as per warranty wording" was attached:

> *The attached "Survey Warranty Wording" states (with emphasis added):*
>
> *Warranted the Salvage Association or its appointee, at the Assured's expense, shall in respect of the items listed below:*
>
> 1. *Approve vessel(s), tug(s), barge(s), towing arrangements, all other carrying conveyances and all lifting equipment including cranes required or loading/unloading operations.*
> 2. *Approve all packing, loading, stowage, securing and unloading arrangements.*
> 3. *Attend and approve all stages of handling during the transportation.*
> 4. *Approve all transport operations including transport to vessel, voyage arrangements and transport from vessel to site.*
> 5. *Approve prevailing weather conditions or stipulate acceptable weather criteria for handling and transit operations.*
>
> *And all recommendations complied with.*
>
> *List of items: (If necessary to be listed on a separate schedule).*
>
> *The Salvage Association to be advised of shipping schedules and any amendments and given all reasonable notice of required attendances in order that the above warranties can be complied with.*
>
> *Underwriters shall be entitled to receive any advices, reports or recommendations from The Salvage Association and/or its appointed surveyor.*

In Black & Veatch's policy, no items were "listed below" in the Survey Warranty Wording, and there was no other document added to the policy that denominated specifically a "separate schedule" of critical items.

Black & Veatch added two endorsements to their policy that included an effective date of April 18, 2000. Endorsement 5 added the Aries Project to the facility "in respect of maritime cargo and consequential loss insurance cover." Endorsement 6 amended certain wording of the policy relating to the Aries Project.

On July 20, 2000, the HRSG component cargo departed from Japan bound for the United States. The HRSG cargo (critical items) had never been surveyed. On July 24, 2000, the ship carrying the cargo was caught in a typhoon causing severe damage to the HRSG component cargo. Toshiba did replace the damaged HRSG components at no charge to Black & Veatch, however the new shipment did not arrive until approximately six months after the original delivery date.

By making changes to the construction sequencing and employing additional labor, the deadline for the plant was met. Black & Veatch stated that these changes resulted in additional costs of $38 million. A claim for these additional costs was submitted to the Underwriters for consequential damages. The Underwriters denied this claim on the basis that the cargo had never been surveyed.

The Underwriters then filed a complaint with the United States District Court for the Western District of Missouri in order to seek a declaration that the policy provided no coverage for consequential losses because of Black & Veatch's failure to comply with the critical items survey requirement. Black & Veatch filed counterclaims seeking a declaratory judgment that their losses were covered under the policy. The district court decided that no survey was required, and that the claims were covered under the second section of the policy. The Underwriters appealed the ruling. The Court of Appeals affirmed the district court's ruling, based on the following reasons.

Both courts found that the policy's language unambiguously states that a survey of the critical items is only required for items that are contained in the "list of items" as described in the Survey Warranty Wording referred to in Section 2. That section also makes it clear that the critical items must be included within the policy and not in an ancillary document outside the written agreement and that the critical items should be surveyed "as per the warranty wording attached."

The courts also made reference to the policy's use of a "separate schedule" in their summary judgment. According to the policy, the items must be listed in the same document but after (or "below") the introductory language. The court concluded that "no reasonable interpretation of the

language would permit us to find that items listed on a separate document not incorporated into the contract were items 'listed below' the introductory language." This conclusion caused the court to reject the Underwriters' argument that a list of items contained in a proposed Endorsement 7, never made part of the agreement, constituted the "list of items" discussed in Section 2 of the policy.

The Underwriters then argued that the HRSGs were listed as critical items in Endorsement 5; the endorsement that added the Aries Project to the coverage. Endorsement 5 stated that as of April 18, 2000, the Aries Project is included with "respect of marine cargo and consequential loss cover." As evidence to support their argument, Underwriters provided the court with the following attachment to the endorsement, which contains numbered points composed by the Underwriters and Black & Veatch's responses.

The attachment includes the following language:

4. *Supervision surveys required on critical items at both loading/discharge—details to be agreed once shipping schedule confirmed—costs for B & V's account.*

   [*Response] We can arrange for these if required. Currently they are not required per our subcontracts. Only two contracts are shipping overseas: Toshiba from Japan HRSG and STG, BFP's and possibly motors from Europe.*

   . . .

6. *Rating indication is on the basis that total value of Cargo (DIC) does not exceed US $50,000,000.*

   [Response] Total value of all components may be larger that [sic] 50 million, but individually is less. Largest component is 24 million for HRSG which is made up of 10 separate shipments.

The court found it difficult to conclude that Endorsement 5 did not constitute a "list of items" that Section 2 called for. In the attachment provided to the court by the Underwriters, Black & Veatch "stated that a survey was not currently required under its subcontracts, and that it could arrange for surveys '*if required*"' (emphasis added). The courts decided that nothing from this submission demonstrated that the parties had agreed that surveys would be required for any particular items. The courts further concluded that Endorsement 5 contained nothing aside from the statement saying that the surveys could be arranged if required and that it raised no ambiguity about the existence of a list of critical items.

Lastly, the Underwriters argued that Endorsement 9 comprised a critical items list. The Underwriters claim that this endorsement proves that both parties agreed that the HRSG component shipments are subject to the survey requirement. Black & Veatch claim that they never received notice of Endorsement 9 and were able to prove that the broker who approved the endorsement was not acting on behalf of Black & Veatch.

These reasons and more led the courts to rule in favor of Black & Veatch. The courts found no evidence that the Underwriters took the proper steps to ensure that a list of critical items was included in the policy before they assumed liability, or the risk of insurance.

Casepoint

The case demonstrates the importance of carefully reading and adhering to the requirements of the contract and shipping documents. The correspondence between the parties was unclear as to the exact items covered and whether a survey was required. The court found that the policy's language unambiguously stated that a survey of the critical items was only required for items that were contained in the "list of items" described in the Survey Warranty Wording. It was also held that the critical items must be included within the policy and not in an ancillary document outside the written agreement and that the critical items should be surveyed "as per the warranty wording attached." So the court decided that no survey was required, and that the claims for consequential damages ($38 million) were covered under the second section of the policy.

Average Clauses

The loss of cargo can be either total or partial. Total loss is ordinarily governed by a *constructive loss* clause in a maritime insurance policy. This usually includes (1) losses exceeding one-half the value of the cargo or (2) losses where the cost of recovery exceeds the cargo's value.

particular average
A loss to a ship or its cargo that is not to be shared in by contributions from all those interested, but is to be borne by the owner of the injured thing.

general average
A contribution by those jointly involved in a maritime venture to make good the loss by one of them for his voluntary sacrifice of a part of the ship or cargo to save the residue of the property and the lives on board, or for the extraordinary expenses necessarily incurred for the benefit and safety of all.

A partial loss is known in the marine insurance industry as a **particular average.** A *free from particular average* (FPA) policy provides the most limited recovery for partial losses. Such a policy ordinarily covers only losses from fire, stranding, sinking, or collision of the vessel. A *with average* (WA) policy provides more protection; however, it ordinarily contains a *franchise* clause that provides for payment only if the loss exceeds a specified minimum amount (the franchise amount). WA policies can also be purchased without a franchise clause.[91]

General average comes about in the carriage of goods at sea when, in order to avoid some threat to the whole venture, some expense has to be incurred, or some loss or damage is deliberately inflicted, in order to save the ship and its cargo. For example, a ship may run aground. In order to get it afloat, some of the cargo or some of the ship's supplies may have to be jettisoned, or salvage tugs may have to be hired. When this happens, everyone having an interest in the ship and its various cargoes will have benefited. Each must then contribute, in proportion to the value of his interest, to restoring the party who suffered the loss or damage or who incurred the expense. This is called a *general average* contribution.

Normally, marine insurance will cover each shipper's contribution. However, if insurance is not purchased or if a policy does not cover general average, then the shipper must pay the contribution before the ship's crew will release the goods. Similarly, if a buyer has already paid for the goods and received a bill of lading, then the buyer (because the bill of lading will transfer the risk of loss to the buyer at that point) must come up with the contribution before the ship's crew will turn over the goods. In either case, the ship will have a lien claim against the goods, and if the contribution is not paid, it may foreclose on the goods, sell them, and retain that portion of the sale price it receives to cover the cost of the contribution.

A person seeking to claim a general average contribution from other parties must show (1) that the loss was incurred to benefit everyone and (2) that the person making the claim was not responsible for causing the danger. For example, a shipping company cannot claim general average when it has hired tugs to refloat a ship that ran aground because of the captain's faulty navigation.

H. Carriage of Goods by Air

The carriage of goods on aircraft is regulated by the 1929 Warsaw Convention (formally known as the Convention for the Unification of Certain Rules Relating to International Carriage by Air).[92] Four amendments to the convention were adopted between 1955 and 1975—the Hague Protocol of 1955,[93] Montreal Protocol No. 1,[94] Montreal Protocol No. 2,[95] and Montreal Protocol No. 4 of 1975.[96] These subsequent amendments together with the original Warsaw Convention came to be known as the *Warsaw System*. The original Warsaw Convention was drafted when the air transport industry was in its infancy, and despite the subsequent amendments, many of its provisions had become outdated. Over time the liability limits became too low by modern standards. Also the laws governing airline liability had become fragmented and confusing as some countries had not introduced all the various amendments to the original laws.

A major additional treaty, the Montreal Convention (formally the Convention for the Unification of Certain Rules for International Carriage by Air), was adopted in 1999 and became effective in 2003. The

[91]W. Grunde, *Servicing World Markets: Administrative Procedures*, p. 61 (1979).

[92]The text of the Warsaw Convention is in United Nations Treaty Series, vol. 261, p. 421, and vol. 266, p. 444. A copy is posted at www.iasl.mcgill.ca/private.htm.

See the International Civil Aviation Organization Treaty Collection Web site at http://www2.icao.int/EN/LEB/Pages/TreatyCollection.aspx.

[93]The text of the Hague Protocol is in *United Nations Treaty Series*, vol. 1963, p. 373, and is posted at *id*.

The Hague Protocol increased the liability limits for injuries to passengers and their baggage to 250,000 francs (approx. $50,000 in 2012) from the 20,000 francs set in the 1929 convention. Warsaw Convention (as amended by the Hague Protocol), Article 22. See the International Civil Aviation Organization Treaty Collection at www2.icao.int/EN/LEB/Pages/TreatyCollection.aspx.

[94]The text of Protocol no. 1 is posted at www.mcgill.ca/files/iasl/montreal1975a.pdf.

Protocol no. 1 limits a carrier's damages to 8,300 Special Drawing Rights (SDRs) for liability to passengers, to 17 SDRs per kilogram for loss of baggage and cargo, and to 332 SDRs for carry-on items.

See the International Civil Aviation Organization Treaty Collection at www2.icao.int/EN/LEB/Pages/TreatyCollection.aspx.

[95]The text of Protocol no. 2 is posted at www.iasl.mcgill.ca/private.htm.

[96]The text of Protocol no. 4 is posted at www.mcgill.ca/files/iasl/montreal1975b.pdf.

See the International Civil Aviation Organization Treaty Collection at www2.icao.int/EN/LEB/Pages/TreatyCollection.aspx.

Note: The states parties to the Montreal Protocol are automatically states parties to the Warsaw Convention as amended by the Hague Protocol. Montreal Protocol no. 4, Article XVII(2).

Montreal Convention provides that it "shall prevail over any rules which apply to international carriage by air" as between contracting states that have also agreed to any of the Warsaw System treaties. In other words, the new treaty will take precedence over earlier Warsaw System treaties between nations that have signed the Montreal Convention. The Montreal Convention reestablished uniformity and predictability of the rules relating to the international carriage of passengers, luggage, and cargo. It consolidates the various earlier legal instruments of the Warsaw System into a single text and provides the basis for genuine uniformity of laws governing air transportation. While maintaining the basic structure and provisions of the Warsaw System, the newer convention updates, modernizes, and adds significant new provisions.

The Montreal Convention changed the liability of air carriers to a strict liability standard, which means that carriers can be held liable without proof of fault once the goods are "in the charge of the carrier," with limited exceptions. (i.e., defective packing by a person other than the carrier, act of war, inherent defect or problem with the goods). This represents a major change as air carrier liability was formerly based on negligence, which meant that the party claiming damages was required to prove some type of lack of due care or fault on the part of the carrier. The Montreal Convention also increased air carrier liability for proven damages up to 113,100 SDRs, a mix of currency values established by the International Monetary Fund, which was approximately U.S. $175,800 as of January 2012. In addition, the carrier's liability can extend beyond these limits if negligence is proved. Liability limits are to be reviewed every five years. The Montreal Convention also provided for:

1. Unlimited liability of carriers in the event of death or injury to passengers
2. Advanced payments to meet immediate needs
3. Increased liability limits in the event of delay
4. Modernization of transport documents (electronic airway bills and tickets)

As with inland carriage, the documents used in air carriage—the air waybills and consignment notes—are not documents of title.[97] This reflects the practical difference between air flight and ship transport. The speed of air transportation means that bills and notes used in air transportation arrive with the goods rather than being sent separately.

At the heart of the Warsaw System agreements was the definition of the **air waybill.** In states that are parties to the convention—but not to Montreal Protocol No. 4 (now the Montreal Convention)—the bill must describe (1) the nature of the goods being shipped; (2) the method of packing and any marks or numbers; (3) the weight, quantity, volume, or dimensions of the goods; (4) the apparent condition of the goods and their packaging; and (5) a statement that the carriage is subject to the convention's rules.[98] The Montreal Convention (and Protocol No. 4), which encourage carriers to use electronic records, require only three things to appear on the paper waybill that accompanies a consignment of goods: (1) the places of departure and destination, (2) an intermediate stopping place in a different state (if the places of departure and destination are in the same state), and (3) the weight of the consignment.[99]

air waybill
An instrument issued by an air carrier to a shipper that serves as a receipt for goods and as evidence of the contract of carriage but is not a document of title for the goods.

The incentive the convention offers carriers for including these required elements on a waybill is a limitation on liability. This is set at 17 SDRs per kilogram.[100] This means that any provision in the waybill establishing a lower amount is void. Of course, a shipper may declare a higher value and pay the cost for insuring the excess.

The benefit to the shipper in using a Warsaw System or Montreal Convention air waybill is that the claimant does not have to prove that the carrier's fault caused the injury to any lost, damaged, or delayed goods. The person entitled to delivery has to make a claim within seven days of when the goods arrived or should have arrived (Warsaw Convention) or 14 days if they are covered by the Montreal Convention for loss or damages. The time limits are 14 days (Warsaw) or 21 days (Montreal Convention) in the case of damages caused by delay.

Because more than 150 countries have signed the Warsaw Convention—or one of the subsequent amendments—and not all have signed the Montreal Convention, the issue of whether one

[97]Article 15(3) of the convention as amended by the Hague Protocol, however, provides that "Nothing in this Convention prohibits the issue of a negotiable waybill."

[98]Warsaw Convention of 1929, Article 8.

[99]Warsaw Convention as amended by Montreal Protocol No. 4, Article 8.

[100]The Warsaw Convention of 1929 specifies a liability limit of 250 gold or Poincaré francs per kilogram (or approximately 200 SDRs per kilogram at current exchange rates).

of the Warsaw System conventions or the Montreal Convention 1999 applies to a claim arising from the carriage of goods by air is an important and, in practice, often complicated question. In all cases, the relevant criterion for the application of any one of the international air conventions and its corresponding legal regime is the concept of "*international carriage*," as defined uniformly in the various international legal instruments. In conclusion, the international air convention that will apply to a particular carriage of goods is the one that has been entered most recently between the nation from which the goods are sent and the destination nation.

Chapter Questions

Shipping Terms—FOB, FAS

1. Seller agreed to ship by sea 10,000 tons of potatoes FOB Tacoma, Washington, to Buyer in Japan. Buyer designated the SS *Russet* to take delivery at pier 7 in Tacoma. On the agreed-upon date for delivery, Seller delivered the potatoes to pier 7, but the ship was not at the pier. Because another ship using the pier was slow in loading, the *Russet* had to anchor at a mooring buoy in the harbor and Seller had to arrange for a lighter to transport the potatoes in containers to the ship. The lighter tied up alongside the *Russet*, and a cable from the ship's boom was attached to the first container. As the container began to cross the ship's rail, the cable snapped. The container then fell on the rail, teetered back and forth for a while, and finally crashed down the side of the ship, causing the lighter to capsize. All of the potatoes were dumped into the sea. Buyer now sues Seller for failure to make delivery. Is Seller liable?
2. Suppose, in Question 1, the contract had been FAS Tacoma. Would Seller be liable?
3. Seller agreed to deliver 1,000 air conditioners to Buyer DES Port Moresby. The air conditioners were transported by ship to Port Moresby, where they were off-loaded to the customs shed for inspection. The ship then sent a cable to Buyer stating that the air conditioners were in the customs shed and that the ship was proceeding on its way. Before Buyer could arrive to pay the customs duties and collect the air conditioners, the customs shed burned down, destroying all the air conditioners. Buyer sues Seller for failing to make delivery. Is Seller liable?

Shipping Terms—CIF

4. Seller in Sydney, Australia, agreed to ship goods on or before December 31 under a CIF Sydney contract to Buyer in Honolulu. The seller was unable to assemble the goods for delivery in time to reach the ship in Sydney and had to transship the goods by rail to Melbourne, where the ship was taking on goods on January 3. Seller did load the goods aboard railway cars in Sydney on December 29 and received a bill of lading from the railway company on that date. Seller later obtained a bill of lading from the ship, and together with an invoice and a marine insurance policy, tendered both bills of lading to Buyer. Buyer refused to accept the documents or to pay Seller. Seller sues to enforce the contract. Will Seller win?
5. Seller in San Francisco agreed to ship goods to Buyer in London under a CIF San Francisco contract. After the goods were loaded aboard the ship, but before it departed from San Francisco, Seller tendered the documents required by the contract to Buyer and asked to be paid. Buyer refused, asserting that it had a right to inspect the goods upon their arrival in London, and that it did not have to pay until it did so and was satisfied that the goods were in compliance with the contract. Seller sues for immediate payment. Will Seller win?

Effect of the Bill of Lading

6. Seller sells 4,000 diamonds to Buyer under Incoterms 2010 and loads them onto the *HMS Bounty*, a ship that is designated by the Buyer. Seller's agent replaces 10 of those diamonds with fake ones and is caught after the *HMS Bounty* has sailed and quartered. The ship's bill of lading states that the 4,000 diamonds were in proper condition and are genuine. Seller sends an SOS to the *HMS Bounty* informing the captain of this discovery and informs Buyer as well before the ship arrives at port. However, when the *HMS Bounty* docks, Buyer demands 4,000 genuine diamonds and sues the ship for the value of the 10 replaced diamonds. Do you think the *HMS Bounty* and its crew are liable?

The Hague and Hague-Visby Rules

7. Captain Ishmael has the misfortune of shipping porcelain vases and sandstone statues for two different English buyers across the Malacca Straits on the *Hispaniola*. He packs the two commodities compactly in crates and secures a carriage-of-goods contract contained in a bill of lading (that does not contain a *force majeure* piracy clause). Given the danger involved, Ishmael employs Starbuck to keep a lookout for pirates but the latter falls asleep and fails to stop pirates from boarding the ship and stealing all of the cargo. The two buyers sue the *Hispaniola* and Starbuck separately for the value of the respective commodities that were being shipped. Discuss their liability.

Maritime Liens

8. Mr. Ess, the owner of the SS *Skimpy* and an American citizen, borrows money from MultiBank in London to outfit his ship, giving the bank a maritime lien. Mr. Ess sells the *Skimpy* to Mr. Tee, a Canadian. Mr. Tee is unaware of the lien and unaware that Mr. Ess has defaulted on the loan. When the ship pulls into a British port, the bank arranges for it to be arrested and sold to pay off the balance due on the loan. Can the bank do this?

CHAPTER 12

Financing

Chapter Outline

A. Financing Foreign Trade
B. Bills of Lading
C. Bills of Exchange
- The Law Governing Bills of Exchange
- Types of Bills of Exchange

D. Promissory Notes
E. Negotiability of Bills and Notes
- Unconditional Promise or Order to Pay
- Definite Sum of Money or Monetary Unit of Account
- Payable on Demand or at a Definite Time
- Signed by the Maker or Drawer

F. The Negotiation and Transfer of Bills and Notes
- Assignment
- Negotiation
- Forged Endorsements
- Limitations on the Excuses That Drawers and Makers Can Use to Avoid Paying Off a Bill or Note
- Liabilities of Makers, Drawers, Drawees, Endorsers, and Accommodation Parties
- The Role of Banks in Collecting and Paying Negotiable Instruments

G. Letters of Credit
- Governing Law
- Applying for a Letter of Credit
- Documentary Formalities
- Advising and Confirming Letters of Credit
- The Obligations of Banks
- Rights and Responsibilities of the Account Party
- Rights and Responsibilities of Beneficiaries

H. Financing Foreign Operations
- Private Sources of Capital
- Governmental Sources of Capital
- Regional and International Development Agencies

I. Countertrade
Chapter Questions

Introduction

International financing encompasses the financing of foreign trade and the underwriting of investments in foreign countries. Foreign trade financing is primarily concerned with how goods and services are paid for across international borders. Long-standing mechanisms for expediting international trade include bills of lading, bills of exchange, and letters of credit. The rights and responsibilities of buyers and sellers in using these documents to expedite international trade are explored in depth in this chapter. The final section of the chapter discusses how a company can finance the establishment or expansion of its overseas operations.

A. Financing Foreign Trade

International traders must know the kinds of documents, trade terms, and financing arrangements used in international sales.

The documents used in international sales are also used in domestic sales, but their domestic use is much less common. Most domestic sales are financed through open-account credit arrangements. That is, the buyer does not sign a formal debt instrument. Formalities are not needed because the seller enters into sales only after investigating the buyer's creditworthiness. In international sales, by comparison, buyers and sellers are separated both by distance and by the differing financial practices of their home countries. This means that it is difficult for the seller to determine the credit standing of a foreign buyer and equally difficult for the buyer to establish reliably the foreign seller's integrity and reputation. To compensate for this, foreign traders use formal documents that assure the parties that their sale will go forward as agreed. The most important of these documents are (1) the bill of lading, which is the transportation document and document of title described in Chapter 11; (2) bills of exchange and promissory notes, which are, respectively, orders to pay money and promises to pay money; and (3) the letter of credit, which is a third party's guarantee of a buyer's creditworthiness.

B. Bills of Lading

bill of lading
An instrument issued by a warehouseman or carrier to a shipper that serves as a receipt for goods shipped, as evidence of the contract of carriage, and as a document of title for the goods.

The essential document for all international sales is the **bill of lading**. As described in Chapter 11, the bill of lading is a document of title. That is, it represents the goods.

In international trade, goods shipped from one country to another might be in the possession of a carrier or warehouseman for several weeks: from the time they are shipped to the time they are delivered. The bill of lading is important, therefore, because it lets the buyer and the seller (or their banks) exchange control over the goods while the goods are in the possession of the warehouseman or carrier. As one British judge once described it, the bill of lading is the "key" that permits its holder "to unlock the door of the warehouse, fixed or floating, in which the goods may chance to be."[1]

This ability to transfer title by the transfer of a bill of lading is central to the use of bills of exchange and letters of credit, the two basic financing and payment instruments used in international trade.

C. Bills of Exchange

bill of exchange (draft)
A written, dated, and signed three-party instrument containing an unconditional order by a drawer that directs a drawee to pay a definite sum of money to a payee on demand or at a specified future date.

A **bill of exchange** (or **draft**, as it is often called) is a written, dated, and signed instrument that contains an unconditional order from the drawer that directs the drawee to pay a definite sum of money to a payee on demand or at a specified future date. It is a useful instrument because it allows one party (the drawer) to direct another (the drawee) to pay money either to himself, to his agent, or

[1] *Saunders v. Maclean, Law Reports, Queen's Bench Division*, vol. 11, p. 341 (1883).

to a third party. Of course, the order is valid only if the drawee has an underlying obligation to pay money to the drawer. This can arise in situations where the drawee is holding money on account for the drawer (i.e., the drawee is a bank), where the drawer lent money to a drawee (i.e., the drawee is a borrower), or where the drawer has sold goods to the drawee and the drawee owes the sale price to the drawer (i.e., the drawee is a buyer).

In the first of these situations (where the drawee is a bank), the bill involved is known as a *check*. In the second situation (where the drawee is a borrower), the bill is called a *note*. The bills referred to in the third situation (where the drawee is a buyer) are called *trade acceptances*.

Bills of exchange are important devices for facilitating international trade because they are negotiable instruments. A person properly holding a negotiable instrument makes it free of most claims or defenses that the drawer might have that the underlying contract was improperly performed or that the instrument was improperly made. This freedom from the so-called *equities* or *personal defenses* of the drawer makes bills of exchange more readily salable, and therefore useful financial tools for raising money.

The Law Governing Bills of Exchange

Until the middle of the seventeenth century, bills of exchange were governed by a single international law, the *lex mercatoria*.[2] This law defined the bill of exchange as an instrument that allowed a *permutatio pecuniae presentis cum absenti* (an exchange of money by one who is present with one who is absent). Because the bill applied specifically to an exchange between *loci distantia* (distant places), it was exempt from the medieval Christian Church's prohibition against interest on loans. Because of this exemption, it rapidly became the key instrument of medieval banking.

In the seventeenth century, however, the rise of national laws brought about differences in the rules governing bills of exchange. The French bill of exchange came to be governed by the *Savary Code* of 1673, the *Perfect Tradesman*, and the works of Jousse. In Germany, the applicable law was the *Wechselrecht*. In England, the courts created a case law that reflected the practice in English banks.

At the end of the nineteenth century, the *lex mercatoria* was codified in England in the **Bills of Exchange Act (BEA)** of 1882. Today, the BEA continues in force in the United Kingdom and in virtually all of Britain's former colonies.

In 1896, in the United States, the National Conference on Commissioners of Uniform Laws drafted a Uniform Negotiable Instruments Law (UNIL), which was largely based on the BEA. By 1920, all of the American states had adopted the UNIL. Then, in the 1940s, the UNIL was modernized and integrated into the more comprehensive **Uniform Commercial Code (UCC)**, which by 1950 had been adopted in all states except Louisiana.[3]

On the European continent, there were calls throughout the latter half of the nineteenth century for the creation of an international negotiable instruments law. Finally, in 1907, a conference convened at The Hague to draw up a convention. A draft was agreed to in 1912, but World War I interrupted ratification. The League of Nations then organized a series of conferences to update the 1912 draft. In 1930, three **Geneva Conventions on the Unification of the Law Relating to Bills of Exchange (ULB)** were signed.[4] The following year, two additional Geneva Conventions on Unification of the Law Relating to Checks (ULC) were also signed.[5] Within 15 years, the ULB and ULC had been ratified by most continental European countries, and today they are the standard laws

Bills of Exchange Act (BEA)
English act of 1882 regulating bills of exchange.

Uniform Commercial Code (UCC)
Model U.S. act. Article 3 regulates negotiable instruments.

Geneva Conventions on the Unification of the Law Relating to Bills of Exchange (ULB)
League of Nations–sponsored conventions signed at Geneva in 1930 that regulate negotiable instruments.

[2]From Latin: "law merchant." Common commercial rules and procedures used throughout Europe during the Renaissance.

[3]The text of the UCC is posted on the Legal Information Institute's Web site at www.law.cornell.edu/ucc/ucc.table.html.

[4]The three are the Convention Providing a Uniform Law for Bills of Exchange and Promissory Notes, the Convention for the Settlement of Certain Conflicts with Bills of Exchange and Promissory Notes, and the Convention on the Stamp Laws in Connection with Bills of Exchange and Promissory Notes.

[5]They are the Convention Providing a Uniform Law for Checks and the Convention for the Settlement of Certain Conflicts of Laws in Connection with Checks.

governing bills of exchange and checks in virtually every nation,[6] with the exception of the Anglo-American common law countries.[7]

Although there are currently no uniform worldwide rules governing bills of exchange and promissory notes, there is a widely followed set of international rules governing the collection of checks[8]: the International Chamber of Commerce's (ICC) Uniform Rules for Collections.[9] Most domestic laws allow banks to incorporate the ICC's Rules into their collection instructions, and this is the common practice for international collections worldwide.[10]

Types of Bills of Exchange

A bill of exchange is an unconditional written order. The party creating the bill (the drawer) orders another party (the drawee) to pay money, usually to a third party (a payee).

The form that a bill of exchange must take depends on the governing law. The common law requires only that a bill (or draft) be in writing and be payable either to order or to bearer.[11] The ULB adds to this the requirements that a bill (1) contain the term *bill of exchange* in the body and language of the check,[12] (2) state the place where the bill is drawn, (3) state the place where payment is to be made, and (4) be dated. These requirements are summarized in Table 12.1.

TABLE 12.1

Form requirements for bills of exchange and promissory notes

Common Law	ULB
1. In writing	1. In writing
2. Payable to order or to bearer	2. Payable to order or to bearer
	3. Contain the term Bill of Exchange or Promissory Note
	4. State the place where drawn
	5. State the place where payable
	6. Be dated

[6]For a brief history of negotiable instrument law in Europe, as well as the text of the ULB, see Frederick Wallace, *Introduction to European Commercial Law*, pp. 92–123 (1953).

[7]The differences between the Anglo-American rules and the Geneva conventions (which are fairly substantial) led to calls in the 1950s for the drafting of a new international convention with true international appeal. The call was taken up belatedly by the UN Commission on International Trade Law (UNCITRAL), which produced a final text in May 1988. In December 1988, the UN General Assembly approved a resolution adopting the text and opened the convention—called the Convention on International Bills of Exchange and International Promissory Notes (CIBN)—for ratification. Although only 10 states must ratify the convention before it will come into effect, as of 2005 only Gabon, Guinea, Honduras, and Mexico had ratified the CIBN. Canada, Russia, and the United States have signed but not ratified the convention. It seems unlikely that it will come into effect anytime soon. See Multilateral Treaties Deposited with the Secretary-General: Status listed as of January 2012, posted at www.jus.uio.no/lm/un.bills.of.exchange.and.promissory.notes.convention.1988/doc.html.

For a brief history and description of the CIBN, as well as the text, see "United Nations Convention on International Bills of Exchange and International Promissory Notes," *International Legal Materials*, vol. 28, pp. 170–211 (1989), with John Spagnole's "Introductory Note."

[8]Both the common law countries and the countries that follow the continental European practice have distinct rules governing bank deposits and the collection of checks. See, for example, Article 4 of the UCC, entitled "Bank Deposits and Collections," along with the ULC.

[9]ICC Publication No. 522 (1996). The Uniform Rules for Collection was first published in 1956. The 1996 edition was the second revision. See the ICC Web site at www.iccbooks.com/Product/ProductInfo.aspx?id=484 for information on this and other ICC publications.

[10]For example, UCC, §4–102(3), states that the provisions in Article 4 (Bank Deposits and Collections) of the UCC may be varied by agreement, except that "the parties to the agreement cannot disclaim a bank's responsibility for its lack of good faith or failure to exercise ordinary care or limit the measure of damages for the lack or failure."

[11]UCC, §3–104(2), provides: "An instrument . . . is (e) a "note" if it is a promise and is a "draft" if it is an order; (f) "check" means (i) a draft, other than a documentary draft, payable on demand and drawn on a bank or (ii) a cashier's check or teller's check. An instrument may be a check even though it is described on its face by another term, such as "money order."; (j) "certificate of deposit" means an instrument containing an acknowledgment by a bank that a sum of money has been received by the bank and a promise by the bank to repay the sum of money. A certificate of deposit is a note of the bank."

[12]In the case of a promissory note, the term would be *promissory note* and, according to the ULC, a check requires the term *check*.

Time and Sight Bills Bills may be either time bills or sight bills. A **time bill** is payable at a definite future time. A **sight bill** (or demand bill) is payable when the holder presents it for payment or at a stated time after presentment. Figure 12.1 shows an example of a time bill.

Trade Acceptances A **trade acceptance** is the bill of exchange most commonly used in the sale of goods. On this bill, the seller of the goods is both the drawer and the payee. The bill orders the buyer—the drawee—to pay a specified sum of money.

The use of a trade acceptance is best illustrated with an example. SunnySales, Inc., in California has traditionally sold raisins to GuttenTag, GmbH, in Germany on terms that require GuttenTag to make payment in 90 days. This year, however, SunnySales needs cash. To get cash, it draws a trade acceptance that orders GuttenTag to pay $100,000 to the order of SunnySales 90 days later. SunnySales then presents the bill to GuttenTag. GuttenTag accepts by signing the bill on its face and returning the bill to SunnySales. GuttenTag's acceptance creates an enforceable promise to pay the bill when it comes due in 90 days.

The advantage to SunnySales of having a trade acceptance is that it can sell the bill of exchange in the money market more easily than it can assign a $100,000 account receivable. A trade acceptance is shown in Figure 12.2.

Checks When the drawee of a bill of exchange is a bank, the bill is known as a **check**. Unlike other bills of exchange, checks are always payable on demand.[13] See Figure 12.3.

time bill
Bill of exchange that is payable at a definite future time.

sight bill
Bill of exchange that is payable at the time it is presented or at a stated time after presentment.

trade acceptance
Bill of exchange on which the drawer and the payee are the same person.

check
Bill of exchange on which the drawee is a bank.

D. Promissory Notes

A written promise to pay a determinate sum of money made between two parties is a **promissory note**, or simply a *note*. The party who promises to pay is called the *maker*; the party who is to be paid is the *payee*. Table 12.2 defines the different parties to bills of exchange and promissory notes.

The only difference between a promissory note and a bill of exchange is that the maker of a note promises to personally pay the payee rather than ordering a third party to do so. Figure 12.4 shows examples of typical promissory notes.

The rules governing bills of exchange apply to promissory notes as well. The forms of both instruments are also alike. Thus, whereas the common law does not require that a note contain the words *promissory note*, the ULB does.

promissory note
A written, dated, and signed two-party instrument containing an unconditional promise by a maker to pay a definite sum of money to a payee on demand or at a specified future date.

July 22, 2012
New York, NY

$ 10,000.00

Ninety days after above date PAY TO THE ORDER OF
Bank of the River
100 Hudson Ave.
New York, NY 02167
------ Ten Thousand and 00/00 ------- Dollars
for value received and charge the same to the account of

To: ______________________

______________________ ______________________

______________________ ______________________
Drawer/Buyer Drawee/Seller

FIGURE 12.1

Time Bill

[13]ULC, Article 28; UCC, §3–104(f).

101 Embarcadero
San Francisco, California

December 31, 2011

To: GuttenTag GmBH
On March 31, 2012 PAY TO THE ORDER OF SunnySales, Inc.
One Hundred Thousand and 00/100 DOLLARS 100,000.00

The obligations of the drawee/acceptor of this bill arise out of the purchase of goods from the drawer. The drawee/acceptor may accept this bill payable at any bank or trust company in the United States which the drawee/acceptor may designate.

Accepted at Essen,Germany on December 31,2011
Payable at Bank of the River SunnySales, Inc.
100 Hudson Ave
New York, NY 02167
Buyer's Signature GuttenTag, GmBH
By Agent or Officer by

FIGURE 12.2

Trade Acceptance

certificate of deposit (CD)
A promissory note on which the maker is a bank.

Notes are used in a variety of credit transactions and are commonly given the name of the transaction involved. For example, a *collateral note* is one secured by personal property; a *mortgage note* is secured by real property; an *installment note* is payable in installments.

When a bank is the maker promising to repay money it has received, plus interest, the promissory note is called a **certificate of deposit (CD)**. CDs in amounts up to $100,000 are customarily

July 15, 2012 11-95/980

PAY TO THE ORDER OF Sandra Smith $ 100.00
One Hundred and 00/100 DOLLARS

BANK OF THE RIVER
100 Hudson Ave.
New York, NY 02167
123456789-09876543

Check

July 15, 2012 at Paris, France

THIS CHECK IS TO BE PAID TO THE ORDER OF Sandra Smith € 500.00
Five Hundred and 00/100 EUROS

by the EX-PATRIOT BANK
at 100 Cours Albert 1er
75008 Paris, France
123456789-09876543

FIGURE 12.3

American Check (top) and French Check (bottom)

TABLE 12.2

Parties to negotiable instruments

Maker	The issuer of a promissory note
Drawer	The issuer of a bill of exchange
Drawee	The person ordered to pay a bill of exchange
Payee	The person to whom a bill or note is to be paid
Endorser	A payee who has signed (endorsed) and delivered a bill or note to an endorsee
Endorsee	A person who receives an endorsed bill or note from an endorser
Bearer	A person who has physical possession of a bill or note that is payable to anyone ("to bearer") or that has been endorsed without naming an endorsee (endorsed "in blank")
Holder	A person who has physical possession of a bill or note that was drawn, issued, or endorsed to him or her, or to his or her order, or to the bearer, or in blank
Holder in due course	Under common law (but not civil law), a person who acquires a bill or note for value, in good faith, and without notice that it is defective, overdue, or that any person has a claim to or defense against it
Acceptor	A drawee of a bill who, by signing the bill on its face, agrees to pay the bill when it is due
Accommodation party	A person who signs a bill or note to lend his or her credit to another party
Accommodation maker or aval	A person who signs a bill or note as a surety and comaker
Accommodation endorser	A person who endorses a bill or note as a guarantor of an endorsee

July 15, 2012 $ **10,000.00**
New York, New York

Ninety days after above date for value received, the undersigned jointly and severally promise(s) to pay to the order of: BANK OF THE RIVER, at its offices at 100 Hudson Ave., New York, New York 02167,

----- Ten Thousand and 00/100 ----- DOLLARS

with interest thereon from the date above at the rate of **-11-** percent per annum (computed on the basis of actual days and a year of 360 days) payable at maturity.

Officer: **Jones**
No. **990-11-9999**

Makers

July 15, 2012 PROMISSORY NOTE € **10,000.00**
Paris, France

Ninety days after above date for value received, the undersigned jointly and severally promise(s) to pay in French Francs this Promissory Note to the order of the EX-PATRIOT BANK at its offices at 100 Cours Albert 1er, 75008 Paris, France, at the official exchange rate on the date of maturity, the equivalent of

----- Ten Thousand and 00/100 ----- EUROS

with interest thereon from the date above at the rate of **-11-** percent per annum (computed on the basis of actual days and a year of 360 days) payable at maturity.

Officer: **Mitterand**
No. **1118-1-7932**

Makers

FIGURE 12.4

An American Promissory Note (top) and a French Promissory Note (bottom)

SMALLTOWN BANK
901 Main St.
Pullman, Washington 99163

88-11/980

NEGOTIABLE CERTIFICATE OF DEPOSIT

Number: 99053
Jan. 1, 2012

THIS CERTIFIES to the deposit in this Bank the sum of
Ten Thousand and 00/100 DOLLARS
which is payable to the order of Apples-R-Us, Inc. on the 1st day of January, 2013 against presentation and surrender of this certificate, and bears interest at the rate of 1-1/2 percent per annum, computed (on the basis of actual days elapsed and a year of 360 days) to, and payable at, maturity. No payment may be made prior to, and no interest accrues after, that date. Payable at maturity in federal funds, and if desired, at the Major National Trust Company, New York.

THE SMALLTOWN BANK OF PULLMAN, WASHINGTON

By: ______________________
Signature

FIGURE 12.5

Certificate of Deposit

called *small CDs*; those for $100,000 or more, *large CDs*. Most large CDs and some small CDs are negotiable. Figure 12.5 shows a negotiable CD.

E. Negotiability of Bills and Notes

Bills of exchange and promissory notes may be either negotiable or non-negotiable. For trade to run smoothly, especially international trade, these instruments need to be negotiable—that is (generally speaking), as freely exchangeable as money. Indeed, so long as the form and content of the instruments are proper, the law guarantees the full transferability of the right to receive payment. If there is any limitation on this right, an instrument is said to be non-negotiable.

To be negotiable, a bill or note must (1) be in the proper form and (2) contain a promise by the maker or drawer to make payment. The requirements for form were discussed earlier (see Table 12.1). To meet the promissory requirements, a bill or note must do the following:

1. State an unconditional promise or order to pay.
2. State a definite sum of money or a monetary unit of account.
3. Be payable on demand or at a definite time.
4. Be signed by the maker or drawer.

Unconditional Promise or Order to Pay

A bill or note must contain a promise or an order to pay that is unconditional.

Promise or Order A bill or note must contain an affirmative promise by the maker, or an order to a drawee, to be negotiable. The promise is inadequate if it is only implied.

For example, an *I.O.U.* only acknowledges an obligation of indebtedness. Although it may imply an obligation to pay, it does not contain an affirmative undertaking to do so. It is not, therefore, a negotiable instrument.

The promissory notes shown in Figure 12.4 are different because they clearly state that the makers promise to pay the payees. Similarly, the bills of exchange shown in Figures 12.1, 12.2, and 12.3 each order a drawee to pay a payee.

Unconditionality The promise or order to pay made in a bill or note cannot be conditioned upon the performance of some other obligation. The reason for this is basic to the concept of negotiability. If the holder of a bill or note had to determine whether a collateral promise had or had not been fulfilled, the utility of these instruments would be greatly reduced.

To illustrate, if Ivan promises to pay Pierre only if Pierre delivers goods to Ivan before July 4, anyone who might be interested in purchasing this promissory note would have to determine whether delivery was actually made. This would be both expensive and, if an error was made, risky. Thus, both the law and the pragmatic requirements of trade dictate that a bill or note containing a promise or order to pay that is conditioned on the performance of a collateral obligation is non-negotiable.

Mere reference to some other agreement, however, does not make a bill or note non-negotiable. It is common practice, in fact, to mention the underlying contract that caused the drawer or maker to issue the bill or note, either for record keeping or for informational purposes. Thus, statements that the bill or note arises out of a separate agreement, or that it is drawn under a letter of credit, or that the ability of the drawer or maker to perform is secured by a mortgage or a security interest do not affect negotiability.[14]

Definite Sum of Money or Monetary Unit of Account

A bill or note must be payable in money, which must be for a definite sum.

Money Both the common law and the ULB specify that the sum paid must be money.[15] The common law defines **money** as "a medium of exchange authorized or adopted by a domestic or foreign government and includes a monetary unit of account established by an intergovernmental organization or by agreement between two or more nations."[16] The ULB provides that the "usages of the place of payment" determine the meaning and the value of money.[17]

money
A medium of exchange authorized or adopted by a domestic or foreign government; it includes a monetary unit of account established by an intergovernmental organization or by agreement between two or more nations.

In international practice or usage, the parties to international bills and notes routinely define their monetary obligations by referring to monetary units of account (such as the International Monetary Fund's Special Drawing Right or the EU's euro) or to an *ad hoc* basket of several foreign currencies (see Chapter 6). Both the common law and the ULB, accordingly, allow bills and notes to be payable in the currency of one country, of several countries, or a monetary unit of account defined by an intergovernmental organization (IGO).

Definite Sum The sum to be paid must be *certain* or *determinate*. In other words, the amount to be paid must be ascertainable from the bill or note itself without reference to an outside source. For example, a promissory note that provides for the payment of £1,000 plus interest of 10 percent per annum until the time it is cashed states a definite sum because the parties can figure out the amount that is due from the information provided on the face of the note.

Both of the principal negotiable instruments laws set out exceptions to this basic rule. Both allow the parties to define the sum to be paid in one currency (the money of account) while requiring payment to be made in another (the money of payment), even though this requires the parties to refer to exchange rates that are not embodied in the bill or note.[18] In addition, the common law allows for payments to be made in installments (the ULB does not).[19] While the ULB does not allow for variable interest rates, the UCC now does allow such rates.[20]

Payable on Demand or at a Definite Time

For a bill or note to function reliably in commerce, the time when it is payable has to be on demand or ascertainable from its face.[21] The time requirement actually serves several functions. It tells the maker, drawee, accommodation maker, or acceptor when he is required to pay. It allows secondary

[14]See UCC, §3–106(b).

[15]UCC, §3–104(a); ULB, Article 1. Article 1 of the ULC contains the same provision for checks.

[16]UCC, §1–201(24).

[17]ULB, Article 41.

[18]UCC, §3–107; ULB, Article 41.

[19]UCC, §3–106(1)(a); ULB, Article 5.

[20]"Interest may be stated in an instrument as a fixed or variable amount of money or it may be expressed as a fixed or variable rate or rates." UCC §3–112(b); ULB, Article 5.

[21]So long as a final definite date for payment can be ascertained from the face of the instrument, this requirement is satisfied. The common law makes exceptions to this rule for acceleration clauses (which push forward the date when an instrument is payable in the event that an installment payment is missed), and the common law also allows for extension clauses (which let a maker or drawer postpone payment for a fixed time period). UCC, §3–109(1)(c).

parties, such as drawers, endorsers, and accommodation endorsers, to determine the date when their obligations arise. It establishes when the statute of limitations will run. And finally, with interest-bearing bills or notes, it defines the period for calculating the present value of the instrument.

Signed by the Maker or Drawer

signature
From Latin: *signare*, "to mark." The name of a person, written by that person, or any distinctive mark meant to authenticate a writing.

Bills of exchange must be signed by the drawer and promissory notes by their maker. For this purpose, a **signature** can be any symbol executed or adopted by a party with present intention to authenticate a writing.[22] Signatures do not have to be put on bills or notes at any particular time. Bills and notes lacking a drawer's or maker's signature are simply incomplete.

F. The Negotiation and Transfer of Bills and Notes

To satisfy commercial needs, bills and notes have to be freely transferable. Contract law governs the relationships between the original parties to a bill or note. Once a negotiable instrument circulates beyond the original parties, however, the laws governing negotiation come into play.

Assignment

assignment
The transfer of all or part of an assignor's contractual rights to an assignee.

The transfer of rights under a contract is called an **assignment**. When an assignment is made, the assignee acquires only those rights that the assignor possessed. Moreover, any objections to honoring the assigned obligations that could be raised against the assignor can also be raised against the assignee.

For example, Anna promises to deliver 10 widgets to Chekhov and Chekhov gives her an I.O.U. for $100. Anna promptly assigns the I.O.U. to Vanya, who several days later presents the I.O.U. to Chekhov, asking him to pay it. Anna, however, failed to deliver the promised widgets, so Chekhov refuses to pay the I.O.U. Because an I.O.U. is a non-negotiable instrument (as mentioned earlier), Vanya can only be an assignee. He has no more rights in the I.O.U. than Anna had. As a consequence, Chekhov can use Anna's failure to make delivery of the widgets as an excuse (or *defense*) for not paying Vanya. Vanya's only recourse is to return to Anna—if Anna can be found—and get back whatever money he may have paid for the I.O.U.

Bankers and merchants, who are well aware of the problems that arise in taking instruments by assignment, are not anxious to do so. They prefer to be paid in cash or by a negotiable instrument—that is, by an instrument that is, for most purposes, the same as cash.

Negotiation

negotiation
The transfer of rights in an instrument, either by endorsement and delivery or merely by delivery, that entitles the holder to sue in his own name and to take the instrument free of some of the claims that persons obliged to pay on the instrument have against the transferor.

Negotiation is the transfer of a bill or note in such a way that the recipient becomes a holder. Unlike an assignee (who acquires only the rights of the assignor), a holder can acquire more rights from the transferor than the transferor possessed. The rights that a holder acquires depend on the manner in which the instrument was negotiated and the governing law.

order paper
A bill of exchange or promissory note that is payable to a named payee.

Negotiating Order Paper **Order paper** is a bill or note that either (1) contains the name of a payee capable of endorsing it, such as "Pay to the order of Francisco Madero," or (2) contains as its last endorsement a so-called *special endorsement*—that is, for example, "Pay to George Washington." (See Figure 12.6.) Order paper is negotiated by delivery and endorsement. That is, a bill payable to the order of Giulio Romano would be negotiated when Giulio signed the back and delivered it to a holder.

FIGURE 12.6
Special Endorsement

pay to
George Washington
Benjamin Franklin

[22]UCC, §1–201(37) states that "Signed includes using any symbol executed or adopted with present intention to adopt or accept a writing."

No definition is given in the ULB, but commercial practice in Europe follows the common law usage.

Abraham Lincoln

FIGURE 12.7

Blank Endorsement

Negotiating Bearer Paper **Bearer paper** is an instrument that either (1) contains on its face an order to pay the bearer or to pay in cash, or (2) contains as its last endorsement a so-called *blank endorsement*, that is, the signature of the payee or the signature of the last endorsee named in a special endorsement. (See Figure 12.7.) Bearer paper is negotiated by delivery alone.

bearer paper
A bill of exchange or promissory note that is payable to the bearer or to cash.

The use of bearer paper is riskier than the use of order paper. If it is lost or stolen it must still be paid, a rule that has existed for more than 200 years, as Case 12-1 points out.

Converting Order to Bearer Paper and Bearer to Order Paper Order paper can be converted to bearer paper by an endorsement in blank or by an endorsement to pay to the bearer. Bearer paper can be converted to order paper through the use of a special endorsement, such as "Pay to John Adams."

CASE 12-1 Miller v. Race

England, Court of King's Bench, 1758
English Reports, vol. 97, p. 398

MAP 12.1

England (1758)

William Finney owed 21 pounds and 10 shillings to Bernard Odenharty. Finney purchased a note in that amount from the Bank of England that was drawn upon the bank itself and that was made payable to bearer. Finney then sent the bank's note to Odenharty in the mail on December 11, 1756. That night the mail was robbed, and the note in question and several other notes were carried off by the robber. On December 12, the note came into the possession of an innkeeper by the name of Miller.

On December 13, having learned of the robbery, Finney applied to the Bank of England to stop payment on the note. The bank agreed to do so.

Shortly thereafter, Miller presented the note to the Bank of England for payment. The bank's clerk, who was named Race, refused either to pay the note or return it to Miller. Miller thereupon brought suit against Race to compel him to make payment.

At issue was the following question: "Whether, under the circumstances of this case, the plaintiff had a sufficient property in this bank note, to entitle him to recover in the present action."

Opinion by Lord Mansfield

***

[This case] has been very ingeniously argued by Sir Richard Lloyd for the defendant. But the whole fallacy of the argument turns upon comparing bank notes to what they do not resemble, *viz*. to goods, or to securities, or documents for debts.

Now they are not goods, not securities, nor documents for debts, nor are they so esteemed—but are treated as money, as cash, in the ordinary course and transaction of business, by the general consent of mankind; which gives them the credit and currency of money, to all intents and purposes. They are as much money as guineas themselves are; or any other current coin, that is used in common payments, as money or cash.

. . . Here, an innkeeper took it, bona fide, in his business from a person who made an appearance of a gentleman. Here is no pretense or suspicion of collusion with the robber—for this matter was strictly inquired and examined into at the trial—and it is so stated in the case, "that he took it for full and valuable consideration, in the usual course of business." Indeed, if there had been any collusion, or any circumstances of unfair dealing, the case had been much otherwise. If it had been a note for 1,000£ it might have been suspicious, but this was a small note for 21£ 10s only, and money was given in exchange for it.

. . . A bank note is constantly and universally, both at home and abroad, treated as money, as cash; and paid and received, as cash; and it is necessary, for the purposes of commerce, that their currency should be established and secured.

. . . No dispute ought to be made with the bearer of a cash note—in regard to commerce, and for the sake of credit—though it may be both reasonable and customary, to stay the payment, till inquiry can be made, whether the bearer of the note came by it fairly, or not.

Judgment for the plaintiff.

Casepoint

The court considered whether a note payable to bearer was more like cash or like goods. The judge looked at the purpose of bearer instruments and stated that they were used as a substitute for cash, and in the absence of any obvious irregularities could be negotiated as cash. Where, as here, the innkeeper gave consideration and took the note in payment "in the ordinary course of business," it was to be treated as cash and the bank had to honor its payment obligation.

The manner in which a bill or note must be negotiated depends on its character at the time of negotiation. If it is order paper, it must be negotiated by delivery and endorsement; if it is bearer paper, by delivery alone. To illustrate: A note is made payable to Mustafa Kemal, who endorses it by signing his name on the back. The note can now be negotiated by delivery alone, and whoever receives it from Kemal can also negotiate by delivery alone. Any subsequent holder can, of course, add a special endorsement to convert the note back to order paper. For example, the note may come into the possession of Ali Jinnah, who could add the statement "Pay Ahmad Khan," sign the note himself, and deliver it to Khan. Khan would then have to endorse it himself before he could negotiate the note.

Endorsements An **endorsement** is required to negotiate a bill or note that is in the form of order paper, and it may optionally be added to bearer paper. Endorsements are signatures, with or without additional statements, that are commonly written on the back of the instrument. There are four basic kinds: (1) special endorsements, (2) blank endorsements, (3) qualified endorsements, and (4) restrictive endorsements. The first two have already been described.

Qualified Endorsements Normally, an endorser guarantees that the instrument will be accepted and paid by the drawee or maker. The endorser can avoid this guarantee, however, by making a **qualified endorsement**. Commonly, this is done by adding the words *without recourse*.[23] Qualified endorsements are commonly used by persons acting in a representative capacity. For example, a lawyer may receive a check that is payable to him, which is really meant to be paid to a client. Because the lawyer is only endorsing the check to make it possible for the client to cash it, he should not have to make good on the check if it is later dishonored. By adding a qualified endorsement, he will not have to do so. (See Figure 12.8.)

Restrictive Endorsements **Restrictive endorsements** limit the rights of subsequent holders. There are several types, including conditional endorsements, endorsements for collection, endorsements prohibiting further endorsements, and agency endorsements. None of these, however, prevents the further transfer or negotiation of a bill or note.[24]

A **conditional endorsement** contains a statement that conditions payment on the occurrence of a specified event. (See Figure 12.9.) The effect of this endorsement is to make the bill or note a non-negotiable instrument as to the endorser only. No subsequent holder has the right to enforce the payment against a conditional endorser until the condition is met.

An **endorsement for collection** makes an endorsee (usually a bank) a collecting agent for the endorser. In common law countries, such an endorsement is usually written as *for deposit only*, *for collection only*, or *pay any bank*. In civil law countries, the phrases *value in collection* and *by procuration* are also commonly used.

The effect of an endorsement for collection is to put the instrument into the bank collection process. In common law countries, only a bank can become a holder once this endorsement has been added to a bill or note, unless the instrument is specially endorsed by a bank to a person who is not a bank.[25] Under the ULB, anyone can become a holder, but he can only endorse the instrument for the purpose of making collection.[26]

An **endorsement prohibiting further endorsements** states that the instrument may be paid only to a particular person. An example is "Pay to Harry Potter only." This endorsement is treated differently by the two main commercial law systems.

without recourse
Edgar A. Poe

FIGURE 12.8

Qualified Endorsement

pay to Muhammad Ali on condition he delivers 1 pair of boxing gloves to me in 1 week
George Foreman

FIGURE 12.9

Conditional Endorsement

endorsement
The act of a payee, drawee, accommodation party, or holder of a negotiable instrument in signing the back of the instrument, with or without qualifying words, to transfer rights in the instrument to another.

qualified endorsement
An endorsement in which the endorser does not guarantee that an instrument will be accepted and paid by the drawer or maker.

restrictive endorsement
An endorsement that restricts the rights of subsequent holders.

conditional endorsement
An endorsement that conditions payment on the occurrence of some event.

endorsement for collection
An endorsement that makes the endorsee a collecting agent for the endorser.

endorsement prohibiting further endorsements
An endorsement that states that the instrument may be paid only to a particular person.

[23]The words *without recourse* are required in the common law countries. UCC, §3–414(e). No particular words are required in Europe. ULB, Article 15.

[24]UCC, §3–206(a); ULB, Article 15.

[25]UCC, §4–201(b)(2).

[26]ULB, Article 18.

In common law countries, an endorsement prohibiting further endorsements is treated as if it were a special endorsement—that is, as though the example said, "Pay to Harry Potter."[27] The ULB treats such an endorsement as if it were a qualified endorsement (e.g., "Pay to Harry Potter, without recourse"); in other words, the endorser does not guarantee acceptance or payment.[28]

agency endorsement An endorsement that requires the endorsee to pay the proceeds from the negotiation of the instrument to the endorser or a designated third party.

An **agency endorsement** requires the endorsee to pay the proceeds from the negotiation of a bill or note to the endorser or to some third party. In common law countries, such an endorsement is phrased as "Pay to Alexander Leslie, agent for Oliver Cromwell [signed] Oliver Cromwell" or "Pay to Alexander Leslie in Trust for Charles Tudor [signed] Oliver Cromwell." In civil law countries, the wording is "Pay to Maximilien Robespierre, for value in security [signed] Napoleon Bonaparte" or "Pay Maximilien Robespierre, for value in pledge to Louis Bourbon [signed] Napoleon Bonaparte."

Under the common law and the ULB, an agency endorsee may properly negotiate the instrument only as directed. This restriction on rights, however, applies only to the immediate endorsee and not to any subsequent holder.[29]

A description of the various types of endorsements is provided in Table 12.3.

Forged Endorsements

forgery The false making or altering of a writing with the intent to defraud.

When an endorsement is a **forgery**, the question arises as to who should have to sue the forger or, if the forger cannot be found, who has to assume the loss. There are several possible ways to answer this question. The one that makes the most sense commercially (i.e., the one that is most likely to

TABLE 12.3

Effect of different endorsements under the common law and the ULB

Type of Endorsement	Example	Endorsee's Status	
		Common Law	**ULB**
Blank	[*signed*] Abraham Lincoln	Holder	Holder
Special	Pay to George Washington, [*signed*] Benjamin Franklin	Holder	Holder
Qualified	Pay to Jane Austen, without recourse, [*signed*] Edgar A. Poe	No rights against endorser	No rights against endorser
Conditional	Pay to Muhammad Ali on condition he delivers 1 pair of boxing gloves to me in 1 week, [*signed*] George Foreman	No rights against endorser until condition is met	No rights against endorser until condition is met
For collection	For collection only, [*signed*] Eleanor Roosevelt	Collecting agent for endorser	Collecting agent for endorser
Prohibiting further endorsements	Pay to Harry Potter only, [*signed*] Ron Weasley	Holder	No rights against endorser
Agency	Pay to Huck Finn, agent for Tom Sawyer [*signed*] Tom Sawyer	Collecting agent for endorser	Collecting agent for endorser

[27]UCC, §3–206(a).

[28]ULB, Article 15.

[29]UCC, §3–206(b); ULB, Article 19.

encourage the free transfer and exchange of bills and notes) is to make the drawer or maker liable. This is the rule adopted by the ULB. The ULB makes a forged endorsement fully effective, and both the person taking an instrument with such an endorsement and all subsequent holders are entitled to payment.[30]

Another possibility is to impose liability on the person who was best able to prevent the forgery from happening. This is possibly the fairest rule, but it also encourages excessive and expensive litigation. It is the rule followed in most common law countries. As a general rule, the common law makes a forged endorsement ineffective, placing the burden for determining the validity of an endorsement on the endorsee taking an instrument from a forger. Case 12-2 illustrates this rule.

There are two major exceptions to the general common law rule that a forged endorsement is ineffective. One is the **imposter rule**. This rule provides that when a drawer, maker, or endorser draws, makes, or endorses an instrument to an imposter, the imposter's subsequent endorsement

imposter rule
A person who pretends to be another so as to have a negotiable instrument drawn, made, or endorsed to that person may effectively endorse the pretended person's signature on the instrument.

CASE 12-2 Mair v. Bank of Nova Scotia

Court of Appeal of Eastern Caribbean States, Civil Division, 1983
West Indian Reports, vol. 31, p. 186 (1983)

MAP 12.2

Antigua and Barbados (1983)

Opinion by Appellate Judge Berridge

This is an appeal from a decision of Judge Robotham dated June 18, 1980, in which judgment was given for the respondent bank in respect of a claim by the appellant alleging negligence and breach of duty in the sum of $6,000 and interest, together with costs.

The brief facts of the case are that sometime in 1974 the appellant, an architect by profession, engaged one Barbara Hill of Barbados, herself an architect, to assist him in Antigua by doing specific architectural work. Hill took up her assignment with the appellant who gave her an advance of $6,000 payable by check drawn on the St John's, Antigua, branch of the Bank of Nova Scotia for work already done and to be done in the future. Shortly thereafter Hill returned to Barbados following differences which arose between her and the appellant and in respect of which there is litigation which is not before the court.

[30]ULB, Article 7.

The check was dated January 16, 1974, and made payable to "Barbara Hill"; but it was altered on the face of it by the addition of the word "Associates" as payee, endorsed "Barbara Hill" and deposited at the branch of the respondent bank at Worthing, Christchurch, Barbados, on January 23, 1974, to the credit of "Barbara Hill Associates."

On January 29, 1974, the check was returned to the Antigua branch of the bank who deducted $6,000 from the appellant's account and in due course the canceled check was forwarded to the appellant who, by letter dated May 7, 1974, drew the bank's attention to the alteration and demanded reimbursement on the grounds that (i) it was negligent in not observing the alteration in which event it should not have paid, and (ii) it had not carried out his instructions. The bank refused to reimburse the appellant and as a consequence proceedings were instituted by the appellant.

***

In arguing the . . . appeal, counsel submitted that the alteration was a material alteration on the face of the instrument which [made it void] under Section 64 of the *Bills of Exchange Act* [of Antigua and Barbuda] the provisions of which are similar to, if not identical with, comparable legislation throughout the Commonwealth. Counsel further contended that (i) the mandate of the drawer of the check was not substantially carried out, (ii) the alteration was apparent, (iii) the bank was not a holder in due course, and (iv) the damage suffered was the debiting of the appellant's account with a payment to someone other than the payee stated by the appellant.

It is pertinent at this stage to set out the provisions of Section 64 of the Bills of Exchange Act, which reads as follows:

1. Where a bill or acceptance is materially altered without the assent of all parties liable on the bill, the bill is avoided except as against a party who has himself made, authorized, or assented to the alteration, and subsequent endorsers. Provided that, where a bill has been materially altered, but the alteration is not apparent and the bill is in the hands of a holder in due course, such holder may avail himself of the bill as if it had not been altered, and may enforce payment of it according to its original tenor.
2. In particular the following alterations are material, namely, any alteration of the date, the sum payable, the time of payment, the place of payment, and where a bill has been accepted generally, the addition of a place of payment without the acceptor's assent.

In *Vance v. Lowther*,[31] where an alteration related to the date of the check, it was held that it was material and invalidated the check; and that the circumstance that the plaintiff had not been guilty of negligence in taking it was immaterial. Baron[32] Pollock said:[33]

> Any material alteration of a bill or note invalidates it, and the question is, what is the true principle on which the materiality must be determined. The county court judge seems to have thought that it was necessary to consider the surrounding circumstances in each case. In that I think he was wrong, and that we ought to look at the question of materiality with reference to the contract itself, and not with reference to the surrounding circumstances.

But it would be unreasonable if the alteration to an earlier date debarred the banker form debiting the customer, if paid after the original date.

Similar in a number of respects to the facts in the instant case are those in *Slingsby v. District Bank, Ltd*.[34] where words were inserted between the payee's name and the words "or order" and endorsed to conform with the designation of the payee as altered. It was held that the check had been materially altered within the body of Section 64(1) of the *Bills of Exchange Act* and therefore the check had been avoided.

The materiality of the alteration being dependent upon its character and effect, it necessarily follows that if the mandate of the customer has been substantially complied with then the banker

[31] *Law Reports, Exchequer's Division*, vol. 1, p. 176 (1876).

[32] "Baron" is the title for the judges of the English Court of Exchequer.

[33] *Id*., at p. 178.

[34] *All England Law Reports*, vol. 1931, p. 143 (King's Bench, 1931).

can charge the customer, the alteration notwithstanding. Authority for the foregoing is to be found in *Halsbury's Laws of England*.[35]

I am of the opinion that the check was materially altered without the assent of the appellant.

To constitute an apparent alteration within the meaning of the *Bills of Exchange Act* it should be apparent upon inspection of the bill that its text has undergone a change. The document itself must show that some revision of the text has taken place and its appearance must be consistent with the revision having occurred after completion or issue, although it may also be consistent with the revision having occurred before completion.[36]

An inspection of the check reveals that the alteration is obviously in a different handwriting from that in which the rest of the document was drawn and it should have been observed that it had undergone a change.

In regard to the difference between the rights of a "holder in due course" and a "holder" I can do no better than quote from the words of Lord Justice Denning in *Arab Bank, Ltd. v. Ross*:[37]

> The difference between the rights of a "holder in due course" and those of a "holder" is that a holder in due course may get a better title than the person from whom he took, whereas a holder gets no better title. In this regard a person who takes a bill, which is irregular on the face of it, is in the same position as a person who takes a bill which is overdue. He is a holder, but not a holder in due course. He does not receive the bill on its own intrinsic credit. He takes it on the credit of the person who gives it to him. He can sue in his own name but he takes it subject to the defects of title of prior parties: see Section 38 of the Act of 1882.

In the instant case the bank took the check which was irregular on the face of it. The bank was not a holder in due course and cannot [therefore] avail itself of the proviso to Section 64(1) of the *Bills of Exchange Act*.

On the question of damages, the appellant's claim is in contract. It is a well-established principle that whenever a party proves a breach of contract but no actual damage (as was contended by learned counsel for the bank) he recovers as a rule nominal damages only.

In the instant case the appellant claims that the damage suffered by him is the debiting of his bank account with an amount payable by check drawn by him to "Barbara Hill" and not "Barbara Hill Associates"; but, I am unable to perceive what damage the appellant has suffered on account of the alteration of the check.

. . .In the circumstances, I would allow the appeal and vary the order of the trial judge by entering judgment for the appellant in the sum of $5 nominal damages. . . .

Casepoint

This case concerns the effect of a forgery of part of the payee's name on a check. Someone (probably the payee) added the word *Associates* to the name of the payee and then negotiated the check. Later, when the drawer of the check noticed the change, he asked the bank to recredit his account. The court held that this was indeed an alteration, which made the bank a *holder* but not a *holder in due course* (who takes the instrument free of underlying defenses). But since the drawer could not show that he had suffered any actual damages due to the alteration, he was awarded only a nominal sum by the court.

is effective. For example, a man walks into a shop, says that he is John Lender, a creditor of the shop owner, Pete Gullible, and asks to be paid. Gullible, believing the man to be his creditor, writes a check made out in favor of John Lender. The man then cashes the check at a nearby supermarket and disappears. Because the man was an imposter, the forged signature he put on the

[35] Vol. 2, p. 205, para. 380 (3rd ed.).

[36] *Automobile Finance Co. of Australia, Ltd. v. Law*, *Commonwealth Law Reports*, vol. 49, p. 1 (Australia, High Court, 1933) refers.

[37] *All England Law Reports*, vol. 1952, pt. 1, p. 709 at p. 717 (Court of Appeal, 1952).

check is effective. Gullible cannot stop payment, and his bank must negotiate the check when the supermarket presents it.

fictitious payee rule A person who solicits and obtains a negotiable instrument drawn or made to a fictitious person may effectively endorse the fictitious person's signature on the instrument.

The second common law exception to the rule that a forged signature is ineffective is the **fictitious payee rule**. This says that when the instrument is issued in the name of a fictitious payee, the person purporting to be that payee can make an effective endorsement. To illustrate: A disgruntled employee, Ann Sly, tells her employer that he needs to sign a check that she has made out so that she can pay a supplier. He does so. Ann then forges the supplier's endorsement and cashes the check herself. In reality, the supplier (whether or not it really exists or was a fiction) has no claim against Sly's employer. The supplier's forged endorsement, however, is effective, and the employer must honor the check when an innocent holder presents it for payment.

The difficulty with the general common law rule is that the determination of whether one or the other of the two exceptions applies has to be made after the fact. In the meantime, the maker, drawer, or drawee can refuse to make payment, and the last holder will have to initiate suit against the dishonoring party to determine who is responsible for pressing the claim against the forger. The loser of that suit will, assuming the forger can be located, have to initiate a second suit to recoup the lost funds. This rule may assure employment for lawyers, but it does not promote the free transferability of negotiable instruments.

The liabilities of endorsers and drawers for forged instruments under the common law and the ULB are compared in Table 12.4.

ULB holder A person who acquires an instrument by negotiation.

Limitations on the Excuses That Drawers and Makers Can Use to Avoid Paying Off a Bill or Note

The major disadvantage of taking a bill, note, or other contractual obligation by assignment is that the maker or drawer can make a wide range of excuses for not having to pay off the instrument. By contrast, the advantage of taking an instrument by negotiation is that many of these excuses are limited.[38]

ULB bad faith Acquiring an instrument knowing that it was not properly negotiated to you.

The most extensive limitations imposed on the excuses of makers and drawers are those contained in the ULB. Anyone who acquires a bill or note by negotiation is a **holder** who is entitled to payment from the maker or drawer. There are only three excuses available to these parties. One is that the possessor is not a holder because he did not acquire title through an uninterrupted series of endorsements. For example, someone possessing an instrument that is payable on its face to one person but endorsed on the back by another cannot be a holder.

ULB gross negligence Acquiring an instrument in such a careless or reckless manner that one should have known that it was not properly negotiated.

The second excuse is that the holder acquired the instrument in bad faith. **Bad faith** includes such things as the actual theft of the instrument; having actual knowledge that the instrument is stolen, lost, or misplaced; or having actual knowledge that the payee, or some prior holder, is not properly entitled to payment.

The third excuse is that the holder acquired the instrument through **gross negligence**. This is essentially the same as bad faith, except that the holder does not have to have actual knowledge. He must, however, have acted in a truly careless manner in failing to detect some defect in the instrument or in the rights of the maker, drawer, or a prior holder.[39] These excuses are summarized in Table 12.5.

TABLE 12.4

Liability when a negotiable instrument is forged

Situation	Common Law	ULB
A stolen instrument is forged.	Immediate endorsee	Drawer
The forger is an imposter.	Drawer	Drawer
The forger endorses for a fictitious payee.	Drawer	Drawer

[38]In the United States, the courts and statutory materials refer to *defenses* rather than excuses. In the United Kingdom, the phrase is *failure of equities*. In the civil law countries, the terms *defenses*, *justifications*, and *excuses* are all used. *Excuses* will generally be used in this book.

[39]ULB, Article 16.

TABLE 12.5

ULB excuses that drawers and makers can use to avoid paying bills of exchange and promissory notes

Person in Possession	Excuse
Not a holder	1. Not a holder
Holder	1. Acquired instrument in bad faith
	2. Acquired instrument through gross negligence

In contrast to the ULB, the common law imposes very few limitations on the excuses that makers and drawers can use to get out of their obligation to pay off a bill or note. To cut short these excuses, a possessor must first (as is the case in the ULB) be a **holder**—that is, someone who acquired the bill or note through an uninterrupted series of endorsements. A person who is not a holder is not entitled to the instrument and must give it up.

common law holder A person who acquires an instrument by negotiation.

When the possessor of a bill or note is an ordinary holder, a maker or drawer can draw upon a lengthy list of excuses for not paying. (See Table 12.6.) The list is narrowed, however, if the holder can prove that he is entitled to the additional status of a **holder in due course (HDC)**.[40] An HDC is a holder who acquires an instrument (1) for value, (2) in good faith, and (3) without notice that it is overdue, that it has been dishonored, or that the maker, drawer, or a prior endorser has a valid excuse for not paying it off.[41] The requirement that an HDC has to give value for an instrument means that someone who receives an instrument as a gift or by inheritance can only be an ordinary holder. Good faith means that the holder cannot have known—or have reasonably suspected—that the instrument was defective.

common law holder in due course A holder who acquires a negotiable instrument for value, in good faith, and without notice that it is overdue, that it has been dishonored, or that persons required to pay on it have a valid excuse for not doing so.

Liabilities of Makers, Drawers, Drawees, Endorsers, and Accommodation Parties

Two kinds of liability are imposed on makers, drawers, and endorsers of bills and notes. One is liability *on the instrument*—that is, liability arising out of a signature. The other is *warranty* liability—that is, responsibility arising out of the implied guarantees a person makes at the time he transfers or presents a negotiable instrument. In neither case, it is important to note, is liability based on the underlying contract.

TABLE 12.6

Common law excuses that drawers and makers can use to avoid paying bills of exchange and promissory notes

Person in Possession	Excuse
Not a holder	Not a holder
Holder	Breach of contract (including breach of contract warranties)
	Lack or failure of consideration
	Fraud in the inducement
	Illegality, incapacity (other than minority), or duress, if the contract is voidable
	Previous payment of the instrument
	Unauthorized completion of an incomplete instrument
	Nondelivery of the instrument
Holder or holder in due course	Forgery
	Fraud in the execution
	Material alteration
	Discharge in bankruptcy
	Minority, if the contract is voidable
	Illegality, incapacity, or duress, if the contract is void

[40] A holder has the burden of proving that he is a holder in due course. UCC, § 3–308(b).

[41] *Id.*, § 3–303.

presentment
A production of an instrument to a party liable to pay on it for that party's acceptance (i.e., commitment to pay) or payment.

Liability on the Instrument A person who signs an instrument has a contractual obligation to make payment. For makers, drawees, and accommodation parties, this obligation is *primary*; that is, they must make payment on **presentment** of the instrument. If it is other than a demand instrument, it must be presented on the day it is due. If it is a demand instrument, it must be presented within a reasonable time after it was signed.

Sometimes the failure to present a check for payment within a reasonable time will prevent the holder from collecting on the instrument, as Case 12-3 demonstrates.

CASE 12-3 Far East Realty Investment, Inc. v. Court of Appeals

The Philippines, Supreme Court, Second Division, 1988
Supreme Court Reports Annotated, Second Series, vol. 166, p. 256 (1988)

MAP 12.3

Philippines (1988)

On September 13, 1960, Dy Hian Tat, Siy Chee, and Gaw Suy An went to the Manila office of Far East Realty Investment, Inc. (Far East) and obtained a loan in the sum of P4,500.00 (Philippine currency), which they needed in their business and which they promised to pay, jointly and severally, in one month's time together with interest at the rate of 14 percent per annum. To assure Far East that it would be repaid, Dy Hian Tat drew a check on his account with China Banking Corporation (the bank), dated September 13, 1960, for P4,500.00, and Siy Chee and Gaw Suy An signed the check on its back as accommodation parties. The three men were to redeem the check in one month's time by paying cash to Far East in the sum of P4,500.00; otherwise, Far East was to present the check for payment at the bank.

Almost four years later, on March 5, 1964, Far East presented the check to the bank for payment. The bank refused to pay, as the account of Dy Hian Tat had been closed for some time. Far

East then made a demand on Dy Hian Tat, Siy Chee, and Gaw Suy An for repayment of their loan. When they refused to pay, Far East brought suit. The City Court of Manila ruled in favor of Far East, so Dy Hian Tat, Siy Chee, and Gaw Suy An appealed. The Court of First Instance of Manila also ruled in favor of Far East but the Court of Appeals reversed, holding that Far East had not presented the check for payment within a reasonable time. Far East (the petitioner) then appealed to the Philippine Supreme Court.

Opinion by Justice Paras

***

The main issue in this case is whether or not presentment for payment and notice of dishonor of the questioned check were made within reasonable time.

. . .Where the instrument is not payable on demand, presentment must be made on the day it falls due. Where it is payable on demand, presentment must be made within a reasonable time after issue, except that in the case of a bill of exchange, presentment for payment will be sufficient if made within a reasonable time after the last negotiation thereof.[42]

Notice may be given as soon as the instrument is dishonored, and, unless delay is excused, must be given within the time fixed by the law.[43]

No hard and fast demarcation line can be drawn between what may be considered as a reasonable or an unreasonable time, because "reasonable time" depends upon the peculiar facts and circumstances in each case.[44]

It is obvious in this case that presentment and notice of dishonor were not made within a reasonable time.

"Reasonable time" has been defined as so much time as is necessary under the circumstances for a reasonable, prudent and diligent man to do, conveniently, what the contract or duty requires should be done, having a regard for the rights and possibility of loss, if any, to the other party.[45]

In the instant case, the check in question was issued on September 13, 1960, but was presented to the drawee bank only on March 5, 1964, and dishonored on the same date. After dishonor by the drawee bank, a formal notice of dishonor was made by the petitioner through a letter dated April 27, 1968. Under these circumstances, the petitioner undoubtedly failed to exercise prudence and diligence on what he ought to do as required by law. The petitioner likewise failed to show any justification for the unreasonable delay.

PREMISES CONSIDERED, the petition is DENIED and the decision of the Court of Appeals is AFFIRMED.

So Ordered.

Casepoint

This case concerned whether the check (a demand instrument) was presented for payment within a reasonable time. The Philippines Supreme Court found that the payee's delay of almost four years in presenting the check for payment was not within a reasonable time, and thus the bank did not have to honor the check.

Liability on the instrument for drawers, endorsers, and accommodation endorsers is *secondary*; that is, they have to pay only if the maker, drawee, or accommodation maker fails to do so.

When a holder or transferee is unable to obtain payment from the maker, drawee, or accommodation maker, she must take three preliminary steps before she can seek recourse from the parties with secondary liability. First, the instrument has to be properly presented. That is, it must contain all necessary endorsements, and it must be timely presented at the place required. Second, the

[42]Negotiable Instruments Law, §75(2).

[43]*Id*., §102.

[44]Arturo M. Tolentino, *Commentaries and Jurisprudence on the Commercial Laws of the Philippines*, vol. 1, p. 327 (8th ed., 1986–1988).

[45]*Citizens' Bank Bldg. v. L. & E. Wertheirmer*, *South Western Reporter*, vol. 189, p. 361, at 362 (Arkansas Supreme Ct., 1917).

instrument must be dishonored—that is, the instrument is not paid at the appropriate time. Evidence of dishonor may be contained in a stamp or writing by the drawee, payor bank, or other parties that payment has been refused,[46] or a more formal document called a "protest." In the United States, a protest may be prepared by a notary public or certain other officials.[47] The protest must identify the instrument and certify either that presentment has been made or, if not made, the reason why it was not made, and that the instrument has been dishonored by nonacceptance or nonpayment. The protest may also certify that notice of dishonor has been given to some or all parties.

The third requirement is to give notice to the parties with secondary liability. This is done, initially, by notifying the drawer and the last endorser. At the same time, any other endorser whose address the holder is aware of must also be notified. In turn, any endorser who receives such a notice must—to maintain his rights against his immediate endorser—notify that person. In the United States, notice must generally be given within 30 days[48]; in Europe, the requirement is two business days.[49] Notice may be given by any commercially reasonable means, including an oral, written, or electronic communication, and will be sufficient if it identifies the instrument and states that the instrument has been dishonored.[50]

Warranty Liability The most dramatic difference between negotiable instrument law in the United States and in Europe (including the United Kingdom) shows up in connection with warranty liability. In Europe, liability can arise only on the instrument. That is, unless someone signs an instrument, he will have no liability for its payment. In sum, there is no warranty liability.

In the United States, by comparison, any person who transfers an instrument in exchange for consideration—which includes a transferor of bearer paper who does not endorse the instrument—makes five warranties, or implied guarantees, to his immediate transferee and to every subsequent holder who takes the instrument in good faith. These are as follows:

1. The transferor has good title to the instrument or is otherwise authorized to obtain payment or acceptance on behalf of one who does have good title.
2. All signatures are genuine or authorized.
3. The instrument has not been materially altered.
4. No defense of any party is good against the transferor.
5. The transferor has no knowledge of any insolvency proceedings against the maker, the acceptor, or the drawer of an unaccepted instrument.

The Role of Banks in Collecting and Paying Negotiable Instruments

Banks perform at least four functions in connection with the negotiation of bills and notes. First, they may issue instruments themselves, such as certified checks or certificates of deposit. Second, they may function as the drawee on a bill of exchange or as the acceptor of a bill or promissory note, assuming primary liability for payment. Third, they can act as an agent for a holder or transferee to make collection. Fourth, they can take an instrument as an endorsee, paying the endorser and presenting the instrument for payment in their own right.

The significance of acting as an endorser rather than as an agent for collection—especially in connection with international transactions—is considered in Case 12-4.

[46]UCC §3–505(2), "A purported stamp or writing of the drawee, payor bank, or presenting bank on or accompanying the instrument stating that acceptance or payment has been refused unless reasons for the refusal are stated and the reasons are not consistent with dishonor."

[47]UCC §3–505(b), "A protest is a certificate of dishonor made by a United States consul or vice consul, or a notary public or other person authorized to administer oaths by the law of the place where dishonor occurs. It may be made upon information satisfactory to that person."

[48]Banks taking the instrument for collection must give notice within one day. UCC, §3–503(c).

[49]ULB, Article 44.

[50]UCC, §3–503(b), "Notice of dishonor may be given by any person; may be given by any commercially reasonable means, including an oral, written, or electronic communication; and is sufficient if it reasonably identifies the instrument and indicates that the instrument has been dishonored or has not been paid or accepted. Return of an instrument given to a bank for collection is sufficient notice of dishonor."

CASE 12-4 Charles R. Allen, Inc. v. Island Cooperative Services Cooperative Association

United States, Supreme Court of South Carolina, 1959
South Carolina Reports, vol. 234, p. 537 (1959)

MAP 12.4

South Carolina and Prince Edward Island (1959)

Island Cooperative Services Cooperative Association, Ltd. ("Island Coop"), a Canadian corporation, sold some seed potatoes to the Charleston County Wholesale Vegetable Market, Inc. ("Vegetable Market"), of Charleston, South Carolina, for a purchase price of $19,620. After the potatoes had been put aboard a ship in Charlottetown, Prince Edward Island, Canada, for shipment to Charleston, South Carolina, Island Coop prepared a draft (or bill of exchange) in the amount of $19,620 on February 7, 1955. Island Coop was the drawer, the Vegetable Market was the drawee, and the Bank of Nova Scotia's branch office at Charlottetown, Prince Edward Island, was the payee.

Island Coop offered this and several other drafts to the Bank of Nova Scotia at a discount, and the bank agreed to take them. Island Coop delivered the drafts to the Bank of Nova Scotia on February 7, 1955, accompanied by the following agreement:

1. The above bills, which represent amounts due to us for goods sold and delivered, are offered for discount. Our claims against Drawee are hereby transferred to you in the event of nonacceptance of any draft. The relative goods have already been shipped.
2. Credit Proceeds to Current A/C Savings A/C No.

The Bank of Nova Scotia endorsed the draft drawn on the Vegetable Market and forwarded it through its correspondent, the Bank of New York, to the South Carolina National Bank of Charleston for collection. The Vegetable Market paid the South Carolina Bank the full $19,620 on February 14, 1955.

At the same time that this transaction was going on between Island Coop, the Vegetable Market, and the three banks, Charles R. Allen, Inc. ("Allen"), a South Carolina corporation, brought suit for breach of contract against Island Coop, and won. The judgment Allen received entitled it to attach Island Coop's assets in South Carolina. Allen thereupon attached the $19,620 held in the South Carolina National Bank, claiming it was an asset of Island Coop. The Bank of Nova Scotia disagreed, and it promptly served a claim on Allen, stating that the proceeds of the draft belonged to it.

The trial court held that the Bank of Nova Scotia had taken the draft as an agent for collection and not as a purchaser, and therefore Island Coop had been the owner of the proceeds of the draft. Accordingly, the trial court held that Allen's attachment was proper. The Bank of Nova Scotia appealed.

Opinion by Justice Moss

***

The basic question for determination in this case is whether the appellant, Bank of Nova Scotia, was the absolute owner of the proceeds of the draft at the time of the attachment of the funds by the respondent. If the appellant was the owner thereof, and Island Coop had no interest therein, then this action must fail. . .

The appellant, in its claim to the proceeds of the draft here involved, asserted that under the laws of Canada that it had full and complete ownership and title to the draft and the proceeds thereof at the time of the attachment. The law of Canada has been proved to the effect that under the facts of this case surrounding the discount transaction as it took place in Canada, the Bank of Nova Scotia acquired under Canadian law an absolute title to and ownership of the draft in Canada at the time the draft was discounted on February 7, 1955. A consideration of the law of Canada and of the law of South Carolina, as applicable to factual situation here, leads us to the conclusion that the laws of Canada and South Carolina are in accord. The application of the laws of Canada or South Carolina requires us to reach the same conclusion. We will, therefore, as is contended for by the respondent, apply the law of South Carolina in this case.

It is the contention of the respondent that because the appellant had the right, in the event of nonpayment of the draft in question, to charge the dishonored draft back to the account of the depositor, that such showed that the appellant was a collecting agent and not the owner of the draft in question. This contention is contrary to the rule in this State. Likewise, the collection of interest upon the draft in question did not prevent the bank from becoming the sole owner thereof.

In the case of *Campbell v. Noble-Trotter Rice Milling Co., Inc. (Ex parte Calcasieu-Marine National Bank)* this Court completely answered these contentions when it said[51]:

> According to the prevailing view, the rule as to the passing of title to commercial paper, deposited and credited as cash, applies, although the bank has the right to charge dishonored paper back to the depositor instead of proceeding against the maker.

And it has been held that an interest arrangement will not prevent a bank from becoming the sole owner of a draft. Thus, where the bank advances the full amount of a draft, it becomes the unconditional owner, though it is understood it will collect interest on the amount advanced, depending upon the time it takes for collection.

***

In the case of *Lawton v. Lower Main Street Bank*, it is said[52]:

> . . .where an item is endorsed without restriction by a depositor, nothing appearing to indicate that it was received for collection, and it is at once passed to his credit by the bank, and he is permitted to check upon the account, he becomes the creditor of the bank, which, as the owner of the paper, is not the agent of the depositor in collecting it but collects on its own behalf. . .

We think that under the authority of the case of *Campbell v. Noble-Trotter Rice Milling Co., Inc*. . . . the lower court must be reversed. The only factual difference between the present case and the *Campbell* case is that in the latter case the bank discounted a draft with a bill of lading attached, while here it discounted the draft only. This factual difference does not make the case inapplicable to the present situation.

---

[51]*South Carolina Reports*, vol. 188, p. 212.

[52]*South Carolina Reports*, vol. 170, p. 334.

In the *Campbell* case it appears that Noble-Trotter Rice Milling Co., Inc., a Louisiana corporation, drew a draft on Allen Bros. Milling Co., Columbia, South Carolina, which represented the purchase price of a shipment of rice. Attached to the draft was a bill of lading covering the shipment, an invoice thereof, and a certificate of insurance. This draft was made payable directly to the Calcasieu-Marine National Bank, located at Lake Charles, Louisiana, and was deposited . . . by the Rice Milling Company in that bank, where it maintained a regular account, and where it had been transacting business for years. The draft, according to the contention of the bank, was not entered for collection, but was treated as cash and was immediately and unconditionally placed to the credit of Rice Milling Co. and made subject to its check.

In due course, the draft, together with attached papers, was forwarded by the bank for collection to the First National Bank, Columbia, South Carolina, where it was paid by the drawee, Allen Bros. Milling Co. The day the draft was paid to the First National Bank of Columbia, South Carolina, the proceeds were attached by one M. P. Campbell for the satisfaction of an unliquidated demand against Noble-Trotter Rice Milling Co. The Louisiana bank intervened, claiming the proceeds of the draft by reason of its ownership thereof. Judgment was rendered in favor of Campbell and the case was appealed to this Court. The question for decision was whether the bank took the draft as owner thereof or as a mere collecting agent for the customer. This court held that the Louisiana bank was entitled to the proceeds of the draft in question. It was said that the determination of the question of title to commercial paper transferred to a bank, which credits it to the depositor's account, involves a question of intention. The Court then discussed how it may be shown that the bank became the owner of the commercial paper rather than a mere agent for collection, and it was expressly stated that the right accorded to a depositor to draw upon funds is especially material as showing an intention that title should pass to the bank. It was stated that another means of ascertaining the intention is a consideration of course of conduct or the ordinary course of business as disclosed by the evidence. It was also held that where there was a deposit of a draft in the ordinary course of banking business, whereby the depositor received from the bank an unconditional credit of the amount as cash against which the depositor had a right to draw, with nothing to qualify the effect of such act, such operated *prima facie* to transfer title of the draft to the bank.

Applying the rule set forth in *Campbell v. Noble-Trotter Rice Milling Co*. to the evidence in this case, and keeping in mind that the burden of proof was upon the respondent [who was the plaintiff in this case] to show ownership of the draft by Island Coop rather than by the Bank of Nova Scotia, we think that under the evidence the only conclusion that can be reached is that the respondent failed to carry the burden of proof. The evidence in behalf of the appellant is conclusive that it was the owner of the draft in question. Island Coop had been a customer of the appellant for a number of years, and over this period of time the bills of Island Coop had been discounted. The draft in question was handled by the discount department rather than by the collection department of said bank. The bank, upon discounting the draft in question, placed it without restriction and unconditionally to the checking account of Island Coop and accorded to it the right to draw upon the funds, which said right was exercised. There is no evidence contradictory of these facts.

. . .We conclude, after a consideration of all the facts in this case, that under the applicable law thereto, that the title to the draft in question passed to the Bank of Nova Scotia, and that it is entitled to the proceeds now held in the custody of the South Carolina National Bank in Charleston, South Carolina.

***

Judgment reversed.

Casepoint

In this case, the legal question was whether a bank holding a draft was the owner of the instrument or had taken it as an agent for collection. The court held that (1) where there was a deposit of a draft in the ordinary course of banking business such that the depositor got from the bank an unconditional credit of that amount as cash against which the depositor had a right to draw and (2) there was nothing to qualify the effect of such act, the bank had acquired the title of the draft and was the owner and therefore entitled to the proceeds.

documents against payment
Term in a sales contract that provides for the seller to deliver shipping documents and title to a bank for release to the buyer after the buyer delivers to the bank a receipt from the seller verifying that the seller has received payment.

documents against acceptance
Term in a sales contract that provides for the buyer to deliver payment to a bank for release to the seller after the seller delivers to the bank a receipt acknowledging that the buyer has accepted the goods.

letter of credit
An instrument issued by a bank or another person at the request of an account party that obliges the issuer to pay to a beneficiary a sum of money within a certain period of time upon the beneficiary's presentation of documents specified by the account party.

account party
The person who requests a bank or some other person to issue a letter of credit.

beneficiary
A person who is not a party to a contract who is designated by a party to receive the benefits of the contract.

G. Letters of Credit

Assume that a buyer purchases goods overseas. The buyer and seller live in different countries, often speak different languages, have different cultural and legal backgrounds, use different currency, and may not have dealt with each other in the past. There is much uncertainty and worry in such a transaction. When must the buyer make payment? How? The seller, undoubtedly, would prefer to be paid in advance. The buyer, on the other hand, would like to make sure, before paying, that (1) the goods are actually shipped and that (2) the goods shipped meet his contractual specifications; and, in actuality, he would prefer (3) to take delivery before paying.

Depending on the relative bargaining power of the buyer and seller, any of these possible arrangements can be included as a term in the sales contract. If the seller is unable to determine the buyer's creditworthiness, he may insist upon *cash in advance*. If the buyer wants to confirm that the goods have been shipped, the term **documents against payment** can be used. In such a case, the seller agrees to deliver a bill of lading to a bank in the buyer's country so that the buyer can confirm that the goods have been shipped. The bank is then to deliver the bill of lading (which is also title to the goods) to the buyer after the buyer delivers a receipt from the seller acknowledging that the seller has received payment. If the buyer insists upon taking delivery before making payment, a **documents against acceptance** term can be used. In this event, the buyer will instruct a bank in the seller's country to release payment only on the bank's receipt of an acknowledgment of delivery issued by the buyer.

None of these terms are used very often. In part, this is so because they imply that both sides distrust each other. To avoid this, contracting parties use a *letter of credit* (or *documentary credit* or *banker's credit* or, simply, a *credit*).[53]

A **letter of credit** is an instrument issued by a bank, or another person, at the request of a customer (called an **account party**). It is a conditional agreement between the issuer and the account party that is intended to benefit a third party. In accordance with this agreement, the issuer is obliged to pay a bill of exchange drawn by the account party, up to a certain sum of money, within a stated time period, and upon presentation by the **beneficiary** of documents designated by the account party.[54]

The function of the letter of credit in international sales transactions is to substitute the credit of a recognized international bank for that of the buyer. In such an undertaking, the buyer is the account party, the buyer's bank is the issuing bank, and the seller is the beneficiary. Figure 12.10 sets out the chronology of a typical letter-of-credit transaction. The mechanics and the reasons for using a letter of credit are described in the following oft-quoted passage of Lord Justice Scrutton from the case of *Guaranty Trust Co. of New York v. Hannay & Co.*[55]

> The enormous volume of sales of produce by a vendor in one country to a purchaser in another has led to the creation of an equally great financial system intervening between vendor and purchaser, and designed to enable commercial transactions to be carried out with the greatest money convenience to both parties. The vendor, to help the finance of his business, desires to get his purchase price as soon as possible after he has dispatched the goods to his purchaser; with this object he draws a bill of exchange for the price, attaches to the draft the documents of carriage and insurance of the goods sold and sometimes an invoice for the price, and discounts the bill—that is, sells the bill with documents attached to an exchange house.

[53]*Letter of credit* is the term most often used in English-speaking countries. *Documentary credit*, which is a literal translation of the French *crédit documentaire*, and similar terms in other languages, is widely used in the rest of the world. It is the term preferred by the Paris-based ICC.

[54]The ICC's Uniform Customs and Practices for Documentary Credits defines a documentary credit or letter of credit as "any arrangement, however named or described, whereby a bank (the issuing bank) acting at the request and in accordance with the instructions of a customer (the applicant for the credit) (i) is to make a payment to or to the order of a third party (the beneficiary) or is to pay or accept bills of exchange (drafts) drawn by the beneficiary, or (ii) authorizes another bank to effect such payment, or to pay, accept or negotiate such bills of exchange (drafts) against stipulated documents, provided that the terms and conditions of the credit are complied with."

[55]*Law Reports, King's Bench*, vol. 1918, pt. 2, p. 659 (1918).

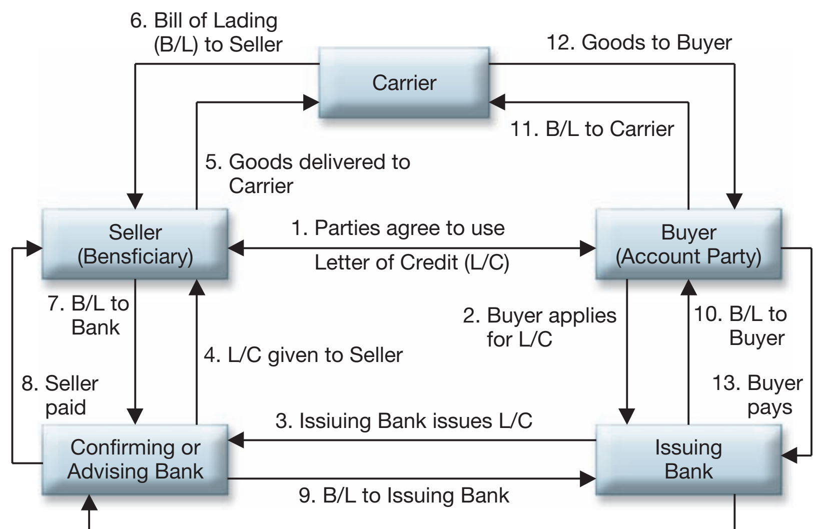


FIGURE 12.10

A Typical Letter of Credit Transaction

> The vendor thus gets his money before the purchaser would, in the ordinary course, pay; the exchange house duly presents the bill for acceptance, and has, until the bill is accepted, the security of a pledge of the documents attached and the goods they represent. The buyer on the other hand may not desire to pay the price till he has resold the goods. If the draft is drawn on him, the vendor or exchange house may not wish to part with the documents of title until the acceptance given by the purchaser is met at maturity. But if the purchaser can arrange that a bank of high standing shall accept the draft, the exchange house may be willing to part with the documents on receiving the acceptance of the bank. The exchange house will then have the promise of the bank to pay, which, if in the form of a bill of exchange, is negotiable and can be discounted at once. The bank will have the documents of title as security for its liability on the acceptance, and the purchaser can make arrangements to sell and deliver the goods.

Letters of credit exist in a wide variety of forms. The different types of credits are named and defined in Table 12.7. Although they are defined separately, they are not necessarily mutually exclusive. Thus, for example, a letter of credit can be both "clean" and "irrevocable" (but not, of course, both revocable and irrevocable).

Governing Law

Virtually all letters of credit are governed by the ICC's **Uniform Customs and Practices for Documentary Credits (UCP)**.[56] Although it is neither a treaty nor a legislative enactment, most banks incorporate the UCP in the terms of the credits they issue.

Uniform Customs and Practices for Documentary Credit (UCP)
Model rules issued by the International Chamber of Commerce for regulating letters of credit.

A few countries do have legislation governing letters of credit. In the United States, for example, Article 5 of the UCC has been adopted in all 50 states. However, even where there is a statute, the UCP can still be made to apply by agreement of the parties. The UCC, again as an example, allows the parties to an agreement, including an agreement creating a letter of credit, to vary the statutory terms.[57]

The UCP gets revised about once every 10 years by the ICC. The rules were first published in 1933. Revised versions were issued in 1951, 1962, 1974, 1983, and 1993. The latest version, UCP

[56]ICC Uniform Customs and Practice for Documentary Credits. UCP 600. ICC Publication No. 600 , 2006 Edition, effective June 1, 2007.

[57]UCC, §5–103. Moreover, the legislatures of Alabama, Arizona, Missouri, and New York, have adopted an amendment to the UCC that makes the code ineffective whenever a letter of credit is subject, by its terms (even in part), to the UCP. See, for example, NY UCC, §5–102(4).

TABLE 12.7

Types of letters of credit

Name	Description	Comments
Irrevocable	Cannot be altered without the beneficiary's express consent.	Preferred by beneficiaries because it provides the most security.
Revocable	Revocable by the issuing bank.	Disliked by beneficiaries because it provides the least security.
Confirmed	A second bank adds its endorsement to the credit, indicating that it too will make payment against the specified documents.	Gives the beneficiary additional assurance that payment will be made.
Negotiable	Permits the designated bills of exchange to be negotiated at any bank.	Only the issuing bank is obliged to pay. However, if another bank pays, it is assured by the issuing bank that it will be reimbursed.
Back to back	The buyer arranges for two credits: one to finance the purchase from the seller; a second, to be used by the seller, to finance a purchase from the seller's supplier.	Helps an exporter who may have difficulty obtaining local financing to make an export sale by facilitating the acquisition of supplies.
Transferable	Permits a beneficiary to transfer the credit to a second beneficiary.	Has the same advantages as a back-to-back credit, but only one credit has to be issued.
Revolving	A standing arrangement in which the buyer is allowed to replenish the credit after it is drawn down by a seller.	Used by large importers with a good credit record who import regularly from the same seller.
Clean	The beneficiary may obtain payment without presenting any documentation.	Used only where the buyer and issuer have a longstanding relationship with the seller.
Standby	A credit obtained by a seller naming the buyer as the beneficiary.	Used as a guarantee that the goods the seller delivers will perform as promised. If they do not, the buyer may return the goods and obtain reimbursement of the purchase price from the bank issuing this credit.
Sight bill	The buyer's bills of exchange will be paid when presented.	The default arrangement.
Time bill	The buyer's bills of exchange will be paid at a specified date or after a specified time.	Gives the buyer time in which to resell the goods before paying the seller.
Deferred payment	The seller agrees not to present a sight bill of exchange until after a specified period after the documents are presented.	Same as a time bill credit, except that the underlying bill is a sight bill.
Red clause	Advances are made to the seller before the seller presents the required documents.	A way to provide the seller with funds prior to shipment. It is beneficial to middlemen and dealers who require prefinancing.

Source: Uniform Customs and Practices for Documentary Credits: Model rules issued by the ICC for regulating letters of credit. See information on the UCP 600, effective July 1, 2007, at: http://www.iccwbo.org/policy/banking.

600, took effect June 1, 2007, replacing UCP 500, which had been in force since 1994. The rules are extremely important, since more than $1 trillion worth of world trade changes hands every year using letters of credit. UCP 600 went through 15 drafts and involved 9 key members, with a consulting group of 41 members from 26 countries. The new version of the UCP 600 reduces the number of articles from 49 (UCP 500) to 39.

One of the goals of the new revisions is to reduce the *discrepancy rate* of letters of credit—in which there is a difference between the documents mentioned in the letter of credit and those

presented to the bank. Although few discrepancies result in nonpayment, there are often delays. One change in the rules is reducing the number of days a bank has to examine the documents from seven banking days to five. Another change in the revised UCP rules makes it more difficult to issue a *revocable letter of credit*. This type of letter of credit was used occasionally in the past when the price of the underlying goods being sold fluctuated greatly. The new rules require that a *revocable* letter of credit be very clearly specified as such. There are also new articles on *definitions* and *interpretations* providing more clarity in the rules.

Other modifications of the UCP rules include: (1) the word *clean* is not required to appear on a transport document; (2) the addresses of the beneficiary and applicant on the letter of credit do not need to match those on the invoices, since a company may have multiple addresses; (3) inclusion of the 12 articles of the e-UCP, the ICC supplement governing the presentation of documents electronically in letter-of-credit transactions; and (4) a definitive description of the negotiation as *purchase* of drafts of documents.[58]

Applying for a Letter of Credit

In most cases, a person who needs a letter of credit must apply to a bank with which he has an existing relationship. In all cases, a Letter of Credit Application must be completed (see Figure 12.11). The application is not an application for credit, but rather a set of instructions telling the bank—which will be the issuing bank—what needs to be included in the letter of credit.[59] Of course, if the bank has not already extended a line of credit to the applicant, or if the applicant does not have sufficient funds on deposit in the bank to cover the face value of the credit, the bank may refuse to issue the letter.

The instructions the buyer needs to provide on the application include the following:

- The amount of the credit
- Whether the credit is revocable or irrevocable
- Whether the credit is transferable
- Whether the credit is to be made available by payment, deferred payment, acceptance, or negotiation
- How the credit is to be advised
- If there are bills of exchange involved, the party on whom they are drawn
- Details of the documents required as a prerequisite to making payment
- When the documents need to be delivered
- Whether partial shipments are prohibited
- Whether transshipment is prohibited
- The date and place at which the credit will expire

The Consequences of Not Obtaining a Letter of Credit When a buyer and seller enter into a contract and the buyer agrees to obtain a letter of credit (or a seller agrees to obtain a standby letter of credit), the consequences of failure to do so depend on whether the letter was (1) a condition precedent to the formation of the contract or (2) a condition for the performance of the contract. In the first case, there will be no contract and consequently no breach. In the second, because the contract already exists, the failure to obtain a letter of credit will be a breach that will entitle the injured party to sue for damages.

Lord Justice Denning examined the legal consequences that can flow from an ill-defined agreement to obtain a letter of credit in Case 12-5.

[58]New Rules Ahead for Letters of Credit, *Business Credit*, March 2007, p. 56; for further information on the newest version of the UCP 600, see also the ICC site at www.iccwbo.org/id533/index.html.

[59]Although the account party and the issuing bank will be parties to a contract, the applicant is not required to pay any consideration for the issuance, or even the modification, of a letter of credit. See UCC, §5–105.

FIGURE 12.11

Letter of Credit Application

Applicant
The Importer, Ltd.
76 Fleet Street
London, England

Issuing Bank
IMPORTERS BANK, PLC
Lnd Branch, 13 Trenton Mews
London, England

Date of Application:
1 June 2012

Date and place of expiration of the credit:
14 July 2012
Buenos Aires, Argentina

[X] Issue by (air) mail
[ ] Issue by air mail with brief advice by telegram or other written communication
[ ] Issue by telegram or other written communication (which shall be the operative credit instrument)
[ ] Transferable credit

Beneficiary
Compañía de Exportes, S.A.
203 Avenida de las Americas
Buenos Aires, Argentina

Confirmation of the credit to the beneficiary
[X] Not requested [ ] Requested

Amount
£18,500 (eighteen thousand five hundred pounds sterling)

[ ] Insurance will be covered by the applicant

Partial Shipment [ ] Allowed [X] Not Allowed
Transshipments [ ] Allowed [X] Not Allowed

Shipment/Dispatch/Delivery to
Buenos Aires

not later than
7 July 2012 for transportation to London

Credit available with

by [ ] sight payment [X] acceptance
[ ] negotiation [ ] deferred payment at

against the documents detailed here

[X] and beneficiary's draft at sight
on yourselves

Goods (brief description without excessive detail)
10,000 pairs of woolen mittens @ £ 1.85/pair

[ ] FOB [X] CIF London
[ ] C&F [ ] Other terms

Commercial invoice and three (3) copies.
Full set of clean on board bills of lading to order and blank endorsed, marked Freight Paid and Notify The Importer, Ltd., 76 Fleet Street, London, England.
Insurance and certificate for invoice value plus 10% covering marine and war risks and including all risks.
Certificates of Origin issued by a Chamber of Commerce in three (3) copies evidencing that the goods are of Argentine origin.
Packing lists in three (3) copies.

Documents to be presented within 7 days after date of issuance of the transport documents but within the validity of the credit.

Additional conditions

We request you to issue your IRREVOCABLE letter of credit for our account in accordance with the above instructions (marked with an X where appropriate). The credit shall be subject to the Uniform Customs and Practices for Documentary Credit (1993 Revision, Publication No. 500 of the International Chamber of Commerce, Paris, France), insofar as they are applicable. We authorize you to debit our account.

for The Importer, Ltd.

No. 994578-213

Treasurer
Name stamp and authorized signature of the applicant

CASE 12-5 Trans Trust Sprl v. Danubian Trading Co., Ltd.

United Kingdom, England, Court of Appeal, 1952
All England Law Reports, vol. 1952, pt. 1, p. 970 (1952)

MAP 12.5

United Kingdom and Belgium (1950)

In September 1950, a British seller agreed to sell 1,000 tons of rolled steel sheets to a Belgian buyer for a price of 8,025 Belgian francs per 1,000 kilos and to deliver them FOB Antwerp in December 1950. To be able to carry out the contract, the British seller had arranged to buy the steel from an American company, S.A. Azur, which was a wholesaler for the manufacturer, S.A. Metallurgique d'Esperance Londoz.

The seller understood that the buyer was to arrange for a confirmed letter of credit with the Krediet Bank in Brussels, made out in favor of S.A. Azur, which would require the bank to pay cash upon the presentation of shipping documents. The buyer, however, did not arrange for the letter of credit and, when prompted to do so by the seller, sent the seller a letter on October 16, 1950, refusing to do so. The seller then sued the buyer, alleging that the contract it had with the buyer required the buyer to arrange for a letter to be opened and confirmed immediately, and that the buyer's failure to do so constituted a breach of contract. The buyer answered that the contract was conditional on a letter of credit being provided and that, if no such letter was provided, no obligation was to be assumed by the buyer.

The trial judge held that there had been a binding agreement between the parties, that a term of that agreement was that the buyer would see that a credit was opened immediately, and that the buyer was in breach of that agreement. The judge awarded the seller £3,214 damages, which was the loss of profit suffered by the seller based on the difference between the price at which the seller had agreed to buy from S.A. Azur and the price it would have received had the contract been performed.

Opinion by Lord Justice Denning

This is another case concerned with the modern practice whereby a buyer agrees to provide a banker's confirmed credit in favor of the seller. This credit is an irrevocable promise by a banker to pay money to the seller in return for the shipping documents. One reason for this practice is because the seller wishes to be assured in advance, not only that the buyer is in earnest, but also

that he, the seller, will get his money when he delivers the goods. Another reason is because the seller often has expenses to pay in connection with the goods and he wishes to use the credit to pay those expenses. He may, for instance, be himself a merchant, who is buying the goods from the growers or the manufacturers and has to pay for them before he can get delivery, and his own bank may only grant him facilities for the purpose if he has the backing of a letter of credit. The ability of the seller to carry out the transaction is, therefore, dependent on the buyer providing the letter of credit, and for this reason the seller stipulates that the credit should be provided at a specified time well in advance of the time for delivery of the goods.

What is the legal position of such a stipulation? (1) Sometimes it is a condition precedent to the formation of a contract, that is, it is a condition which must be fulfilled before any contract is concluded at all. In those cases the stipulation "subject to the opening of a letter of credit" is rather like a stipulation "subject to contract." If no credit is provided, there is no contract between the parties. (2) In other cases a contract is concluded and the stipulation for a credit is a condition which is an essential term of the contract. In those cases the provision of the credit is a condition precedent, not to the formation of a contract, but to the obligation of the seller to deliver the goods. If the buyer fails to provide the credit, the seller can treat himself as discharged from any further performance of the contract and can sue the buyer for damages for not providing the credit.

The first question is: What was the nature of the stipulation in this case? When the buyers sent their order, they stated in writing on Sept. 25, 1950, that "a credit will be opened forthwith." It was suggested that the buyers were not making any firm promise on their own account, but were only passing on information which had been given to them by their American buyers. The judge did not accept that suggestion and I agree with him. The statement was a firm promise by the buyers by which they gave their personal assurance that a credit would be opened forthwith. At that time there were some discrepancies about gauges and dates of delivery which had to be cleared up, but these were all resolved at the meetings in Brussels, and there was then, as the judge found, a concluded contract by the sellers to sell, and the buyers to buy, the steel for December/January delivery, and it was a part of that contract that the buyers would be personally responsible for seeing that a credit should be opened forthwith. On those findings it is clear that the stipulation for a credit was not a condition precedent to the formation of any contract at all. It was a condition which was an essential term of a contract actually made. That condition was not fulfilled. The sellers extended the time for the credit, but it never came, not even after reasonable notice. The sellers were, therefore, discharged from any further performance on their side, and are entitled to claim damages.

But what is the measure of damages? That is the important question in the case. The price of the goods had steadily risen from the date of the contract onwards and the buyers say that the sellers could at any time have resold the goods for more than the contract price, and are, therefore, only entitled to nominal damages. If the claim of the sellers had been for damages for nonacceptance of goods or for repudiation of the obligation to take delivery, then the damages would, no doubt, be nominal. But it is none of those things. It is a claim for damages for not providing a letter of credit. The buyers say that, even so, the credit is only a way of paying the price, and that the damages recoverable on that score are only nominal because the seller could resell the goods at a profit. This argument . . . treats the obligation to provide a credit as the same thing as the obligation to pay the price. That is, I think, a mistake. A banker's confirmed credit is a different thing from payment. It is an assurance in advance that the seller will get paid. It is even more than that. It is a chose in action[60] which is of immediate benefit to the seller. It is irrevocably by the banker, and it is often expressly made transferable by the seller. The seller may be relying on it to get the goods himself. If it is not provided, the seller may be prevented from getting the goods at all. The damages he will then suffer will not, in fact, be nominal. Even if the market price of the goods has risen, he will not be able to take advantage of the rise because he will not have any goods to re-sell. His loss will be the profit which he would have made if the credit had been provided. Is he entitled to recover that loss? I think he is, if he can show that such a loss was at the time of the contract foreseeable by the buyer as the probable consequence of a breach. That was clearly the case here. The buyers knew that the sellers could not get the

[60]From French *chose*: "a thing." A *chose in action* is a "thing in action." It is the right to bring an action, or suit, in a court of law to procure the return of a thing or the payment of a sum of money.

goods at all unless the credit was provided. The foreseeable loss was the loss of profit, no matter whether the market price of the goods went up or down. It is, therefore, the proper measure of damages.

Casepoint

The parties had a contract for the sale of goods, which included a promise by the buyer to furnish a letter of credit forthwith. The buyer never did arrange for a letter of credit, and the goods were never delivered. Now the seller has sued for damages for loss of profits. The court stated that some letters of credit were part of the contract, while others were "precedent" to the making of the contract. Here, clearly the seller was depending on the letter of credit as an essential part of the agreed-upon contract, and thus the breach of this obligation will require payment of damages by the buyer.

Documentary Formalities

Although a letter of credit does not have to be in any particular form, it does need to be (1) in writing, (2) signed by the issuer, and (3) complete and precise.[61] A credit must also clearly indicate if it is irrevocable. Should there be any doubt, the credit will be interpreted as being revocable.[62] An example of an irrevocable letter of credit is shown in Figure 12.12.

Letters of credit must additionally indicate clearly when and how they are to be paid. That is, they must "clearly indicate whether they are available by sight payment, by deferred payment, by acceptance, or by negotiation."[63] Finally, they must name the bank that is authorized to pay the credit, or to accept bills of exchange drawn in accordance with the letter, or to negotiate the credit.[64]

Advising and Confirming Letters of Credit

Once a bank issues a letter of credit, it will commonly deliver the credit to a correspondent bank located in the beneficiary's county, which will in turn deliver the credit to the beneficiary. The correspondent, formally known as an **advising bank**, assumes no liability for paying the letter of credit. Its only obligation is to the issuing bank, to ensure that the beneficiary is advised and the credit delivered, and to take "reasonable care to check the apparent authenticity of the credit."[65] It does this by comparing the signature on the credit with the authorized signatures it maintains on file.

An issuing bank may also request another bank to confirm an irrevocable letter of credit. A confirmation is an independent promise by a **confirming bank** that it will pay, accept, or negotiate a credit, as appropriate, when the documents specified in the credit are presented to it and the other terms and conditions of the credit have been complied with.[66] An example of a confirmation is shown in Figure 12.13.

A confirming bank is entitled to reimbursement from the issuing bank if the documents it receives are in order. If they are not, the confirming bank will be left with title to the goods in its own name, and it will have to assume the risk of liquidating them as best it can. A confirming bank also assumes the risk that the issuing bank or the account party may be unable to reimburse it. Again, it would retain title to the goods, so its losses may be partly offset by whatever price it gets from the sale of the goods.

advising bank
A bank engaged by the issuer of a letter of credit to advise the beneficiary that it has a credit for delivery and to deliver the credit upon verification of the beneficiary's signature.

confirming bank
A bank that makes an independent promise to pay, accept, or negotiate a letter of credit issued by another bank when the documents named in the credit are delivered to it.

[61] UCC, §5–104 as recently amended, now provides:
"A letter of credit, confirmation, advice, transfer, amendment, or cancellation may be issued in any form that is a record and is authenticated (i) by a signature or (ii) in accordance with the agreement of the parties or the standard practice referred to in Section 5-108(e)."

[62] UCP, Article 7, states: (a) Credits may be either [i] revocable, or [ii] irrevocable. (b) All credits, therefore, should clearly indicate whether they are revocable or irrevocable. (c) In the absence of such indication the credit shall be deemed to be revocable.

[63] *Id.*, Article 11(a).

[64] *Id.*, Article 11(b).

[65] *Id.*, Article 8.

[66] *Id.*

FIGURE 12.12

An Irrevocable Letter of Credit

<table>
<tr><td></td><td>Issuing Bank
IMPORTERS BANK PLC
London Branch, 13 Trenton Mews
London WC1, England</td></tr>
<tr><td>Place and date of issue
London, 15 June 2012</td><td rowspan="2">Beneficiary
Compañía de Exportes, S.A.
203 Avenida de las Americas
Buenos Aires, 1109 Argentina</td></tr>
<tr><td>Date and place of expiration of the credit
London, 14 July 2012, at the counters of the advising bank</td></tr>
<tr><td></td><td>Amount
£18,500 (eighteen thousand five hundred pounds sterling)</td></tr>
<tr><td>Advising Bank Banco del Sur
47 Calle Corto
Buenos Aires
1117 Argentina</td><td rowspan="3">Credit available with
by
[ ] sight payment [x] acceptance [ ] negotiation
[ ] deferred payment at

against the documents detailed here

[x] and beneficiary's draft at sight
on Banco del Sur
47 Calle Corto, Buenos Aires, 1117 Argentina</td></tr>
<tr><td>Partial Shipment [ ] Allowed [x] Not Allowed
Transshipments [ ] Allowed [x] Not Allowed</td></tr>
<tr><td>Shipment/Dispatch/Taking in charge from/at
Buenos Aires
for transportation to:
London</td></tr>
<tr><td colspan="2">SIGNED INVOICE IN THREE (3) COPIES certifying that the goods are in accordance with The Importer, Ltd.'s Order No. 0791 of 22 May 2012.

FULL SET OF CLEAN ON BOARD BILLS OF LADING to order and blank endorsed, marked Freight Paid and Notify The Importer, Ltd., 76 Fleet Street, London, England.

INSURANCE AND CERTIFICATE for invoice value plus 10% covering marine and war risks and including all risks.

CERTIFICATES OF ORIGIN issued by a Chamber of Commerce in three (3) copies evidencing that the goods are of Argentine origin.

Packing lists in TRIPLICATE.
covering woolen mittens, CIF, London.</td></tr>
<tr><td colspan="2">Documents to be presented within 7 days after date of issuance of the transport documents but within the validity of the credit.</td></tr>
<tr><td colspan="2">Additional conditions</td></tr>
<tr><td colspan="2">We hereby issue this IRREVOCABLE letter of credit in your favor. It is subject to the Uniform Customs and Practices for Documentary Credit (1993 Revision, Publication No. 500 of the International Chamber of Commerce, Paris, France), insofar as they are applicable. The number and state of the credit and the name of our bank must be quoted in all drafts requested if the credit is available by negotiation, each presentation must be noted on the reverse of this advice by the bank where the credit is available.

This document consist of 1 signed page(s)
IMPORTERS BANK PLC
London Branch</td></tr>
</table>

FIGURE 12.13

Confirmation of an Irrevocable Letter of Credit

	Advising Bank Number **07889** BANCO DEL SUR 47 Calle Corto Buenos Aires, 1117 Argentina
Issuing Bank **Importers Bank, Plc.** **London Branch** **13 Trenton Mews** **London, England**	Reference Number of Advising Bank **1534** Place and date of notification **Buenos Aires, 17 June 2012**
Reference Number of Issuing Bank **07889**	Amount **£18,500 (eighteen thousand five hundred pounds sterling)**
Applicant **The Importer, Ltd.** **76 Fleet Street** **London, England**	Beneficiary **Compañía de Exportes, S.A.** **203 Avenida de las Americas** **Buenos Aires, Argentina**

We have been informed by our correspondent (the issuing bank above) that the letter of credit described above has been issued in your favor. Please find enclosed the advice intended for you.

PLEASE CHECK THE CREDIT TERMS CAREFULLY. If you do not agree with the terms and conditions or if you feel that you are unable to comply with any of the terms and conditions, please ARRANGE AN AMENDMENT OF THE CREDIT THROUGH YOUR CONTRACTING PARTY (the applicant for the credit).

[ ] This notification and the enclosed advice are sent to you without engagement on our part.
[**X**] As requested by our correspondent, we hereby confirm the credit described above.

BANCO DEL SUR

The Obligations of Banks

An issuing bank, or any bank that pays, accepts, or negotiates a letter of credit, is obliged to "examine all documents with reasonable care to ascertain that they appear on their face in accordance with the terms and conditions of the credit."[67] If a paying, accepting, or negotiating bank believes the documents are irregular, it is required to pass them along to the issuing bank for the latter to determine whether it will honor or refuse them. The issuing bank must do so "on the basis of the documents alone."[68]

One should note that the issuing bank's obligations only relate to the appearance of the documents. So long as the documents appear regular on their face, the bank must pay. A bank is not to concern itself with matters "off the document," such as the condition of the goods or even their existence.[69] This was emphasized in *Maurice O'Meara Co. v. National Park Bank of New York*. In that case, the issuing bank refused to pay on a letter of credit because it said that it had a reasonable doubt about the quality of the goods (newspaper print) involved. The seller, who was forced to sell the goods at a loss, sued the bank. In its decision in favor of the seller, the court said:[70]

> [The letter of credit] . . . was in no way involved in or connected with, other than the presentation of the documents, the contract for the purchase and sale of the paper mentioned. That was a contract between buyer and seller, which in no way concerned the bank. The bank's obligation was to pay sight drafts when presented if accompanied by genuine documents specified in the letter of credit. If the paper when delivered did not correspond to what had been purchased, either in weight, kind, or quality, then the purchaser had his remedy against the seller for damages. . . . The bank was concerned only in the drafts and the documents accompanying them. This was the extent of its interest. If the drafts, when presented, were accompanied by the proper documents, then it was absolutely bound to make the payment under the letter of credit, irrespective of whether it knew, or had reason to believe, that the paper was not of the tensile strength contracted for. . . . It has never been held, so far as I am able to discover, that a bank has the right or is under an obligation to see that the description of the merchandise contained in the documents presented is correct.

rule of strict compliance
A bank may reject a document submitted by a beneficiary seeking to obtain payment on a letter of credit when the document does not exactly comply with the description stated in the credit.

The Rule of Strict Compliance In determining whether the documents submitted by the beneficiary are in order, a bank is entitled to apply the so-called **rule of strict compliance**. In other words, a bank may reject documents that do not exactly comply with the terms specified in the letter of credit. For example, in the case of *Moralice (London), Ltd. v. E. D. and F. Man*, an English court held that an issuing bank had properly refused to pay on a letter of credit involving the shipment of 5,000 bags when the bill of lading the seller presented indicated that only 4,997 bags had been shipped.[71] Similarly, an American court, in the case of *Beyene v. Irving Trust Co.*, held that the misspelled name ("Soran" instead of "Sofan") of the person entitled to notice of the arrival of the goods being shipped was a material discrepancy that relieved a confirming bank from its duty to honor a letter of credit.[72]

Despite all the safeguards, however, it is still occasionally possible for deceitful persons to create fraudulent documents that result in big payoffs to the dishonest dealers and sellers. For example, in 2010 a man named Arjunan Rajasekaran won a contract to deliver 70,000 bicycles by March 2011 to the government of Uganda, for use by local officials all over the country. However, by October 2011, only 1,200 bicycles had been delivered and apparently no more will be delivered because the company has no money. Rajasekaran had been dealing with three men he previously knew. Two were from India and

[67]*Id.*, Article 15.

[68]*Id.*, Article 16(b).

[69]*Id.*, Article 17 provides: "Banks assume no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification, or legal effect of any documents, or for the general and/or particular conditions stipulated in the documents or superimposed thereon; nor do they assume any liability or responsibility for the description, quantity, condition, packing, delivery, value, or existence of the goods represented by any documents, or for the good faith or acts and/or omissions, solvency, performance, or standing of the consignor, the carriers, or the insurers of the goods, or any other person whomsoever."

[70]*New York Reports*, vol. 239, p. 386 (1925).

[71]*Lloyd's Reports*, vol. 2, p. 533 (1954).

[72]*Federal Reporter, Second Series*, vol. 762, p. 4 (2nd Circuit Ct. of Appeals, 1985).

FIGURE 12.14

An Outdoor Market Selling Bicycles

Source: Nigel Cattlin / Alamy

claimed to represent "many manufacturers of bicycles in North India," and one was their partner in Uganda. Together they promised to supply 30,000 bicycles. In February 2011, after being assured that the bicycles would be delivered to the Mombasa port within 25 days, Rajasekaran was given a Bill of Lading worth $1.3 million. After presenting the Bill of Lading to a local bank in late February 2011, the Bank of Uganda and the Uganda Government made a $1.7 million payment on March 14, 2011, and Mr. Rajasekaran then transferred $1 million to two companies in Hong Kong as the two Indian suppliers had requested, and paid $500,000 to their partner in Uganda. But when Rajasekaran's agent in Uganda went to Mombasa and presented the shipping documents to collect the container of the 30,000 bicycles, it was discovered that no such container existed. The agent and Rajasekaran learned that the Bill of Lading was a fake, forged document. Rajasekaran confronted the trio through e-mail and demanded that he be repaid. Instead of receiving his money back, however, Rajasekaran received death threats from the trio, which prompted him to contact the Commissioner of Police and bring charges against the trio.[73]

Amendments Discrepancies can come about in documents in a wide variety of ways, including typographical errors and simple mistakes. In cases where only a minor discrepancy exists, banks will commonly obtain a written waiver from the account party. The new UCP 600 rules (2007) issued by the ICC attempt to prevent minor discrepancies from causing major problems with letters of credit. If there is a major discrepancy or if the seller is unable to perform as originally agreed, the letter of credit can be amended. Amendments, however, require the approval of the issuing bank, the confirming bank (if there is one), and the beneficiary.[74]

Waiver Should an issuing bank be notified of a discrepancy, it has "a reasonable time in which to examine the documents and to determine . . . whether to take up or to refuse the documents."[75] The new UCP 600 rules provide that if the bank fails to act in a timely fashion or if it fails to return the documents to the person who presented them, "it is precluded from claiming that the documents are not in accordance with the terms and conditions of the credit."[76] In other words, failure to act is tantamount to an implied waiver.

Fraud Suppose that a bank is aware that the seller has perpetrated a **fraud** on the buyer. For example, suppose that a seller delivers mislabeled goods to a carrier to obtain the documents it needs to collect against a letter of credit. The documents themselves are obviously genuine. May the issuing bank pay the seller if it knows of this fraud? The answer is yes. The UCP states that "banks assume no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any documents."[77]

fraud
A knowing misrepresentation made with intent of causing another to rely upon it to the latter's detriment.

The harder question is: May the bank refuse to pay on the credit when the underlying transaction is fraudulent? If the letter of credit is revocable, the answer is obviously yes. If the credit is

[73] H. Bogere, "How LCs' Bicycles Vanished, Supplier Says He Was Conned of Shs 5.6bn. ($1.7 million)," *The Observer*, Nov. 3, 2011

[74] UCP, Article 10(d).

[75] *Id.*, Article 16(c).

[76] *Id.*, Article 16(e).

[77] *Id.*, Article 17.

irrevocable, the answer seems to be no. The UCP states that the obligation to pay on an irrevocable letter of credit "constitutes a definite undertaking of the issuing bank, provided that the stipulated documents are presented and the terms and conditions of the credit are complied with."[78] The UCP also states that "credits, by their nature, are separate transactions from the sales or other contracts on which they may be based and banks are in no way concerned with or bound by such contracts."[79] Read together, these two provisions suggest that the issuing bank must pay, regardless of any underlying fraud.

The suggestion in the UCP is supported by case law. In the case of *Discount Records, Ltd. v. Barclays Bank, Ltd.*, an English court was asked to enjoin payment of an irrevocable credit on an allegation of fraud. Judge Megarry refused, observing: "I would be slow to interfere with bankers' irrevocable credits, and not least in the sphere of international banking, unless a sufficiently good cause is shown; for interventions by the court that are too ready or too frequent might gravely impair the reliance which, quite properly, is placed on such credits."[80]

Nonetheless, Judge Megarry's decision and the UCP leave open the possibility that a court may intervene in exceptionally grievous circumstances. Case 12-6 is a famous example of just such a case.[81]

Fraud in the Collection Process In addition to the buyer, a collecting bank may also perpetrate fraud. To illustrate: X Company agrees to sell a large number of widgets to Y Corp., and Y Corp. arranges for Bank I to issue a letter of credit that requires X Company to present a bill of lading as a prerequisite to being paid. X Company is not able to deliver all of the widgets ordered, and it has to alter the bill of lading in order for the bill to comply with the requirements of the letter of credit. X Company takes the letter of credit and the bill of lading to Bank C. X Company is a longtime customer of Bank C, and X Company owes Bank C substantial sums. Bank C realizes that if X Company does not collect on the letter of credit, X will be bankrupt and unable to pay any of its obligations. Bank C agrees to pay the letter of credit, even though it knows that X altered the bill of lading. But it does so only if X will agree to use the money to first pay off the loans it has from Bank C. X Company agrees. Bank C pays, and X turns over the letter of credit and the bill of lading. Bank C, in turn, forwards the credit and the bill to Bank I, demanding to be reimbursed. In the case of *Pubali Bank*

---

[78]*Id.*, Article 10(a). The UCC takes a slightly different stand. UCC, §5–114, now provides:

a. In this section, "proceeds of a letter of credit" means the cash, check, accepted draft, or other item of value paid or delivered upon honor or giving of value by the issuer or any nominated person under the letter of credit. The term does not include a beneficiary's drawing rights or documents presented by the beneficiary.
b. A beneficiary may assign its right to part or all of the proceeds of a letter of credit. The beneficiary may do so before presentation as a present assignment of its right to receive proceeds contingent upon its compliance with the terms and conditions of the letter of credit.
c. An issuer or nominated person need not recognize an assignment of proceeds of a letter of credit until it consents to the assignment.
d. An issuer or nominated person has no obligation to give or withhold its consent to an assignment of proceeds of a letter of credit, but consent may not be unreasonably withheld if the assignee possesses and exhibits the letter of credit and presentation of the letter of credit is a condition to honor.
e. Rights of a transferee beneficiary or nominated person are independent of the beneficiary's assignment of the proceeds of a letter of credit and are superior to the assignee's right to the proceeds.
f. Neither the rights recognized by this section between an assignee and an issuer, transferee beneficiary, or nominated person nor the issuer's or nominated person's payment of proceeds to an assignee or a third person affect the rights between the assignee and any person other than the issuer, transferee beneficiary, or nominated person. The mode of creating and perfecting a security interest in or granting an assignment of a beneficiary's rights to proceeds is governed by Article 9 or other law. Against persons other than the issuer, transferee beneficiary, or nominated person, the rights and obligations arising upon the creation of a security interest or other assignment of a beneficiary's right to proceeds and its perfection are governed by Article 9 or other law.

It should be noted, however, that courts have hardly ever actually enjoined honor using this provision.

[79]UCP, Article 3. Similarly, Article 4 provides: "In credit operations all parties concerned deal in documents, and not in goods, services and/or other performances to which the documents relate."

[80]*All England Law Reports*, vol. 1975, pt. 1, p. 1075 (Chancery Division, 1974).

[81]A case examining the spread of the rule suggested in *Discount Records, Ltd. v. Barclays Bank, Ltd.* and set out in *Sztejn v. J. Henry Schroeder Banking Corp.* to most English-speaking jurisdiction is *The Inflatable Toy Co. Pty Ltd. v. State Bank of New South Wales*, *New South Wales Unreported Judgments* (1998), BC9405157 (Supreme Ct. of New South Wales, Equity Division, 1994).

CASE 12-6 Sztejn v. J. Henry Schroeder Banking Corp.

United States, New York County Supreme Court, Special Term, 1941
New York Supplement, Second Series, vol. 31, p. 631 (1941)

MAP 12.6

India (1941)

Transea Traders in India contracted to sell hog bristles to Sztejn, the plaintiff. At the request of Sztejn, the J. Henry Schroeder Banking Corp. (Schroeder), the defendant, issued an irrevocable letter of credit in favor of Transea covering the shipment of the hog bristles and payable upon presentation of certain documents, including a maritime bill of lading. Transea allegedly filled 50 cases with cow hair and other rubbish and delivered these to the carrier in order to obtain the required bill of lading. This bill, along with the other required documents, and a draft payable to Transea, were presented to Schroeder by the Chartered Bank of India, acting as an agent for Transea. Before Schroeder could pay on the credit, Sztejn brought this action against Schroeder to enjoin it from doing so. Schroeder asked the court to dismiss the case.

Opinion by Justice Shientag

One of the chief purposes of the letter of credit is to furnish the seller with a ready means of obtaining prompt payment for his merchandise. It would be most unfortunate interference with business transactions if a bank before honoring drafts drawn upon it was obliged or even allowed to go behind the documents, at the request of the buyer, and enter into controversies between the buyer and the seller regarding the quality of the merchandise shipped. . . . Of course, the application of this doctrine presupposes that the documents accompanying the draft are genuine and conform in terms to the requirements of the letter of credit.

However, I believe that a different situation is presented in the instant action. This is not a controversy between the buyer and seller concerning a mere breach of warranty regarding the quality of the merchandise; on the present motion, it must be assumed that the seller has intentionally failed to ship any goods ordered by the buyer. In such a situation, where the seller's fraud has been called to the bank's attention before the drafts and documents have been presented for payment, the principle of independence of the bank's obligations under the letter of credit should not be extended to protect the unscrupulous seller. It is true that even though the documents are forged or fraudulent, if the issuing bank has already paid the draft before receiving

notice of the seller's fraud, it will be protected if it exercised reasonable diligence before making such payment. However, in the instant action Schroeder has received notice of Transea's active fraud before it accepted or paid the draft . . .

Although our courts have used broad language to the effect that a letter of credit is independent of the primary contract between the seller and buyer, that language was used in cases concerning alleged breaches of warranty; no case has been brought to my attention on this point involving an intentional fraud on the part of the seller which was brought to the bank's notice with the request that it withhold payment of the draft on this account. The distinction between a breach of warranty and active fraud on the part of the seller is supported by authority and reason. As one court has stated: "Obviously, when the issuer of a letter of credit knows that a document, although correct in form, is, in point of fact, false or illegal, he cannot be called upon to recognize such a document as complying with the terms of a letter of credit.". . .

While the primary factor in the issuance of the letter of credit is the credit standing of the buyer, the security afforded by the merchandise is also taken into account. In fact, the letter of credit requires a bill of lading made out to the order of the bank and not the buyer. Although the bank is not interested in the exact detailed performance of the sales contract, it is vitally interested in assuring itself that there are some goods represented by the documents.

Accordingly, the defendant's motion to dismiss . . . is denied.

Casepoint

As has been explained in the previous section of this chapter, letters of credit are designed to facilitate payment in sales of goods transactions without requiring the bank to determine if the correct goods were delivered on time and at the right place. Normally, if the documents are prepared and delivered in correct form, the letter of credit must be honored and paid by all. However, in the extremely rare case such as this one–where the bank knows before it has accepted or paid the draft that the seller has engaged in deliberate fraud—the bank might be enjoined from honoring the letter of credit.

v. City National Bank, which involved a similar (but more complex) set of facts, the court held that the issuing bank did not have to pay. The court said that because the paying bank had participated in the fraud, it could "not hide behind the cloak" of a neutral collecting bank. The paying bank was therefore liable for the money it had paid out.[82]

Rights and Responsibilities of the Account Party

The account party's rights and obligations are based on two contracts: the underlying contract with the beneficiary (usually the seller) and the contract with the issuing bank relating to the letter of credit. Ordinary contract law determines the account party's rights under the first contract. International practice limits the account party's rights under the second contract.

The main limitation on an account party's rights under the contract with the issuing bank is the doctrine of privity. That is, because the account party is in privity (i.e., in a contractual relationship) only with the issuing bank, it can look only to the issuing bank for performance. In other words, it has no right to bring an action against the advising or confirming banks based on their contract with the issuing bank.

To illustrate, in the case of *Auto Servicio San Ignacio v. Compañía Anonima Venezolana de Navigación*, an account party sued a confirming bank for its negligence in failing to verify the authenticity of a bill of lading containing misleading information and in honoring the related letter of credit. Judge Schwarz dismissed the complaint, observing that the confirming bank owed a duty only to its customer, the issuing bank, and not to the issuing bank's customer, the account party, even though that party was involved in the underlying contract.[83]

[82] *Federal Reporter, Second Series*, vol. 676, p. 1326 (Ninth Circuit Ct. of Appeals, 1982).

[83] *Federal Supplement*, vol. 586, p. 259 (Dist. Ct. for E. Dist. of Louisiana, 1984).

Rights and Responsibilities of Beneficiaries

The right of beneficiaries to collect on letters of credit is based not on contract, but on commercial practice. This is important because it means that the beneficiary has no subsidiary contractual rights with respect to the letter-of-credit transaction. UCP, Article 6, puts it plainly: "A beneficiary can in no case avail himself of the contractual relationships existing between the banks or between the applicant for credit and the issuing bank."

Before a beneficiary is entitled to collect on a letter of credit, he must comply with the terms and conditions of the credit and present to the issuer (or the issuer's agent) the documents designated in the credit.[84] Commonly, these include:

- a certificate of origin—to comply with customs requirements;
- an export license and/or a health inspection certificate—to show that the goods are approved for export;
- a certificate of inspection—to show that all of the goods have been shipped;
- a commercial invoice—to identify the shipment;
- a bill of lading—to show title to the goods; and
- a marine insurance policy.

As soon as a letter of credit is delivered to a beneficiary for advisement, he needs to examine it carefully to make sure that it reflects the underlying agreement he has with the account party. Changes can be made by amendment, but they need to be made promptly.[85]

Standby Letters of Credit To ensure that a seller will perform, a buyer can insist that the seller procure a **standby letter of credit**. Standby credits are most commonly used in situations where the seller is delivering a product that the buyer needs time to evaluate, such as a stand-alone factory or a computer installation. If the goods delivered do not perform as promised, the buyer may be left in the awkward position of absorbing the loss or suing the seller. To avoid this, the buyer may insist that the seller arrange for an irrevocable credit, one that will reimburse the buyer in the event that the goods do not perform.

standby letter of credit
A letter of credit obtained by a buyer naming the seller as a beneficiary.

H. Financing Foreign Operations

Multinational enterprises cannot always generate internally all of the funds they need for capital investment and operating expenses. To expand, to avoid cash flow problems, and for a variety of other reasons, they have to turn to the world's capital markets, and to governmental and intergovernmental investment and development programs.

Private Sources of Capital

As we discussed in Chapter 6, both equity and debt funding are available from the private sector to finance the operations of multinational ventures. **Equity funding** is generally available from stock exchanges, although it is not uncommon, especially for smaller firms, to raise funds privately. **Debt funding** is available in the multinational enterprise's home country, in its host countries, and now, more commonly, in a large number of so-called *capital-exporting* countries.[86]

equity funding
Investments in the capital of a company.

debt funding
Loans to a person or company.

Governmental Sources of Capital

Both host and home governments provide capital for foreign investors.

Host Country Development Banks and Government Agencies As discussed in Chapter 5, virtually every country—including less developed and developing nations—has an established bureaucracy that promotes local investment. Many have development banks that provide low-interest-rate,

[84] UCP, Article 10(a).

[85] *Id.*, Article 10(d).

[86] Entrepreneur.com maintains links to 100 international capital venturers at www.entrepreneur.com/vc100.

long-term loans to foreign investors. Morocco's Banque Nationale pour le Development Economique and Greece's National Investment Bank for Industrial Development are just two examples.

Information about investment opportunities in host countries is available from their embassies and consulates. A current list of embassies and consulates can be found in the *Europa Encyclopedia*. Most embassies and consulates also have Web sites.[87]

Home Country Import and Export Financing Agencies Virtually every developed country has a variety of agencies that finance imports and exports. In the United States, for example, the U.S. Agency for International Development (AID) lends money directly to foreign governments to finance purchases from American exporters. As discussed in Chapter 2, the U.S. Overseas Private Investment Corporation (OPIC) provides loans, loan guarantees, and insurance to American firms to underwrite activities in developing countries. The U.S. Export–Import Bank promotes international trade by making loans to both American importers and foreign exporters. It provides guarantees of working capital loans for U.S. exporters, and guarantees the repayment of loans or makes loans to foreign purchasers of U.S. goods and services. [88] The U.S. Commercial Service is the trade promotion arm of the U.S. Department of Commerce's International Trade Administration.[89] And the U.S. Small Business Administration provides loans to American exporters.[90] Despite the good intentions of the program, there are always people who try to use dishonest means to take advantage of an agency that has money to spend, as the following box shows:

Owner of Miami Company Sentenced to 46 Months in Prison for Scheme to Defraud the U.S. Export–Import Bank

On June 23, 2010, Guillermo O. Mondino plead guilty in the United States District Court in Washington, D.C., to one count of conspiracy to commit mail fraud and one count of money laundering connected with a plan to defraud the Export–Import Bank of approximately $24 million. Mondino was sentenced to 46 months in prison, 3 years of supervised release, and a fine of $13.3 million in restitution and $2.7 million in forfeiture. Mondino was the owner of Texon Inc., which is a Miami export company of various types of equipment to South and Central American buyers. Mondino confessed to assisting several foreign buyers to obtain fraudulent loans that were insured by the Export–Import Bank from 2003 through 2009. Only $6.4 million of the $24 million of the insured fraudulent loan proceeds were transferred by Mondino to the foreign buyers.

Sources: U.S. Department of Justice, "Owner of Miami Company Sentenced to 46 Months in Prison for Scheme to Defraud the U.S. Export–Import Bank," November 2, 2011. Retrieved November 28, 2011, from 7th Space Web site; Toluse Olorunnipa, "Miami Exporter Sentenced in Federal Fraud Case," *Miami Herald*, November 2, 2011.

The U.S. Export–Import Bank Web site is at
www.exim.gov.
The U.S. Small Business Administration Web site is at
www.sba.gov.

Regional and International Development Agencies

A number of regional development agencies promote investment within their regions. The African Development Bank,[91] the Asian Development Bank,[92] the Central American Bank for Economic

[87]For a list of embassy and consulate Web sites, see www.embassyworld.com/embassy/directory.htm.

[88]See Web site at www.exim.gov. The United Nations also publishes Business Development Online on the Internet. It provides information on projects financed by the leading development banks, including the African, Asian, Caribbean, Inter-American, and North American development banks; the European Bank for Reconstruction and Development; and the World Bank. See www.devbusiness.com.

[89]See the U.S. Commercial Service Web site at http://trade.gov/cs/.

[90]The Small Business Administration's international trade loans are described at www.sba.gov/financing/frinternational.html.

[91]The African Development Bank's Web site is at www.afdb.org.

[92]The Asian Development Bank's Web site is at www.adb.org.

Integration,[93] the European Bank for Reconstruction and Development,[94] the European Investment Bank,[95] and the Inter-American Development Bank[96] are the principal examples.

The African Development Bank Web site is at
www.afdb.org.
The European Bank for Reconstruction and Development Web site is at
www.ebrd.com.
The Inter-American Development Bank Website is at
www.iadb.org.

The world's most important development bank is the International Bank for Reconstruction and Development (IBRD), commonly called the World Bank.[97] The World Bank, together with its two subsidiary agencies, the International Development Association (IDA) and the International Finance Corporation (IFC), have a combined capital of more than $107 billion for investment, primarily in the less developed and developing countries. New lending commitments of $26.7 billion were made by the IBRD in fiscal 2011, and new commitments of $16.3 billion were made by the IDA.[98]

The World Bank and the IDA provide funds directly to governments. The IFC, on the other hand, provides funds to private companies.

The World Bank Web site is at
www.worldbank.org.

I. Countertrade

Not all international trade involves the sale of goods or services for a monetary price. Often what is exchanged is not money, but goods or services. Such an exchange, when it is made in addition to, or in place of, a financial settlement is known as a **countertrade**.

countertrade
Any transaction linking exports and imports of goods or services in addition to, or in place of, a financial settlement.

Contracting parties agree to countertrade for a number of reasons: when the buyer lacks commercial credit or a convertible currency; when the buyer wants to exploit a favorable market position to obtain better terms; or when a government purchaser seeks to protect or stimulate the output of domestic industries or to maintain the balance of its overseas trade. A number of transactions fit the definition of a countertrade, including:

- Barter: The exchange of a seller's goods or services for a buyer's goods or services.
- Buyback: An arrangement in which an exporter provides equipment or technology and the buyer uses it to produces goods that are used to pay for the equipment or technology.
- Counter purchase: A business deal in which the parties enter into two separate contracts specifying the goods or services to be delivered under the first contract and then the goods or services to be delivered under the second contract at a later date. Such an arrangement allows performance of the first contract to go ahead when the performance of the second needs to be delayed. An example of a counter purchase is the delivery of goods in exchange for agricultural produce that is to be harvested at a later date.
- Offset: An agreement between a seller of high-priced items (such as military aircraft) and a government procurement agency in which the seller agrees to buy goods from the purchasing country to "offset" the negative effects of the large foreign purchase on the country's balance-of-payments account.

[93]The Central American Bank for Economic Integration's Web site is at www.bcie.org/(in Spanish).

[94]The European Bank for Reconstruction and Development's Web site is at www.ebrd.com.

[95]The European Investment Bank's Web site is at www.eib.org.

[96]The Inter-American Development Bank's Web site is at www.iadb.org.

[97]The World Bank Group's Web site is at www.worldbank.org.

[98]See "Frequently Asked Questions about the World Bank" at http://web.worldbank.org/WBSITE/EXTERNAL/EXTSITETOOLS/0,,contentMDK:20062181\~pagePK:98400\~piPK:98424\~theSitePK:95474,00.html; the World Bank Annual Report for 2011 is at http://siteresources.worldbank.org/EXTANNREP2011/Resources/8070616-1315496634380/WBAR11_YearIn-Review.pdf.

- Production sharing: A transaction, similar to a buyback, but used in mining and energy projects where the developer is paid out of a share of a mine or well's production.
- Swap: An agreement used when both parties (usually one of which is a government) face large debt burdens. It involves the exchange of a monetary debt for another form of debt, such as an equity share or an obligation to deliver products, goods, or services.
- Tolling: A foreign supplier employs a processor to process raw materials that the processor cannot afford to purchase. The supplier then sells the processed goods to a third party to pay for the processing.

A countertrade is agreed to by negotiation and contracting. The basic terms of a countertrade contract are the same as those for any other contract. They include a description of the goods or services, the time and place for performance, the price (if money is to be exchanged), guarantees and warranties, remedies in the event of a breach, the governing law, and agreement as to the settlement of disputes. The United Nations Commission on International Trade Law's (UNCITRAL's) *Legal Guide on International Countertrade Transactions* provides detailed guidance for entering into a countertrade contract.[99]

Opponents of countertrade say it is a restraint of free trade that costs jobs in the supplier nation. If the U.S. Department of Commerce and Congress are taking an interest in the offset game, it may be because U.S. companies have to comply with offset demands when selling arms abroad, while there is no similar requirement for foreign companies selling into the United States other than needing a U.S. presence.

In recent years the use of countertrade has been growing, and it seems to be spreading from just arms and aerospace purchases to civil infrastructure projects. Some governments have actually stated that they are more concerned with the offset package offered that with the items being purchased. Kuwait has gone so far as to require countertrade commitments from all foreign companies, or national companies acting as agents for foreign companies on civil-sector contracts of more than KD10 million (U.S. $33 million) with the Kuwaiti government. Lesser-developed countries use countertrade to appear as "trade partners" of technologically and economically richer countries, rather than aid recipients. And because developing countries often find it hard to buy much-needed goods or equipment due to a lack of foreign exchange, countertrade may be the only effective mechanism for doing business.[100]

Chapter Questions

Types of Instruments

1. Identify the following instruments:
   a. A written promise by a bank to repay money received from a depositor.
   b. A written promise to pay another a certain sum of money.
   c. An instrument drawn by one person ordering another to pay a third at a definite future time.
   d. An instrument drawn by one person ordering another to pay a third at presentment or at a stated time after presentment.
   e. An instrument drawn by person A ordering person B to pay person A.
   f. An instrument drawn by one person ordering a bank to pay a third person on demand.
   g. A written promise to pay another a certain sum of money that is secured by personal property.
   h. A written promise to pay another a certain sum of money that is secured by real property.
   i. A written promise to pay another a certain sum of money that is due in installments.
   j. An instrument that serves as a carrier's receipt for goods, as evidence of a contract of carriage, and as a document of title.

Negotiability Issues

2. You win a game of poker and your two opponents (one American and the other German) write you two separate I.O.U.s. They initially start with "I, the undersigned, do acknowledge. . ." Because you know that a mere acknowledgement is not a promise, you ask them to rewrite it. They start again: "I, _________, the undersigned, acknowledge that I owe________ ten million dollars, payable in

[99]The guide is available in Arabic, Chinese, English, French, Russian, and Spanish. To order this document and for a wide variety of other resources related to countertrade, see the UNCITRAL Countertrade Web site at www.uncitral.org/uncitral/. . ./uncitral. . ./1992Guide_countertrade.html. Additional information is available from the Global Offset and Countrade Organization at www.globaloffset.org.

[100]Ross Davis, "A Deal with Strings Attached," *Financial Times*, p. 8, July 18, 2002.

London on October 6, 2012. Signed at Tripoli." Would this constitute a negotiable promissory note? Is there a problem if the instrument is non-negotiable from the maker's point of view? Discuss.

3. You approach a bank in the United Kingdom with a check issued in your favor in Australia. While waiting at the bank, you doodle on the back of the check. The bank refuses to recognize the check as valid, claiming it is an altered version of the original check that had been issued. Do you think the bank might win if you take this case to court? Discuss.

Liability of the Drawer Where the Payee Is Fictitious

4. Ben Arnold has been an employee of Tom Jefferson for several years. During that time, Jefferson has relied on Arnold to prepare payroll checks, checks to pay suppliers, etc. Unknown to Jefferson, Arnold is a compulsive gambler who owes large sums of money to various underworld figures. Arnold, who has been threatened with death if he fails to pay on his debts, prepares a check payable to a nonexistent supplier. Jefferson innocently signs the check. Arnold then endorses the check with "Pay to Ben Arnold" and the supplier's name. Later, Arnold takes the check to his bank, endorses it in blank, deposits it in his personal checking account, and then, later still, withdraws the money and flees the country. Meanwhile, Arnold's bank sends the check through the collection process and Jefferson's bank pays the check. When Jefferson discovers that Arnold has abandoned his job and defrauded him of a large sum of money, he demands that Arnold's bank credit his account at his bank. Must Arnold's bank do so? Under the BEA or UCC? Under the ULB?

Rights of the Holder

5. Ms. V, a wealthy art collector in Country W, is interested in buying a rare painting from Mr. Y in Country Z. Both parties agree that the price is to be determined by an independent appraiser. V informs Y that she will send her agent, X, with a check to collect the painting. V draws a check payable to Y but leaves the amount blank. She gives the check to X and instructs him to deliver it to Y. Without authority, X fills in the amount for $1 million and presents it to Y, who has, in the meantime, received the appraisal. The appraised price is $750,000. X tells Y that Ms. V had made the check out for $1 million to ensure that it will exceed the appraisal price, and that V has instructed X to return with the painting and the difference in cash. Y gives X the painting and $250,000. X delivers the painting but then disappears with the $250,000 in cash. When V discovers what has happened, she stops payment on her check and offers to pay Y $750,000 for the painting. Y insists that V must pay the check's full face value of $1 million. Is Y correct?

Effect of Alteration of the Instrument

6. Doug Drawer makes out a check for $9 to Phil Payee. Phil cleverly alters the number 9 to 90 and the written nine to ninety and then cashes the check at a local convenience store. Must Doug (or Doug's bank) pay $90 to the store? Under the BEA or UCC? Under the ULB?

Fraud in the Execution

7. John Johnson, who works for a well-known parcel delivery service, delivered a large package to Pete Peterson and had Pete sign what Pete believed was an acknowledgment of delivery. The package contained component stereo parts that Pete had ordered from a foreign supplier, and Pete was delighted to receive them. Pete did not give the matter a second thought until several months later, when Donna Doe demanded payment of $5,000. Pete discovered that he had signed a three-month negotiable promissory note, rather than the acknowledgment of a delivery, and that Donna had innocently purchased the note from John. Must Pete pay the note? Under the BEA or UCC? Under the ULB?

Letter-of-Credit Requirements

8. X enters into an agreement with Y whereby X was to deliver some goods to Y. The agreement mentions that Y would provide X with a letter of credit by way of compensation, the amount of which would be in conformity with the prevailing market rate for such goods. However, Y realizes that a letter of credit would have to be very specific and as the compensation would depend upon the market rate he decides to make the payment in cash upon receiving the goods from X. When Y receives a communication from X to this effect, he decides to sue X for breach of contract. X argues that as the agreement was conditional on the mode of compensation, there was no obligation assumed by him if the letter is not provided. Is X's justification valid? Discuss.

Duty of a Bank Under a Letter of Credit

9. Rousseau et Fils has signed a contract to buy 10,000 "new coffee percolators in the manufacturer's original packaging, with standard manufacturer's warranty," from Schwartz, GmBH. Schwartz agrees to ship the percolators CIF, and Rousseau agrees to make payment by means of an irrevocable letter of credit. Rousseau contacts Thermidor Bank, which issues a letter of credit promising to honor a promissory note payable to Schwartz when it is accompanied by an invoice and a clean, on board bill of lading for "10,000 new coffee percolators in the manufacturer's original packaging, with standard manufacturer's warranty." Rousseau learns from Weiss, a competitor of Schwartz, that even though Schwartz had obtained actual bills identifying the goods as "10,000 new coffee percolators in the manufacturer's original packaging, with standard manufacturer's warranty," the percolators were actually used and inoperable. Is there anything that Rousseau can do?

10. In Question 9, would it make any difference if Rousseau had positive proof that a fraud had been perpetrated?

11. In Question 9, would it make any difference if Schwartz's bank had confirmed the letter of credit and paid the promissory note before Rousseau learned of the supposedly defective shipment?

Case Index

Principal cases are indicated by boldface page numbers.

Key:

Arb.—Arbitration Tribunal
EFTA—European Free Trade Area
ICJ—International Court of Justice
ICSID—International Center for the Settlement of Investment Disputes
ILO—International Labor Organization Administrative Tribunal
ITLOS—International Tribunal for the Law of the Sea
PCA—Permanent Court of Arbitration
PCIJ—Permanent Court of International Justice
UAE—United Arab Emirates
UK—United Kingdom
US—United States
WTO—World Trade Organization

A

Abbott v. Republic of South Africa (Spain 1992), **163–167**
Acsyngo v. Compagnie de Saint-Gobain (France) S.A. (Belgium 1986), **90–91**
Adams v. Burks (US 1873), 536 n. 153
Adams v. Lindsell (UK 1818), 582 n. 86
Administrative Decision No.V (United States v. Germany) (Arb. 1924), 141 n. 64
Adoni, Cases 115 and 116/81 (EU 1982), 464
Aerial Incident of July 27 1955 (United States v. Bulgaria) (Preliminary Objections) (ICJ 1959), 132 n. 39
AGIP Co. SpA (Italy) v. Congo (ICSID 1979), 144
Airbus Industrie G.I.E. v. Patel (UK 1998), 180 n. 181, **208–209**
The Albazero (UK 1976), 634
Alcoa Minerals of Jamaica, Inc. (United States) v. Jamaica (ICSID 1979), 142, 143 n. 50, 144, 199, 207
Alvarez-Machain v. United States (US 2003), 459 n. 144
Amar Nath Sehgal v. Union of India (India 2007), **499–501**
American Securit Co. v. Shatterproof Glass Corp. (US 1959), 552
Anglo-Iranian Oil Co. Case (United Kingdom v. Iran) (ICJ 1952), 90
Anglo-Norwegian Fisheries Case (United Kingdom v. Norway) (ICJ 1951), 27
Arab Republic of Egypt v. Southern Pacific Properties, Ltd., et al. (France 1984), **249–250**
Arbitration Between Wintershall AG et al. and the Government of Qatar (Ad Hoc Arbitral Tribunal 1988), **271–274**
Asahi Metal Industry Co., Ltd. v. Superior Court of California, Solano County (US 1987), 154 n. 108, 210, 218, **219–224**
Asante Technologies, Inc. v. PMC-Sierra, Inc. (US 2001), **562–566**
Assicurazioni Generali (Underwriters) v. Black & Veatch (US 2004), **651–653**
Australia—Measures Affecting Importation of Salmon (WTO 1998), **403–408**
Auto Servicio San Ignacio v. Compañia Anonima Venezolana de Navigación (US 1984), 696

B

Bank of India v. Gobindram Naraindas Sadhwani and Others (Hong Kong 1982), **172–175**
Barcelona Traction, Light and Power Co., Case Concerning (Second Phase) (Belgium v. Spain) (ICJ 1970), 91–92, 97, **187–189**
Batchelder v. Kawamoto (US 1998), **288–290**
Beyene v. Irving Trust Co. (US 1985), 692
Bhopal Case (India 1989), **277–281**
Brady v. Brown (US 1995), **257–262**
Bumper Development Corp., Ltd. v. Commissioner of Police of the Metropolis and Others (Union of India and Others, Claimants) (UK 1991), **150–153**

C

Canada Malting v. Paterson Steamships, Ltd (US 1932), 176
Canevaro Case (PCA 1912), 96
Centrafarm v. Sterling Drug (EU 1974), 537
Centrafarm v. Winthrop (EU 1974), 537
Charles R. Allen, Inc. v. Island Cooperative Services Cooperative Association (US 1959), **679–681**
Chattin v. United Mexican States (Mex.-US General Claims Comm. 1927), **93–96**
Chicago Prime Packers, Inc. v. Northern Food Trading Co. (US 2005), **595–598**
Chinese Seamen's Foreign Technical Services Co. v. Soto Grande Shipping Corp., Sa (China 1987), **648–650**
CNL-Sucal v. Hag (EU 1990), 538
Coditel v. Ciné Vog Films (No. 1) (EU 1980), 538
Colourprint Ltd. v. McDonald's Corp. (Kenya 1980), 515
Commission of the European Communities v. Federal Republic of Germany (Case 274/87) (EU 1987), **51–53**

Costa v. ENEL (EU 1964), 50
Croft & Scully Co. v. M/V Skulptor Vuchetich et al. (US 1982), **640–643**

D

Denmark v. Norway, 26
De Sanchez v. Banco Central De Nicaragua (US 1985), **63–65**
Discount Records, Ltd. v. Barclays Bank, Ltd. (UK 1974), 694
Dogger Bank Inquiry (Inquiry 1904), 128
Dow Jones & Co. Inc. v. Gutnick (Australia 2002), 210, **211–213**
DUBERG v. UNESCO (ILO 1955), **452–454**

E

EMI v. CBS United Kingdom, Case 51/75 (EU 1976), 539
England and Another v. Attorney-General of St. Lucia (Eastern Caribbean States 1987), **476–479**
European Communities—Regime for the Importation, Sale, and Distribution of Bananas (Ecuador, Guatemala, Honduras, Mexico, United States v. European Communities) (WTO 1997), **431–434**
Exchange of Greek and Turkish Populations Case (PCIJ 1925), 29
Experience Hendrix, L.L.C. v. Hammerton, **516–521**

F

Far East Realty Investment, Inc. v. Court of Appeals et al. (Philippines 1988), **676–677**
Filanto, SpA v. Chilewich International Corp. (US 1992), **585–587**
Filartiga v. Pena-Irala (US 1980), 457, 458
Finance Ministry v. Manfattura Lane Marz Otto, SpA (Italy 1973), **378–379**
Flatow v. The Islamic Republic of Iran (US 1998), 77, **78–83**

G

Gonzalez et al. v. Chrysler Corporation et al. (US 2002), **177–179**
Great China Metal Industries Co. Ltd. v. Malaysian International Shipping Corp. (Australia 1998), **635–639**
Greco-Bulgarian Communities Case (PCIJ 1930), 28
Guaranty Trust Co. of New York v. Hannay & Co. (UK 1918), 682

H

Hadley v. Baxendale (UK 1854), 606
Haig v. Agee (US 1981), 468–469
Hoffman-La Roche Ltd. v. Empagran (US 2005), **209–210**
Holiday Inns/Occidental Petroleum Corp. v. Government of Morocco (ICSID 1980), 141
Hunt et al. v. Alliance North American Government Income Trust, Inc. et al. (US 1987), **344–345**

I

I'm Alone Case (Arb. 1934), 103
Ignacio Sequihua v. Texaco, Inc. et al. (US 1994), **23**
In Re Sealed Case (US 1987), **347–350**
Interhandel Case (Switzerland v. United States) (ICJ 1959), 98

J

Japan—Taxes on Alcoholic Beverages (Canada v. Japan, European Communities v. Japan, United States v. Japan) (WTO 1996), **138–140**
Japan—Taxes on Alcoholic Beverages (WTO 1998), **381–384**
Jorge Luis Machuca Gonzalez et al. v. Chrysler (US 2002), **177–179**

L

Legal Status of Eastern Greenland (Denmark v. Norway) (PCIJ 1933). *See* Denmark v. Norway
Letelier and Moffitt, Re (Chile—U.S. International Comm. 1992), **104–105**
Libyan American Oil Company (LIAMCO) v. Government of the Libyan Arab Republic (Arb. 1977), 89
Libyan Arab Foreign Bank v. Bankers Trust Company (UK 1987), **355–356**
Lighthouses arbitration (France v. Greece) (Arb. 1956), 88
Loewen Group, Inc. v. United States (ICSID 1998), **145–147**
L'Oréal v. eBay (Court of Justice 2011), **540–541**
The Lotus (France v. Turkey) (PCIJ 1927), 27

M

Mair v. Bank of Nova Scotia (Eastern Caribbean States 1983), **671–673**
Maurice O'Meara Co. v. National Park Bank of New York (US 1925), 692
McCullough Tool Co. v. Well Surveys, Inc. (US 1965), 552
McDonald's Corp. v. Hassan Arzouni, Case 803/85 (UAE 1986), 515
Menendez v. Saks and Company (US 1973), **319–322**
Mergé Claim (Arb. 1955), 97
Metro Industries v. Sammi Corp. (US 1996), **200–205**
M. Golodetz & Co., Inc. v. Czarnikow-Rionda CO., Inc. (The Galitia) (UK 1978), **629–632**
Military and Paramilitary Activities in and against Nicaragua (Nicaragua v. United States) (ICJ 1986), 85
Miller v. Race (UK 1758), **667–668**
Monsanto Co. v. Coramandal Indag Products, (P) Ltd. (India 1986), **507–509**
Moralice (London) Ltd. v. E.D. and F. Man (UK 1954), 692
Morelli v. Cedel (US 1998), **483–486**
Multi Product International v. Toa Kogyo Co., Ltd. (Japan 1977), 170
M/V SAIGA Case (Merits) (Saint Vincent and the Grenadines v. Guinea) (ITLOS 1999), **98–103**

N

Natural Gas Case (Austria 1996), **591–594**
Neer Claim (Arb. 1920), 88
Nicaragua Case (ICJ 1984), 28
Nissan Motor Mfg. Corp., U.S.A. v. United States (US 1989), **264–266**
Nipon Steel Corporation v. United States (US 2006), **410–414**
Norwegian Loans Case (France v. Norway) (Preliminary Objections) (ICJ 1957), 132
Nottebohm Case (Liechtenstein v. Guatemala) (ICJ 1964), 97

O

Oil Platforms Case (Islamic Republic of Iran v. United States of America) (ICJ 2003), **133–134**

P

Parke, Davis v. Centrafarm, Case 24/67 (EU 1968), 536
Performing Right Society, Limited v. Hickey (Zambia 1978), **494–496**
Phillips Puerto Rico Core, Inc. v. Tradax Petroleum, Ltd. (US 1985), **616–620**
Pubali Bank v. City National Bank (US 1982), 694–696

R

Ransome-Kuti v. Phonogram, Ltd. (Ghana 1976), **543–545**
Republic of Argentina et al. v. Weltover, Inc. et al. (US 1992), **303–305**
Richard v. American Union Bank (US 1930), 302
Rio Tinto Zinc Corporation v. Westinghouse Electric Corporation (UK 1978), 207
Riverstone Meat Co. Pty., Ltd. v. Lancashire Shipping Co., Ltd. (UK 1961), 634
Rutili v. French Minister of the Interior, Case 36/75 (EU 1975), 464

S

Sandline International Inc. v. Papua New Guinea (Arb. 1998), **73–76**
Scott Paper Co. v. Marcalus Mfg. Co. (US 1945), 552
Sealed Case, In Re (US 1987), **347–350**
Sei Fujii v. State of California (US 1952), 29, **30–32**
Shell v. R.W. Sturge, Ltd. (US 1995), **154–159**
Shoe Seller's Case (Germany 1994), **600–602**
Sosa v. Alvarez Machain (US 2004), **459–460**
Southern Bluefin Tuna Cases: Provisional Measures (New Zealand v. Japan; Australia v. Japan (ITLOS 1999), **112–116**
Spiess et al. v. C. Itoh & Co. (America) Inc. (US 1979), **480–482**
St. Paul Guardian Insurance Company v. Neuromed Medical Systems & Support, GmbH (US 2002), **610–614**
State v. Nagami (Japan 1968), **470–472**
Sztejn v. J. Henry Schroeder Banking Corp. (US 1941), **695–696**

T

Terrapin v. Terranova, Case 119/75 (EU 1976), 536, 538
Timberlane Lumber Co. v. Bank of America (US 1976), 199–200
Timberlane Lumber Co. v. Bank of America National Trust and Savings Assn. (US 1984), 23, 24, 199–200
Touche Ross & Co. v. Bank Intercontinental, Limited (Cayman Islands 1988), **232–235**
Trail Smelter Arbitration (United States v. Canada) (Arb. 1938 and 1941), **35–37**
Trans Trust Sprl v. Danubian Trading Co., Ltd. (UK 1952), **687–689**
Treibacher Industrie, A.G. v. Allegheny Technologies, Inc., **576–579**
Tubantia Incident (Inquiry 1916), 129

U

United States v. Aluminum Co. of America (US 1945), 199
United States v. Blondek, Tull, Castle, and Lowry (US 1990), **225–229**
United States Diplomatic and Consular Staff in Teheran Case (United States v. Iran) (ICJ 1980), 134
United States—Import Prohibition of Certain Shrimp and Shrimp Products (WTO 1998), **389–394**
United States v. National Lead Co. (US 1947), 542
United States v. Studiengesellschaft Kohle, M.B.H. (US 1976), 549

V

Van Duyn v. Home Office, Case 41/74 (EU 1974), 464
Van Zuylen v. Hag, Case 119/76 (EU 1976), 538
Vishipco Line et al. v. Chase Manhattan Bank, N.A. (US 1981), **351–354**

W

Wienerwald Holding, A.G. v. Kawn, Wong,Tan and Fong (Hong Kong 1979), 516
Wilson, Smithett & Cope, Ltd. v. Terruzzi (UK 1976), **315–319**
Wintershall AG et al. and the Government of Qatar, Arbitration Between (Ad Hoc Arbitral Tribunal 1988), **271–274**
World-Wide Volkswagen Corp. v. Woodson (US 1980), 210, **217–218**
W.S. Kirkpatrick Co. Inc. v. Environmental Tectonics Co., **167–169**

Z

Zenith Radio Corp. v. Hazeltine Research, Inc. (US 1917), 504

Statutory Index

A

Agreement Between the Government of the United States of America and the Commission of European Communities Regarding the Application of Their Competition Laws, 1991, 198 n. 44
Agreement on the Conservation of Polar Bears, 1976, 124 n. 121
Argentina, Foreign Investment Law, 1977, 269 n. 143
Argentina, Law No. 11,723 on Copyright, 1933
  Article 1, 501 n. 52
  Articles 47–63, 503 n. 56
Argentina, Law No. 21617 on the Transfer of Technology, 1972
  Article 10(c), 539 n. 169
  Article 10(i), 546 n. 180
Australia, Foreign Proceedings (Excess of Jurisdiction) Act, 1984, 347 n. 160
Australia, Foreign Proceedings (Prohibition of Certain Evidence) Act, 1976, 347 n. 160
Australia, Patents Act 1990 No. 83, 1990
  Article 144(2)(a), 547 n. 203
  Article 144(2)(b), 547 n. 204, 552 n. 216

B

Bangui Agreement, 1977, 523 n. 94
BEA. *See* Bills of Exchange Act, 1882
Belgium, Copyright Law, 1886, 491, 497
Bills of Exchange Act, 1882, 659
Brazil, Foreign Capital Investment Law, 269 n. 143
Brazil, Normative Act No. 015 of the National Institute of Industrial Property, 1975
  Article 2.5.2, 548 n. 206
  Article 2.5.2(b)(i), 539 n. 168, 546 n. 189
  Article 3.5.2(c)(i), 539 n. 168, 546 n. 189
  Article 4.5.2(d)(i), 539 n. 168, 546 n. 189
  Article 4.5.2(d)(vi), 552 n. 216
  Article 5.5.2(d)(i), 539 n. 168, 546 n. 189
  Article 6.5.2(b), 553 n. 227
Brazil, Patent Law, 1809, 505
Brussels Convention. *See* International Convention for the Unification of Certain Rules of Law Relating to Maritime Liens and Mortgages
Brussels Protocol. *See* International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading, Brussels Protocol, 1968

C

Canada, Bank Act, 1985, 347 n. 157
Canada, Foreign Extraterritorial Measures Act, 1984, 347 n. 160
Canada, Foreign Investment Review Act, 1973–1974, Section 2(2), 243 n. 27
Cayman Islands, Confidential Relationships (Preservation) (Amendment) Law (Law 26 of 1979), 347 n. 160
Cayman Islands, Confidential Relationships (Preservation) Law (Law No. 16 of 1976), 347 n. 160
Charter of the International Military Tribunal, 1945, Article 6(c), 149 n. 95
Chicago Convention on International Civil Aviation, 1944, Annex 16 on Environmental Protection, 122
Chile, Foreign Investment Statute, 1977, 269 n. 141, 440
CIBN. *See* United Nations, Convention on International Bills of Exchange and International Promissory Notes, 1988
CISG. *See* United Nations, Convention on Contracts for the International Sale of Goods
CMR. *See* Convention on the Contract for the International Carriage of Goods by Road, 1956
Colombia, Law No. 23 on Copyright, 1982
  Article 2, 501 n. 52
  Article 6(2), 501 n. 51
Colombia, Patent Law, 1925, 510 n. 74
Convention Concerning International Carriage by Rail, 1980, 622
Convention Concerning the Protection of the World Cultural and Natural Heritage, 1972, 124 n. 123, 395 n. 135
Convention for the Prevention of Pollution from Ships, 1973, 116
Convention for the Prevention of Pollution of the Sea by Oil, 1954, 116
Convention for the Protection of Antarctic Seals, 1972, 124 n. 121
Convention for the Protection of Cultural Property in the Event of Armed Conflict, 1954, 395
Convention for the Protection of Performers, Producers of Phonograms, and Broadcasting Organizations, 1961, 527
Convention for the Settlement of Certain Conflicts with Bills of Exchange and Promissory Notes. *See* Geneva Conventions on the Unification of the Law Relating to Bills of Exchange, 1930
Convention for the Unification of Certain Rules Relating to International Carriage by Air, Montreal Protocol
  No. 2, 1975, 654
  No. 4, 1975, 654
Convention on Biological Diversity, 124, 248
Convention on Civil Liability for Nuclear Damage, 1963, Article V, 124 n. 124
Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, 196, 224
Convention on International Trade in Endangered Species of Wild Fauna and Flora, 1973, 124 n. 121
Convention on Oil Pollution Preparedness, Response, and Cooperation, 1990, 116
Convention on Salvage, 1989, 116
Convention on the Conservation of Antarctic Marine Living Resources, 1980, 124 n. 121
Convention on the Conservation of Migratory Species of Wild Animals, 1979, 124 n. 121
Convention on the Contract for the International Carriage of Goods by Road, 1956, 622
  Article 17.2, 622 n. 50
Convention on the Means of Prohibiting and Preventing the Illicit Import,

Export, and Transfer of Ownership of Cultural Property, 1970, 395
Convention on the Prevention of Marine Pollution by Dumping of Wastes and Other Matter, 1972, 116
Convention on the Prevention of Marine Pollution from Land-Based Sources, 1974, 116
Convention on the Protection of the Archaeological, Historical, and Artistic Heritage of the American Nations, 1976, 395
Convention on the Settlement of International Disputes between States and Nationals of Other States, 1965, 140
Convention on the Stamp Laws in Connection with Bills of Exchange and Promissory Notes. *See* Geneva Conventions on the Unification of the Law Relating to Bills of Exchange, 1930
Convention on Wetlands of International Importance Especially as Waterfowl Habitat, 1971, 124 n. 121
Convention Providing a Uniform Law for Bills of Exchange and Promissory Notes. *See* Geneva Conventions on the Unification of the Law Relating to Bills of Exchange, 1930
Convention Relating to a Uniform Law on the Formation of Contracts for the International Sale of Goods, 1964, 560
Convention Relating to a Uniform Law on the International Sale of Goods, 1964, 560, 567
Convention Relating to Civil Liability in the Field of Maritime Carriage of Nuclear Material, 1971, 124 n. 123
Convention Relating to Intervention on the High Seas in Case of Oil Pollution Casualties, 1969, 116
Convention Relating to the Distribution of Program-Carrying Signals Transmitted by Satellite, 1974, 530
Convention Respecting Free Navigation of the Suez Canal (1888), 34 n. 41
Corpus Juris Civilis, 65–66
COTIF. *See* Convention Concerning International Carriage by Rail
Council of Europe, Convention on Insider Trading, 296–297
  Article 5, 296 n. 224
  Preamble, 296 n. 223
Council of Europe, European Convention on Human Rights, 1950, 464
  Article 1, 466
Council of Europe, European Convention on Information on Foreign Law, 1968, 180
  Article 1(1), 181 n. 187
  Article 6(2), 181 n. 187
Council of Europe, European Convention on the Protection of the Archaeological Heritage, 1992, 395 n. 135
Cuba, Foreign Investment Act, 1995, Article 10, 252 n. 48

D

Draft Convention on the Responsibility of States for Damage Done in Their Territory to the Person or Property of Foreigners, 1929, Article 9, 93 n. 55

E

EAEC Treaty. *See* European Union, European Atomic Energy Community Treaty
EC Treaty. *See* European Union, Treaty Establishing the European Community
ECSC Treaty. *See* European Union, European Coal and Steel Community Treaty
England, laws of. *See* headings at United Kingdom
Euratom Treaty. *See* European Union, European Atomic Energy Community Treaty
European Convention on State Immunity, 1975, 161
European Union, Block Exemption for Patent Licensing, 1989, Article 2(9), 547 n. 202
European Union, Directive 68/360, 463, 463 n. 167
European Union, European Atomic Energy Community Treaty, 1957, 46
  Article 48, 463 n. 162
European Union, European Coal and Steel Community Treaty, 1951, 46
European Union, European Community Treaty. *See* European Union, Treaty Establishing the European Community
European Union, European Union Treaty, 1992, 46
  Article 165, 57 n. 70
  Article 176, 57 ns. 70–71
European Union, Regulation 44/2001, Regulation on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, 2000, 180
European Union, Regulation 1612/68, 463
  Article 3, 463 n. 170
  Article 7, 464 n. 173
  Article 9, 464 n. 173
  Article 9(1), 464 n. 172
European Union, Social Charter, 1961, 466–468
European Union, Treaty Establishing the European Community, 1957, 46
European Union, Treaty of Amsterdam, 1997, 46, 206 n. 61
European Union, Treaty of Nice, 2001, 46

F

Final Act Embodying the Results of Uruguay Round of Multilateral Trade Negotiations, 1994, 363 n. 25, 366
France, Civil Code, 1804, 67, 560 n. 21
  Article 1341, 579 n. 76
  Section 1150, 606
France, Code of Commerce, 1807, 560 n. 21
France, Copyright Act, 1791, 490
France, Declaration of the Rights of Man and Citizen, 1789, 455
France, Law No. 57–298, 1957
  Article 27, 493 n. 34
  Article 28, 491 n. 25
  Article 31(3), 492 n. 30
  Article 41(3), 504 n. 65
France, Patent Law, 1791, 504
France, Penal Code, Article 425(3), 492 n. 31
France, Savary Code, 1673, 659

G

GATT 1994. *See* World Trade Organization, General Agreement on Tariffs and Trade, 1994
General Agreement on Tariffs and Trade, 1994. *See* World Trade Organization, General Agreement on Tariffs and Trade, 1994

Geneva Convention on Long-Range Transboundary Air Pollution, 1979, 122
Geneva Conventions on the Unification of the Law Relating to Bills of Exchange, 1930, 659–660, 661, 665, 669–671
Article 5, 665 n. 39
Article 15, 669 n. 43, 670 n. 48
Article 16, 674 n. 59
Article 18, 669 n. 46
Article 19, 670 n. 49
Article 41, 665 n. 37
Article 44, 678 n. 69
Geneva Conventions on Unification of the Law Relating to Checks, 1931, 659–660
Article 1, 665 n. 35
Article 28, 661 n. 33
Germany, Act Against Restraints on Competition, 1957, 546
Article 20.1, 549
Article 20.2(1), 550 n. 213
Article 20.2(4), 547 n. 196
Germany, Civil Code 1896, 67, 560 n. 21
Section 446(1), 598 n. 150
Germany, Copyright Law, 1837
Section 16, 491 n. 23
Germany, Copyright Law, 1965
Section 2(1), 502 n. 54
Section 15(2), 493 n. 35
Section 17(1), 492 n. 29
Section 47, 504 n. 61
Section 53, 504 n. 63
Germany, Securities Prospectus Act of December 13, 1990, 285 n. 176
Germany, Securities Trading Act of August 1, 1994, 291 n. 195
Ghana, Capital Investment Decree, 269
Ghana, Copyright Law, 1985, Section 2(2), 501 n. 51

H

Hague Agreement Concerning the International Deposit of Industrial Designs, 1925, 532 n. 141
Hague Convention for the Pacific Settlement of International Disputes, 1899, 128
Hague Convention for the Pacific Settlement of International Disputes, 1907, 129
Hague Convention on Certain Questions Relating to the Conflict of Nationality Laws, 1930, Article 4, 96 n. 57
Hague Draft Convention on Jurisdiction and Foreign Judgments in Civil and Commercial Matters, 180 n. 182
Hague Rules. *See* International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading, 1924
Hague-Visby Rules. *See* International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading, Brussels Protocol, 1968
Hamburg Rules. *See* United Nations, Convention on the Carriage of Goods by Sea, 1978
Honduras, Law on Patents, 1919, Article 24, 536

I

ICSID Convention. *See* Convention on the Settlement of International Disputes between States and Nationals of Other States, 1965
India, Guidelines for Industries, 1976–1977, Chapter 3, Article 9.ix, 553 n. 226
India, Guidelines for Industries, 1988, Chapter 3, Article 9(v), 539 n. 167
India, Monopolies and Restrictive Trade Practices Act No. 54, 1969, Article 39.3, 546 n. 190
India, Patents Act 1970
Article 140.4(c), 547 n. 202
Article 141(1), 552 n. 216
India, Trade Marks Act, 1999, 185 n. 25
Indonesia, Foreign Capital Investment Law, 269
Institute of International Law, Regulation on the Procedure of International Conciliation, Article 1, 128 n. 22
International Bank for Reconstruction and Development, Instrument for the Establishment of the Restructured Global Environment Facility
Article I, Section 16, 325 n. 113
Article I, Section 7, 325 n. 113
International Chamber of Commerce, Uniform Customs and Practices for Documentary Credits, 630, 682 n. 74, 683–684
Article 3, 694 n. 99
Article 10(a), 694 n. 98, 697 n. 104
Article 10(d), 697 n. 105
Article 16(c), 693 n. 94
Article 16(e), 693 n. 96
Article 17, 693 n. 97
International Chamber of Commerce's Uniform Rules for Collections, 1996, 660
International Convention for the Conservation of Atlantic Tunas, 118 n. 108
International Convention for the Protection of Birds, 1950, 124 n. 121
International Convention for the Protection of Industrial Property (Paris Convention), 524, 527, 531, 554
International Convention for the Protection of Industrial Property, 1883, 527
Article 19, 527 n. 112
International Convention for the Protection of Performers, Producers of Phonograms, and Broadcasting Organizations, 1961, 530
International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading, 1924, 623
Article 3, 634 n. 75
Article 3, Section 6, 643 n. 103
Article 4, 634 n. 77
Article 4, Section 5, 640 n. 92
International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading, Brussels Protocol, 1968
Article 3, 634 n. 75
Article 3, Section 6, 643 n. 101
Article 4, 634 n. 77
Article 4, Section 5, 640 n. 94
International Convention for the Unification of Certain Rules of Law Relating to Maritime Liens and Mortgages, 647
International Convention on Civil Liability for Oil Pollution Damage, 1969, 124 n. 125
International Convention on the Establishment of an International Fund for Compensation of Oil Pollution Damage, 1971, Article V, 124 n. 126
International Court of Justice, Statute of. *See* United Nations, Statute of the International Court of Justice
International Labor Organization, Constitution, Article 26(2), 449 n. 111

International Labor Organization, Convention Concerning Employment of Women at Night (ILO Convention No. 4), 446
International Labor Organization, Convention Concerning Freedom of Association (ILO Convention No. 87), 450
International Labor Organization, Convention Concerning the Application of the Principles of the Right to Organize and to Bargain Collectively (ILO Convention No. 98), 450
International Labor Organization, Statute of the International Labor Organization Administrative Tribunal
  Article 2, 451 n. 119
  Article 7, 451 n. 121
  Article 2, 451 n. 121
International Law Commission, Draft Articles on State Responsibility, 1979
  Article 19, 89 n. 49
  Article 3, 72 n. 22
International Maritime Organization Convention for the Suppression of Unlawful Acts against the Safety of Maritime Navigation, 1988, 77
International Monetary Fund, Articles of Agreement
  Article III, Section 2(a), 310 n. 55
  Article III, Section 2(c), 310 n. 55
  Article III, Section 2(d), 310 n. 55
  Article III, Section 3(a), 310 n. 51
  Article IV, Section 1(iii), 314 n. 68
  Article IV, Section 2(b), 313 n. 64
  Article VIII, Section 2(a), 322
  Article VIII, Section 2(b), 314, 317, 318
  Article VIII, Section 3, 322
  Article VIII, Section 4, 322
  Article VIII, Section 5, 322
  Article VIII, Section 6, 322
  Article VIII, Section 7, 322
  Article IX, 322 n. 98
  Article XII, Section 5(a), 310 n. 52
  Article XIV, 323
  Article XXIX(a), 314 n. 68
  Article XXX(d), 322 n. 96
International Trade Organization, Charter, 308
International Tropical Timber Agreement, 1983, 124 n. 121
IPIC Treaty. *See* Treaty on Intellectual Property in Respect of Integrated Circuits
Israel, Sales Law, Section 22(b), 598 n. 150

J

Japan, Antimonopoly Act Guidelines for International Licensing Agreements, 1969, 549
  Section 1.1(a), 539 n. 168
  Section 1.1(b), 539 n. 169
  Section 1.6, 546 n. 189
Japan, Civil Code, 214
  Article 415, 214 n. 76
Japan, Law Concerning the Application of Laws in General, 1898, Article 7, 170 n. 156, 171 n. 161
Japan, Law No. 54 on the Prohibition of Private Monopolies and the Preservation of Fair Trade, 1974
  Article 24–3, 543 n. 181
  Article 24–3.1, 543 n. 179
  Article 24–3.2, 543 n. 179
  Article 24–3.3, 543 n. 179
  Article 24–4, 543 n. 181
  Article 24–4.1, 543 n. 180
Japan, Securities and Exchange Law, Article 58, 292
Japan, Utility Model Law, 1905, 506
Japan–United States Friendship, Commerce, and Navigation Treaty, 1953, 479
  Article VIII, para. 1, 479 n. 225
  Article VIII, para. 2, 479 n. 225

K

Kenya, Copyright Law, 1982, Section 3(2), 501 n. 51

L

Lisbon Agreement for the Protection of Appellations of Origin and Their International Registration, 1958, 532 n. 143
Locarno Agreement Establishing an International Classification for Industrial Designs, 1968, 532 n. 141

M

Madrid Agreement Concerning the International Registration of Marks, 1881, 533 n. 145
Madrid Agreement for the Repression of False or Deceptive Indications of Sources of Goods, 1891, 531, 532
Malaysia, Copyright Act, 1987, Section 7(3)(b), 501 n. 51
Mexico, Foreign Investment Act, 1993, Article 8, 260 n. 89
Mexico, Law on the Registration of the Transfer of Technology and the Use and Working of Patents, Trade Names, and Trade Marks, 1972
  Article 7(x), 547 n. 205
  Article 7(xi), 546 n. 189
Mexico, Summary of the General Criteria for the Application of the Law Concerning Registration of the Transfer of Technology and the Use and Working of Patents, Trade Names and Trademarks, 1974, 522 n. 168

N

Nairobi Treaty for the Protection of the Olympic Symbol, 1981, 533 n. 145
New York, Code of Civil Procedure, 69
New York, Uniform Commercial Code, Section 5–102(4), 683 n. 77
Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks, 1957, 533 n. 145
Nigeria, Decree No. 70 Establishing the National Office of Industrial Property, 1979
  Article 6.2(3), 550 n. 212
  Article 6.2(j), 546 n. 189
  Article 6.2(o), 551 n. 214
Nigeria, Law No. 61 on Copyright, 1970, Section 1(2)(b), 501 n. 51
North American Free Trade Agreement (NAFTA), 444–445
  Article 1102, 146
  Article 1103, 444 n. 89
  Article 1104, 444 n. 91
  Article 1108, 445 n. 98
  Article 1108, para. 1(c), 445 n. 99
  Article 1109, 444 n. 93
  Article 1110, 444 n. 94
  Article 1120, 444 n. 95
  Article 1201, para. 2(b), 445 n. 98
  Article 1202, 444 n. 90
  Article 1203, 444 n. 89
  Article 1204, 444 n. 91
  Article 1206, 445 n. 98
  Article 1206, para. 1(c), 445 n. 99

Article 1306, 444 n. 88
Article 1405, 444 n. 90
Article 1409, 445 n. 98
Article 1409, para. 1(c), 445 n. 99
Article 1411, 444 n. 88
Article 1802, 444 n. 88
Chapter 11, 144

O

Ontario, Business Corporations Act, 1982, Section 42(2), 292 n. 208

P

Panama Canal Treaty, 1977, 34 n. 41
Paris Convention for the Protection of Industrial Property. *See* International Convention for the Protection of Industrial Property
Patent Cooperation Treaty, 1970, 525
Philippines, Omnibus Investments Code, 1987 (Executive Order No. 226)
Articles 3–9, 246 n. 30
Article 32, 247 n. 35
Philippines, Regulation to Implement Article 5 of Presidential Decree No. 1506 n. 195 Establishing the Technology Board Within the Ministry of Industry, 1978
Article 5.1(c), 546 n. 189
Philippines, Regulation to Implement Article 5 of Presidential Decree No. 1520 Establishing the Technology Board Within the Ministry of Industry, 1978
Article 28.1, 547 n. 197
Article 5.1(c)(1), 553 n. 227
Article 5.1(c)(5), 546 n. 189
Phonogram Piracy Convention. *See* Convention for the Protection of Producers of Phonograms against Unauthorized Duplication of Their Phonograms, 1971
Poland, Law on Civil Procedure, Section 331(1), 180 n. 184
Poland, Public Trading in Securities and on Trust Funds Law of March 22, 1991, 285 n. 183
Portugal, Foreign Investment Code, 1977, Article 28.1(f), 546 n. 189

R

Rio Declaration. *See* United Nations, Declaration on Environment and Development (Rio Declaration)
Rome Convention. *See* International Convention for the Protection of Performers, Producers of Phonograms, and Broadcasting Organizations, 1961
Rome Statute. *See* United Nations Diplomatic Conference of Plenipotentiaries on the Establishment of an International Criminal Court (Rome Statute), 1998
Rome, Corpus Juris Civilis, 65, 66
Rome, Twelve Tables, 65
Russia, Civil Code, Article 479, 491 n. 25
Russia, Federal Law on Foreign Investment, 1999, 269
Article 5, 269 n. 143
Article 8, 269 n. 138
Article 10, 269 n. 138
Article 11, 269 n. 139

S

Satellite Transmission Convention. *See* Convention Relating to the Distribution of Program-Carrying Signals Transmitted by Satellite, 1974
Saudi Arabia, Foreign Capital Investment Code (Royal Decree No. M/4 of 2.2.1399 A.H., 1979), 250 n. 39
Saudi Arabia, Regulations for Companies, (Royal Decree No. M/6 of 22.3.1385 A.H., 1968), Section 228, 250 n. 39
Saudi Arabia, Tender Regulations, (Royal Decree No. M/14 of 7.4.1397 A.H., 1977), Article 1(d)(3), 250 n. 40
Serbia and Montenegro, Law on Long-term Cooperation in Production, Commercialtechnical Cooperation and the Awarding and Acquiring of Technology Between Organizations of Associated Labor and Foreign Persons, 1978
Article 37(4), 547 n. 197
Article 37(5), 553 n. 222, 553 n. 227
Article 37(9), 546 n. 189
Article 37(10), 539 n. 169
South Korea, Foreign Investment Promotion Act (Revised Act No. 5982, 24, 1999), Article 27, 246 n. 30
Spain, Ministry of Industry Order Regulating the Entry of Contracts for the Transfer of Technology in the Register Established by Decree No. 2342 of September 21, 1973, Section 3.6, 546 n. 189
Stockholm Declaration. *See* United Nations, Declaration of the United Nations Conference on the Human Environment, 1972 (Stockholm Declaration)
Strasbourg Agreement Concerning the International Patent Classification, 1971, 532 n. 141
Sudan, Encouragement of Investment Act, 1980, 271
Sweden, Conclusion of Contracts Act, 1915, Article 6, 584 n. 97
Sweden, Law No. 729 on Copyrights, 1960, Section 2(3), 492 n. 29
Sweden, Sales Act
Section 10, 598 n. 150
Section 39, 605 n. 188
Switzerland, Federal Copyright Law, 1922, Article 12(1), 492 n. 29

T

Tanzania, National Investment (Promotion and Protection) Act, 1990, 252 n. 47
Section 4(2)(m), 270 n. 147
Tokyo Convention on Offenses and Certain Other Acts Committed on Board Aircraft, 1963, 77
Trademark Law Treaty, 1994, 523 n. 94, 531
Treaty of Rome, 1957, 464
Treaty of Versailles, 1919, 445
Treaty on Intellectual Property in Respect of Integrated Circuits, 1989, 502, 527, 531
Treaty on the International Registration of Audiovisual Works, 502
Treaty on the Non-Proliferation of Nuclear Weapons, 1968, 123, 397
Tunisia, Investment Code, 1994, 269 n. 143

U

UCC. *See* United States, Uniform Commercial Code
UCP. *See* International Chamber of Commerce, Uniform Customs and Practices for Documentary Credits
Uganda, Copyright Act, 1966, Section 2, 501 n. 51

ULB. *See* Geneva Conventions on the Unification of the Law Relating to Bills of Exchange, 1930
ULC. *See* Geneva Conventions on Unification of the Law Relating to Checks, 1931
UNCLOS. *See* United Nations, Convention on the Law of the Sea, 1982
UNESCO, Convention Concerning the Protection of the World Cultural and Natural Heritage, 1972, 395 n. 135
UNESCO, Convention for the Protection of Cultural Property in the Event of Armed Conflict, 1954, 395
UNESCO, Convention on the Means of Prohibiting and Preventing the Illicit Import, Export, and Transfer of Ownership of Cultural Property, 1970, 395
Unidroit, Convention on Stolen or Illegally Exported Cultural Objects, 1995, 396
UNIL. *See* United States, Uniform Negotiable Instruments Law, 1896
United Kingdom, Bill of Lading Act, 1855, 624 n. 61
United Kingdom, Bill of Rights, 1689, 455
United Kingdom, Carriage of Goods by Sea Act, 1971, 624 n. 60
United Kingdom, City Code on Takeovers and Mergers, 1985, 294
United Kingdom, Company Securities (Insider Dealing) Act, 1985
  Chapter 8, Section 1, 291
  Chapter 8, Section 1(1)(c), 292 n. 202
United Kingdom, Copyright Act, 1709, 490
United Kingdom, Copyright Act, 1956, 502 n. 54
  Article 12, 554 n. 256
  Section 2(5), 491 n. 24, 492 n. 29, 492 n. 32
  Section 3, 492 n. 32, 493 n. 34
United Kingdom, Copyright (Computer Software) Amendments Act, 1985, 502 n. 54
United Kingdom, Financial Services Act of 1986, 291 n. 200
United Kingdom, Financial Services and Markets Act of 2000, 291 n. 200
United Kingdom, Immigration Rules (HC 395), para. 57(vii), 474 n. 210
United Kingdom, Judicature Act, 1873, 69
United Kingdom, Judicature Act, 1875, 69
United Kingdom, Law Reform (Enforcement of Contracts) Act, 1954, 579 n. 74
United Kingdom, Patent Law, 1623, 505
United Kingdom, Patents Act, 1977
  Article 44.4(a), 547 n. 203
  Article 44.4(b), 547 n. 204
  Article 45(1), 552 n. 216
United Kingdom, Sale of Goods Act, 1893, 560 n. 21, 579, 588
  Section 14, 589 n. 125
  Section 20, 598 n. 150
  Section 20(2), 594 n. 147
  Section 49, 604
  Section 50(2), 606 n. 196
  Section 51(2), 606 n. 196
  Section 52, 588 n. 113
  Section 53(2), 606 n. 196
United Kingdom, Sale of Goods Act, 1979, 560 n. 21
  Section 44, 605 n. 188
  Section 45, 605 n. 188
  Section 46, 605 n. 188
  Section 49, 604
United Kingdom, State Immunity Act, 1978, 160
  Section 1(1), 160 n. 135, 161 n. 142
  Section 3(1), 161 n. 139
  Section 5, 161 n. 138
  Section 6, 161 n. 138
  Section 7, 161 n. 138
  Section 13(3), 162 n. 144
United Kingdom, Statute of Frauds, 1677, 579
United Kingdom, Statute of Monopolies, 1623, 505
United Kingdom, Statute of Westminster, 1285, 68
United Kingdom, Terrorism Act, 2000, 78
United Nations, Charter
  Article 1, 31
  Article 33(1), 129 n. 26
  Article 41, 398 b. 158
  Article 55, 31
  Article 56, 31
  Article 71, 39 n. 47
  Article 94, 130 n. 28
  Article 94(1), 134 n. 46
  Article 94(2), 134 n. 47
  Article 96, 130 n. 31
  Preamble, 455
United Nations, Commission on Human Rights Resolution 32 (XXXVII) (1981), 456 n. 131
United Nations, Convention on Biological Diversity, 1992
  Cartagena Protocol on Biosafety, 124 n. 122
United Nations, Convention on Contracts for the International Sale of Goods, 66, 302, 560–574
  Article 1, 560 n. 22
  Article 2, 567 n. 49
  Article 4, 569 n. 54
  Article 4(b), 605 n. 189
  Article 5, 569 n. 54
  Article 6, 562 n. 24
  Article 7(1), 570 n. 55
  Article 7(2), 574 n. 63
  Article 8, 578, 580
  Article 8(3), 575, 578
  Article 9, 575–576
  Article 9(1), 575
  Article 9(2), 575
  Article 11, 579, 580
  Article 12, 580 n. 78
  Article 13, 580 n. 78
  Article 14, 580
  Article 14(1), 580 n. 80
  Article 14(2), 582 n. 82
  Article 15, 582 n. 84
  Article 16(1), 582 n. 85
  Article 16(2), 582 n. 88
  Article 17, 584 n. 94
  Article 18(1), 587 n. 103
  Article 18(2), 584
  Article 18(3), 584, 584 n. 92
  Article 19(1), 584 n. 96
  Article 19(2), 584 n. 97
  Article 19(3), 584
  Article 21(1), 584 n. 91
  Article 21(2), 580 n. 78, 584 n. 91
  Article 22, 584 n. 93
  Article 23, 580 n. 79
  Article 24, 582 n. 83
  Article 25, 588
  Article 26, 588 n. 107
  Article 28, 588 n. 111, 604
  Article 29(2), 580 n. 78
  Article 30, 567 n. 46, 589 n. 116
  Article 31, 589 n. 117
  Article 32(1), 589 n. 120
  Article 32(2), 589 n. 118
  Article 32(3), 589 n. 119
  Article 33, 589 n. 122
  Article 33(b), 589 n. 123
  Article 35(1), 589
  Article 35(2), 589
  Article 35(3), 590 n. 129, 590 n. 131
  Article 38(3), 590 n. 133
  Article 39(1), 590 n. 134

Article 39(2), 590 n. 135
Article 40, 590 n. 135
Article 41, 130, 143, 590 n. 127
Article 42, 590 ns. 128–132
Article 45, 589 n. 121
Article 45(2), 599 n. 157
Article 45(3), 599 n. 158
Article 46, 588 n. 109, 600 n. 159
Article 47(1), 600 n. 162
Article 48, 600 n. 164
Article 48(2), 574 n. 62
Article 49, 589 n. 121
Article 49(1), 600 n. 161
Article 49(2), 600 n. 163
Article 50, 602 n. 170, 603 n. 174
Article 51(1), 602 n. 177
Article 51(2), 603 n. 178
Article 52(1), 603 n. 175
Article 52(2), 603 n. 176
Article 53, 591 n. 136
Article 54, 567 n. 47, 591 n. 137
Article 55, 580–581
Article 56, 581 n. 81
Article 57(1)(a), 591 n. 141
Article 57(1)(b), 591 n. 142
Article 58(1), 591 n. 138
Article 58(2), 591 n. 138
Article 58(3), 591 n. 140
Article 59, 591 n. 139
Article 60, 594 n. 145
Article 61, 603 n. 179
Article 62, 588 n. 110, 604 n. 180
Article 64, 604 n. 185
Article 65, 574 n. 62
Article 65(1), 604 n. 186
Article 65(2), 604 n. 187
Article 66, 594 n. 146, 594 n. 147
Article 67, 594 n. 146
Article 67(1), 598 n. 151
Article 67(2), 598 n. 150
Article 68, 594 n. 146, 599 n. 153
Article 69, 594 n. 146
Article 69(1), 599 n. 155
Article 69(2), 599 n. 154
Article 69(3), 599 n. 156
Article 70, 594 n. 146
Article 71, 604–605
Article 71(3), 574 n. 62
Article 72, 605
Article 72(2), 574 n. 62, 605 n. 191
Article 73(1), 605 n. 193
Article 73(2), 605 n. 194
Article 73(3), 605 n. 195
Article 74, 589 n. 121
Article 75, 604 n. 184, 606 n. 197
Article 76(1), 606 n. 198
Article 76(2), 606 n. 199
Article 77, 574 n. 62, 606 n. 200
Article 79, 603 n. 173
Article 79(1), 606 n. 201
Article 79(2), 607 n. 204
Article 79(3), 607 n. 205
Article 79(4), 574 n. 62, 607 n. 203
Article 81(1), 588 n. 109
Article 82, 588 n. 108
Article 85, 574 n. 62, 606 n. 200
Article 86, 574 n. 62, 603 n. 175, 606 n. 200
Article 87, 606 n. 200
Article 88, 606 n. 200
Article 88(1), 574 n. 62
Article 96, 579–580, 580 n. 78
United Nations, Convention on International Bills of Exchange and International Promissory Notes, 1988, 660 n. 27
United Nations, Convention on the Carriage of Goods by Sea, 1978, 623 n. 57
United Nations, Convention on the Law of the Sea, 1982
Article 193, 111 n. 93
Article 194(1), 111
United Nations, Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 181
Article II, 181 n. 90
United Nations, Declaration of the United Nations Conference on the Human Environment, 1972 (Stockholm Declaration), 109–110
United Nations, Declaration on Environment and Development (Rio Declaration), 37, 110, 119
United Nations, Diplomatic Conference of Plenipotentiaries on the Establishment of an International Criminal Court (Rome Statute), 1998, 135–136
United Nations, Framework Convention on Climate Change, 118–120
Article 3(3), 119
Article 4, 119
Kyoto Protocol, 119–120
United Nations, General Assembly Resolution 37/7 (XXXVII), World Charter for Nature, 1982, 124
Resolution 2398 (XXII), Convening the Conference on the Human Environment, 1968, 109
Resolution 2625 (XXV) (October 24, 1970), 456 n. 129
Resolution 2997 (XXVII), Establishing the United Nations Environment Program, 1972, 110 n. 82
United Nations, International Covenant on Civil and Political Rights, Article 12, 1966, 468 n. 192
United Nations, International Covenant on Economic, Social and Cultural Rights, 451, 455
Article 2(1), 462
United Nations, Security Council
Resolution 9 (1946), 130 n. 28
Resolution 418 (1977), 398 n. 160
Resolution 661 (1990), 398 n. 161
Resolution 1441 (2002), 398
United Nations, Statute of the International Court of Justice
Article 34, 130 n. 30
Article 36, 130 n. 30
Article 36(1), 130
Article 36(2), 130–131
Article 36(6), 132
Article 38(1), 25, 28
Article 59, 139 n. 62
Article 60, 134
Article 65(1), 130 n. 31
United Nations, Universal Declaration of Human Rights, 1948, 455–459
Article 4, 456
Article 5, 456
Article 13(2), 468 n. 192
Article 20, 456
Article 22, 456
Article 23, 456
Article 24, 456
Article 25, 456
Article 26, 456
United States, Age Discrimination Employment Act, 1967, 483–486
United States, Americans with Disabilities Act, 1990, 483
United States, Antiterrorism and Effective Death Penalty Act, 1996, 80–83
United States, Bill of Lading Act (Interstate and Foreign Commerce) Title 46, Section 13406, 624 n. 61
United States, Bill of Rights, 1790, 455
United States, Bryan Treaties, 129
United States–Canada, Memorandum of Understanding as to Notification, Consultation, and Cooperation with Respect to Application of National Antitrust Laws Between the United States and Canada, 1984, 198 n. 44
United States, Carriage of Goods by Sea Act, 1936
Section 1300 *et seq.*, 624 n. 60

United States, Carriage of Goods by Sea Act, 1936 (continued)
Section 1303(3), 624 n. 63
Section 1303(4), 624 n. 64
United States, Civil Rights Act, 1964, Title VII, 480
United States, Clayton Act, 1914, 197
Section 12, 198–199
United States, Code. *See also* specific laws
Title 8, Section 1101, 472 n. 199
Title 8, Section 1101 *et seq*., 475 n. 215
Title 8, Section 1101(a)(15)(H), 475 n. 213
Title 8, Section 1101(a)(15)(L), 475 n. 213
Title 8, Section 1103, 472 n. 199
Title 8, Section 1151, 476 n. 219
Title 8, Section 1153, 475 n. 216
Title 8, Section 1157, 476 n. 220
Title 8, Section 1182, 472 n. 199
Title 8, Section 1184, 472 n. 199
Title 8, Section 1186a, 472 n. 199
Title 8, Section 1187, 472 n. 199
Title 8, Section 1221, 472 n. 199
Title 8, Section 1281, 472 n. 199
Title 8, Section 1282, 472 n. 199
Title 12, Section 36(c), 342 n. 150
Title 12, Section 601, 350 n. 168
Title 15, Section 1127, 512 n. 80
Title 17, Section 602(a), 503 n. 38
Title 35, Section 271(f), 512 n 79
Title 42, Section 12111(24), 483 n. 237
Title 42, Section 2000e(f), 483 n. 236
Title 46, Appendix, Section 1709, paras. (b)(1) & (b)(2), 623 n. 54
Title 50, Sections 1701-1706, 350 n. 171
United States, Code of Federal Regulations. *See also* specific laws
Title 8, Section 1602 *et seq*., 160 n. 131
Title 8, Section 214.2(b), 473 n. 204
Title 8, Section 214.2(f)(1)(I)(A), 474 n. 208
Title 8, Section 214.2(f)(1)(i)(B), 474 n. 208
Title 8, Section 214.2(f)(5)(iii), 474 n. 208
Title 8, Section 214.2(f)(9), 474 n. 209
Title 8, Section 214.2(h)(1)(i), 475 n. 213
Title 8, Section 214.2(h)(2)(i)(c), 475 n. 214
Title 8, Section 214.2(m)(1)(i)(A), 474 n. 208
Title 8, Section 214.2(m)(i)(13), 474 n. 209
Title 8, Section 214.2(m)(i)(14), 474 n. 209
Title 8, Section 217.2, 473 n. 201
Title 12, Section 204, 339 n. 144
Title 12, Section 204.3(f)(1), 343 n. 153
Title 12, Section 211 *et seq*., 339 n. 144
Title 12, Section 217, 339 n. 144
Title 18, Section 1964(c), 198
United States, Computer Software Protection Act, 1980, 502 n. 54
United States, Constitution, 1789, 505
United States, Copyright Act, 1790, 490
United States, Copyright Act, 1976, 494–496
Section 101, 492 n. 32
Section 102, 501 n. 51
Section 102(b), 504 n. 60
Section 106(1), 491 n. 26, 492 n. 29
Section 106(4), 492 n. 32
Section 110(01), 504 n. 62
Section 115, 554 n. 256
Sections 401–407, 503 n. 57
United States, Edge Act, 1919, 339 n. 144
United States, Equal Pay Act, 1963, 483
United States, Export Control Act, 1949, 396
United States, Export Trading Company Act, 1982, 197 n. 43
United States, Federal Reserve Act, 1913, 339 n. 144
United States, Federal Rules of Civil Procedure
Rule 4, 198 n. 45
United States, Federal Trade Commission Act, 1914, 197 n. 43
United States, Foreign Assistance Act, 1982, 107 n. 75
United States, Foreign Bank Supervision Enhancement Act, 185
United States, Foreign Corrupt Practices Act, 1976, 196, 224–229
United States, Foreign Money Judgment Recognition Act, 181
United States, Foreign Sovereign Immunities Act, 1976, 23 n. 25, 80, 160, 161
Section 1603(d), 161 n. 137
Section 1604, 160 n. 136, 161 n. 142
Section 1605, 161 n. 139
Section 1605(3), 161 n. 138
Section 1605(4), 161 n. 138
Section 1605(5), 161 n. 138
Section 1605(a)(1), 162 b. 144
United States, Foreign Trade Zones Act, 1934, Title 39, Sections 81a–81u, 264 n. 110
United States, Harter Act, Title 66, Sections 210–216, 624 n. 61
United States, Hart-Scott-Rodino Improvements Act, 1976, 197 n. 43
United States, Hawley-Smoot Tariff Act, 1930, 360
United States, Immigration and Nationality Act, 1952, 473, 474, 475
United States, International Antitrust Enforcement Assistance Act, 1994, 198 n. 44
United States, International Banking Act, 1978, 339 n. 144
United States, Lanham Trademark Act, 1946, 185 n. 25, 512 n. 80
para. 1127, 550 n. 213
United States, National Cooperative Research and Production Act, 1984, 197 n. 43
United States, Omnibus Trade and Competitiveness Act of 1988, 224 n. 99
United States, Patent Act, 1952
Section 103, 507 n. 71
Section 112, 510 n. 72
United States, Patent Law Amendment Act, 1984, 512 n. 79
United States, Restatement of Foreign Relations Law of the United States, Tentative Draft No. 4, 1983, Section 801(a)(2), 380 n. 101
United States, Restatement (Second) of Foreign Relations Law of the United States, 1965
Section 23, 200 n. 52
Section 42, 200 n. 52
United States, Restatement (Second) of the Law: Torts, 1965, Section 402A, 216 n. 79
United States, Restatement (Third) of Foreign Relations Law of the United States, 1987
Section 402, 200 n. 52
Section 403, 24, 149 n. 96, 200 n. 52
Section 403(3), 24
Section 404, 149 ns. 93–95
United States, Robinson-Patman Act, 1936, 197
United States, Securities Act, 1933
App. A, 285 n. 176

Section 3, 285 n. 180
Section 4(6), 285 n. 182
United States, Securities and Exchange Commission
Rule 10b-5, 291
Rule 415, 285 n. 175
Rule 504, 285 n. 182
Rule 505, 285 n. 182
United States, Securities Exchange Act, 1934, Section 10(b), 291, 292
United States, Sherman Antitrust Act, 1890, 196–207, 198
Section 1, 197
Section 2, 197
United States, Sonny Bono Copyright Term Extension Act, 1998, 504 n. 60
United States, Taft Treaties, 129
United States, Uniform Commercial Code, 560 n. 21, 579
Article 4, 660 n. 28
Section 1–102(3), 660 n. 30
Section 1–201(24), 301 n. 22, 665 n. 36
Section 1–203, 574 n. 60
Section 1–205, 576 n. 70
Section 2–106, 567 n. 48
Section 2–201, 579 n. 73
Section 2–202, 575 n. 67
Section 2–205, 582 n. 87
Section 2–208, 576 n. 70
Section 2–313, 589 n. 125
Section 2–314, 589 n. 125
Section 2–319, 623 n. 55
Section 2–319(1)(c), 615 n. 39
Section 2–501, 594 n. 147
Section 2–509, 598 n. 150
Section 2–615, 607 n. 202
Section 2–704, 605 n. 188
Section 2–709, 604
Section 2–715(2), 606 n. 196
Section 2–716(1), 588 n. 114
Section 3–104, 660 n. 31
Section 3–104(2), 660 n. 31
Section 3–104(a), 665 n. 35
Section 3–106(1)(a), 665 n. 39
Section 3–106(b), 665 n. 34
Section 3-107, 665 n. 38
Section 3–107(2), 665 n. 38
Section 3–109(1)(c), 665 n. 41
Section 3–112(b), 665 n. 40
Section 3–206(1), 670 n. 47
Section 3–206(a), 669 n. 44
Section 3–303, 675 n. 65
Section 3–508(2), 678 n. 66
Section 4–102(3), 637 n. 31
Section 4–201(2), 669 n. 45
Section 5–104, 689 n. 81
Section 5–105, 685 n. 79
Section 5–114(2), 694 n. 98
Section 8–102(1), 282 n. 166
Section 8–320(1), 286 n. 186
United States, Uniform Negotiable Instruments Law, 1896, 659
United States, Uniform Sales Act, 1896, 579
United States, Webb-Pomerene Act, 1918, 197 n. 43, 207
United States, Williams Act, 1968, 293–294
Uruguay Round Protocol to the General Agreement on Tariffs and Trade, 1994, para. 1, 422 n. 255

V

Venezuela, Decree No. 746 on Transfer of Technology Agreements, 1975, Article 1(d), 545 n. 187
Venezuela, Decree No. 2442 on the Treatment of Foreign Capital, Trademarks, Patents, Licenses, and Royalties, 1977
Article 1, 553 n. 227
Article 71, 552 n. 216
Venice, Patent Law, 1474, Preamble, 505
Vienna Agreement Establishing an International Classification for the Figurative Elements of Marks, 1973, 533 n. 145
Vienna Convention for the Protection of the Ozone Layer, 1985, Montreal Protocol on Substances That Deplete the Ozone Layer, 1987, 122
Vienna Convention on Consular Relations, 1963, Article 31(4), 165
Vienna Convention on Contracts for the International Sale of Goods. *See* United Nations Convention on Contracts for the International Sale of Goods
Vienna Convention on Diplomatic Relations, 1961, 165
Article 22(3), 165 n. 145
Article 31(4), 165 n 146
Article 36, 22
Vienna Convention on the Law of Treaties, 1969
Article 31(1), 573 n. 57
Article 32, 573 n. 56
Vienna Convention on the Law of Treaties, 1980, Article 2(1)(a), 26
Vienna Convention on the Law of Treaties, 1986, Article 53, 28
Vienna Convention on the Succession of States in Respect of Treaties
Article 16, 38 n. 45
Article 34, 38
Vietnam, Law on Foreign Investment
1987 Law, 239 n. 21
1996 Law, 239 n. 21
2000 Amendments, 239 n. 21

W

Washington Convention. *See* Convention on the Settlement of International Disputes between States and Nationals of Other States, 1965
Washington Treaty. *See* Treaty on Intellectual Property in Respect of Integrated Circuits
Wassenaar Arrangement on Export Controls for Conventional Arms and Dual-Use Goods and Technologies, 1996, 396
World Bank. *See* International Bank for Reconstruction and Development, Instrument for the Establishment of the Restructured Global Environment Facility
World Intellectual Property Organization, Copyright Treaty, 530
World Intellectual Property Organization, Performances and Phonograms Treaty, 1966, 530 n. 130
World Trade Organization, Agreement Establishing the World Trade Organization, 1994
Article II, para. 1, 366 n. 40
Article II, para. 2, 365 n. 36
Article II, para. 3, 365 n. 37
Article II, para. 4, 376 n. 90
Article III, para. 1, 366 n. 41
Article III, para. 2, 366 n. 42
Article III, para. 3, 366 n. 43
Article III, para. 4, 366 n. 44
Article III, para. 5, 366 n. 45
Article IV, paras. 1–24, 369 n. 64
Article IV, paras. 2–25, 371 n. 71
Article IV, para. 3, 136 n. 52
Article IV, para. 5, 369 n. 65
Article IX, para. 1, 372 n. 75
Article IX, para. 3, 375 n. 83
Article VI, para. 2, 370 n. 69
Article XI, para. 1, 368 n. 58
Article XI, para. 2, 368 n. 59

World Trade Organization, Agreement Establishing the World Trade Organization (continued)
Article XII, para. 1, 368 n. 55, 368 n. 61
Article XII, para. 2, 368 n. 61
Article XIV, para. 1, 368 n. 58
Article XIV, para. 2, 368 n. 58
Article XV, para. 1, 369 n. 63
Article XVI, para. 1, 367 n. 51
World Trade Organization, Agreement on Agriculture, 1994, 422, 424
Annex 2, 424 n. 259
Annex 5, 422 n. 254
Article 1(a), 424 n. 258
Article 1(d), 424 n. 258
Article 1(e), 424 n. 261
Article 1(h), 424 n. 258
Article 2, 422 n. 252
Article 4, para. 1, 424 n. 257
Article 4, para. 2, 422 n. 253
Article 9, para. 1, 424 n. 262
Article 13, para. 2(a), 424 n. 264
Article 13, para. 3, 424 n. 263
Article 13, para. 3(a), 424 n. 264
World Trade Organization, Agreement on Government Procurement, 399 n. 163
World Trade Organization, Agreement on Implementation of Article VI of GATT 1994, 409
Article 2, para. 1, 409 n. 200, 410 n. 212
Article 3, n. 29, 409 n. 202
Article 4, para. 1, 409 n. 203
Article 5, para. 1, 410 n. 204
Article 5, para. 2, 409 n. 207
Article 5, para. 6, 409 n. 205, 410 n. 207
Article 5, para. 8, 409 n. 207
Article 6, para. 1, 410 n. 208
Article 6, para. 11, 410 n. 208
Article 6, para. 14, 397 n. 209
Article 6, para. 2, 410 n. 208
Article 7, para. 1, 410 n. 210
Article 7, para. 2, 410 n. 210
Article 7, para. 3, 410 n. 210
Article 9, para. 1, 410 n. 211
Article 9, para. 3, 410 n. 212
Article 11, para. 1, 410 n. 213
Article 11, para. 2, 410 n. 213
Article 11, para. 3, 410 n. 213
Article 14, para. 1, 409 n. 206
Article 14, para. 2, 409 n. 207
World Trade Organization, Agreement on Implementation of Article VII of GATT 1994
Article 1, para. 1, 399 n. 166
Article 2, para. 1(a), 399 n. 168
Article 3, para. 1(a), 399 n. 169
Article 4, 399 n. 171
Article 5, para. 1(a), 399 n. 170
Article 6, para. 1(a), 399 n. 171
Article 7, para. 1, 399 n. 172
Article 8, para. 1, 399 n. 167
World Trade Organization, Agreement on Import Licensing Procedures, 1994, 408–409
Article 1, para. 3, 408 n. 196
Article 1, para. 5, 409 n. 197
Article 1, para. 6, 409 n. 197
Article 1, para. 7, 409 n. 198
Article 1, para. 8, 409 n. 199
World Trade Organization, Agreement on Preshipment Inspection, 1994, 400
Article 2, para. 1, 400 n. 173
Article 2, para. 2, 400 n. 174
Article 2, para. 3, 400 n. 175
Article 2, para. 4, 400 n. 176
Article 2, para. 21(a), 400 n. 177
World Trade Organization, Agreement on Rules of Origin, 1994
Article 1, para. 1, 425 n. 270
Article 1, para. 1(f), 426 n. 273
Article 3(e), 426 n. 274
Article 5, 426 n. 274
Article 6, 426 n. 275
Article 7, 426 n. 275
Article 8, 426 n. 275
Article 9, para. 1, 425 n. 271
World Trade Organization, Agreement on Safeguards, 1994, 421–422
para. 2, 421 n. 246
para. 5, 421 n. 247
para. 10, 421 n. 248
para. 13, 422 n. 249
para. 21, 421 n. 245
para. 22(b), 421 n. 245
para. 23, 421 n. 245
World Trade Organization, Agreement on Subsidies and Countervailing Measures, 1994, 415–421
Article 1, 415 n. 215
Article 2, 415 n. 218
Article 3, para. 1(a), 415 n. 219
Article 3, para. 1(b), 415 n. 220
Article 3, para. 2, 415 n. 221
Article 4, 416 n. 225
Article 4, para. 1, 416 n. 226
Article 4, para. 4, 416 n. 227
Article 4, para. 7, 416 n. 230
Article 4, para. 8, 416 n. 229
Article 4, para. 9, 416 n. 230
Article 4, para. 10, 420 n. 233
Article 5, 415 n. 222
Article 6, para. 1, 415 n. 223
Article 6, para. 2, 415 n. 223
Article 6, para. 3, 415 n. 223
Article 7, 416 n. 225
Article 7, para. 1, 416 n. 226
Article 7, para. 4, 416 n. 227
Article 7, para. 6, 416 n. 229
Article 7, para. 7, 416 n. 230
Article 7, para. 9, 416 n. 230
Articles 10–23, 420 n. 235
Article 27, para. 2, 421 n. 236
Article 27, para. 2 bis, 421 n. 236
Article 27, paras. 6–14, 421 n. 238
Article 29, para. 1, 421 n. 239
Article 29, para. 2, 421 n. 239
World Trade Organization, Agreement on Technical Barriers to Trade, 1979, 400–401
Annex 1, para. 1, 401 n. 180
Article 9, 402 n. 183
World Trade Organization, Agreement on Textiles and Clothing, 1994, 424
World Trade Organization, Agreement on the Application of Sanitary and Phytosanitary Measures, 402, 403–408
para. 20, 402 n. 195
Preamble, 402 n. 185
World Trade Organization, Agreement on Trade-Related Aspects of Intellectual Property Rights, 1994, 498, 504, 554
Article 1, 532 n. 138
Article 2, 532 n. 138
Article 4, 528 n. 122
Article 9, para. 1, 498 n. 46
Article 9, para. 2, 501 n. 50
Article 9–40, 527 n. 116
Article 10, para. 1, 502 n. 54
Article 11, 493 n. 33
Article 12, 504 n. 60
Article 14, 492 n. 32
Article 18, 522 n. 93
Article 19, 523 n. 96
Article 22, 512 n. 82
Article 23, 512 n. 82
Article 23, para. 4, 512 n. 82
Article 25, 532 n. 141
Article 26, 532 n. 141
Article 26, para. 3, 532 n. 141
Article 27, para. 1, 507 n. 70
Article 27, para. 2, 511 n. 76
Article 27, para. 3, 511 n. 77

Article 31(b), 554 n. 231
Article 31(d), 554 n. 232
Article 31(e), 554 n. 233
Article 31(f), 554 n. 234
Article 31(h), 554 n. 235
Article 33, 512 n. 78
Article 35, 502 n. 55
Article 39, 524 n. 100
Article 39, para. 22, 524 n. 100
Article 40, para. 22, 534
Article 63, 528 n. 121
Article 68, 526 n. 110
Preamble, 527 n. 114
World Trade Organization, Agreement on Trade-Related Investment Measures, 1994, 402–403
Annex, paras. 1–2, 408 n. 195
Article 2, para. 1, 408 n. 193
Article 2, para. 2, 408 n. 194
Article 5, para. 2, 408 n. 194
World Trade Organization, Decision on Institutional Arrangements for the General Agreement on Trade in Services, 1994, 438 n. 70
World Trade Organization, Decision on Measures in Favor of Least-Developed Countries, 1994, para. 1, 368 n. 60
World Trade Organization, General Agreement on Tariffs and Trade, 1994, 376–398
Article I, para. 1, 377
Article II, 377
Article III, para. 2, 382
Article III, para. 4, 380
Article III, para. 6, 384 n. 104
Article III, para. 8(a), 384 n. 104
Article IV, 385 n. 107
Article VI, 409 n. 200
Article VIII, 386
Article X, 386
Article X, para. 1, 380 n. 101
Article XI, 385
Article XI, para. 2(a), 385 n. 109
Article XI, para. 2(b), 385 n. 110
Article XI, para. 2(c), 385 n. 111
Article XII, para. 1, 385 n. 108
Article XVIII, para. 4(a), 385 n. 113
Article XIX, 382
Article XIX, para. 1(a), 388 n. 122
Article XIX, para. 2, 388 n. 123
Article XIX, para. 3, 388 n. 124
Article XX(b), 388 n. 120
Article XX(h), 387 n. 119
Article XXI, 378
Article XXIV, 378
Article XXIV, para. 5(a), 386 n. 118
Article XXIV, para. 5(b), 386 n. 118
Article XXIV, para. 7(b), 386
Article XXIV, para. 8, 380 n. 95
Article XXIV, para. 8(a), 386 n. 117
Article XXIV, para. 8(b), 386 n. 116
Article XXVIII bis, 385 n. 114
Article XXXVI, para. 8, 380 n. 98
World Trade Organization, General Agreement on Trade in Services, 1994, 268 n. 136, 429–439
Annex of Article II Exemptions, 435 n. 38
Annex of Article II Exemptions, para. 6, 435 n. 39
Annex on Air Transport Services, 439
Annex on Financial Services, 439
Annex on Movement of Natural Persons Supplying Services under the Agreement, 431 n. 25, 439
Annex on Negotiations on Maritime Transport Service, 439
Annex on Telecommunications, 439
Article I, Section 2, 431 n. 28
Article II, Section 1, 435 n. 36
Article III, Section 1, 435 n. 41
Article III, Section 3, 435 n. 42
Article III, Section 4, 435 n. 43
Article IV, Section 1(a), 435 n. 44
Article V bis, 436 n. 47
Article V, Section 1(a), 435 n. 45
Article V, Section 1(b), 435 n. 46
Article VI, Section 1, 436 n. 50
Article VI, Section 4, 436 n. 50
Article VI, Section 5, 436 n. 50
Article VII, Section 1, 436 n. 50
Article VII, Section 2, 436 n. 50
Article VIII, Section 1, 436 n. 51
Article IX, Section 2, 436 n. 52
Article X, 436 n. 57
Article XI, Section 1, 436 n. 53
Article XII, Section 1, 436 n. 54
Article XII, Section 2, 436 n. 55
Article XIII, 436 n. 57
Article XIV, 437 n. 60
Article XIV bis, 437 n. 61
Article XIV bis para. (d), 437 n. 62
Article XIV bis para. (e), 437 n. 63
Article XVI, Section 1, 431 n. 29, 438 n. 67
Article XVI, Section 2, 437 n. 65
Article XVII, Section 1, 431 n. 29, 438 n. 67
Article XIX, Section 1, 438
Article XX, Section 1, 437 n. 64
Article XXI, Section 1(b), 438 n. 68
Article XXI, Section 2(a), 438 n. 68
Article XXIV, 438 n. 69
Article XXV, Section 2, 439 n. 71
Article XXVIII, para. (d), 431 n. 27
Article XXVIII, para. (g), 431 n. 26
Article XXVIII, para. (j), 431 n. 26
World Trade Organization, General Interpretive Note to Annex IA (GATT 1994), 375 n. 83
para. 1(d), 376 n. 80
para. 1(e), 375 n. 80
World Trade Organization, Ministerial Decision on Trade in Services and the Environment, 1994, 436 n. 56
World Trade Organization, Trade Policy Review Mechanism, 1994, 375 n. 87
para. A(i), 376 n. 88
World Trade Organization, Understanding in Respect of Waivers of Obligations under GATT 1994
para. 1, 375 n. 81
para. 2, 375 n. 81
para. 3, 375 n. 85
World Trade Organization, Understanding on Rules and Procedures Governing the Settlement of Disputes, 1994
para. 2.4, 372 n. 74
para. 3.2, 137 n. 55
para. 4.3, 136 n. 51
para. 4.8, 136 n. 51
para. 8.7, 136 n. 54
para. 9.1, 136 n. 54
para. 9.3, 136 n. 54

Z

Zambia, Industrial Development Act, 1977
Article 15(b), 553 n. 223, 553 n. 227
Article 16, 545 n. 186

Topical Index

A

absolute sovereign immunity, 159
acceptance, 582–587
  defined, 582
  with modifications, 584–587
  by performance of act, 584
  purchase order as example of, 583
  receipt rule, 583, 584
  silence, effect of, 582
  time of, 583
  withdrawal of, 584
account party, 682
accounting standards, 275
act of state doctrine, 167–169
administrative law, 68
admiralty, 68
advising banks, 689
advisory jurisdiction, 130, 132
advocate general, 56
African Union (AU), 58
AFTA. *See* ASEAN Free Trade Area (AFTA)
agency endorsements, 670
Agency for International Development (AID), 107, 698
Agenda 41, 110
agents, for multinational enterprises, 192
Agreement on Agriculture, 422
Agreement on Implementation of Article VI of GATT 1994 (Anti-dumping Code), 409
Agreement on Implementation of Article VII of GATT 1994 (Customs Valuation Code), 399
Agreement on Import-Licensing Procedures, 408
Agreement on Preshipment Inspection, 400
Agreement on Rules of Origin, 425
Agreement on Safeguards, 421
Agreement on Subsidies and Countervailing Measures (SCM Agreement)
  actionable subsidies, 415
  developing states, treatment of, 420–421
  nonactionable subsidies, 415
  prohibited subsidies, 415
  remedies and countervailing measures, 416
  states transitioning to market economies, treatment of, 420–421
Agreement on Technical Barriers to Trade (TBT Agreement), 400
Agreement on Textiles and Clothing, 424–425
Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement), 402
Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), 136, 498, 527
  copyrights, duration of, 504
  Council for TRIPS, 527
  patent denials, 511
  purpose of, 527–528
  trademarks, term of, 524
  "undisclosed information," protection of, 524
Agreement on Trade-Related Investment Measures (TRIMs Agreement), 402
agriculture, trade agreement on, 422
AIA. *See* ASEAN Investment Area (AIA)
AICO. *See* ASEAN Industrial Cooperation (AICO)
AID. *See* Agency for International Development (AID)
air, carriage of goods by, 654–656
air pollution, regulation of, 118–122
Alien Tort Claims Act (ATCA), 457–461
  forced labor case, 458–459
  state-sponsored transborder abduction case, 459
alternative dispute resolution, 127
  arbitration (*See* arbitration)
  mediation, 128
  under WIPO, 525
American Arbitration Association, 148
American International Group Global & Political Risk Insurance Co., 107
AMF. *See* Arab Monetary Fund (AMF)
Amnesty International, 61
Anglo-American common law system, 68–69
anticipatory avoidance, 605
anticompetitive effects of licenses, regulation of, 534–535
Anti-dumping Code. *See* Agreement on Implementation of Article VI of GATT 1994 (Anti-dumping Code)
anti-suit injunctions, 180, 208
antitrust, 197
  enforcement provisions of, 197–198
  extraterritorial application of, 198
  personal jurisdiction requirement of, 198
  subject-matter jurisdiction requirement of, 199
applications
  foreign investment (*See* applications, foreign investment)
  for letters of credit, 685–689
  patent, 510–511
applications, foreign investment, 246–248
  agencies, screening, 246–247
  approval/disapproval of, 249
  disclosure requirements, 247–248
  evaluation criteria, 248
  formal processes, 248
  informal processes, 248
  screening of, 246–248
appraisal rights, 276
Arab League, 59
Arab Monetary Fund (AMF), 336
arbitrage, 346
arbitration, 62
  foreign arbitral awards, recognition of, 181
  organizations providing, 148
  under ICSID, 140–148
  under WIPO, 525
Articles of Incorporation, 274
artistic property, 490
ASEAN. *See* Association of Southeast Asian Nations (ASEAN)
assignment, 666
Association of Southeast Asian Nations (ASEAN)
  Free Trade Area (AFTA), 245
  Industrial Cooperation (AICO), 245
  Investment Area (AIA), 245
  regional investment policies, 245–246
ATCA. *See* Alien Tort Claims Act (ATCA)
Atlantic Charter, 361
AU. *See* African Union (AU)
Australia Group, 396
avoidance as remedy for breach of sales contracts, 588, 600–602, 604

B

bank deposits, 339
Bank for International Settlements (BIS), 333–336
  bridging loans, 334
  facilities, 334

as international settlement agent, 335
monetary cooperation, promotion of, 334–335
purposes of, 333–336
structure of, 334
banks. *See also* monetary systems
advising, 689
Bank for International Settlements (BIS) (*See* Bank for International Settlements (BIS))
bills of exchange, role in collecting and paying, 678–681
branches (*See* branch banking)
central, 338, 343
commercial, 339, 343
confirming, 689
correspondent, 343
development banks (*See* development banks)
letters of credit, obligations related to, 692
World Bank (*See* World Bank)
Battle of the Forms, 584
BEA. *See* Bills of Exchange Act (BEA)
bearer paper, 667
bearer securities, 282
beneficiaries and letters of credit, 682, 697
Berlin Declaration, 46
Berne Convention for the Protection of Literary and Artistic Works (Berne Convention), 491, 498, 503, 524, 528, 529, 553–554
bilateral investment treaties (BITs), 239–243
Chile-China BIT, text of, 243–245
India's BITs, listing of, 242–243
number of, 239
bilateral treaties, 25
bills of exchange, 346, 658–661
acquired in bad faith, 674
acquired through gross negligence, 674
assignment, 666
banks' role in collecting and paying, 678–681
checks, 658–661, 661, 662
defined, 658
definite sum or monetary unit, requirement for, 665
endorsements (*See* endorsement of bills and notes)
form of, 660–661
holder, 674, 675
holder in due course (HDC), 675
law governing, 659
liabilities of parties to, 675–678
liability on the instrument, 676
limitations on excuses for not paying, 675
negotiability of, 664–666
negotiation (*See* negotiation of bills and notes)
parties to, 661
protested, 678
sight bills, 661
signature requirements, 666
time bills, 661
time of payment, requirements regarding, 665–666
trade acceptances, 659, 661, 662
types of, 660–661
unconditional promise to pay, requirement for, 664–665
warranty liability, 678
Bills of Exchange Act (BEA), 659
bills of lading, 623–634, 658
claused, 624
clean, 624
defined, 623, 658
domestic laws governing, 623–624
purposes of, 624
receipt for goods, 624–632
treaties governing, 623
biological weapons, export controls related to, 396–397
biotech foods, 402
BIS. *See* Bank for International Settlements (BIS)
BITs. *See* bilateral investment treaties (BITs)
blank endorsements, 667
blocking statutes, 207
bluefin tuna, overfishing of, 116–118
Board of Governors, IMF, 310–313
bona fide purchaser, 283
Bonaparte, Napoléon, 67
bonded warehouses, 268
bonds, 282
bottleneck principle, 542
bound tariff rate, 385
branch banking, 184, 346
conflicts between home and host state regulations, 351–356
extraterritorial jurisdiction over foreign banks,U.S. attempts at, 347
home state treatment of foreign branch, 346–347
host state treatment of foreign branch, 346–347
branch, of multinational enterprise, 184, 192
bank branches (*See* branch banking)
breach of contract, remedies for, 599–606
anticipatory avoidance, 605
avoidance, 588, 600–602, 604
buyer's remedies, 599, 605
as cumulative and immediate, 599, 603
damages, 606
early delivery, refusal of, 603
excess quantity, refusal of, 603
installment contracts, avoidance of, 605
missing specifications, 604
Nachfrist notice, 600, 604
nonconformity in part, effect of, 603
price reduction, 602
seller's remedies, 603–606
specific performance, 588, 600, 604
suspension of performance, 604
Bretton Woods Conference, 308, 324, 362
bridging loans
Bank for International Settlements (BIS) loans, 334
International Monetary Fund (IMF) loans, 324
Brussels Convention. *See* International Convention for the Unification of Certain Rules of Law Relating to Maritime Liens and Mortgages (Brussels Convention)
burden of proof, 214
Bürgerliches Gesetzbuch. *See* German Civil Code of 1896
business forms, 186

C

Calvo clause, 97
Cambacérès, Jean Jacques, 67
canon law, 65
care, standard of. *See* standard of care
cartels, 542
cash forward contracts, 346
causation, and state responsibility, 87–88
caveat venditor, 293
CCC. *See* Customs Cooperation Council (CCC)
CDs. *See* certificates of deposit (CDs)
Cedel Bank. *See* Clearstream
CEFTA. *See* Central European Free Trade Agreement (CEFTA)
CEMAC, *See* Economic and Monetary Community of Central Africa (CEMAC)
Central American Monetary Union (UMCA), 336

central banks, 338, 343
Central European Free Trade Agreement (CEFTA), 61
certificated securities, 283
certificates of deposit (CDs), 339, 342, 662
certification marks, 512
CFR. *See* cost and freight (CFR)
chain-style business arrangement, 533
charter, 40
charterparties
  bill of lading and, 647
  defined, 645
  general average, 654
  particular average, 654
  recent developments, 646
  voyage, 646
checks, 659, 661, 662
chemical weapons, export controls related to, 396–397
choice of law, 170
  by agreement of the parties, 170
  clauses, 159, 170, 561, 562
  governmental interest doctrine, 175
  most significant relationship doctrine, 171–175
  statutory provisions, 170–171
  vested rights doctrine, 171
Churchill, Winston, 361
CIF. *See* cost, insurance, and freight (CIF)
CISG. *See* Convention on Contracts for the International Sale of Goods (CISG)
City Code on Takeovers and Mergers, 294
civil law, 65, 68
claused bill of lading, 624
Clayton Act, 197
clean bill of lading, 624
Clean Slate Doctrine, 38
clearance and settlement of securities, 286–287
  depository receipts, 287
  international clearinghouses, 286–287
Clearstream, 287
climate change, 118–122
clothing and textiles, trade agreement on, 424
CMR. *See* Convention on the Contract for International Carriage of Goods by Road (CMR)
CNA Credit, 107
COCOM. *See* Coordinating Committee on Multilateral Export Controls (COCOM)
Code Civil. *See* French Civil Code of 1804
Code Napoléon. *See* French Civil Code of 1804
codes of conduct
  for IMF member states, 313
  for multinational enterprises, 62
collateral note, 662
collective marks, 512
collusive actions, 144
Colombo Plan for Cooperative Economic and Social Development in Asia and the Pacific, 61
comity, 22, 23, 169
commentators, 66
commercial activity exception, to sovereign immunity, 160–161
commercial banks, 339, 343
commodity arrangements, 387–388
common carrier, 623
common enterprise liability, 231–235
common law, 68–69
common origin doctrine, 538–539
common rules principle
  Berne Convention, 528–529
  Paris Convention, 531
Commonwealth of Independent States, 59
Commonwealth of Nations, 59
Compagnie Française d’Assurance pour le Commerce Exterieur, 107
comparative law, 65
compensatory damages, 103
compensatory financing facility, 324
compulsory licenses, 533–534, 553–554
  and AIDS crisis, 554
  compulsory copyright license, 557
  patents, 553–554
  statutory copyright license, 554
computed value method of customs valuation, 399
conciliation, 128
conditional endorsements, 669
conference lines, 623
Conference of the Parties, 119–120
Conference on the Environment and Development (UNCED). *See* United Nations Conference on the Environment and Development (UNCED)
confirmation patents, 506
confirming banks, 689
conformity assessment procedures, 401
conformity of goods to contract, 589–590
  curing defects, 590
  determining, 589–590
  notice of defect, 590
  third-party claims to goods, effect of, 590
  time for examining goods, 590
  waiver of, 590
constitutional law, 68
constitutional treaties, 29
constitutive doctrine, 33
contentious jurisdiction, 130
contingent credit lines, 324
contracts
  exchange contracts, defined, 314
  foreign exchange (*See* foreign exchange contracts)
  sales (*See* sales contracts)
Convention Concerning Freedom of Association (ILO Convention No. 87), 450
Convention Concerning International Carriage by Rail (COTIF), 622
Convention Concerning the Application of the Principles of the Right to Organize and to Bargain Collectively (ILO Convention No. 98), 450
Convention Establishing World Intellectual Property Organization (Stockholm Convention), 524
Convention for the Protection of Cultural Property in the Event of Armed Conflict, 395
Convention for the Protection of Performers, Producers of Phonograms, and Broadcasting Organizaions (Rome Convention), 529
Convention for the Unification of Certain Rules Relating to International Carriage by Air. *See* Warsaw Convention
Convention on Biological Diversity, 124
Convention on Contracts for the International Sale of Goods (CISG), 560. *See also* sales contracts
  case law interpreting, 573
  comparison with French and United States sales law, 570–572
  contractual issues excluded from, 569–572
  excluded goods and transactions, 567
  formation of sales contracts, 580–587
  general principles as basis for interpreting, 574
  goods, defined, 567
  interpretation of CISG, 574
  interpretation of sales contracts (*See* interpretation of sales contracts)

mixed sales of goods and services, applicability to, 568
opting in or out of, 562–567
parties to, 560, 561
performance, general standards of, 587–588
personal injury actions, exclusion of, 569, 570
plain meaning rule, 573
preemption of domestic law where CISG applicable, 570–572
private international law rules as source for interpreting, 574
sales, defined, 567
third-party claims, exclusion of, 569, 570
transactions covered by, 560–569
travaux préparatoires, 573
Convention on Insider Trading, 296
Convention on Nomenclature for the Classification of Goods in Customs Tariffs, 386
Convention on Stolen or Illegally Exported Cultural Objects, 396
Convention on the Contract for International Carriage of Goods by Road (CMR), 622
Convention on the Means of Prohibiting and Preventing the Illicit Import, Export, and Transfer of Ownership of Cultural Property, 395
Convention on the Protection of the Archaeological, Historical, and Artistic Heritage of the American Nations, 395
Convention on the Settlement of International Disputes between States and Nationals of Other States, 62
Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 140
Convention Relating to the Distribution of Program-Carrying Signals Transmitted by Satellite (Satellite Transmission Convention), 530
Coordinating Committee on Multilateral Export Controls (COCOM), 396
copyrights, 490–504
compulsory licenses, 557
defined, 490
distribution rights, 492
doctrine of exhaustion, 492
duration of, 504
exceptions to, 504
expression, 501
formalities, 503
moral rights, 497–498
neighboring rights, 502
original works, 501
pecuniary rights, 491
performance rights, 493
reproduction rights, 491–494
scope of, 503
works covered by, 498
Corpus Juris Civilis, 65, 66
correspondent banks, 343
corruption, at World Bank, 326
Cosmopolitans, 22
cost and freight (CFR), 616
cost, insurance, and freight (CIF), 616
COTIF. *See* Convention Concerning International Carriage by Rail (COTIF)
Council for Trade in Services, GATS, 436–437, 438
Council for Trade-Related Aspects of Intellectual Property Rights (TRIPS Council), 526
Council of Europe, 58
worker rights, protection of, 466–468
Council of the European Union, 54
counterterrorism conventions, 77–78
countertrade, 699–700
countervailing measures
Agreement on (*See* Agreement on Subsidies and Countervailing Measures (SCM Agreement))
defined, 420
country of origin of goods, 425
Court of Common Pleas, 68
Court of Exchequer, 68
Court of King's Bench, 68
courts
Court of Common Pleas, 68
Court of Exchequer, 68
Court of King's Bench, 68
European Court of First Instance, 57
European Court of Justice, 56
International Court of Justice (ICJ) (*See* International Court of Justice (ICJ))
municipal (*See* municipal courts)
pepoudrous, 66
credit *tranche*, 323–324
creditors of subsidiaries, protections for, 276–277
creeping expropriation, 108
cross-licensing agreements, 542
cross-ownership of shares, 293
culpa (fault), 87
cultural property, export controls for protection of, 395–396
currency. *See also* money
basket (*See* currency basket)
cash forward contracts, 346
convertibility guarantees, OPIC, 108
exchange mechanisms (*See* currency exchange)
hard, 343
intermediary, 343
soft, 343
support function, of IMF (*See* currency support, by IMF)
currency basket
defined, 305
Special Drawing Right (SDR), 305–307
currency exchange
enforcement of exchange control regulations, 314–319
enforcement of general obligations, 322–323
exchange contracts, defined, 313–314
exemptions for new members, 323
obligations of IMF member states, 313–314
par value system, 313
Second Amendment system, 313–314
currency support, by IMF, 323–324
compensatory financing facility, 324
concessional facility, 324
conditionality, 324
contingent credit lines, 324
credit *tranche*, 323
extended fund facility, 323
facilities available to member states, 323–324
Poverty Reduction and Growth Facility, 324
reserve *tranche*, 323
special facilities, 324
standby arrangements, 324
supplemental reserve facility, 324
current international transaction, 322
custom, 27–28
defined, 27
opinio juris sive necessitates, 27
persistent objections to, 27–28
usus, 27
Custom of Paris, 67
Customs Cooperation Council (CCC), 386, 425
customs unions, 60, 386
customs valuation, 399

Customs Valuation Code. *See* Agreement on Implementation of Article VII of Gatt 1994 (Customs Valuation Code)

D

damages
- for breach of contract, 606
- compensatory damages, 103
- foreseeability test, 606
- mitigate losses, duty to, 606

dead freight charge, 646
debt funding, 696
declaratory doctrine, 33
deductive value method of customs valuation, 399
delicts, 171
delivered ex ship (DES), 614
delivery of goods, sales contracts
- by carrier, 598–599
- means of, 598–599
- place for, 589
- time for, 589
- trade terms (*See* trade terms)
- without being transported, 599

demurrage, 646
denial of justice, 93–96
dependent states, 32–33
depository receipts, 287
Depository Trust Company Corporation (DTCC), 286
derived value method of customs valuation, 399
DES. *See* delivered ex ship (DES)
design patents, 506
destination contracts, 599
development banks, 324–333
- financing of foreign operations, 697–698
- International Fund for Agricultural Development (IFAD), 325
- regional development organizations, 325
- World Bank (*See* World Bank)

diplomacy, 127–129
- defined, 127
- inquiry, 128–129
- mediation, 128
- negotiation, 128

direct effect, of GATT 1994 provisions, 376
dirty hands, 103, 606–607
disclosure obligations, of subsidiaries, 274–276
dispositive treaties, 38
dispute settlement, 127–181
- choice of law (*See* choice of law)
- by diplomacy (*See* diplomacy)
- International Labor Organization (ILO), 449
- jurisdiction (*See* jurisdiction)
- in municipal courts (*See* municipal courts)

Dispute Settlement Body (DSB), WTO, 136, 416
distinctiveness, of trademarks, 516
distribution rights, copyrighted works, 492–496
distributorships, 533
documents against acceptance, 682
documents against payment, 682
DSB. *See* Dispute Settlement Body (DSB),WTO
DTCC. *See* Depository Trust Company Corporation (DTCC)
Dumbarton Oaks conference, 361
dumping
- Anti-dumping Code, 409–410
- defined, 409

duty-free zones. *See* free retail zones

E

EAEC. *See* European Atomic Energy Community (EAEC or Euratom)
Eastern Caribbean Currency Authority (ECCA), 336
EC Treaty. *See* European Community Treaty (EC Treaty)
ECB. *See* European Central Bank (ECB)
ECCA. *See* Eastern CaribbeanCurrency Authority (ECCA)
Economic and Monetary Community of Central Africa (CEMAC), 337
Economic and Social Council (ECOSOC), United Nations, 41, 387
economic consultative associations, 61
ECOSOC. *See* Economic and Social Council (ECOSOC), United Nations
ECSC. *See* European Coal and Steel Community (ECSC) Treaty
effects test, subject matter jurisdiction, 199
EFTA. *See* European Free Trade Association (EFTA)
EMCC. *See* Emerging Markets Clearing Corporation (EMCC)
Emerging Markets Clearing Corporation (EMCC), 287
eminent domain, 89
employment law. *See* labor laws and regulations
EMU. *See* European Monetary Union (EMU)
endorsement of bills and notes
- agency, 670
- blank, 667
- for collection, 669
- conditional, 669
- defined, 669
- effect of, under common law and ULB, 670
- fictitious payee rule, 674
- forged, 670–674
- imposter rule, 671
- prohibiting further endorsements, 669
- qualified, 669
- restrictive, 669
- special, 666–667

enforcement
- of disclosure requirements for subsidiaries, 276
- foreign investment laws or agreements, penalties for noncompliance with, 282
- of foreign judgments, 181
- of ICSID awards, 148
- of IMF currency exchange regulations and general obligations, 314–323
- of securities regulations, 295–298
- of WTO dispute settlements, 137

environmental protection, 109–124
- Conference on the Environment and Development (*See* United Nations Conference on the Environment and Development)
- liability for environmental damage, 124
- natural resources protection, 123–124
- nuclear materials, 123
- pollution, regulation of (*See* pollution, regulation of)
- precautionary approach, 110
- Stockholm Conference on the Human Environment, 109
- toxic waste, regulation of, 123

EPZs. *See* export processing zones (EPZs)
equality of treatment doctrine. *See* national standard of care
equity, 68
equity funding, 697
escape clause, under GATT 1994, 388
ESCB. *See* European System of Central Banks (ESCB)

estoppel, 38
Estrada doctrine, 34
EU. *See* European Union (EU)
EU Treaty. *See* European Union (EU) Treaty
Euratom. *See* European Atomic Energy Community (EAEC or Euratom)
euro, 338
Euroclear, 286
Eurocurrency deposits, 342
Eurodollars, 342
European Atomic Energy Community (EAEC or Euratom), 46
European Central Bank (ECB), 58, 337
European Coal and Steel Community (ECSC) Treaty, 46
European Commission, EU, 55
European Community Treaty (EC Treaty), 46, 206, 462–463
European Convention on Human Rights of 1950, 466–468
European Council, EU, 54–55
European Court of Auditors, EU, 58
European Court of First Instance, EU, 57
European Court of Human Rights, 59
European Court of Justice, EU, 47, 56–57
European Economic and Social Committee, EU, 57
European Free Trade Association (EFTA), 61
European Monetary Union (EMU), 337
European Parliament, EU, 55–56
European Social Charter, 467–468
European Space Agency, 59
European System of Central Banks (ESCB), 58, 337, 338
European Union (EU), 45–47
  Berlin Declaration, 46
  codecision procedure, 56
  Council of the European Union, 54
  Court of Auditors, 58
  Court of First Instance, 57
  Court of Justice, 47, 56–57
  Economic and Social Committee, 57
  European Central Bank (ECB), 58
  European Commission, 55
  European Council, 54–55
  European Parliament, 55–56
  European System of Central Banks (ESCB), 58
  freedom of movement of workers, 462–465
  freedom to provide services, 442
  historical background, 46
  institutions of, 54–62
  labor laws, 462–465
  member states, 45–46
  passport requirements, 469
  right of establishment, 441–442
  Services Directive, 442
  supranational powers, 47–53
  trade in services, law on, 441–442
European Union (EU) Treaty, 46
ex works (EXW), 620
exceptions
  commercial activity exception to sovereign immunity, 159–162
  to GATT 1994, 388–389
  to General Agreement on Trade in Services (GATS), 437–438
exchange contracts, defined, 314–315
exclusive licenses, 543–545
executive agreements, 29
Executive Board, IMF, 310–313
exhaustion-of-rights doctrine, 492, 536–539
export controls, 389, 395
  Australia Group, 396
  cultural property, protection of, 395–396
  Missile Technology Control Regime, 398
  Nuclear Suppliers Group (NSG), 397–398
  United Nations sanctions, 398
  Wassenaar Arrangement, 396
  Zangger Committee, 397
export processing zones (EPZs), 267
export restrictions, on intellectual property licenses, 539
Export-Import Bank, 698
Exporters Insurance Company of Bermuda, 107
exporting businesses, 184
expropriation, 89–93
  constitutional provisions regarding, 268
  creeping, 108
  defined, 89, 268
  guarantees related to, 268–269
  insurance coverage for, 108
extended fund facility, 323
extraordinary rendition, 77
extraterritorial application of laws
  labor laws and regulations, 483–486
  over foreign banks, by U.S. subpoenas of foreign branches, 346–347
  securities regulations,U.S., 295
EXW. *See* ex works (EXW)

F

facilities
  of Bank for International Settlements (BIS), 334
  of International Monetary Fund (IMF), 323–324
factor. *See* agents, for multinational enterprises
Fahd, King of Saudi Arabia, 69–70
false conflicts case, choice of law in, 175
FAS. *See* free alongside ship (FAS)
fault, and state responsibility, 87
FCA. *See* free carrier (FCA)
fictitious payee rule, 674
Field Code of New York, 69
Field, David Dudley, 69
field-of-use restrictions, on intellectual property licenses, 548–549
Final Act, Uruguay Round, 365, 366, 367
financial contagion, 324
financing, 657–701
  bills of exchange (*See* bills of exchange)
  bills of lading (*See* bills of lading)
  countertrade, 699–700
  foreign operations (*See* financing foreign operations)
  of foreign trade, 658
  letters of credit (*See* letters of credit)
  promissory notes (*See* promissory notes)
financing foreign operations, 697–699
  debt funding, 697
  development banks, 697
  equity funding, 697
  governmental sources of capital, 697–698
  import and export financing agencies, 698
firm offers, 582
FOB. *See* free on board (FOB)
force majeure, 603, 606–607
Foreign Credit Insurance Association, 107
foreign exchange
  contracts (*See* foreign exchange contracts)
  defined, 343
  market, 343
foreign exchange contracts, 344–346
  forward contracts, 346
  future contracts, 344
  hedging contracts, 344–255
  option contracts, 346
  spot contracts, 344

foreign investment, 238–299
applications (*See* applications, foreign investment)
bilateral investment treaties (BITs) (*See* bilateral investment treaties (BITs))
business forms, 250–252
direct investment in India, 252–256
foreign equity limitations, 252
free trade areas (FTAs), 60, 263
free zones (*See* free zones)
geographic limitations, 257–262
guarantees (*See* guarantees, for foreign investment)
laws and codes, 238–299
modification of investment agreements, 271–274
national policies, 243–245
operational reviews, 270
penalties for noncompliance with laws or agreements, 281
protection of subsidiaries (*See* subsidiaries)
regional policies, 245–246
sectoral limitations (*See* sectoral limitations, on foreign investment)
securities regulations (*See* securities regulations)
start-up standards, 270
supervision of, 270–274
foreign judgments, recognition of, 181
foreign priority sectors, 253
foreseeability test, damages, 606
forged endorsements, 670–674
forum, 148
forum non conveniens, 176, 224
forum selection clauses, 154–159
forward contracts, 346
Four Freedoms Speech (Roosevelt), 455
franchises and franchising, 185–186, 533–534
chain-style business arrangement, 533
defined, 533
distributorships, 533
license, distinguished, 533
manufacturing or processing plant, 533–534
fraud
and letters of credit, 693–696
at World Bank, 326
Frederick the Great, 67
free alongside ship (FAS), 616
free carrier (FCA), 620
free city, 263
free on board (FOB), 615–616
free retail zones, 267
free trade areas (FTAs), 60, 263, 386
free trade zones (FTZs), 263
free zones, 262–268
activities allowed in, 267
bonded warehouses, 268
defined, 262–268
export processing zones (EPZs), 267
free city, 263
free retail zones, 267
free trade areas (FTAs), 60, 263
free trade zones (FTZs), 263
maquiladora program, 267
subzones, 263
freedom of movement of workers, EU, 462–463
freedom to provide services, in EU, 441
freight forwarders, 620
French Civil Code of 1804, 67
FTAs. *See* free trade areas (FTAs)
FTZs. *See* free trade zones (FTZs)

G

GATS. *See* General Agreement on Trade in Services (GATS)
GATT. *See* General Agreement on Tariffs and Trade (GATT)
GEF. *See* Global Environment Facility (GEF)
General Agreement on Tariffs and Trade (GATT 1947), 363, 387, 399
codes, 364
Kennedy Round, 364
most-favored-nation status, 363
multilateral trade negotiations, 363–364
national treatment principle, 363
Tokyo Round, 364
transparency requirement, 363
Uruguay Round, 364–365, 367
General Agreement on Tariffs and Trade (GATT 1994), 136, 376–398
commodity arrangements, 387–388
contents of, 376–398
cultural property, protection of, 395–396
direct effect of, 376
escape clause, 388
exceptions, 388–389
export controls, 389, 395
Generalized System of Preferences (GSP), 380
most-favored-nation rule, 380
national treatment rule, 380
nondiscrimination principle, 380
safeguards, 388
South-South Preferences, 380
tariffs, use of, 385
transparency requirement, 386
General Agreement on Trade in Services (GATS), 136, 429–441
annexes, 436–437, 439–441
Council for Trade in Services, 436–437
Framework Agreement, 430
general exceptions, 437
general obligations of member states, 435–436
institutional structure, 438
most-favored-nation (MFN) treatment, 435
NAFTA provisions compared, 444
national treatment, 435–436
progressive liberation as goal of, 438
purpose of, 429–488
regional economic integration, 435
restrictions, requirements regarding, 435–436
Schedules of Specific Commitments, 438–441
scope and definitions, 430–434
security exceptions, 437
specific commitments to market access for sectors, 437–438
trade in services, defined, 430
transparency provision, 435
General Assembly, United Nations, 41
general average, in maritime ventures, 654
general exceptions
to GATT 1994, 388–389
to General Agreement on Trade in Services (GATS), 437
general IGOs, 58–59
general principles of law, 28
Generalized System of Preferences (GSP), 380
genetically modified foods, 402
Geneva Conventions on the Unification of the Law Relating to Bills of Exchange (ULB), 659, 670, 675
Geneva Conventions on Unification of the Law Relating to Checks (ULC), 659
genuine link, lack of, 97
geographic limitations, on foreign investment, 257–262
German Civil Code of 1896, 67
Global Environment Facility (GEF), 325
Global Financial Stability Report, 309
global warming, 118–122
globalization, 359
glossators, 65
gold bullion standard, 307
gold standard, 307

good offices, 128
goods
 conformity of (*See* conformity of goods to contract)
 defined, 567
 delivery of (*See* delivery of goods, sales contracts)
 trade in (*See* trade in goods)
governing law. *See* choice of law
governmental interest doctrine, 175
grant-back provisions, 551
gray marketing, 539
Great Depression, 307, 308, 360–362
Group of 77 (G-77), 61
Group of Eight (G-8), 240
GSP. *See* Generalized System of Preferences (GSP)
guarantees, for foreign investment, 268–270
 nondiscrimination guarantees, 269
 repatriation guarantees, 269
 stabilization clauses, 270

H

Hague Choice of Courts Agreement Convention, 24
Hague Rules. *See* International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading
Hague-Visby Rules, 623, 634
hard currencies, 343
Harmonized System (HS) of tariffs, 386
Havana Charter, ITO, 362, 367
Hawley-Smoot Tariff Act of 1930, 360
HDC. *See* holder in due course (HDC)
hedging contracts, 344–345
Henry II, King of England, 68
Himalaya clause, 644
Hobbesian view of international law, 22
holder, 675
holder in due course (HDC), 675
holding companies, 193
horizontal competition agreements, 542
HS. *See* Harmonized System (HS) of tariffs
human rights, 62–65
 European Convention on Human Rights of 1950, 465–466
 intergovernmental organizations (IGOs) and, 58–59
 state responsibility compared, 62–65
 of workers, 456–462
Human Rights Commission, 59
humanists, 66

I

IAEA. *See* International Atomic Energy Agency (IAEA)
IASB. *See* International Accounting Standards Board (IASB)
ICANN. *See* Internet Corporation for Assigned Names and Numbers (ICANN)
ICC. *See* International Chamber of Commerce (ICC); International Criminal Court (ICC)
ICJ. *See* International Court of Justice (ICJ)
ICSID. *See* International Center for the Settlement of Investment Disputes (ICSID)
IDA. *See* International Development Agency (IDA)
IFAC. *See* International Federation of Accountants (IFAC)
IFAD. *See* International Fund for Agricultural Development (IFAD)
IFC. *See* International Finance Corporation (IFC)
IGOs. *See* intergovernmental organizations (IGOs)
ijtihad, and Islamic law, 70
ILO. *See* International Labor Organization (ILO)
ILO Convention No. 87. *See* Convention Concerning Freedom of Association (ILO Convention No. 87)
ILO Convention No. 98. *See* Convention Concerning the Application of the Principles of the Right to Organize and to Bargain Collectively (ILO Convention No. 98)
IMF. *See* International Monetary Fund (IMF)
immunity, 148
 act of state doctrine, 167–169
 defined, 148
 sovereign (*See* sovereign immunity)
import-licensing procedures, 408
importing businesses, 184
imposter rule, 671
imputability doctrine, 72
impute, 72
in personam jurisdiction, 149–150
in rem jurisdiction, 159
in-transit contracts, 599
incorporation, doctrine of, 29
Incoterms, 610
independent lines, 623
independent states, 32
India
 bilateral investment treaties (BITs), 242–243
 foreign direct investment in, 253–256
industrial property, 490
 inventions, 490
 trademarks (*See* trademarks)
injunctions, anti-suit, 180
inland carriage of goods, 621–622
inquiry, 128–129
insider, 291
insider trading, 287–292
 Convention on Insider Trading, 296
 defined, 287
 material information, 291, 292
installment note, 662
instruction, money transfers, 346
insurance, 103–106
 defined, 103
 maritime (*See* maritime insurance)
 multilateral investment guaranty programs, 109
 national investment guaranty programs, 107–109
 private insurers, 107
 types of international products, 103
Integrated Program for Commodities (IPC), 388
integration clauses, 575
intellectual property, 490
 artistic property, 490
 copyrights (*See* copyrights)
 creation of rights, 490–524
 defined, 490
 industrial property (*See* industrial property)
 international organizations protecting, 524
 international transfer of, 533–534
 know-how, 523–524
 licensing of (*See* licensing of intellectual property)
 patents (*See* patents)
 treaties, 526–533
intentional tort liability, 210–213
Inter-American Commission on Human Rights, 59
interest, on bank deposits, 343
intergovernmental organizations (IGOs), 40–53. *See also* European Union (EU); United Nations; specific organizations
 defined, 40
 general IGOs, 58–59
 legal capacity of, 40
 numbers of, 40
 specialized IGOs, 59–61

intermediary currency, 344
International Accounting Standards Board (IASB), 275
International Air Transport Association, 61
International Atomic Energy Agency (IAEA), 42, 123
International Bar Association, 61
International Bureau of Industrial Property, 40
International Bureau of Literary Property, 40
International Center for the Settlement of Investment Disputes (ICSID), 140–148, 239, 240
 constituting a tribunal, 141–142
 enforcement, 147
 as exclusive remedy, 143
 investment, defined, 142
 jurisdiction, 143–144
 NAFTA arbitrations under, 144–145
 organizational structure, 140
 place of arbitration, 142
 provisional measures and awards, 147
 purpose of, 140
 rules for arbitration and conciliation, 141
 selecting arbitrators, 142
 unilateral withdrawal, effectiveness of, 142
International Chamber of Commerce (ICC), 62, 148
 Incoterms, 599, 610, 614
 Uniform Rules for Collections, 660
International Coffee Organization, 59–60
International Committee of the Red Cross, 61
International Convention for the Protection of Industrial Property (Paris Convention), 505, 524, 527, 531
International Convention for the Protection of Performers, Producers of Phonograms, and Broadcasting Organizations (Rome Convention), 529
International Convention for the Unification of Certain Rules of Law Relating to Bills of Lading (Hague Rules), 623
International Convention for the Unification of Certain Rules of Law Relating to Maritime Liens and Mortgages (Brussels Convention), 647
International Court of Justice (ICJ), 25, 129–134
 advisory jurisdiction, 130, 132
 composition of, 129–130
 contentious jurisdiction, 130
 functions of, 129
 judgments, 132
 jurisdiction of, 130–134
 optional clause jurisdiction, 130–131
 rule of reciprocity, 131
 self-judging reservations, 132
International Covenant on Economic, Social and Cultural Rights, 455
International Criminal Court (ICC), 135
International Criminal Police Organization (INTERPOL), 60
International Development Agency (IDA), 325
International Federation of Accountants (IFAC), 275
International Finance Corporation (IFC), 325
International Fund for Agricultural Development (IFAD), 325
International Institute for the Unification of Private Law (UNIDROIT), 60, 389
International Labor Organization (ILO), 62, 445–462
 Administrative Tribunal, 450
 Commission of Inquiry, 449
 Committee of Experts on the Application of Conventions and Recommendations, 448
 Conference Committee on the Application of Conventions and Recommendations, 449
 conventions, 446, 450
 disabilities, report on workers with, 447
 dispute settlement, 449
 Fact-Finding and Conciliation Commission, 450
 General Conference, 445
 goal of, 445
 Governing Body, 445
 institutional structure, 445
 International Labor Office, 445, 450
 international labor standards, 446
 recommendations, 447
 reporting requirements for member states, 448
 special list of defaultees, 449
international law, 21–70
 Cosmopolitan view of, 22
 defined, 21
 Hobbesian view of, 22
 in international tribunals, 28–29
 jurisdiction (*See* jurisdiction)
 making of, 25
 in municipal courts, 29–30
 parties to, 32–62
 Positivist view of, 22, 72
 rights of individuals under, 62–65
 scope of, in actual practice, 28–32
 sources of, 25–28
International Monetary Fund (IMF), 307–313, 361
 Articles of Agreement, 307, 308, 309
 cooperation with World Bank, 332–333
 currency exchange (*See* currency exchange)
 currency support (*See* currency support, by IMF)
 operations of, 313, 331–332
 organization of, 312
 origin of, 307–309
 purpose and functions of, 309, 328–329
 quotas, 310
 recipients of funding, 330
 size and structure, 328–329
 sources of funding, 330
 Special Drawing Right (SDR), 306, 307, 309
 role of, 309
 World Bank compared and contrasted, 328–333
international monetary system, 307–313
international multinational enterprises, 190–192
International Securities Clearing Corporation (ISCC), 287
international standard of care, 88–89
International Trade Organization (ITO), 362, 367
International Tribunal for the Law of the Sea, 112–116
Internet Corporation for Assigned Names and Numbers (ICANN), 526
INTERPOL. *See* International Criminal Police Organization (INTERPOL)
interpretation of sales contracts, 574–580
 integration clauses, effect of, 575
 negotiations, consideration of, 575
 objective intent approach, 575
 parol evidence rule, applicability of, 575
 practices, 575–579
 statements and conduct of parties, 575
 subjective intent approach, 575
 usages, 575–579
inventions, 490
inventive step, for patents, 507

investment
 defined, for ICSID arbitrations, 144
 foreign (*See* foreign investment)
IPC. *See* Integrated Program for Commodities (IPC)
irrevocable letters of credit, 689, 690
ISCC. *See* International Securities Clearing Corporation (ISCC)
Islamic banking, 340–342
Islamic law system, 69–70
ITO. *See* International Trade Organization (ITO)

J

Japan
 insider trading regulations, 292
 product liability laws, 214–215
joint venture, 193
joint venture laws, 238–239
Joseph II, King of Austria, 67
judgments
 foreign, recognition of, 181
 of International Court of Justice (ICJ), 132
juridical entities, 186
juridical person *(persona ficta)*, 143, 149–150
jurisdiction
 bases for exercising, 24–25
 in civil cases, 149–159
 in criminal cases, 148–149
 forum non conveniens as grounds for refusal to exercise, 176
 forum selection clauses, 154–159
 immunity from (*See* immunity)
 of International Center for the Settlement of Investment Disputes (ICSID), 144–145
 of International Court of Justice (ICJ), 130–134
 of International Criminal Court (ICC), 135
 of municipal courts, 148–159
 nationality nexus, 149
 opposing exercise of, 176–180
 personal (*See in personam* jurisdiction)
 in personam (*See in personam* jurisdiction)
 protective nexus, 149
 reasonableness requirement, 149
 refusal to exercise, 176
 in rem, 159
 subject matter (*See* subject matter jurisdiction)
 territoriality nexus, 148
 universality nexus, 149
jurisdictional rule of reason test, 199
jus cogens, 28
jus commune, 66, 67
Justinian, Emperor, 65

K

Kant, Immanuel, 497
Kennedy Round, GATT, 364
Keynes, John Maynard, 308, 309
Khomeini,Ayatollah, 70
know-how, 523–524
Kohler, Josef, 497
Kyoto Protocol, 119–122

L

labor laws and regulations, 446
 Council of Europe worker protections, 468
 of European Union, 462–463
 extraterritorial application of, 483–486
 foreign workers, regulation of, 479–482
 human rights of workers, 456–462
 International Labor Organization (ILO) (*See* International Labor Organization (ILO))
 Organization for Economic Cooperation and Development (OECD) standards, 465
 transnational labor unions, 468
labor unions, transnational, 468
laches, 103
Land Record Management and Information System Project (LRMIS), 327
law
 administrative, 68
 civil, 65–68
 common, 68–69
 comparative, 65
 constitutional, 68
 extraterritorial application of (*See* extraterritorial application of laws)
 international (*See* international law)
 Islamic, 69–70
 municipal (*See* municipal law)
 proving foreign, 180–181
 public, 68
 supremacy of, 68
lay days, 646
League of Nations, 40, 360
legal capacity, of international organizations (IGOs), 40
legal dispute, 144
letters of credit, 682–697
 account party, 682, 696
 advising, 689
 amendments, 693
 application for, 685–689
 banks obligations, 692
 beneficiary, 682, 697
 confirming, 689, 691
 defined, 682
 failure to obtain, consequences of, 685–689
 form of, 689
 fraud, effect of, 693–696
 irrevocable, 689, 690
 law governing, 683–685
 revocable, 685
 rule of strict compliance for documentation for, 692
 standby, 697
 types of, 683–685
 waiver, 693
lex mercatoria, 66, 659
liability
 for environmental damage, 124
 of parties to bills and notes, 675–678
licensing of intellectual property, 185–186, 534–553
 anticompetitive effects of licenses, regulation of, 534
 cartels, 542
 common origin doctrine, 538–539
 compulsory licenses (*See* compulsory licenses)
 cross-licensing agreements, 542
 exclusive licenses, 543–545
 exhaustion-of-rights doctrine, 492, 536
 expiration of licensing agreement, restrictions after, 552
 expiration of statutory rights, restrictions after, 550
 export restrictions, 539–542
 field-of-use restrictions, 548–549
 franchising (*See* franchises and franchising)
 grant-back provisions, 551
 gray marketing, 539
 license, 533
 multiple licensing agreements, 542
 no-challenge clauses, 547
 noncompetition clauses, 546
 package licensing, 552
 patent pools, 542

licensing of intellectual property (*continued*)
- price-fixing clauses, 546
- quality control clauses, 550–551
- quantity restrictions, 548–549
- research and development, restrictions on, 550
- sales and distribution arrangements, 545
- territorial restrictions, 536–539
- tying clauses, 547–548

London Court of International Arbitration, 148
long arm statutes, 198
LRMIS. *See* Land Record Management and Information System Project (LRMIS)

M

Maastricht Treaty, 337
Madrid Agreement for the Repression of False or Deceptive Indications of Sources of Goods, 531
mailbox rule, 582
maintenance of value clause, 305
manufacturing or processing plant franchise, 533–534
maquiladora program, 267
marine pollution, regulation of, 111–118
maritime insurance, 650–654
maritime liens, 647–650
market access, 437
master nationality, 96
material information, 291, 292
mediation, 128
Memorandum of Association, 274
memorandums of understanding (MOUs), 295
Meng, K'ung, 62
MERCOSUR. *See* Southern Cone Common Market (MERCOSUR)
Merger Rule, 38
Merger Treaty, 46
MFA. *See* Multi-Fiber Arrangement (MFA)
MFN. *See* most-favored-nation (MFN) treatment
MIGA. *See* Multilateral Investment Guaranty Agency (MIGA)
minimum contacts test, personal jurisdiction, 199
minority shareholders of subsidiaries, protections for, 276
Missile Technology Control Regime, 398
missing specifications remedy for breach of contract, 604
mitigate losses, duty to, 594
MNEs. *See* multinational enterprises (MNEs)
modification of investment agreements, 271–274
monetary systems
- international, 307–313
- national (*See* national monetary systems)
- regional, 336–338

money, 301–307. *See also* currency
- choice of, 302–304
- defined, 301, 665
- in international transactions, 302
- maintaining monetary value, 302
- monetary systems (*See* monetary systems)
- official, 301
- private, 301
- value of, 301–302

money of account, 302
money of payment, 302
moral rights, copyrighted works, 498
mortgage note, 662
most significant relationship doctrine, 171–175
most-favored-nation (MFN) treatment
- Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), 498
- GATT 1947 provisions, 363
- GATT 1994 provisions, 382
- General Agreement on Trade in Services (GATS) provisions, 435

MOUs. *See* memorandums of understanding (MOUs)
movement of workers, 468–487
- foreign workers, regulation of, 479–482
- passport requirements, 469
- percentile legislation, 479
- visas (*See* visas)

Moving Boundaries Rule, 38
Multi-Fiber Arrangement (MFA), 425
Multilateral Investment Guaranty Agency (MIGA) (World Bank), 109
multilateral investment guaranty programs, 109
multilateral trade agreements, of WTO Agreement, 365, 398–426
- agriculture, agreement on, 422
- Anti-dumping Code, 409–410
- customs valuation, 399
- import-licensing procedures, 409
- preshipment inspection (PSI), 400
- regulatory agreements, 398–426
- rules of origin, 425
- safeguards, 421
- sanitary and phytosanitary measures, 402
- sectoral agreements, 398, 422
- technical barriers to trade, 400–401
- textiles and clothing, agreement on, 424–425
- trade-related investment measures, 402

multilateral trade negotiations, GATT, 363–364
multilateral treaties, 25
multinational enterprises (MNEs), 62, 183–237
- anti-suit injunctions, 208
- blocking statutes, 207
- branches, 184
- bribery, 196
- business forms, 186 (*See* business forms)
- common enterprise liablility, 231–232
- corruption, 196
- exporting, 184
- home state regulation of, 196–231
- host state regulation of, 231–236
- importing, 184
- insurance for (*See* insurance)
- international regulation of, 193–196
- licensing and, 185–186
- long arm statute, 198
- multinational organization, 186–193
- organization of (*See* organization of multinational enterprises)
- parent company, 186
- product liability, 213
- sharp practices, 224–225
- subordinate structure, 192–193
- subsidiaries, 184
- unfair competition laws, 196–210

multiple licensing agreements, 542
municipal courts, 148–159
- choice of law (*See* choice of law)
- immunity of states from jurisdiction of, 159–169
- international law in, 29–30
- jurisdiction of, 148–159
- proving foreign law, 180–181

municipal law, 65–70
- Anglo-American common law system, 68–69
- as subservient to international law, 28
- Islamic law system, 69–70
- Romano-Germanic civil law system, 65–68

N

Nachfrist notice, 600, 604
NAFTA. *See* North American Free Trade Agreement (NAFTA)
national investment guaranty programs, 107–108
national monetary systems, 338–357
  arbitrage, 346
  bank deposits, 339
  branch banking (*See* branch banking)
  central banks, 338
  commercial banks, 339
  Eurocurrency deposits, 342
  foreign exchange contracts (*See* foreign exchange contracts)
  foreign exchange market, 343
  interbank deposit market, 342
  political agencies, 338
  transfers of money, 346
national multinational enterprises, 189–190
National Securities Clearing Corporation (NSCC), 286
national standard of care, 88
national treatment rule
  Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), 529
  Berne Convention, 529
  GATT 1947, 363
  GATT 1994, 380
  General Agreement on Trade in Services (GATS), 435–436
  Paris Convention, 531
nationality
  defined, 96
  lack of, as objection to state responsibility, 96–97
  master, 96
nationality nexus, for criminal jurisdiction, 148
nationalization. *See* expropriation
natural person, 143, 149
natural resources, protection of, 123–124
naturalists. *See* cosmoplitans
Nederlandsche Credietverzekering Maatsschappij, 107
negligence, 214
negotiable instruments. *See* bills of exchange; promissory notes
negotiation
  as consideration in sales contract interpretation, 575
  defined, 128
negotiation of bills and notes, 669
  converting order to bearer paper and vice versa, 667
  endorsements (*See* endorsement of bills and notes)
  order paper, 666, 669
newness requirement, for patents, 507
NGOs. *See* nongovernmental organizations (NGOs)
no-challenge clauses, 547
nominalism, 301–302
Non-Proliferation Treaty Exporters' Committee. *See* Zangger Committee
non-self-executing treaties, 29
noncompetition clauses, 546
nonconditional protection principle, 529
nondiscrimination guarantees, 269
nonexclusive rights, in intellectual property license, 543
nongovernmental organizations (NGOs), 61–62
nonimputable acts, 72–77
nonmultinational enterprises, 186, 189
nonprofit NGOs, 61–62
North American Free Trade Agreement (NAFTA), 61, 387
  ICSID arbitrations, 144–148
  investor protection provisions, 245
  trade in services, provisions governing, 444
notes. *See* promissory notes
NSCC. *See* National Securities Clearing Corporation (NSCC)
NSG. *See* Nuclear Suppliers Group (NSG)
nuclear materials, export controls related to, 397
Nuclear Suppliers Group (NSG), 397–398

O

OAS. *See* Organization of American States (OAS)
objections to state responsibility complaints, 96–103
  Calvo clauses, effect of, 97
  dirty hands, 103
  failure to exhaust remedies, 97–98
  genuine link, lack of, 97
  laches, 103
  nationality, lack of, 96–97
  standing, lack of, 96
  waiver of rights, 97
objective intent approach to sales contract interpretation, 575
objective territoriality jurisdiction, 24
OECD. *See* Organization for Economic Cooperation and Development (OECD)
offer, 580
  defined, 580
  definiteness requirement, 580
  effectiveness of, 582
  firm offers, 582
  mailbox rule, 582
  pro forma invoice as example of, 580, 581
  rejection of, 584
  revocation of, 582
  specific offerees, requirement for, 581
official money, 301
OMAs. *See* orderly marketing arrangements (OMAs)
OPEC. *See* Organization of Petroleum Exporting Countries (OPEC)
operational reviews, of foreign-owned enterprises, 270
OPIC. *See* Overseas Private investment Corporation (OPIC)
opinio juris sive necessitatis, 27
option contracts, 346
optional clause jurisdiction, 130–131
order bill of lading, 632
order paper, 666, 669
orderly marketing arrangements (OMAs), 421
Organization for Economic Cooperation and Development (OECD), 61
  employment standards, 465
  Guidelines for Multinational Enterprises, 465–466
  securities regulations, 294
Organization of American States (OAS), 58, 389
organization of multinational enterprises
  branches, 184
  parent company, 186
  subsidiaries (*See* subsidiaries)
Organization of Petroleum Exporting Countries (OPEC), 61
organizational documents, disclosure of, 274
Overseas Private Investment Corporation (OPIC), 107–109, 698
  currency convertibility guarantees, 108
  expropriation coverage, 108
  political violence, insurance for losses due to, 108

P

package licensing, 552
Panama canal, 34
Pandectists, 67, 497
par value system, 313
Paris Convention. *See* International Convention for the Protection of Industrial Property (Paris Convention)
parol evidence rule, 575
particular average, in maritime industry, 654
partnerships
  defined, 186
passports, 469
Patent Cooperation Treaty, 532
patent pools, 542
patents, 504–512
  of addition, 506
  applications for, 510–511
  capable of industrial application requirement, 506–507
  compulsory licenses, 553–554
  confirmation, 506
  defined, 504
  design, 506
  duration of, 512
  excluded inventions, 511
  inventive step, 507
  newness requirement, 507
  petty, 506
  plant, 506
  precautionary, 506
  private property justification for, 504–505
  public-interest justification for, 505
  publication requirement, 510–511
  qualifications review, 510–511
  scope of, 512
  utility, 506
payment of price, sales contracts, 591–594
PCIJ. *See* Permanent Court of International Justice (PCIJ)
pecuniary rights, copyrights, 491
pepoudrous courts, 66
percentile legislation, 479
performance rights, copyrighted works, 493
Permanent Court of International Justice (PCIJ), 445–446
permanent visas, 475–476
persistent objection, to custom, 27–28
personal jurisdiction, 143
personalists, 497
petty patents, 506
place of payment, in international transactions, 302
plain meaning rule, 573
plant patents, 506
Plurilateral Trade Agreements, of WTO Agreement, 365
political violence, insurance for losses due to, 108
pollution, regulation of, 111–123
  air pollution, 118–122
  marine pollution, 111–118
Portalis, Jean, 67
Positivists view of international law, 22, 72
Poverty Reduction and Growth Facility, 324
practices, in sales contract interpretation, 575
precautionary approach to environmental protection, 110, 119
precautionary patents, 506
precedent, 68
preempt, 570
presentment, 676
preshipment inspection (PSI), 400
price reduction remedy, breach of contract, 602
price-fixing clauses, 546
primary commodities, 387
private insurers, 107
private international law, 21, 22
private money, 301
privity, 214, 696
product liability laws, 210, 213–224
product regulations, 122–123
promissory notes, 661–664
  acquired in bad faith, 675
  acquired through gross negligence, 675
  assignment, 666
  banks' role in collecting and paying, 678–681
  certificates of deposit (CDs), 339, 343, 662
  collateral note, 662
  definite sum or monetary unit, requirement for, 665
  endorsements (*See* endorsement of bills and notes)
  examples of, 662
  holder, 675
  holder in due course (HDC), 675
  installment note, 662
  liabilities of parties to, 675–678
  liability on the instrument, 677
  limitations on excuses for not paying, 675
  maker, 661
  mortgage note, 662
  negotiability of, 664–666
  negotiation (*See* negotiation of bills and notes)
  parties to, 661
  payee, 661
  signature requirements, 666
  time of payment, requirements regarding, 665
  unconditional promise to pay, requirement for, 662–663
  warranty liability, 678
property
  artistic, 490
  cultural, export controls for protection of, 395–396
  industrial (*See* industrial property)
  intellectual (*See* intellectual property)
  succession of states and, 38
prospectus, 284
protection independent of protection in the country of origin principle, 529
protectionism, 360–362
protective nexus, for criminal jurisdiction, 149
PSI. *See* preshipment inspection (PSI)
public international law, 21, 22
public law, 68
publication requirement, for patents, 510–511

Q

qualified endorsements, 669
quality control clauses, 550–551
quantity restrictions, on intellectual property licenses, 548–549
quotas, IMF, 310

R

recognition
  constitutive doctrine, 33
  declaratory doctrine, 33
  Estrada doctrine, 34
  of intergovernmental organizations (IGOs), 40
  of states or governments, 33–38
recommendations, by ILO, 447
red herring prospectus, 285
regional monetary systems, 336–338
registered securities, 282

registration
of securities, 285–286
of trademarks, 516
relief, 103
compensatory damages, 103
restitution in kind, 103
satisfaction, 103
remedies. *See also* specific remedy
for breach of contract (*See* breach of contract, remedies for)
damages (*See* damages)
failure to exhaust, 97–98
in state responsibility cases, 103–104
under Agreement on Subsidies and Countervailing Measures (SCM Agreement), 415
repatriation guarantees, 269
reporting requirements
for ILO member states, 448
for subsidiaries, 274–275
representative office, 192
reproduction rights, copyrighted works, 491–494
res, 647
reserve currencies, 301
reserve *tranche*, 323
restitution in kind, 103
restrictive endorsements, 669
restrictive sovereign immunity, 159
revocable letters of credit, 685
revocation of offer, 582
right of establishment, EU, 442
right of priority, 531
Rio Conference. *See* United Nations Conference on the Environment and Development (UNCED)
Rio Declaration, 110
risk transfer, sales contracts, 594–599
Robinson-Patman Act, 197
Roman Catholic Church, 65
Romano-Germanic civil law system, 65–68
Rome Convention. *See* International Convention for the Protection of Performers, Producers of Phonograms, and Broadcasting Organizations (Rome Convention)
Rome Statute, 135–136
Roosevelt, Eleanor, 455, 456, 459
Roosevelt, Franklin D., 361, 455
Root, Elihu, 72
rule of reason, 196, 535
rule of reason determinations, restrictive trade practices, 535, 542
rule of reciprocity, 131
rule of strict compliance, as to documentation for letters of credit, 692
rules of origin, 425

S

safeguards
Agreement on, 421
under GATT 1994, 388
sales, 559–608
contracts (*See* sales contracts)
defined, 567
sales and distribution arrangements, 545
sales contracts. *See also* Convention on Contracts for the International Sale of Goods (CISG)
breach of contract, remedies for (*See* breach of contract, remedies for)
buyer's obligations, 591–594
conformity of goods (*See* conformity of goods to contract)
delivery of goods (*See* delivery of goods, sales contracts)
dirty hands, 606–607
force majeure, 606–607
form of, 579–580
formation of, 580–587
fundamental breach of, 588
interpretation of (*See* interpretation of sales contracts)
maintenance of value clause, 305
nonperformance, excuses for, 606–607
offer (*See* offer)
passage of risk, 594–599
payment of price, 591–594
remedies for breach of (*See* breach of contract, remedies for)
seller's obligations, 589–590
trade terms (*See* trade terms)
turning over of documents, by seller, 589
writing requirement, 579
sanctions, by United Nations, 398
sanitary and phytosanitary measures, 402
Satellite Transmission Convention. *See* Convention Relating to the Distribution of Program-Carrying Signals Transmitted by Satellite (Satellite Transmission Convention)
satisfaction, 103
Savary Code of 1673, 659
Savigny, Friedrich Karl von, 67
Schedules of Specific Commitments, GATS, 438–441
SDR. *See* Special Drawing Right (SDR)
sea, carriage of goods by, 622–645
bill of lading (*See* bills of lading)
charterparties (*See* charterparties)
commercial invoice, 625
common carrier, 622
conference lines, 623
dock receipt, 627
independent lines, 623
maritime insurance (*See* maritime insurance)
packing list, 626
tramp vessels, 623
Second Amendment system, IMF, 313–314
Secretariat, United Nations, 41–42
sectoral limitations, on foreign investment
closed sectors, 252
foreign priority sectors, 253
restricted sectors, 252
securities, 282–283
bearer, 282
bonds, 282
certificated, 283
defined, 282
registered, 282
regulation of (*See* securities regulations)
stock (*See* stock)
transfers of, 283, 293
uncertificated, 283
Securities and Exchange Act of 1934, 291, 292, 295
securities regulations, 282–294, 295
clearance and settlement (*See* clearance and settlement of securities)
enforcement internationally, 294–298
exchanges, 285, 288
extraterritorial application of U.S. laws, 295
insider trading (*See* insider trading)
issuance of securities, 285–286
memorandums of understanding (MOUs), 295
OECD Code of Liberalization of Capital Movements, 294
registration requirements, 285–286
trading in securities, 283
Security Council, United Nations, 41
security exceptions
to GATT 1994, 389
to General Agreement on Trade in Services (GATS), 435–436
security exchange, 283

self-executing treaties, 29
self-judging reservations, 131
service marks, 512
service sectors, 430–431
Services Directive, EU, 442
Shari'a, 69–70
sharp practices, 224–225
Sherman Antitrust Act, 196, 197, 535, 542
shipment contracts, 598
sight bills, 661
soft currencies, 343
sole rights, in intellectual property license, 543
South-South Preferences, 380
Southern Cone Common Market (MERCOSUR), 61
sovereign immunity, 159–167
 absolute, 159
 defined, 159
 restrictive, 159
 waiver of, 160
Special Drawing Right (SDR), 301, 305–307
special endorsements, 666
specialized IGOs, 59–61
specific performance, 588, 600, 604
spread eagles, 346
SPS Agreement. *See* Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement)
stabilization clauses, 270
standard of care, 88–96
 denial of justice, 93–96
 expropriation, 89–93
 international standard, 88–89
 national standard, 88
standards, TBT Agreement requirements, 400
standby arrangements, 324
standby letters of credit, 697
standing, lack of, 96
stare decisis, 134
start-up standards, for foreign investors, 270
state immunity. *See* sovereign immunity
state practice, 25
state responsibility, 62–65, 72–88
 defined, 72
 environmental protection (*See* environmental protection)
 fault and causation, 87
 human rights compared, 62–65
 imputable conduct, 72–77
 insurance for MNEs (*See* insurance)
 nonimputable acts, 72–77
 objections to claims of (*See* objections to state responsibility complaints)
 relief available, 103
 standard of care (*See* standard of care)
 terrorism and, 77–78
state terrorism, 77–78
states, 32–39
 defined, 32
 dependent, 32–33
 inchoate, 32
 independent, 32
 recognition of, 33–38
 territorial sovereignty (*See* territorial sovereignty)
statutory copyright license, 554, 557
stock. *See also* securities
 defined, 282
 regulatory schemes (*See* securities regulations)
Stockholm Conference on the Human Environment, 109
Stockholm Convention. *See* Convention Establishing World Intellectual Property Organization (Stockholm Conventon)
Stockholm Declaration, 109
straddles, 346
straight bill of lading, 632
strict liability theory of product liability, 215
subject matter jurisdiction
 ICSID arbitration tribunals, 145
subjective intent approach to sales contract interpretation, 575
subrogation rights, of OPIC, 108
subsidiaries, 184, 192
 annual reporting requirements, 274–276
 creditor protections, 276–277
 disclosure obligations, 274–276
 minority shareholder protections, 276
 organizational documents, disclosure of, 274
 protection of, 274–281
 tort victims of, protections for, 277
subsidies
 1979 Subsidies Code, 414–415
 Agreement on (*See* Agreement on Subsidies and Countervailing Measures (SCM Agreement))
 Agreement on Agriculture provisions for reduction of agricultural export subsidies, 422
 defined, 414–415
 examples of, 415
 U.S.-Chinese disagreement on, 420
subzones, 263
succession of states, 38
Suez canal, 34
supplemental reserve facility, 324
supranational powers, of EU, 47–53
supremacy principle, 47
supremacy, of the law, 68
suspension of performance remedy for breach of contract, 604–605

T

takeovers, 292–294
 City Code on Takeovers and Mergers, 294
 cross-ownership of shares restricting, 293
 restrictions on transfers of shares, effect of, 293
 voting restrictions on shares inhibiting, 293
 Williams Act, 293–294
Tariff Truce Conference, 360–361
tariffs, 385
 Agreement on Agriculture provisions, 422
 bound tariff rate, 385
 Harmonized System (HS), 386
TBT Agreement. *See* Agreement on Technical Barriers to Trade (TBT Agreement)
technical barriers to trade, 400–401
technical regulations, 401
temporary visas, 472–475
tender offer, 293
territorial basis, for jurisdiction, 24
territorial restrictions, on intellectual property licenses, 536–539
territorial sovereignty
 changes in, 38–39
 Clean Slate Doctrine, 38
 defined, 34
 Merger Rule, 38
 Moving Boundaries Rule, 38
territoriality nexus, for criminal jurisdiction, 148
terrorism, 77–78
 characteristics of, 77–78
 counterterrorism conventions, 77–78
 defined, 77
textiles and clothing, trade agreement on, 425
time bills, 661
time charterparties, 646
tippee, 291

tipper, 291
Tokyo Round, GATT, 364
tombstone advertisement, 285
tort laws, 210
  protections for tort victims of subsidiaries, 277
toxic waste, regulation of, 123
trade
  financing (*See* financing)
  in goods (*See* trade in goods)
  in services (*See* trade in services)
trade acceptances, 659, 661, 662
trade in goods, 358–428
  Bretton Woods system, 362
  General Agreement on Tariffs and Trade (*See* General Agreement on Tariffs and Trade (GATT 1947); General Agreement on Tariffs and Trade (GATT 1994))
  multilateral trade agreements (*See* multilateral trade agreements, of WTO Agreement)
  protectionism, 361
  sales contracts (*See* sales contracts)
  transportation of goods (*See* transportation of goods)
  World Trade Organization (WTO) (*See* World Trade Organization (WTO))
trade in services, 429–488
  European Union law, 441–444
  General Agreement on (*See* General Agreement on Trade in Services (GATS))
  North American Free Trade Agreement (NAFTA) law, 444–445
trade name, 512
Trade Policy Review Board,WTO, 376
trade secrets, 523–524
trade terms, 609–620
  cost and freight (CFR), 616
  cost, insurance, and freight (CIF), 616
  defined, 609
  delivered ex ship (DES), 614
  ex works (EXW), 620
  free alongside ship (FAS), 616
  free carrier (FCA), 620
  free on board (FOB), 615–616
  free, defined, 615
  Incoterms, 595, 610, 614
trade-related investment measures, 402
Trademark Law Treaty, 531
trademarks, 490, 512–523
  acquiring, 515–516
  certification marks, 512
  collective marks, 512
  common origin doctrine, 538–539
  distinctiveness of, 516
  functions of, 512
  refusal of registration, 521–522
  registration of, 516–521
  review of registration, 522
  service marks, 512
  term of, 522
  true, 512
  usage requirements, 523
tragedy of the commons, 118
tramp vessels, 623
tranche, 323
transaction value method of customs valuation, 399
transformation, doctrine of, 29
transparency provisions
  Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), 534
  GATT 1947, 363
  GATT 1994, 386
  General Agreement on Trade in Services (GATS), 435
  regional integration, 386–387
transportation of goods, 609–656
  by sea (*See* sea, carriage of goods by)
  freight forwarders, 620
  inland carriage, 621–622
  liablility limits, 640–643
  third-party rights, 644–645
  time limitations, 643–644
  trade terms (*See* trade terms)
transshipment contracts, 599
travaux préparatoires, 573
treaties, 25–26. *See also* specific treaties
  bilateral, 25
  changes in territorial sovereignty and, 38–39
  constitutional, 29
  defined, 25
  dispositive, 38
  executive agreements, 29
  multilateral, 25
  non-self-executing, 29
  self-executing, 29
Treaty Establishing the European Community (EC Treaty). *See* European Community Treaty (EC Treaty)
Treaty of Amsterdam, 46
Treaty of Nice, 46
Treaty on Intellectual Property in Respect of Integrated Circuits (Washington Treaty), 531–532
Treaty on the Non-Proliferation of Nuclear Weapons, 123, 397–398
TRIMs Agreement. *See* Agreement on Trade-Related Investment Measures (TRIMs Agreement)
TRIPS. *See* Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)
TRIPS Council. *See* Council for Trade-Related Aspects of Intellectual Property Rights (TRIPS Council)
true conflicts case, choice of law in, 175
Truman, Harry, 362
Trusteeship Council, United Nations, 42
Twelve Tables, 65
tying clauses, 547–548

U

UCC. *See* Uniform Commercial Code (UCC)
UCP. *See* Uniform Customs and Practices for Documentary Credits (UCP)
UEMOA. *See* West African Economic and Monetary Union (UEMOA)
ULB. *See* Geneva Conventions on the Unification of the Law Relating to Bills of Exchange (ULB)
ULC. *See* Geneva Conventions on Unification of the Law Relating to Checks (ULC)
UMCA. *See* Central American Monetary Union (UMCA)
UNCED. *See* United Nations Conference on the Environment and Development (UNCED)
uncertificated securities, 283
UNCITRAL. *See* United Nations Commission on International Trade Law (UNCITRAL)
UNCLOS. *See* United Nations Convention on the Law of the Sea (UNCLOS)
UNCTAD. *See* United Nations Conference on Trade and Development (UNCTAD)
UNEP. *See* United Nations Environment Program (UNEP)
UNESCO. *See* United Nations Education, Scientific and Cultural Organization (UNESCO)

unfair competition laws
anticompetitive behavior laws, EU (*See* anticompetitive behavior laws, EU)
antitrust laws (*See* antitrust laws, U.S.)
UNFCCC. *See* United Nations Framework Convention on Climate Change (UNFCCC)
UNIDROIT. *See* International Institute for the Unification of Private Law (UNIDROIT)
Uniform Commercial Code (UCC), 659
Uniform Customs and Practices for Documentary Credits (UCP), 683–685
Uniform Domain Name Dispute Resolution Policy, 526
Uniform Negotiable Instruments Law (UNIL), 659
Uniform Rules for Collections, 660
UNIL. *See* Uniform Negotiable Instruments Law (UNIL)
United Kingdom
insider trading regulations, 287, 291–292
passport requirements, 469
takeover regulations, 292–294
United Nations, 40, 41–42, 361
Charter, 40, 41
Economic and Social Council (ECOSOC), 41
General Assembly, 41
goals of, 41
human rights, 455–456
International Court of Justice (*See* International Court of Justice (ICJ))
organs of, 41–42
sanctions to maintain international peace, 398
Secretariat, 41–42
Security Council, 41
specialized agencies of, exhibit listing, 43
Trusteeship Council, 42
United Nations Ad Hoc Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting, 275
United Nations Climate Change Conference, 121
United Nations Commission on International Trade Law (UNCITRAL), 148
United Nations Commission on Transnational Corporations, 62
United Nations Conference on the Environment and Development (UNCED), 110–111, 123–124
Agenda 41, 110
Convention on Biological Diversity, 124
Rio Declaration, 110, 124
UNFCCC, 118
United Nations Conference on Trade and Development (UNCTAD), 240, 388
United Nations Conference on Trade and Employment, 362
United Nations Convention on Contracts for the International Sale of Goods. *See* Convention on Contracts for the International Sale of Goods (CISG)
United Nations Convention on the Law of the Sea (UNCLOS), 111–112
United Nations Education, Scientific and Cultural Organization (UNESCO), 395–396
United Nations Environment Program (UNEP), 110
United Nations Framework Convention on Climate Change (UNFCCC), 118–119
Conference of the Parties, 119–120
Kyoto Protocol, 119–122
objectives of, 119
United Nations Monetary and Financial Conference. *See* Bretton Woods Conference
United Nations System, 42
United Nations World Tourism Organization (UNWTO), 43
United States
Alien Tort Claims Act (*See* Alien Tort Claims Act (ATCA))
antitrust laws (*See* antitrust laws)
insider trading regulations, 291
passport requirements, 469
takeover regulations, 292–294
treaty negotiation and ratification, 29
visa regulations, 474
Universal Declaration of Human Rights, 455–456
legal effect of, 456–459
movement of workers, 468–469
rights listed in, 456
universality nexus, for criminal jurisdiction, 149
upper credit *tranches*, 323
Uruguay Round, GATT, 359, 364–365, 367
usage requirements, for trademarks, 523
usages, in sales contract interpretation, 575–579
usus, 27
utility patents, 506

V

value, of money, 301–307
VERs. *See* voluntary export restraints (VERs)
vertical competition agreements, 542
vested rights doctrine, 171
Vienna Convention on the Law of Treaties, 26, 28
visas, 469–479
compliance with, 476
permanent, 475–476
temporary, 472–475
U.S. regulations, 474
waiver program, 474
voluntary export restraints (VERs), 421
von Gierke, Otto, 497
voyage charterparties, 646

W

waiver, 375
of conformity of goods, 590
letters of credit, 693
of sovereign immunity, 160
Warsaw Convention (Convention for the Unification of Certain Rules Relating to International Carriage by Air), 654
Washington Convention. *See* Convention on the Settlement of Investment Disputes between States and Nationals of Other States
Washington Treaty (Treaty on Intellectual Property in Respect of Integrated Circuits), 531
Wassenaar Arrangement on Export Controls for Conventional Arms and Dual-Use Goods and Technologies, 396
West African Economic and Monetary Union (UEMOA), 336
White, Harry Dexter, 308
William the Conqueror, 68
Williams Act, 293–294
WIPO. *See* World Intellectual Property Organization (WIPO)
Wolfowitz, Paul, 327

workers
  labor laws (*See* labor laws and regulations)
  labor unions, transnational, 468
  movement of (*See* movement of workers)
World Bank, 62, 140, 325, 361
  cooperation with IMF, 332–333
  corruption and fraud at, 326
  Global Environment Facility (GEF), 325
  IMF compared and contrasted, 327–333
  International Development Agency (IDA), 325
  International Finance Corporation (IFC), 325
  operations of, 330–331
  purposes of, 328–329
  recipients of funding, 330
  size and structure, 329–330
  sources of funding, 330
World Charter for Nature, 123
World Economic Outlook, 309
World Intellectual Property Organization (WIPO), 40, 524–526
  Arbitration and Mediation Center, 525
  Copyright Treaty, 530
  ICANN Uniform Domain Name Dispute Resolution, 526
World Monetary and Economic Conference, 360–361
World Trade Organization (WTO), 42, 363, 367
  Agreement, 365–367
  Appellate Body, 137–138, 420
  consultation, 136–137
  Council for Trade in Goods, 369, 371
  decision making by consensus, 372
  Dispute Settlement Body (DSB), 136, 375, 416
  Dispute Settlement Panel, 136–137
  dispute settlement procedures, 136–140
  enforcement of reports adopted by DSB, 137
  establishment of, 365–367
  functions of, 366
  General Council, 369–371
  membership of, 367–369
  Ministerial Conference, 371
  multilateral trade agreements (*See* multilateral trade agreements, of WTO Agreement)
  plurilateral trade agreements, 365
  precedential effect of dispute settlement rulings, 137–140
  structure of, 369–371
  third party participation, 136–137
  Understanding on Rules and Procedures Governing the Settlement of Disputes (Dispute Settlement Understanding), 136–140
  waivers, 375
World Wildlife Federation, report on bluefin tuna fishery, 117
writs, 68
WTO. *See* World Trade Organization (WTO)

Z

Zangger Committee, 397