

THIRD  
EDITION

# INTERNATIONAL BUSINESS LAW AND THE LEGAL ENVIRONMENT

A Transactional Approach

LARRY A. DIMATTEO



ROUTLEDGE

# INTERNATIONAL BUSINESS LAW AND THE LEGAL ENVIRONMENT

*International Business Law and the Legal Environment* provides business students with a strong understanding of the legal principles that govern doing business internationally. Not merely about compliance, this book emphasizes how to use the law to create value and competitive advantage.

DiMatteo's transactional approach walks students through key business transactions—from import and export, contracts, and finance to countertrade, dispute resolution, licensing, and more—giving them both context and demonstrating real world application. This new edition also includes:

- New material on comparative contract and sales law, European private law, joint ventures, and collaborative alliances.
- A new part on foreign direct investment that includes a chapter on emerging markets.
- New chapters on privacy law and environmental concerns.
- Greater coverage of the World Trade Organization.
- “Case highlights” and court opinions, featuring edited court transcripts which expose students to actual legal reasoning and an understanding of underlying legal principles. These decisions are drawn from a broad range of countries, offering a truly international look at the subject.

Students of business law and international business courses will find DiMatteo's clear writing style easy to follow. A companion web site includes an instructor's manual, PowerPoints, and other tools to provide additional support for students and instructors.

**Larry A. DiMatteo** is the Huber Hurst Professor of Contract Law and Legal Studies at the University of Florida, USA. He is the author of over 80 books, articles, and book chapters. His research spans several areas of international business law including international contract, intellectual property, and sales laws.

This is an excellent source for students, academics, and practitioners alike interested in legal, ethical, and strategic issues in international business transactions. The author carries out a detailed analysis of important pieces of legislation, and provides a number of useful examples of different types of transactions.

**Douglas Cumming**, *York University, Canada*

Professor DiMatteo's text provides a well-organized, comprehensive tour of international business law. The up-to-date text is sufficiently detailed for the advanced student, but works equally well as an introduction to numerous topics in international law. Clearly written, the text provides both an overview of international business issues and strategies, as well as detailed summaries and highlights of international agreements. The instructor has a wealth of exceptionally detailed case studies and questions to explore with students. An internationally recognized expert in international contract, Professor DiMatteo has included information on the rise of China in global trade, including the attendant economic and ethical implications. Legal issues involving sustainability, including environmental ethics, climate change, and human rights raise some of the most pressing issues of our times for students.

**Stephanie M. Greene**, *Boston College, USA*

In a globalized world, success of any market player depends on adhering to the complex market rules. DiMatteo's textbook provides a helpful guide. Offering a comprehensive overview of international business transactions through the assessment of applicable theories, supported with practical examples and relevant judicial decisions, this text would be of particular use to both students and practitioners.

**Pavel Repeuski**, *Leeds Beckett University, UK*

DiMatteo advances an original approach to the relationship between international law and business. The textbook provides an authoritative account of the rules in an accessible and user-friendly structure to ensure that chapters are easy to navigate and key information can be readily broken down and retained. It is a valuable resource for educators and researchers alike with an interest in international business law.

**T. Leigh Anenson**, *University of Maryland, USA*

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Larry A. DiMatteo

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LAD



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## PREFACE TO THE THIRD EDITION

It has been said that all business now is international business. Smaller and smaller companies, including “mom and pop” businesses, are actively involved in exporting and importing goods and services. The Internet, government assistance programs, low trade barriers, as well as dependable transport, financial, and payment structures have opened access to foreign markets and lowered the risks of doing business internationally. The continued outsourcing of manufacturing inputs (raw materials and component parts) and of services, such as contact centers has increased business opportunities and the growth of international trade. The information society and accelerated technological development have made technology transfers and intellectual property licensing a growing part of world GDP. This book examines the means and practices developed in law and business to facilitate transborder trade and mitigate the risks of doing business internationally.

### **Legal, International, Transactional, and Practical Perspectives**

Creating a “generalist” book on international business law seems an exceptional challenge because there is no single body of international business law as such. International business law is at most a compilation of different national systems. This book deals with this abundance of law through its transactional orientation. The text presents international business transactions with an emphasis on rules and practice. It is the author’s belief that it is these practical legal aspects of international business that are most relevant to today’s business and law students.

This transactional approach is the book’s distinctive characteristic. It draws from a broad variety of law, economic, and sociological sources, and above all it deals with international business transactions in the context of their real settings. This grounding of the legal aspects of international business is evident in the numerous practical bits of information that are not a reflection of law, but are related to law. The practices and techniques discussed are directed at fully utilizing the facilitative nature of law and are directed at avoiding the regulatory side of law, such as litigation, corruption, and violations of laws and regulations.

Use of the case method is retained with the utilization of sizable excerpts that expose the student to the court’s actual legal reasoning. The case selection avoids the American-only perspective as the cases are drawn from a variety of legal systems. Each case is followed by a synopsis highlighting the main points of each case. These “Case Highlights” distill the key legal points of each case for easier student understanding.

The selection of a variety of laws, regulations, case decisions, and principles and practices from numerous countries and international instruments provides a truly “international perspective” on doing business internationally. Again, the book makes a point of using judicial opinions from different countries, in both common law and civil law systems, and refers to legislation and practices from many parts of the world.

As noted above, the book is much more than a recitation on black letter law. It takes a more practical approach to international business law, focusing on a great range of information taken from business practice, providing material which is of use to legal and business practitioners (or students aiming to practice). This more technical approach equips students with the practical skills of negotiating an international sales contract and drafting the

supporting documents. To this end, the book provides students with a plentiful amount of practical examples of decided cases and disputes, checklists, and practice notes. The book is interested in how the law impacts business decisions and strategy. In that way, it possesses a major legal focus, yet also adds a managerial and contract-based focus. The subtitle, *A Transactional Approach*, is captured by some 178 “Figures” or capsules that provide additional commentaries, legal forms, checklists, practical examples, and legal analyses. These Figures come in three types: *Comparative Law*, *Doing Business Internationally*, and *Focus on Transactions*.

### **The Global Marketplace**

The international marketplace offers great opportunity for domestic enterprises seeking to expand. It is also a place where the risks of loss are somewhat unique in character. Accordingly, the American businessperson must become an astute manager of international business risk in order to minimize the chances of financial loss. This book will illuminate the risks of doing business internationally and at the same time provide tools for their minimization. The legal issues relevant to international business transactions can be seen as a due diligence checklist. The sophisticated international entrepreneur directly addresses the legal issues discussed in this book before transacting international business. The tremendous expansion of international business is a testament to the fact that the legal issues in international business transactions are easily discernible. Furthermore, the real world often provides solutions to the risks associated with those issues. The trend is likely to continue with an increasingly greater percentage of American gross national product related to international business dealings. This trend began at the end of World War II with the establishment of the World Bank, International Monetary Fund, United Nations, and the evolution of the General Agreement on Tariffs and Trade (GATT). The trend continued to accelerate with the adoption of the North American Free Trade Agreement (NAFTA), the deepening of the European Union (EU), and the establishment of the World Trade Organization (WTO). It continued to accelerate with the opening of new markets occasioned by the fall of Communism, the transition of China from a Communist planned economy to a market economy beginning in the 1980s and culminating with its 2001 accession to membership in the WTO, as well as the explosion of international e-commerce. As such, small to large-sized companies will have to develop an “international business strategy” in order to stay competitive. This book provides an introduction to the legal issues relating to international business transactions in order to better equip the reader in formulating such a strategy.

### **Law as Risk Management**

The major theme of this book is that businesses can “go international” without incurring a great deal of risk if the businessperson understands the legal mechanisms that have developed to minimize, and in many cases eliminate, such risks. The nature of the free trade era is that small and medium-sized companies, along with large companies, may and should enter the international marketplace. The aim of this book is to clearly explain how business is conducted internationally, with a strong emphasis on the exporting–importing of goods and the licensing of intellectual property, and how the law is used as a facilitator, not an obstacle, to doing business internationally. What distinguishes this textbook from the other textbooks in the field, as noted above, is that it provides a transactional-practical focused approach to the topic of international business law. It provides the necessary legal material but always in the context of real world transactions.

The perspective and presentation of the materials in the book move beyond complying with the “law,” to using the law to create value and competitive advantage. That is, international business law should be applied proactively to encourage international business transactions by being used creatively to keep parties from breaching contracts, resolving disputes amicably, and to preserving the contracting parties’ relationship. This perspective necessitates teaching lawyers and business managers the basics of international business law as a vital part in doing business and minimizing the unique risks of transborder transactions. This is especially true for small and medium-sized businesses.

## Coverage

The book retains its “transactional” focus, but is now more comprehensive in its expanded coverage of more “macro” matters such as international trade law. Six new chapters have been added: Chapter 7 on free trade agreements; Chapter 8 on doing business in the European Union; Chapter 9 on doing business in China; Chapter 10 on comparative legal systems; Chapter 17 on agency and distribution; and Chapter 20 on foreign direct investment. All the other chapters have been updated with expanded coverage, especially in Chapter 6 on national import and export regulation and Chapter 21 on international e-commerce. The idea for added coverage of the EU and China is based upon their status as two of the three largest economies in the world, with the United States being the other one. They are also representative studies of doing business in the developed world (EU) and with emerging economies. China was chosen as the major economy in the BRIC (Brazil, Russia, India, and China) bloc of major emerging economies. Given the size of the Chinese economy it can be said that China has an “emerged” economy. But, despite its size, the Chinese economy still has internal structural problems and will need to mature and become more sophisticated. Chapter 9 will focus on both the benefits and pitfalls of doing business in China. Thus, the earlier editions’ focus on transactions-based coverage (exporting–importing; licensing; sales of services; e-commerce) is now complemented with substantial coverage of the legal environment of international business.

The *new* edition provides additional materials on contracting law with an emphasis on comparative contract and sales law and European private law. The book is divided into seven parts: Part I: Legal Environment of International Business; Part II: Trade Regulation; Part III: Doing Business in the European Union and China; Part IV: Comparative Legal Systems, Contract, and Sales Law; Part V: Exporting, Importing, and Trade Finance; Part VI: Licensing and Intellectual Property Rights; and Part VII: Foreign Direct Investment and E-Commerce.

## Other Revisions to the Third Edition

The Third Edition is filled with too many instances of updating and new materials to list here. However, below is a list of the expanded coverage and new subjects that represent some of the more important changes:

### *Part I: Legal Environment of International Business*

- Chapter 1: Consignment sales
- Chapter 1: List of the myths of the risks of doing business internationally
- Chapter 1: Government export assistance programs
- Chapter 2: Foreign Corrupt Practices Act and the Siemens Case
- Chapter 2: At the end of the chapter a lengthy case study (“Choosing Values: Public–Private Relationships in a Global Economy”) is presented involving an American company that has a manufacturing plant in a less developed country. The case study deals with numerous issues of law and ethics, and serves a number of purposes. Areas covered in the case study include: application of ethical schools of thought; environmental ethics; short-termism; sustainability; corruption; third-party relationships; issues related to joint venturing; strategic decision-making; stakeholder analysis; and corporate social responsibility.
- Chapter 4: *New lex mercatoria*
- Chapter 4: Principle of fair and equitable decision-making in arbitration
- Chapter 4: Commercial arbitration in East Asia
- Chapter 4: Negotiating an arbitration clause
- Chapter 4: Choosing an arbitrator
- Chapter 4: Ad hoc versus institutional arbitration
- Chapter 4: UNCITRAL Model Rules of Arbitration
- Chapter 4: Choice of law in international arbitration

- Chapter 4: Challenging arbitration awards
- Chapter 4: NAFTA arbitration

*Part II: Trade Regulation*

- Chapter 5: Expanded coverage of WTO
- Chapter 6: Harmonized tariff schedule (HTS)
- Chapter 6: Export licensing, export-processing zones, bonded warehouses
- Chapter 6: Sanitary and phytosanitary standards
- Chapter 6: Importation of genetically manufactured foods
- Chapter 6: Import licensing and Customs and Border Protection's automated system
- Chapter 6: "Special" Section 301
- Chapter 6: Marking requirements
- Chapter 6: Forced or indentured product information
- *New Chapter 7: Free trade agreements*
  - NAFTA
  - Korea–United States FTA (KORUS)
  - Central America–Dominican Republic FTA (CAFTA-DR)
  - Transatlantic Trade and Investment Partnership (T-TIP)
  - Trans-Pacific Partnership (TPP)
  - Free trade zones

*Part III: Doing Business in the European Union and China*

- *New Chapter 8: European Union*
  - History of EU and EU institutions
  - General principles of EU law
  - "Four Freedoms"
  - Sources of EU Law
  - EU law-making
  - Treaty of Lisbon
  - Eurozone
  - EU Charter of Fundamental Rights
  - Importing goods into EU
  - EU competition (antitrust) law
- *New Chapter 9: Emerging Economies: China*
  - BRIC countries
  - Language and culture
  - Pillars of the Chinese economic system
  - Role of the Chinese Communist Party
  - Negotiating in China
  - Chinese legal system
  - Modern Chinese law
  - Joint venturing in China
  - Franchise law in China
  - Problem of corruption
  - Protecting IPR
  - Doing business in Hong Kong

*Part IV: Comparative Legal Systems, Contract, and Sales Law*

- *New Chapter 10: Comparative Legal Systems*
  - Comparative law
  - Civil law tradition
  - Common law tradition
  - Chinese legal tradition
  - Islamic legal system
  - Hindu legal tradition
  - Canadian legal system
  - Mixed jurisdictions (Scotland and South Africa)
  - Transnational law
- Chapter 11: Common European Sales Law (CESL)
- Chapter 11: Consumer contract law
- Chapter 12: CISG in American courts

*Part V: Exporting, Importing, and Trade Finance*

- Chapter 13: Carriage conventions
- Chapter 13: Hamburg Rules
- Chapter 14: Methods of payment
- Chapter 14: Import certifications
- Chapter 14: Labelling requirements
- Chapter 14: *INCOTERMS 2010*
- Chapter 14: Bearer instruments
- Chapter 14: Electronic bills of lading
- Chapter 15: UCP 600
- Chapter 15: Society for Worldwide Interbank Financial Telecommunication (SWIFT)
- Chapter 15: International Standard Banking Practice (ISBP)
- Chapter 15: Real-time digital payments
- Chapter 15: Bitcoins and virtual currencies
- Chapter 15: Export–Import Bank (Eximbank)
- Chapter 16: Growth in sales and services
- Chapter 16: General Agreement on Trade in Services (GATS)
- *New Chapter 17: Hiring Agents and Distributors*
  - Commercial agents and agency law
  - Indonesia case study
  - Termination of the agency relationship
  - Just-in-Time and “Just-in-Case” supply chain
  - Distribution agreements
  - Importance of post-contract obligations

*Part VI: Licensing and Intellectual Property Rights*

- Chapter 18: World Intellectual Property Organization (WIPO)
- Chapter 18: Protecting IPR
- Chapter 18: Developing an international IPR strategy
- Chapter 19: Brand Protection Units
- Chapter 19: License writing problem

*Part VII: Foreign Direct Investment and E-Commerce*

- *New Chapter 20: Foreign Direct Investment*
  - Methods of investing
  - Greenfield investing
  - Bilateral Investment Treaties (BITs)
  - Strategic joint venturing
  - Trends in FDI
  - International Centre for Settlement of Investment Disputes
  - Competition law
- Chapter 21: Legal issues relating to the Internet
- Chapter 21: EU Directive on Data Privacy
- Chapter 21: Types of e-commerce
- Chapter 21: Methods of payment
- Chapter 21: Internet sales and small businesses
- Chapter 21: Minimizing Internet fraud
- Chapter 21: Korea–U.S. FTA and e-commerce
- Chapter 21: UNCITRAL Model Law on Electronic Commerce
- Chapter 21: UN Convention on the Use of Electronic Communications in International Contracts
- Chapter 21: Bolero Project

### **Special Features**

#### ***Managerial Perspective***

Throughout the book capsules and materials will be provided to illustrate the law of international business transactions *as practiced*. A variety of methods will be utilized to provide the student with a real world perspective. These methods include case studies, checklists, forms, tables, and summaries.

#### ***Text Boxes***

Learning the terminology of international business is an important part of any international business law course. Text boxes provide definitions of key legal and nonlegal terminology, as well as additional information on the material covered in the text.

#### ***Case Highlights***

At the end of each case, instead of asking a set of generic questions, a summation of “case highlights” are provided. These capsules list principles of law, concepts, and business practices presented in the case. Some of the highlights summarize the reasons why the case was inserted into the textbook. Other highlights alert the student to the fact that most legal disputes involve multiple issues. Many of these “external” highlights are examined elsewhere in the textbook. The intent of the “highlights capsules” is to make sure the reader clearly understands the key issues presented by the case. The instructor may also use these as a starting point for a more in-depth discussion of the multiple issues of the case.

#### ***Chapter Summaries and Key Terms***

A list of key terms and concepts covered in the chapter is provided, and new to this edition, chapter summaries are located at the end of each chapter.



### ***Ethics Coverage***

As well as expanded coverage of ethics in Chapter 2, ethical issues are raised throughout the book, some explicitly and others implicitly can be mined by instructors wanting to discuss ethical issues that arise in various contexts. These contexts include the ethics of negotiations, disclosure of information, dealing with foreign governments, corruption, and the divergence between home country and host country laws. The student will be encouraged to form a mind-set in which ethical behavior will become an inherent part of their approach to international business.

### ***International and Foreign Sources***

The text reflects an earnest attempt to expose the student to a sampling of foreign and international laws. National laws from approximately two-dozen countries are referenced and used for purposes of illustration. There are numerous references throughout the text to a number of primary sources, such as American law, Chinese law, Russian law, EU law, and the law of individual European countries. The reader may refer to the endnotes for the proper citations. The use of national law serves to illuminate the typical issues found in international business transactions.

### ***Style and Structure***

A premium has been placed upon readability by the use of clear narrative, carefully edited case summaries and articles, and concise use of tangential materials. Also, in the spirit of the practical-managerial focus of the book, more in-depth insight is offered in certain areas so that the student is exposed not only to *why* a given rule of law has evolved, but also *how* it is applied in practice. The chapter coverage allows for the use of the chapters as individual modules or as blocks of chapter. The first seven chapters can be viewed as foundational in that they provide the legal environment of international business, including: international business risks, international business ethics, strategies for doing business internationally, international dispute resolution, national and international trade regulation, and international contract law. Chapters 8 and 9 are essentially case studies relating to the EU and China. They are stand-alone chapters that can be assigned anywhere in the course syllabus. Chapters 10 through 12 review different legal systems, national contract laws, and international sales embodied in the UN Convention on Contracts for the International Sale of Goods (CISG). Chapters 13 through 17 focus upon the legalities of transporting goods, exporting–importing, international trade finance relating to the sale of goods, and the hiring and sale of services. Chapters 18 and 19 pertain to the important area of the protection of intellectual property rights, as well as technology transfer and the international licensing of intellectual property rights. Finally, Chapters 20 and 21 provides coverage of foreign direct investment and the ever-evolving area of international e-commerce.

### ***End of Chapter Problems***

Each chapter concludes with problems appropriate for classroom discussion.

### ***Internet Exercises and Other Internet Sources***

A number of Internet exercises are provided throughout the book. These provide important web sites that students can use for reference or to answer a question or project posed. These projects can be used in individual or group assignments. In addition, at the end of each chapter are important Internet addresses that can be used for extended study and research projects.

## ACKNOWLEDGMENTS

I would like to thank my lovely and legally educated wife Colleen for her editorial assistance, as well as the editorial staff at Routledge, especially my editor Sharon Golan.

# ACRONYMS

Agreement on Technical Barriers to Trade (TBT)  
Agreement on the Application of Sanitary and Phytosanitary Measures (SPS)  
Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)  
Agreement on Trade-Related Investment Measures (TRIMs)  
Alien Tort Claims Act (ATCA)  
American Arbitration Association (AAA)  
American Institute of Marine Underwriters (AIMU)  
American Law Institute (ALI)  
Anti-Cybersquatting Consumer Protection Act (ACPA)  
Asia-Pacific Economic Cooperation (APEC)  
Automated Export System (AES)  
Bilateral Investment Treaties (BITs)  
Brazil, Russia, India, and China (BRIC)  
British Pounds Sterling (GBP)  
Business Software Alliance (BSA)  
Business-to-Business (B2B)  
Business-to-Consumer (B2C)  
Carriage of Goods by Sea Act (COGSA)  
Central America–Dominican Republic FTA (CAFTA-DR)  
China International Economic and Trade Arbitration Commission (CIETAC)  
Chinese Contract Law (CCL)  
Comité Maritime International (CMI)  
Common European Sales Law (CESL)  
Convention on Contracts for the International Sale of Goods (CISG)  
Customary Freight Unit (CFU)  
Department of Commerce (DOC)  
Directorates Generals (DG) (EU)  
Dispute Resolution Understanding (DSU)  
Dispute Settlement Body (DSB)  
Economic Espionage Act of 1996 (EEA) (US)  
Electronic Data Interchange (EDI)  
European Central Bank (ECB)  
European Court of Human Rights (ECHR)  
European Court of Justice (ECJ)  
European Patent Convention (EPC)  
European Union (EU)  
Export Administration Regulations (EAR)

## ACRONYMS

Export Control Classification Number (ECCN)  
Export-Import Bank (Eximbank)  
Export Management Company (EMC)  
Export Trading Company (ETC)  
Federal Trade Commission (FTC) (US)  
Federal Trademark Dilution Act (FTDA)  
Foreign Corporation Insurance Agency (FCIA)  
Foreign Corrupt Practices Act (FCPA)  
Foreign Direct Investment (FDI)  
Foreign or Free Trade Zones (FTZ)  
Foreign Sovereign Immunities Act (FSIA)  
Free Trade Agreement (FTA)  
General Agreement on Tariffs and Trade (GATT)  
General Agreement on Trade in Services (GATS)  
General Usage for International Digitally Ensured Commerce (GUIDEC)  
Generalized System of (Tariff) Preferences (GSP)  
Genetically Modified Organisms (GMOs)  
German Civil Code or Bürgerliches Gesetzbuch (BGB)  
Gross Domestic Product (GDP)  
Harmonized Tariff Schedule (HTS)  
Institute of London Underwriters (ILU)  
Intellectual Property Rights (IPR)  
International Accounting Standards (IAS)  
International Bar Association (IBA)  
International Centre for Settlement of Investment Disputes (ICSID)  
International Chamber of Commerce (ICC)  
International Institute for the Unification of Private Law (UNIDROIT)  
International Labour Organization (ILO)  
International Monetary Fund (IMF)  
International Organization for Standardization (ISO)  
International Organization of Securities Commissions (IOSCO)  
International Patent Searching Authorities (ISA)  
International Standard Banking Practice (ISBP)  
International Standby Practices (ISP 98)  
International Trade Commission (ITC)  
Just-in-Time Contracting (JIT)  
Korea–U.S. Free Trade Agreement (KORUS FTA)  
Less-Developed Countries (LDCs)  
Measure Equivalent to a Quantitative Restriction (MEQR)  
Members of the European Parliament (MEPs)  
Ministry of Foreign Trade and Economic Cooperation (MOFTEC) (China)  
Multilateral Investment Guarantee Agency (MIGA)  
Multimodal Transport Operators (MTOs)  
Mutual Recognition Agreement (MRA)  
Nongovernmental Organizations (NGOs)  
Nontariff Barriers (NTBs)  
North American Free Trade Agreement (NAFTA)  
Organisation for Economic Co-operation and Development (OECD)  
Overseas Private Insurance Corporation (OPIC)

## ACRONYMS

Pacific Bridge Initiative (PBI)  
Patent Cooperation Treaty (PCT)  
Principles of European Contract Law (PECL)  
Protection and Indemnity Policy (P & I)  
Qualified Majority Voting (QMV) (EU)  
Rules of Origin (ROO)  
Sanitary and Phytosanitary Standards (SPS)  
Shipper's Export Declaration (SED)  
Small and Medium-Sized Enterprises (SMEs)  
Small Business Administration (SBA)  
Society for Worldwide Interbank Financial Telecommunication (SWIFT)  
Special Administrative Region (SAR) (Hong Kong)  
Special Drawing Rights (SDR)  
Special Import Measures Act (SIMA) (Canada)  
State-Owned Enterprises (SOEs) (China)  
Supreme People's Court (SPC) (China)  
Technical Barriers to Trade (TBT)  
Trade and Investment Cooperation Agreement (TICA)  
Trade and Investment Framework Agreement (TIFA)  
Trans-Atlantic Business Dialogue (TABD)  
Transatlantic Trade and Investment Partnership (T-TIP)  
Trans-Pacific Partnership (TPP)  
Treaty of the European Union (TEU) (Maastricht Treaty)  
Treaty on the Functioning of the European Union (TFEU) (Treaty of Rome)  
UNIDROIT Principles of International Commercial Contracts (PICC)  
Uniform Commercial Code (UCC) (U.S.)  
Uniform Computer Information Transactions Act (UCITA)  
Uniform Customs and Practice for Documentary Credits (UCP 600)  
Uniform Electronic Transactions Act (UETA)  
United Nations Commission on International Trade Law (UNCITRAL)  
United Nations Conference on Trade and Development (UNCTAD)  
United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention)  
United Nations Educational, Scientific, and Cultural Organization (UNESCO)  
United States International Trade Commission (ITC)  
United States Trade and Development Agency (USTDA)  
United States Trade Representative (USTR)  
U.S. Customs and Border Protection (CBP)  
U.S. Trade Representative (USTR)  
Value-Added Tax (VAT)  
World Customs Organization (WCO)  
World Intellectual Property Organization (WIPO)  
World Trade Organization (WTO)

Part I

LEGAL ENVIRONMENT OF  
INTERNATIONAL BUSINESS



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## INTRODUCTION TO INTERNATIONAL BUSINESS TRANSACTIONS

The purpose of this chapter is to briefly review some of the major topics and issues involved in international business transactions. The remaining chapters of the book will expand on the topics outlined in this chapter. The first part of Chapter 1 will highlight the tremendous growth in international business transactions and some of the causes behind this expansion. One factor that has aided the expansion of international trade is the development of a supranational trade law. Chapter 1 will therefore introduce the reader to the concept of customary international law.

We will examine the ways international business is transacted. The concepts of direct and indirect exporting, licensing, and foreign direct investment will be introduced. This discussion will provide a basic understanding of the perceived advantages and disadvantages of each method of transacting international business. These methods will be explored further in Chapter 3, along with hybrid ways of transacting business, such as **franchising** and joint venturing.

The second half of Chapter 1 will focus on the risks involved in international business transactions. The great opportunities presented by international trade do not come without risk. Some risks are the same as those in purely domestic transactions; others are more unique to the international business environment. First, we will analyze how companies evaluate such risks. Second, we will review the generic risks associated with international business transactions. These include risks associated with cultural and language differences, currency risks, legal risks, and political risks. Finally, we will briefly explore the tools that have been developed to minimize and manage such risks. We conclude by discussing strategies for managing international business risks, including the development of an export plan, use of intermediaries, and a form of international business known as **countertrade**.

Ultimately, the goal of teaching international business law is to sensitize future entrepreneurs and lawyers to the risks of international business and the ways to manage such risks: A savvy entrepreneur is adept at analyzing risk and knowledgeable about the techniques to minimize risk. While Chapter 1 will introduce the reader to the risks of international business transactions, the rest of the textbook will explore more fully how such risks are minimized in the areas of exporting, foreign direct investment, and intellectual property transfer.

### **Global and Regional Marketplace**

The United States (U.S.) is the world's second largest exporter, with \$2.06 trillion in goods and services exports in 2011, according to the World Trade Organization's *World Trade Report 2012*. In 2011, the U.S. was the top exporter of services and second largest exporter of goods, behind China. For American companies, large or small, the potential for increased sales through international trade is high given that 95 percent of the world's consumers live outside of the U.S. So if a company is selling only domestically, it is reaching just a small share of potential customers. Exporting enables Small and medium-sized enterprises (SMEs) to diversify their portfolios and insulates them against periods of slower growth in the domestic economy. In a similar way, companies wanting to remain competitive need to extend their supply chains into foreign channels and by outsourcing some of their functions.

A number of factors have decreased the obstacles to international trade. The most important factor has been the success of the **World Trade Organization (WTO)**, and its predecessor the **General Agreement on Tariffs and**



**Trade (GATT)**, in lowering tariffs and **nontariff barriers** to trade; the almost complete removal of the threat of **expropriation** as countries have moved to privatize their industries due to inefficiency; and the proliferation of **free trade agreements (FTAs)** that have further opened foreign markets. Other factors resulting in the growth of international trade include the disintegration of the Soviet Union and Warsaw Pact, the advent of “emerging economies,” dramatic advances in telecommunications and information technology, and the development of vibrant international capital markets in Europe and North America. The result of these watershed events has been the creation of global supply chains, as well as an economically and financially interdependent world.

Traditionally, international trade (**exporting–importing**) consisted of selling and transporting finished products from one country to another. However, in modern times these transborder movements include the transformation of raw materials and the assembly of component parts as the products moved across national borders. This fragmentation of the manufacturing process is known as the **global supply chain**, which includes numerous intermediary steps in the production of goods in different countries. For example, “in the manufacture of consumer electronics, intermediate inputs now account for close to three-quarters of imports from large emerging economies like Brazil and China.”<sup>1</sup> This has resulted in the specialization of labor where different countries specialize on the parts of the supply chain where they are most competitive. This is efficient and leads to economic growth, but also makes the countries economically vulnerable when there is a downturn in the demand for the end products.

The result has been significant increases in cross-border trade in manufacturing goods and services, international joint ventures, mergers, acquisitions, strategic alliances and affiliations, infrastructure projects, **privatization**, and international direct investment. The liberalization of trade and investment rules has created a “world of opportunities” for the international entrepreneur.<sup>2</sup> The mobility of goods and services has allowed domestic companies to search the world for new markets to sell their products or to procure component parts used in the manufacture of their products. The producer of goods and services, or the innovator of technology, can maximize profits with a global business strategy. This strategy encompasses not only developing foreign markets for a company’s products but also outsourcing materials, labor, and component parts. Even a company that takes a more isolated domestic sales strategy is likely to be affected by international developments.

One measure of globalization has been the tremendous growth in the international **trade in goods**. Table 1.1 and Table 1.2 show the values of the amount of goods imported and exported into the U.S. The leading countries that import into the U.S. are China, Canada, and Mexico. Despite the economic recession, the overall growth of imported goods from China grew 27 percent from 2010 to 2014. China exports represent 20 percent of all goods imported into the U.S. The Chinese legal and business environment will be reviewed in Chapter 9’s “Emerging Economies: China.” It is also interesting to note that the two **North American Free Trade Agreement (NAFTA)** countries of Canada and Mexico combined are the U.S.’s largest trading partners, totaling 27 percent of all U.S. outstanding imports in 2014. Table 1.2 shows by far that Canada and Mexico are the largest purchasers of American goods, purchasing 34.4 percent of all U.S. exports in 2014. This is partially due to the power of NAFTA, which removed trade barriers between the three NAFTA countries. NAFTA will be covered in Chapter 7’s coverage of FTAs.

*Table 1.1* United States Imports of Goods (Billion USD)

<i>Exporter</i>	<i>2010</i>	<i>2011</i>	<i>2012</i>	<i>2013</i>	<i>2014</i>
Rest of World	1,966	2,262	2,333	2,328	2,408
China	382	417	444	460	486
Canada	279	319	327	336	352
Mexico	232	265	280	283	297
Japan	123	132	150	142	137
Germany	84	100	110	117	125
UK	50	52	56	54	55
South Korea	50	58	61	65	72

## INTERNATIONAL BUSINESS TRANSACTIONS

*Table 1.2* United States Exports of Goods (Billion USD and Annual Percent)

<i>Importer</i>	<i>2010</i>	<i>2011</i>	<i>2012</i>	<i>2013</i>	<i>2014</i>
Rest of World	1,277	1,480 (16.5%)	1,545 (4.4%)	1,578 (2%)	1,622 (2.8%)
Canada	248	281 (13%)	292 (4%)	300 (2%)	312 (3%)
Mexico	163	197 (21%)	216 (11%)	226 (5%)	240 (6%)
China	92	104 (13%)	110 (6%)	122 (10%)	124 (2%)
Japan	60	66 (9%)	70 (6%)	65 (-7%)	67 (3%)
UK	48	56 (16%)	55 (-2%)	47 (-14%)	54 (14%)
Germany	48	49 (2%)	48 (-2%)	47 (-2%)	54 (15%)
South Korea	39	43 (10%)	42 (-2%)	44 (5%)	72 (39%)

*Table 1.3* Exports of Services (Billion USD)

<i>Exporter</i>	<i>2010</i>	<i>2011</i>	<i>2012</i>	<i>2013</i>	<i>2014</i>
USA	557	619	651	683	709
UK	267	296	292	297	334
Germany	247	274	270	291	272
France	196	235	216	237	264
China	162	176	191	205	223
Japan	141	145	145	148	162
Netherlands	118	138	133	149	157
India	117	139	146	151	155

These events depressed economic growth and increased investment risk, leading to a dramatic increase in capital outflows from Russia. Table 1.2 also shows the fluctuations from year to year due to macroeconomic forces. Japan has been fighting an economic recession for a long period of time, beginning in the 1990s, as shown by a modest 2.9 percent increase per year in the purchase of U.S. goods, including a negative 7 percent rate from 2012 to 2013.

Table 1.3 shows that the U.S. is the world's largest exporter of services, more than double that of the United Kingdom, which rates number two overall. U.S. exports of services have increased 27.3 percent from 2010 to 2014 despite economic times characterized by recession or slow growth in Europe and Japan. It is interesting to note that India has become the eighth largest exporter of services. Given the growth pattern over the five-year period from 2010 to 2014, India should soon overtake Japan in the export of services. During that span, India exports experienced 32.5 percent in growth compared to 15 percent for Japan. Chapter 16 will cover the area of sale of services.

Another measure of globalization is **foreign direct investment (FDI)**. FDI represents the capital investments made by companies in other countries. This includes the purchase of real estate, manufacturing plants, service and distribution centers, or foreign businesses. Between 1981 and 1985 total world FDI averaged \$98 billion per year. In 1997, FDI had reached \$440 billion. In 2014, net FDI inflows (investment capital brought into a country minus investment outflows) were \$348 billion for China and \$295 billion for the U.S. alone. See also Table 20.1 in Chapter 20 (FDI inflows, 2010–2013). The dramatic increase in world FDI has, much like trade, occurred mostly in the three major regional trade areas of Europe, the Americas, and East Asia. Clearly, political and economic stability are key factors in attracting FDI. An example of this is the case of the Russian Federation, which saw FDI inflows drop by 50 percent in 2014 when compared to the year before. This was due to the uncertainty caused by the Russian invasion of Crimea, followed by Western financial sanctions against Russia, the decline of oil prices (Russia's top export), and the subsequent collapse of the Russian currency (ruble). By the end of 2014, Russia was

suffering net investment outflows with net FDI in Russia recorded at –\$608 million in the third quarter 2014 and –\$3.4 billion in the fourth quarter 2014. This demonstrates that national economies are highly interconnected and that national decisions can have dramatic consequences on FDI and a country’s economic stability.

Globalization is likely to expand both at the regional level and at the global level. The causes of this expected growth include the advance of global telecommunications and the increased transferability of services and intellectual property. The service and knowledge industries, such as entertainment, education, and health care, have benefited from the expansion of the GATT into the nonsale of goods area.

The growth in international trade is not always smooth as countries continue to bring actions against each other for violations of the **WTO Agreements**. Also, when there is a decline in demand, such as caused by the world recession beginning in 2008, some countries responded by enacting additional trade restrictions. While tariff rates remain at historical lows, an International Chamber of Commerce Report shows that the number of trade restrictions, known as nontariff measures (NTMs), have increased since the 2008 financial crisis and most of them have come from the developed economies (G-20). Many of these restrictions are anti-dumping measures to prevent the importation of goods being sold below their cost of production or the sale of lower-priced goods due to illegal government subsidies.

**G-20 Countries** include Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russian Federation, Saudi Arabia, South Africa, South Korea, Turkey, United Kingdom, United States, and the European Union as a whole.

In response, the WTO hosted the **Ninth Ministerial Conference** in Bali in 2013 (the first such Conference since the establishment of the WTO in 1995). The success of the Bali Conference was especially important due to the failure of the Doha Round of negotiations in 2001, which was unsuccessful due to a major conflict between the developed and less-developed countries (LDCs). The Bali Conference focused on improving market access for LDCs, facilitation of trade, and new rules for the exporting of agricultural goods. The end result was a **Trade Facilitation Agreement (TFA)** that aims to reduce, mostly bureaucratic barriers, to the flow of products through global supply chains. The TFA aims at streamlining customs and border procedures and infrastructure communications. Many of these changes will have to be done by the LDCs since it is much more difficult to import goods into these countries than into developed countries. However, the ultimate goal is greater access to foreign markets for LDCs’ exports referred to as “duty free and quota free access.” Major questions remain as to what countries will ratify the TFA and where the funding will come from to make the border improvements.

### **Law of International Business Transactions**

International law generally refers to the historically developed transnational rules and norms that national courts use to regulate three primary relationships: (1) the relationship between two nations, (2) the relationship between a nation and an individual, and (3) the relationship between persons or entities from different countries. This book is primarily concerned with the person-to-person relationship between two parties transacting business across national borders. The first two types of relationships will be reviewed, at times, because of their effect upon private business relationships. Thus, the regulations promulgated by the WTO will be studied in Chapter 5 because of their direct impact on the export and import of goods, services, and intellectual property rights.

There are numerous sources of international business law. **Article 38 of the Statute of the International Court of Justice**<sup>3</sup> lists the sources of international law. In order of superiority they are: (1) international conventions and treaties, (2) international custom or general practice, (3) general principles of law recognized by civilized nations, and (4) judicial decisions and scholarly writings. These are the same sources of law often used by private parties in international litigation or arbitration proceedings.

The term *convention* is used in connection with multilateral agreements, as opposed to bilateral arrangements. The Vienna Convention on the Law of Treaties defines a treaty as “an international agreement between States and governed by international law.” Under U.S. law a treaty becomes federal law and is binding on federal, state, and local governments.

The primary source of law in international business transactions is the private contract entered into by the business parties. The contract will be the primary source of law in case of a dispute. At times, however, the contract may fail to provide a solution either because it does not deal with the issue in dispute or because the parties interpret the contract differently. It is said that “no written contract is ever complete; even the most carefully drafted document rests on volumes of assumptions that cannot be explicitly expressed.”<sup>4</sup> This quote illustrates that a substantial core of any international business transaction is nonlegal in nature. Businesspersons prefer the language of business and are often unconcerned with the legal language of the formal contract document.

Despite this informal attitude, the language of business has been “codified” into legally recognizable custom and trade usage. This transformation is a tradition that dates back to the medieval *lex mercatoria*.<sup>5</sup> The *lex mercatoria*, or law of merchants, provides the mechanism in which courts and arbitral tribunals recognize day-to-day trade usage and business practices as **customary international law**. The latter half of the twentieth century saw a broad expansion of international practices, codes, and rules emanating from public and private organizations. This transformation has resulted in a radical expansion of international business law.

The original *lex mercatoria* (Latin for “merchant law”) is the body of commercial law used by merchants throughout Europe during the medieval period. It evolved as a system of custom and best practices, which were enforced through a system of merchant courts along the main trade routes. In modern international commercial disputes, arbitrators often apply *lex mercatoria* principles.

The reality of trade liberalization and the rapid expansion of exporting in services and **licensing**, combined with the technological enhancement of business relationships, have increased the number of international conventions and supranational responses to globalization. Businesspersons and lawyers should incorporate these conventions and standards in international business transactions because such “neutral” (nonnational) sources are a good way of overcoming cultural, language, and legal differences in cross-border transactions. In the long term, international legal unification and harmonization will reduce transaction costs relating to international contracting.

Most international business disputes stem from poorly written contracts or the parties’ failure to recognize key substantive issues. Given the universal nature of business transactions and the globalization of the marketplace, contractual failures attributable to inherent linguistic and cultural differences have significantly diminished, but when they do occur, they can lead to a high level of contract damages. Another cause of legal disputes is the existence of fundamental differences in national rules relating to the interpretation of contracts. Thus, a primary way to understand the legal risk of international business transactions is to research cases and arbitral decisions dealing with key issues.

### *Customary International Law*

Businesspersons can avoid misunderstandings by following standard practices, custom, and trade usage to minimize the risks of legal disputes. These secondary sources of international business law can be divided into two general groups. The first includes international conventions or regional initiatives aimed at harmonizing rules relating to cross-border transactions. Examples include the Hague Rules<sup>6</sup> on the liability of international carriers of goods by sea and the WTO’s Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

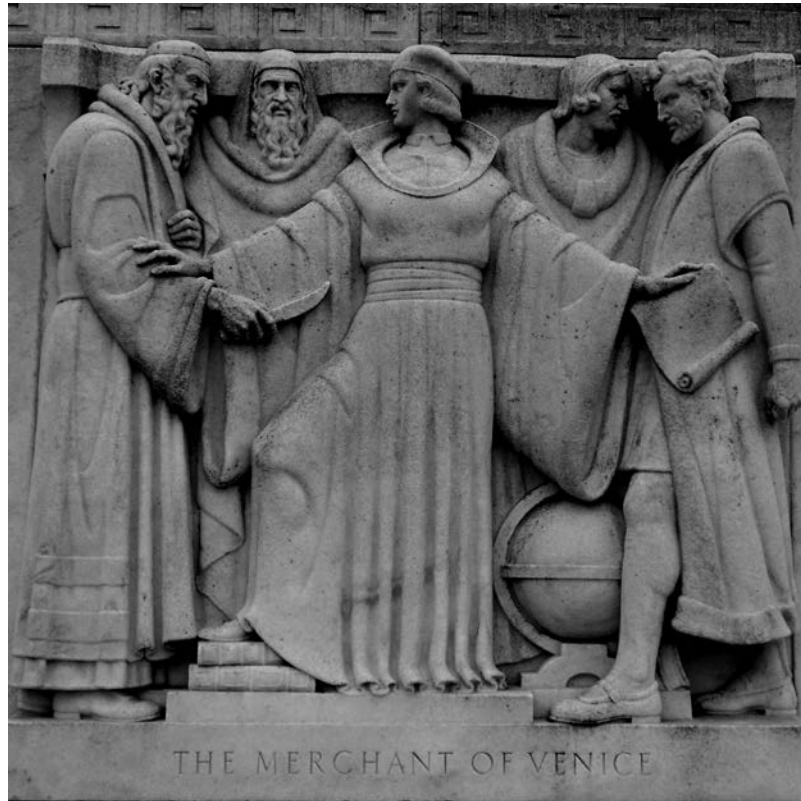


Image 1.1 Merchant of Venice.

Source: Smallbones, WikiCommons.

Regional efforts generally revolve around major free trade areas such as NAFTA and the European Union (EU), and also include broader-based institutions such as the Organisation for Economic Cooperation and Development (OECD).

The other secondary source of international law, the *lex mercatoria* or customary international law, has developed to bridge language, cultural, and legal differences between businesspersons throughout the world. The materials produced by the **International Chamber of Commerce (ICC)** illustrate the evolution of the *lex mercatoria*. The ICC was created in 1919 to promote free trade and private enterprise and to represent business interests at the international level. Members include national councils from more than sixty countries. Headquartered in Paris, France, the ICC is a nongovernmental organization that works to promote world trade, harmonize trade practices, and provide practical services to businesspersons. These services include the International Court of Arbitration in Paris, the Centre for Maritime Cooperation in London, the Counterfeiting Intelligence Bureau in London, and the Institute of International Business Law and Practice in Paris. The ICC's UCP 600 (Uniform Customs and Practices for Documentary Credits)<sup>7</sup> and its INCOTERMS 2010 manual (of trade terms) are examples of international trade customs that have risen to near-universal acceptance in the international banking and business communities.

Businesspersons doing business internationally require a firm understanding of the substantive laws of the countries in which they intend to transact business. All countries have immutable or mandatory rules that vary in type and content. For example, a clearly written, principal-friendly termination clause in an agency agreement will

not survive the **evergreen laws** found in a number of European countries. An evergreen provision is a statutory preemption of the termination and commission clauses of a private agency contract. Therefore, disclaimer of liability clauses enforceable in the U.S. would not be enforceable under EU law. Evergreen laws will be discussed in Chapter 17's coverage of agency and distribution contracts.

### *The Written Contract*

A clear and properly written contract remains the international entrepreneur's best protection in minimizing the risks of doing international business. However, the **United Nations Convention on Contracts for the International Sale of Goods (CISG)**<sup>8</sup> states that written agreements are not required and a contract may be proved by "any means including witness testimony." In practice, many business transactions are characterized by a high degree of informality. As an English court noted: "One has to bear in mind that commercial men and women do not look at things from the lawyer's point of view."<sup>9</sup> Despite the informal nature of business contracting and the common use of standard forms, it is likely that sophisticated businesspersons base their agreements on at least a semiformal writing. This seems especially prudent given the obstacles of foreign languages and cultures, including differences in negotiating styles. These factors, and the potential difficulty and expense of obtaining a legal remedy in a foreign country, justify the additional time spent researching legal issues and writing a contract. Negotiating a written contract will often highlight the latent differences of language and law while there is time to reconcile differences before the execution of the contract. Differences in foreign legal systems and national contract laws will be examined in Chapters 10 and 11. The CISG, as the major international sales contracts law, will be reviewed in Chapter 12.

Behind every business transaction is the fear of nonperformance requiring one of the parties to seek a legal remedy. Understanding international contract dispute resolution is important in order to negotiate and draft an effective contract. Just as prenuptial agreements are written in anticipation of a possible divorce, contracts should be written in anticipation of possible contract disputes. What can international businesspersons write into their contracts to make dispute resolution less likely to be needed? What can they write into the contract that would make dispute resolution less painful or costly in the event it is necessary? What can be included in the contract to increase the chances for success in a dispute resolution? These questions will be addressed in Chapter 4 on "International Commercial Dispute Resolution."

### **Scope of International Business Transactions**

All business transactions involve considerable risk. The essence of being a businessperson or entrepreneur is a willingness to confront loss in the search for profits. Profit seeking or risk taking underscores the capitalistic, free-market system. The most consistently successful entrepreneurs are those who take steps to avoid or minimize risk. Risk-aversion techniques and strategies have been developed to provide stability and security to international business transactions. Risk minimization is essential for both domestic transactions and those that cross national boundaries, but there are profound differences in approach between international and domestic business transactions.

The "**basket of risks**" associated with an international transaction is different in many ways from that of a purely domestic transaction. Businesses' efforts to minimize risk differ, too. Many international risk management devices, although longstanding, are likely to be unfamiliar to the U.S. businessperson on his or her initial foray into exporting, licensing, or foreign direct investment. International dealings are further complicated by the fact that the basket of risks to be confronted is constantly fluctuating, depending on the type of business entity, the type of good or service being sold, the country of the other party, the country of performance, and the means of transportation.

At the broadest level of analysis, the risk characteristics will depend largely on the type of transaction. Transactions are categorized under four general groupings: exporting–importing (sale of goods), **sale of services** (consulting, distribution, transportation, marketing, sales), licensing (technology, intellectual property transfer and licensing), and foreign direct investment (foreign operations). This classification is overly simplified because many