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International Business Law and its Environment

Schaffer · Agusti · Dhooge

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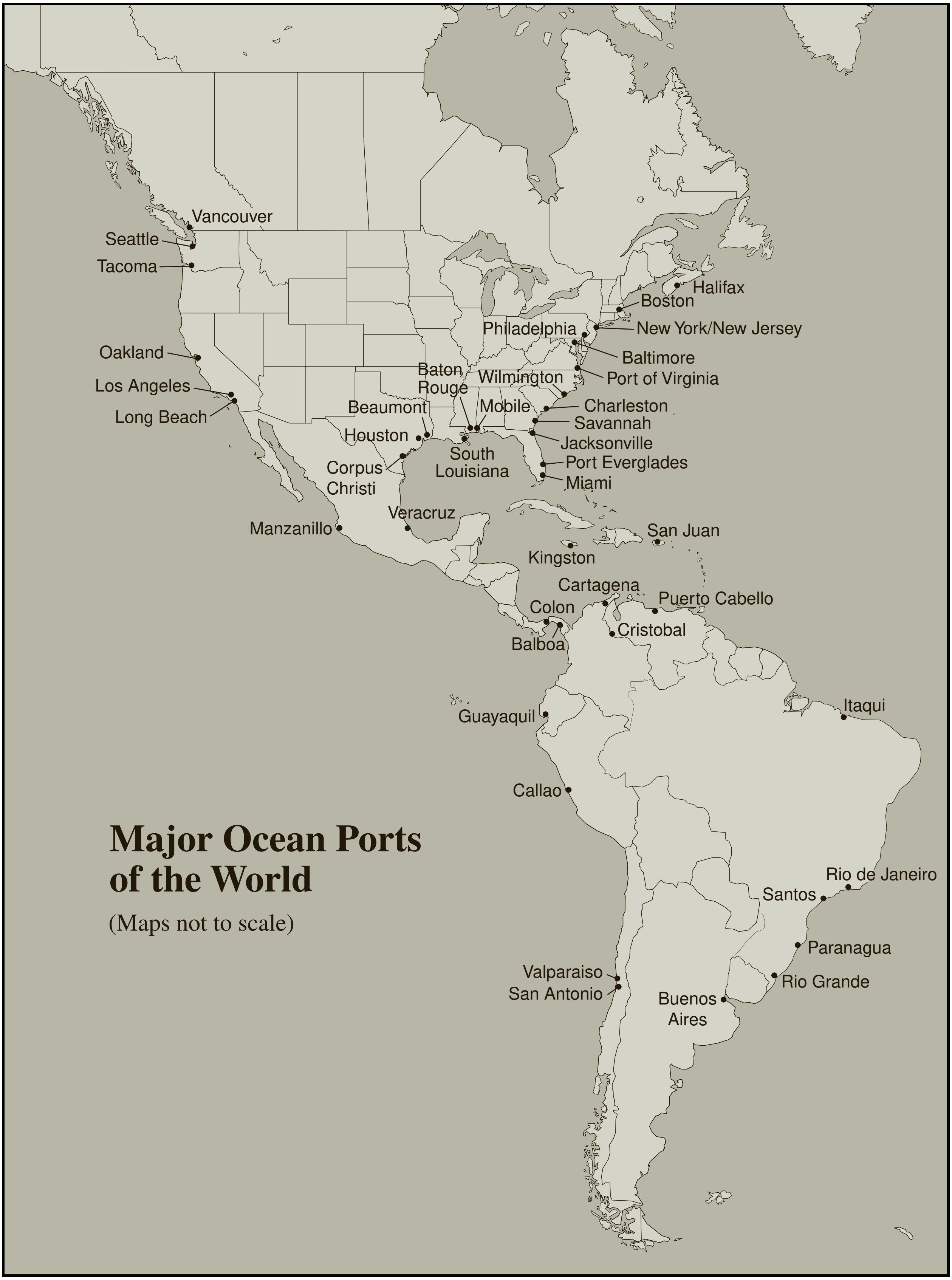

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International Business Law and its Environment

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***International Business Law and its Environment,* Tenth Edition**
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R. S.

To Avery, for her love, patience, and encouragement.

F. A.

To my father, Filiberto, and my mother, Maria Luisa, who sacrificed so much that I might be free to write as I wish; and to my wife, Suki, and our daughters, Caroline, Olivia, and Jordan, for their abundant patience.

L. J. D.

To my wife, Julia, for her encouragement, support, and patience.

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Richard Schaffer is Professor Emeritus of Business Law (retired) in the Department of Finance of the Walker College of Business at Appalachian State University. He has taught business law, international business law and transactions, and the law of international trade and investment since 1977. Professor Schaffer received his J.D. from the University of Mississippi and his LL.M. from New York University. From 1976 through 1982, he assisted United Nations agencies in New York, San Jose, and Vienna, with projects examining the relationship between corrupt practices, multinational corporations, and socioeconomic development, and served as rapporteur of UN working groups on international economic crime. Schaffer was director of international business studies at ASU and founder of its business study abroad programs. He has served as consultant to business schools on the internationalization of curriculum, and to industry trade groups. Professor Schaffer has extensive experience in business, including manufacturing and global sourcing, and has consulted with companies on matters related to the international home textile industry.

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After completing an undergraduate degree in history at the University of Colorado in 1980, Professor Dhooge attended the University of Denver College of Law where he received his Juris Doctor in 1983. He received his LL.M. in 1995 from the Georgetown University Law Center where he specialized in international and comparative law. Prior to coming to Georgia Tech, Professor Dhooge spent eleven years in private law practice and twelve years serving on the faculty of the University of the Pacific in California. Professor Dhooge has authored more than fifty-five scholarly articles, co-authored thirteen books, and has presented research papers and courses throughout the United States as well as in Asia, Europe and South America. Professor Dhooge is the recipient of numerous research awards given by the Academy of Legal Studies in Business, including seven Ralph C. Hoeber Awards for excellence in research. He was designated the outstanding junior business law faculty member in the United States by the Academy in 2002 and received the Kay Duffy Award for outstanding service in 2005. Professor Dhooge was the program chair for the Academy's 2009 international conference in Denver, Colorado and served as Academy President in 2009-10. Professor Dhooge is a past editor-in-chief of the *American Business Law Journal* and the *Journal of Legal Studies Education*.

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Preface

It has been said that America's interest in international education has peaked and ebbed with the changing tide of the American political climate, rising in times of economic expansion and ebbing during periods of political isolation or economic protectionism. Perhaps, however, the cycle has finally been broken, and industry leaders, government policymakers, and educators alike have come to understand the importance of making a permanent commitment to international business education.

In the last half century, America faced an increasingly competitive global marketplace and a mounting trade deficit. Rather than seek protection behind often-politicized trade laws, America's leaders committed the nation to policies of free trade and open investment. American managers realized that they had no choice but to compete aggressively with international competitors, in markets both at home and abroad. Witness not only the success of America's great multinational corporations but also that of the many small and medium-sized companies that today do business internationally.

Among nations, the post-World War II spirit of free trade became contagious. Examples could be seen everywhere: The rush of nations to join the World Trade Organization, the growth of regional economic integration, privatization of national economies, the opening of once tightly controlled markets in developing countries and in formerly communist countries, and China's rise to prominence. The outcome has been the globalization of firms and of world markets for goods, services, and ideas, and the interdependence of national economies. It is in this climate that we have seen perhaps the greatest renewal of interest in international business education in America's history.

TRADE, INTELLECTUAL PROPERTY, AND FOREIGN DIRECT INVESTMENT:A THEMATIC APPROACH

International Business Law and Its Environment is intended for use in such courses as International Business Law, International Business Transactions, or The Law of International Trade and Investment. Our thematic approach tracks the basic market-entry strategies of many firms as they expand into international markets: trade in goods and services, the protection and licensing of intellectual property rights, and foreign direct investment. Through the study of law, we examine each of these market-entry methods—and their variations and combinations—as they might fit into the overall strategy of a firm. We begin our discussion with trade, which involves the least penetration into the international market, and progress to the protection and licensing of intellectual property, and end with foreign direct investment, which immerses the firm completely in the social, cultural, and legal systems of its host country. Each step in the progression presents new and more complex risks, and following the old adage, we hope the sequence of this book teaches us to walk before we run. This progression patterns the life cycle of many firms, as well as the careers of many of our graduates, as they mature and then move more aggressively into new international markets.

PRIVATE AND PUBLIC INTERNATIONAL LAW

International Business Law and Its Environment emphasizes both private and public law. The private law applicable to international business transactions includes the law of international sales, trade finance and letters of credit, licensing and distribution agreements, agreements with foreign sales representatives, and other governing law.

Public international law includes conventions, treaties, and agreements among nations that provide a legal basis for their relationships with each other, and with individuals, and which make up the legal framework within which international business takes place. Customs and tariff laws are good examples, as are laws that open markets to international investors. The treaties of the European Union, the agreements of the World Trade Organization, and NAFTA are prime sources of public international law. We also treat general principles of the law of nations, the jurisdiction and work of international courts and tribunals, as well as the work of various intergovernmental organizations (such as UN agencies, the WTO, and the OECD), because these are fundamentals needed for study.

INTERNATIONAL AND COMPARATIVE APPROACH

No text can attempt to teach the law of every nation in which a firm might do business, and we have resisted the temptation to merely catalog foreign laws. Instead, we present foreign laws and foreign court decisions throughout the book for comparison purposes, to illustrate differences in legal or economic systems, and to show how business is done in other countries. Where applicable, we introduce and compare civil law, common law, socialist law, Islamic law, and concepts from different legal systems. Examples are contract law, labor and employment law, advertising law, agency law, and competition law. The text focuses on international agreements, uniform codes, and the decisions of international tribunals relevant to international firms. Moreover, the text is appropriate for use anywhere because of its international and comparative perspective, its treatment of developing countries, and its focus on the legal issues facing all firms exporting to the United States.

THE MECHANICS AND THEORY OF INTERNATIONAL BUSINESS TRANSACTIONS

International Business Law and Its Environment not only teaches the "hands on" mechanics of international business transactions but also provides the theory needed for businesspeople to understand the consequences of their actions.

Common commercial transactions are examined and explained to the nonlawyer. This includes negotiating contracts for the sale of goods and services, negotiating contractual terms of trade, handling shipping contracts and cargo insurance, understanding agency contracts, dealing with letters of credit and other banking arrangements, considering alternatives for dispute settlement, and more. The importance of understanding intellectual property licensing agreements, employing persons abroad, and other issues are addressed. Similarly, we take readers through many thorny problems of dealing with government, such as learning how to use the harmonized tariff code when entering goods and "clearing customs," or when licensing exports.

A MANAGERIAL PERSPECTIVE ON RISK

We begin with the premise that the world of international business is a dangerous place and that the management of international business is the management of risk. Whether one is developing and implementing an international business strategy or managing an international business transaction, an understanding of the special risks involved will help ensure a project's success. in keeping with our thematic approach, we examine the risks of trade (for example, managing credit and marine risk); protecting and licensing intellectual property (for example, dealing with gray-market goods and registering foreign patents); handling foreign mergers and acquisitions (for example, coping with unexpected differences in foreign corporate or labor law); and evaluating political risk in less stable regions of the world. We then show how to avoid, reduce, or shift the risk to other parties or intermediaries. The case study approach is excellent for this purpose, as it shows readers the mistakes others have made, and how disputes have been resolved.

We also stress strategic business decision-making. For example, our chapter on imports, customs, and tariff law does not view importing as an isolated transaction. Rather, it addresses the importance of customs and tariff law from the strategic business perspective as well as its impact on the modern global supply chain.

THE CULTURAL, POLITICAL, SOCIAL, AND ECONOMIC ENVIRONMENT AND HUMAN RIGHTS CONCERNS

As with each previous edition, we have made a special effort to discuss the cultural, economic, political, and social aspects of international business as they bear on differences in attitudes toward the law, their impact on trade relations, and how they affect the way we do business in another country.

Any discussion of trade policy is almost inseparable from economic policy, foreign policy, or even domestic politics. Although we have tried to remain focused on the legal issues at hand, policy issues are addressed. We hope this is evident in our coverage of unfair trade laws, trade enforcement remedies, and other areas. Of course, we also address the foreign policy and national security issues affecting export controls and trade sanctions imposed for reasons of foreign policy or national security. We have also devoted considerable attention to current events in many countries and their impact on international business there.

Many topics require a historical perspective, such as the *Smoot-Hawley* era of the 1930s, the development of GATT in the 1940s, export controls and the Cold War, the Iranian Revolution of 1979 or fifty years of U.S.-Cuba relations. We often try to draw on the lessons of history, such as the implications of President Carter's grain embargo of the Soviet Union in response to that nation's invasion of Afghanistan, or President Reagan's embargo of U.S. participation in the construction of the Siberian natural gas pipeline to Western Europe.

Throughout the book, readers are asked to consider the impact of world current events on their strategic business decisions, particularly in unstable regions or under hostile political and economic conditions.

We believe that it is impossible to cover the real world of international business without exploring the larger problems of human rights. Thus, we treat the areas of human rights law and international criminal law as global issues of concern to international business.

DEVELOPING COUNTRIES

The developing countries of Africa, Asia, Latin America, and the Caribbean present special problems for their richer trading partners. We have tried to paint a realistic picture of trade and investment opportunities, colored by the realities of disease, poverty, and environmental degradation that threaten much of our planet.

Trade, IP, and investment issues in developing and emerging market countries are incorporated in all parts of the book. Examples include the *Generalized System of Preferences*, the CARICOM *Single Market and Economy Treaty*, the *Doha Development Agenda*, labor and worker's rights issues, environmental issues in developing and island countries, and U.S. trade initiatives for Latin America, the Caribbean, and Africa. Doing business with China is stressed.

ETHICS AND SOCIAL RESPONSIBILITY

Because ethical questions can arise in varying contexts, we have chosen to integrate the subject throughout the book. However, we give a more focused treatment to ethics, social responsibility, and corporate codes of conduct in Chapter 2, the chapter on international law. All chapters conclude with a hypothetical case problem on ethics, called *Ethical Considerations*. Examples include, among others:

- *Codes of conduct*
- *Bribery and corruption*
- *Child labor*
- *Workers' rights, health and safety*
- *Protection of the environment and of fish and wildlife*
- *Prison, forced and indentured labor*
- *Labor and Environmental Standards in Trade Agreements*

- *Fair trade initiatives*
- *Human rights issues*
- *AIDS and other world health issues*
- *Discrimination issues in foreign countries*
- *Special issues related to U.S. investments*
- *Mexican maquiladora plants*
- *Maritime fraud*

WHY STUDY INTERNATIONAL BUSINESS LAW?

As you begin your study of international business law using this text, realize that no book can tell you what the law "is." We can only introduce you the legal environment of international business, explain some basic principles of international law and international business law, and challenge you to consider the legal implications of any international business strategy or transaction. Thus, we study international business law because we want to understand:

1. How the legal and regulatory environment affects firms operating internationally;
2. The legal issues bearing on international business(IB) decision-making or strategies;
3. That the management of IB is the management of risk;
4. The sources of public and private international law, particularly international business law, as reflected in treaties and other international agreements, harmonized codes, national laws, and the decisions of national and international courts and tribunals;
5. The mechanics and legal implications of common IB transactions, particularly regarding trade in goods, the licensing of intellectual property, and foreign direct investment;
6. The influence of ethics and social responsibility in IB and when doing business in foreign countries, to encourage the development of an individual ethical value system for IB managers, and in particular to develop an appreciation for the rights of workers, consumers, and other stakeholders in civil society when doing business in foreign countries;
7. The importance of advance planning for dispute resolution in IB and the alternatives for dispute resolution;
8. The special legal and regulatory issues facing the multinational firm, and the relationship between the firm and host governments;
9. How to better communicate with attorneys on IB matters;
10. The role of agents, contractors, and intermediaries in IB, particularly those involved in international sales, transportation, banking, insurance, and customs brokerage.

TO OUR INTERNATIONAL READERS

We are pleased to know that our work has contributed to student learning at universities on virtually every continent and in every region of the world. Naturally, our audience is primarily an American one. We necessarily devote a major portion of the text to American law, U.S. trade relations, and the needs of the American firm. However, we have made every effort to maintain our international perspective and to draw important international comparisons. Non-U.S. cases are presented, as are decisions of international courts and tribunals, and discussions of foreign codes and practices. Moreover, the increased reliance on uniform rules, harmonized codes, and international standards makes the book suitable for any student interested in international business law.

KEY REVISIONS TO THE TENTH EDITION

The tenth edition of *International Business Law and its Environment* was prepared during the early period of the Trump Administration. Certainly, our greatest challenge was to discount the rhetoric of the 2016 presidential campaign, to cautiously eye the early trade policy statements of the new administration, and to note the shifting "trade winds" where appropriate. We strongly believe that our job, as always, has been to teach the principles of IBL in a way that helps readers better understand and scrutinize trade policy issues on their own.

As with the previous edition, we have tried to make the tenth edition even more readable and manageable. We continued to condense an ever-expanding body of legal material, clarify and simplify key terms and concepts, and refocus on the essentials of international business law. The writing style is tighter, boxed cases are shorter, coverage has been streamlined, and many details not necessary to an introductory course have been eliminated. Although dated material has been removed throughout, some historical perspectives are richer and more meaningful. Following are some of the major content changes to the tenth edition.

Part 1: The Legal Environment of International Business

- *Chapters 1 and 2 have been updated, including material on political risk in developing countries. Key terms have been clarified. There is a new case problem on customary international law.*
- *Chapter 3 has been updated, with new case on personal jurisdiction and the Internet (Elayysan), a new case on forum non conveniens (Fallhowe),and several new case problems.*

Part 2: International Sales, Credits, and the Commercial Transaction

- *Chapter 4 has a new American case on the CISG (It's Intoxicating, Inc.) and a new British case on force majeure (Tandrin). Includes three new case problems.*
- *Chapter 5 includes a new case on carrier's liability for misdelivery (Ample Bright), and a new case interpreting Incoterms (Cedar Petrochemicals). Four new case problems have been added.*
- *Chapters 6 and 7 have been updated and contain new case problems.*

Part 3: International and U.S. Trade Law

- *Chapter 8 on national lawmaking has been reorganized with major portions completely rewritten. Contains new or revised sections on presidential powers, the history of U.S. trade policy since 1962, the import–export clause, and on the organization of federal departments affecting trade. It includes reflections on major changes in U.S. trade policy.*
- *Chapter 9 on the WTO has been simplified in key areas, with a significant rewrite of the materials on national treatment, quotas, import licensing and nontariff barriers, and the U.S. GSP statute. The WTO "rare earth elements" case is discussed. The chapter challenges readers to consider the successes and failures in the WTO system and major policy announcements of the Trump Administration. It contains new case problems on global e-commerce and digital trade.*
- *Chapter 10 includes a significant rewrite of the materials on transparency, telecommunications and agricultural trade, the licensing of foreign professionals, and on U.S. trade remedies and enforcement. It includes new material on Section 301 and now includes "dormant" Section 338. It challenges readers to evaluate all sides of the trade policy argument.*
- *In Chapter 11 on import competition, the materials on dumping and subsidies has been significantly simplified, with all new sections on extraordinary trade remedies, enforcement, and anti-circumvention efforts. It includes significant updating to materials on the CVD rules, new U.S. trade legislation of 2016, and the changing role of CBP. Six new chapter case problems have been added.*
- *Chapter 12 on imports and customs has been significantly reorganized and rewritten for clarity. It contains a new case on classification (Otter Box), a case discussion on substantial transformation (Energizer Battery), and a discussion of classification issues on imports of the Apple Watch. The approach to rules of origin includes a discussion of their impact on global supply chains. The material on marking and labeling, and foreign trade zones, is new. There are several new chapter case problems that encourage readers to use the Customs Rulings Online Search System.*
- *Chapter 13 on export controls and sanctions has been largely reorganized, shortened, and rewritten for clarity, with a focus on the most important topics. Two cases were eliminated, and one new IEEPA enforcement case (Mousavi) added. Material on U.S. relations with China and Russia, as it affects export controls, has been updated and strengthened, including recent cybersecurity issues. Sanctions policy and law, including the Iranian sanctions, has been explained. New case problems were added and older ones dropped.*
- *Chapter 14 has been updated, addressing the Trump Administrations views on NAFTA. A case on right to entry under NAFTA (Kirk v. New York) and several case problems have been added.*
- *Chapter 15 has been updated to reflect the Brexit changes and the euro financial crisis. A new case has been added on the free movement of services (Blanco and Fabretti) from the European Court of Justice, along with four new case problems.*

Part 4: Regulation of the International Marketplace

- *Chapter 16 has been updated and now discusses implications of 2016 WikiLeaks disclosures of widespread official corruption in emerging countries. It includes revised material and new case (U.S. v. Rodriguez) on FCPA enforcement, including Yates Memo on enforcement priorities.*
- *Chapter 17 has been updated throughout. There is a new discussion of 2016 EU trademark reform, geographical indications, the marking of scents and sounds, the seizure of counterfeits, compulsory licensing, and the debate over the patenting of organisms.*
- *Chapter 18 has been streamlined and shortened as well as updated. Also new are the discussions of the ICSID, a new FSIA case (OBB Personenverkehr AG), and tax materials on the foreign tax credit, taxation of controlled foreign corporations, and 2017 proposals for U.S. legislative change. It also includes discussion of EC VAT relative to Internet sales.*
- *Chapter 19 includes significant updating of employment law materials, including new material and case (Duncan) on the applicability of U.S. law to foreign entities under U.S. control. Also discussed is the Chinese attitude toward migrant worker activism and the latest changes to U.S. trade laws regarding imports of goods made by forced labor.*
- *Chapter 20 is updated and contains two new ICJ cases: The decision on customary international law and transboundary environmental damage (Costa Rica v. Nicaragua), and another on compulsory jurisdiction to enforce treaties on the preservation of animal species (Whaling in the Antarctic, Australia v. Japan). There is other new material on GMOs, an update on the Montreal Protocol and restoration of the ozone layer, the 2016 Paris Agreement on controlling greenhouse gases, and island-nation concerns over rising sea levels.*
- *Chapter 21 has been updated and discusses new EU rules on private damage actions for competition law violations, and two new ECJ cases, one on the extraterritorial applicability of EU competition law (Innolux Corp) and the other on the free movement of services (Blanco and Fabretti).*

PEDAGOGICAL FEATURES OF THE TENTH EDITION

The *Key Terms* section at the end of each chapter gives the most important international business vocabulary and operative terminology expected of the successful student. The *Ethical Considerations* feature provides end-of-chapter case studies containing ethical or social responsibility issues.

The end-of-chapter questions, many of which are based on actual cases (citations provided), encourage students to apply the material they have learned, to consider broader issues, to view opposing policy arguments, to engage in outside research, and to use key online resources available to the international trade community. The *Managerial Implications* section provides case problems suitable for extended discussions.

Primary source materials include landmark and cutting-edge cases from U.S. and foreign courts, and decisions of the WTO, NAFTA, ICSID, International Court of Justice, European Court of Justice, and other international judicial and arbitral tribunals.

In addition, we have incorporated the following:

- *Business and industry examples, sample documents, and forms*
- *A transactions-oriented approach to those areas likely to be encountered by students, including international sales contracts, documentary sales and trade terms, handling letters of credit, procedures for import customs clearance and export licensing are examples*
- *An expanded list of acronyms frequently used in international business*

COMPREHENSIVE LEARNING RESOURCES

Online Resources for Instructors and Students. The *International Business Law and Its Environment* instructor supplements are available exclusively on the textbook companion site, which is accessible through www.cengagebrain.com. You must log in using your Faculty SSO account.

- *The Instructor's Manual has been revised and enhanced by aligning with all of the new book content. The Instructor's Manual provides answers to case questions and problems, end-of- chapter questions, Managerial Implications, and Ethical Considerations. It also offers teaching summaries, supplemental cases and exercises, teaching suggestions, and class activities.*
- *Chapter PowerPoint® slides are also available to instructors for use during lectures.*
- *NEW! The fully revised and updated Test Bank is now available in the Cognero online testing system. Cengage Learning Testing Powered by Cognero provides you with an easy interface that guides you through the creation and management of your tests. Choose from a variety of question types, and use the searchable metadata tags to ensure your tests are complete and compliant.*

MindTap. New to this edition is the MindTap product. Each unit has 10 multiple choice review questions, followed by 6–8 brief hypotheticals, and finishes with 4 legal reasoning questions. Students can review the material and then move into application with the hypotheticals. Finally, the legal reasoning questions walk the students through the reasoning process of solving ethical dilemmas. Written by Charles Miller, University of Texas-Arlington, the questions provide an opportunity for all levels of Bloom's from remembering to analysis. MindTap® Business Law is the digital learning solution that powers students from memorization to mastery. It gives you complete control of your course—to provide engaging content, to challenge every individual, and to build their confidence. Empower students to accelerate their progress with MindTap. MindTap: Powered by You.

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Richard Schaffer
Filiberto Agusti
Lucien J. Dhooge

PART 1

The Legal Environment of International Business

Part 1 of *International Business Law and Its Environment* provides a framework for understanding both international business and the legal environment in which it operates. This part covers several main areas: international business, the nature and sources of international business law, international public law, and the resolution of international business disputes. It also covers the economic, social, political, and historical forces that have influenced the development of the national and international law.

Chapter 1 introduces international business from a legal perspective. It explains the three major forms of international business: trade (importing and exporting); licensing agreements for the transfer and legal protection of patents, copyrights, trademarks, and other intellectual property; and direct investments in foreign firms. The reader is also introduced to the environment of doing business in the developing and newly industrialized countries. This chapter discusses how the risks of international business differ from those of doing business at home; how a firm deals with the added risks of doing business over great distances, including those associated with language and cultural barriers, foreign financial and political risk, the risks of restrictions on trade or investment, and the risks of foreign laws and foreign litigation. By illustrating some of the risks of international business, Chapter 1 sets the stage for the remainder of the book, which teaches that the law is an important tool for managing international business risk.

Chapter 2 defines and explains international business law and the larger area of international law. It explains the sources of international law, including custom, treaties, and international conventions; its basic concepts; and the role of intergovernmental organizations in developing international standards and legal codes, which become binding on the nations that adopt them. Many of these directly affect business operations worldwide. Whether a problem is related to the ethical treatment of labor in developing countries, setting standards for the protection of the world's oceans, or developing uniform rules for international sales contracts, international organizations can be useful in bringing individual nations to agreement on difficult issues. Many of the international codes address ethical issues faced by business people operating globally, such as corruption or child labor, and these, too, are examined. The chapter takes a comparative look at different legal systems, including the common law, civil law, and Islamic law systems, with a special emphasis on China and the Middle East. We examine several legal topics and see how culturally diverse countries in different regions of the world approach these subjects differently.

Chapter 3 discusses how disputes are settled in an international business transaction, including both litigation and arbitration. It addresses issues of jurisdiction and procedural rules for litigating international cases. For instance, the chapter attempts to answer such questions as: If a company does business in a foreign country, can the company be sued there? If a buyer purchases goods from a foreign firm that does not regularly do business in the United States, under what circumstances can the buyer sue that firm in U.S. courts? If a product that is produced in one nation injures a consumer in another nation, where should the injured party's claim be heard? If a firm obtains a court judgment in one country, can the firm enforce it against the defendant's assets held in another country? Finally, because the costs and risks of foreign litigation are substantial, the chapter addresses what the parties can do in advance to provide an alternative to litigation should a dispute result.

CHAPTER 1

Introduction to International Business

INTRODUCTION

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

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

FORMS OF INTERNATIONAL BUSINESS

This text classifies international business into three categories: (1) trade, (2) protection and licensing of intellectual property (IP), and (3) foreign direct investment. To the marketer, these broad categories describe three ways a firm may enter a foreign market, or foreign market entry methods. To the international lawyer, they represent three forms of doing business in a foreign country and the legal relationship between parties to an international business transaction. Each form represents a different level of commitment to a foreign market, a different level of involvement in the life of a foreign country, and a different set of managerial challenges. Each form exposes firms to different sets of business and legal risks. Trade usually represents the least involvement, and thus the least political, economic, and legal risk; we buy or sell goods or services to others in foreign countries. A firm that wants to use its intellectual property worldwide must first protect it from infringement, and then contract to let others distribute it or license it to users. . However, the greatest risks come with the full or partial ownership and operation of a foreign firm, perhaps a factory. This carries with it the obligations of corporate citizenship and means the complete involvement in all aspects of life in the foreign country—economic, political, social, cultural, and legal.

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

Trade

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

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

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

Foreign sales representatives are independent sales agents who solicit orders on behalf of their principals and receive compensation on a commission basis. They have the advantage of knowing the foreign market, having established customer loyalty, and carrying a range of complementary products. For instance, one agent may represent several different manufacturers of U.S. sporting goods in Japan—one that makes baseball bats, another that makes gloves, and a third that makes baseballs.

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

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

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

Japanese trading companies (called *sogo shosha*) are well known for their successes worldwide. Their early advantage over trading companies in the United States was their ability to bring together many competing producers in the Japanese market to take advantage of economies of scale in exporting. For example, a trading company might bring together several makers of competing large appliances and coordinate pricing and distribution in foreign countries. This proved to be very effective for the Japanese.

In the United States, until 1982, any collusion by competitors to fix prices and market jointly would have been considered a violation of the U.S. antitrust laws. In that year, the U.S. Congress passed the *Export Trading Company Act*, giving American exporters the same competitive advantage as the Japanese. U.S. **export trading companies**, or ETCs, can apply for and receive an **Export Trade Certificate of Review** from the U.S. Department of Commerce, with the approval of the Department of Justice, that waives the application of U.S. antitrust laws to their specified export activities. For example, it is illegal for two competing firms that manufacture similar products to agree to fix prices in the U.S. market. However, if both companies are members of an approved ETC, they may jointly establish export prices, enter into joint export marketing arrangements, allocate export territories, and do business in ways that would be illegal if done with the U.S. market. The waiver is issued only if it is shown that the advantage will not lessen competition within the United States, or unreasonably affect domestic prices of the exported products. There are many other advantages in selling through an ETC, such as teaming up to bid on large foreign projects, filling large and complex foreign orders, joint marketing of complementary or competing products, division of foreign territories by competing firms, sharing of marketing and distribution costs, and reducing rivalry between U.S. firms in dealing with foreign customers.

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

Tarbert Trading, Ltd. v. Cometals, Inc.

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

BACKGROUND AND FACTS

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

NEWMAN, SENIOR JUDGE

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

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

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

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

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

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

Comment. Trading companies play an important role in world trade. While what happened here is obviously a rare case, it does give us an opportunity to introduce some of the documents required in international trade and to question the legal and ethical conduct of the parties. It also teaches us the importance of knowing more about the people we do business with.

Case Questions

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

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

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

What does it take for a small business to be a successful exporter? First, most people agree that looking to foreign markets is not a panacea for a company's failures at home. Due to the time and resources necessary to enter a foreign market, a firm that is already failing at home will likely be unable to bear the cost of expansion and will probably repeat its same mistakes again. Second, experience shows that success or failure in entering a foreign market is often due to the commitment made to international business at a company's executive level. Many small companies that are new to exporting may lack the global view and commitment to foreign customers of a multinational corporation. In some cases they wrongly look for new customers abroad only when the economy declines at home. But this has proven shortsighted. During the time needed to gear up for the export process, which can take months or years, the domestic economy may heat up again, domestic customers return, and the new-to-export firm may lose interest in its newfound foreign customers. Without a long-term commitment, foreign buyers view these firms as unreliable suppliers. Many small companies soon learn that entering international markets requires time, patience, and commitment. Third, many small companies learn too late that international business is not merely a distant extension of domestic business. It requires the company to adapt to a new social, cultural, political, and economic environment and to be prepared to meet new challenges. For example, it may have to adapt its products and services to the expectations of the foreign market, develop new channels of distribution, visit foreign customers, and comply with new legal regulations, and so on. Finally, one of the greatest mistakes made by small business exporters, especially "new-to-export" firms, is the failure to have an **export plan** (see Exhibit 1.1).

Licensing and Protection of Intellectual Property Rights

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

Exhibit 1.1

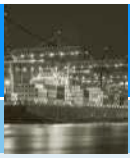
Components of an Export Plan

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

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

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

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



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

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

BACKGROUND AND FACTS

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

COGAN, DISTRICT JUDGE

The Copyright Act establishes that the "legal or beneficial owner of an exclusive right under a copyright" may bring suit for infringement under the act [citations omitted]. However, when this provision is invoked by an exclusive licensee, the licensee may seek relief from infringement only for the rights that the licensee has been exclusively licensed by the copyright holder.

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

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

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

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

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

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

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

Case Questions

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

Case Comment

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

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

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

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

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

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

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

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

Dayan v. McDonald's Corp.

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

BACKGROUND AND FACTS

Dayan received an exclusive franchise to operate McDonald's restaurants in Paris, France. The franchise agreement required that the franchise meet all quality, service, and cleanliness (QSC) standards set by McDonald's. The agreement stated that the rationale for maintaining QSC standards was that a "departure of restaurants anywhere in the world from these standards impedes the successful operation of restaurants throughout the world, and injures the value of [McDonald's] patents, trademarks, trade name, and property." Dayan agreed not to vary from QSC standards without prior written approval. After several years of quality and cleanliness violations, McDonald's sought to terminate the franchise. Dayan brought this action to enjoin the termination. The lower court found that good cause existed for the termination and Dayan appealed.

BUCKLEY, PRESIDING JUSTICE

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

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

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continued

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

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

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

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

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

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

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

Case Questions

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

Foreign Direct Investment

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

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

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

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

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

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

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

CONDUCTING BUSINESS IN DEVELOPING AND NEWLY INDUSTRIALIZED COUNTRIES

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

It is often useful to group countries according to socioeconomic criteria, even though they may be otherwise very different and in different geographic regions. For example, the countries of Vietnam in Asia, Libya in North Africa, and Bolivia in South America each have different cultures, religions, geography, and per capita income levels, and very different political and trade relationships with the United States and other Western countries. Yet they have many of the same traits as other developing countries. So too are the countries of India, Brazil, and Malaysia; they are vastly different in their locations, cultures, geographies, and even sizes. However, the socioeconomic data of these countries show that they have much in common with each other and with other newly industrialized countries. Grouping like this is helpful in discussion and aids in statistical analysis. However, there is no one universally accepted definition for the terms “developing” or “newly industrialized” because economists are grouping countries for different purposes, and because there are so many different indicators of socioeconomic development.

Developed Countries

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

Developing Countries

Compared to developed countries, developing countries generally have a lower per capita income, a lower standard of living, higher foreign debt, more rapid population growth, and a history of greater state control over their economy. The “typical” developing country is impossible to describe. Some rely almost exclusively on petroleum exports as their source of income. Many have large agrarian populations, densely populated cities, and a plentiful supply of unskilled labor. Many support high-tech industries. Although some are rich in natural resources, such as Brazil, others have depleted theirs. The protection of the environment often takes a back seat to industrialization and economic “progress,” and so pollution often chokes their air and water. Sanitation and water systems are often inadequate. In some areas, toxic waste dumps may threaten entire communities. Economic crimes such as smuggling, hijacking and ocean piracy, organized crime, government corruption, and illicit drug production are frequently major problems. Education levels are generally far below that of the developed countries. Poor communication and transportation systems make business difficult. Inadequate distribution systems make it costly to get goods to market. Floods and natural disasters, exacerbated by inappropriate agricultural, land management and industrial policies, have disrupted entire populations. Overpopulation, homelessness, malnutrition, and disease are still common in many areas. The epidemic of plague that struck India in 1994, for example, caused workers to flee industrial communities in fear and forced the closing of many factories. Despite this bleak picture, developing countries do present trade, franchising, and investment opportunities for U.S. companies.

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

Trade and Investment Policies in Developing Countries. Firms that do business in developing countries can face a host of adverse government policies, including high tariffs, taxes, import licensing requirements, financial regulation, controls on technology transfer, and trade and investment barriers that protect local industries from competition. Consider these examples: Governments in developing countries might allow the import of goods and services needed for their own socioeconomic development plans, such as tractors, machine tools, or power plants. However, they might ban or discourage the import of goods and services considered nonessential, or those that are available from local producers. They may allow investment in a chemical or pharmaceutical plant, but not one making consumer goods for local sale. They may allow a foreign firm to produce there, but only if it does so in a joint venture with a local partner, to whom it must disclose or license its latest technology patents.

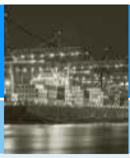
Another problem in doing business in developing countries is that the rules affecting international business often lack transparency; government regulations are often not published or made easily available to foreign firms. This makes regulations feel more like "red tape," and compliance almost impossible.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

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

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

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

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



In re Union Carbide Corporation Gas Plant Disaster at Bhopal

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

BACKGROUND AND FACTS

Union Carbide Corporation (UCC) had been one of the largest chemical and industrial companies in the world, operating in dozens of countries. UCC's subsidiary in India, UCIL, had grown to fourteen plants, employing more than 9,000 Indian citizens, manufacturing a variety of products, including chemicals, plastics, batteries, fertilizers, and pesticides. UCIL was incorporated under the laws of India. Fifty-one percent of UCIL stock was owned by UCC, 24 percent by the government of India, and the balance by approximately 23,500 Indian citizens. The stock was publicly traded in India. In the 1970s, India issued a license to UCIL to produce pesticides at a plant to be built in Bhopal. UCC provided the basic design for the plant, but India insisted that its own engineering firms and contractors build it. From 1972–1980, the construction was supervised by Indian engineers and many changes were made to the design. Labor and employment policies were set by the Indian government and the construction was managed and operated entirely by Indian citizens. The operations of the plant were regulated by more than two dozen Indian governmental agencies; however, enforcement of environmental, health, and safety standards by regulators was weak and ineffective. Maintenance procedures and record keeping at the plant were inadequate. In 1984,

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

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

MANSFIELD, CIRCUIT JUDGE

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

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

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

India's interest is increased by the fact that it has for years treated UCIL as an Indian national, subjecting it to intensive regulations and governmental supervision of the construction, development, and operation of the Bhopal plant, its emissions, water and air pollution, and safety precautions. Numerous Indian government officials have regularly conducted on-site inspections of the plant and approved its machinery and equipment, including its facilities for storage of the lethal methyl isocyanate gas that escaped and caused the disaster giving rise to the claims. Thus India has considered the plant to be an Indian one and the disaster to be an Indian problem. It therefore has a deep interest in ensuring compliance with its safety standards. Moreover, plaintiffs have conceded that in view of India's strong interest and its greater contacts with the plant, its operations, its employees, and the victims of the accident, the law of India, as the place where the tort occurred, will undoubtedly govern.

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

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

Case Questions

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

The Newly Industrialized Countries

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

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

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

The Least-Developed Countries

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

SOME COMMON RISKS OF INTERNATIONAL BUSINESS

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

Distance and Logistics

Managing many international transactions means managing the risks of shipping goods, getting paid, and doing business over great distances. In an import/export transaction, the risk that the buyer will fail or refuse to pay is called **payment or credit risk**. This may mean finding special ways of assuring payment for goods being shipped to far-off countries, including the use of international banking services. For many exporters it means attending international trade shows and visiting their customers to get to know them personally.

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

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

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

Transatlantic Financing Corporation v. United States

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

BACKGROUND AND FACTS

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

J. SKELLY WRIGHT, CIRCUIT JUDGE

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

It seems reasonable, where no route is mentioned in a contract, to assume the parties expected performance by the usual and customary route at the time of contract. Since the usual and customary route from Texas to Iran at the time of contract was through Suez, closure of the Canal made impossible the expected method of performance. But this unexpected development raises rather than resolves the impossibility issue, which turns additionally on whether the risk of the contingency's occurrence [closure of the canal] had been allocated and, if not, whether performance by alternative routes was rendered impracticable.

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

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

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