

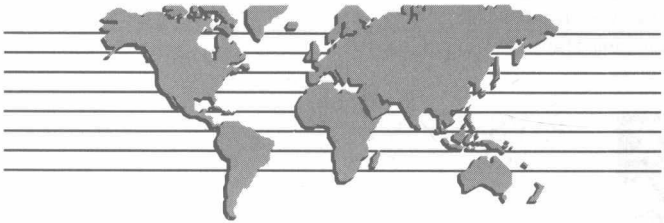
International Dimensions of

THE LEGAL ENVIRONMENT OF BUSINESS

Michael Litka



International Dimensions of
**THE LEGAL ENVIRONMENT
OF BUSINESS**



Michael Litka
University of Akron

THE KENT INTERNATIONAL DIMENSIONS OF BUSINESS SERIES

David A. Ricks

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Boston, Massachusetts

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PWS-KENT Publishing Company is a division of Wadsworth, Inc.

Printed in the United States of America

1 2 3 4 5 6 7 8 9 — 92 91 90 89 88

Library of Congress Cataloging-in-Publication Data

Litka, Michael P.

International dimensions of the legal environment of business.

(The Kent international dimensions of business series)

Includes bibliographies and index.

1. Foreign trade regulation. 2. Commercial treaties.
3. Export sales contracts. 4. International business
enterprises — Law and legislation. I. Title. II. Series.

K563.B87L58 1988 341.7'54 88-17966

ISBN 0-534-87208-5

THE KENT INTERNATIONAL DIMENSIONS OF BUSINESS SERIES

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Series Foreword

Prior to World War II, the number of firms involved in foreign direct investment was relatively small. Although several U.S. companies were obtaining raw materials from other countries, most firms were interested only in the U.S. market. This situation changed, however, during the 1950s — especially after the creation of the European Economic Community. Since that time, there has been a rapid expansion in international business activity.

The majority of the world's large corporations now perform an increasing proportion of their business activities outside their home countries. For many of these companies, international business returns over one-half of their profits, and it is becoming more and more common for a typical corporation to earn at least one-fourth of its profits through international business involvement. In fact, it is now rather rare for any large firm not to be a participant in the world of international business.

International business is of great importance in most countries, and that importance continues to grow. To meet the demand for increased knowledge in this area, business schools are attempting to add international dimensions to their curricula. Faculty members are becoming more interested in teaching a greater variety of international business courses and are striving to add international dimensions to other courses. Students, aware of the increasing probability that they will be employed by firms engaged in international business activities, are seeking knowledge of the problem-solving techniques unique to international business. As the American Assembly of Collegiate Schools of Busi-

ness has observed, however, there is a shortage of available information. Most business textbooks do not adequately consider the international dimensions of business, and much of the supplemental material is disjointed, overly narrow, or otherwise inadequate in the classroom.

This series has been developed to overcome such problems. The books are written by some of the most respected authors in the various areas of international business. Each author is extremely well known in the Academy of International Business and in his or her other professional academies. They possess an outstanding knowledge of their own subject matter and a talent for explaining it.

These books, in which the authors have identified the most important international aspects of their fields, have been written in a format that facilitates their use as supplemental material in business school courses. For the most part, the material is presented by topic in approximately the same order and manner as it is covered in basic business textbooks. Therefore, as each topic is covered in the course, material is easily supplemented with the corresponding chapter in the series book.

The Kent International Dimensions of Business Series offers a unique and much-needed opportunity to bring international dimensions of business into the classroom. The series has been developed by leaders in the field after years of discussion and careful consideration, and the timely encouragement and support provided by the PWS-KENT staff on this project. I am proud to be associated with this series and highly recommend it to you.

David A. Ricks

Consulting Editor to the

Kent International Dimensions of Business Series

Professor of International Business,

University of South Carolina

Preface

The world trade that began for the United States in the era of the Yankee clipper ship — long since faded — continues to grow. Modern transportation and communication have facilitated the expansion of the international marketplace. Today, exporting and importing are not restricted solely to the movement of goods; nations export and import capital, technology, patents, and any number of services, and people move across and within international borders. The evolution of international trade in its many forms and the resulting charge by the American Assembly of Collegiate Schools of Business to present material on this subject to students are of concern to collegiate schools of business.

An introductory text on the international legal environment of business will necessarily present some type of survey or overview of law. This author has adopted a broad approach so that the student will be able to grasp the whole of the subject while gaining an understanding of some of the basic principles. For example, an investor will have to have a general understanding of the Act of State Doctrine as it applies to the risks of the individual transaction. Likewise, before an investor can properly analyze a particular commercial treaty, he or she must understand that a treaty is a contract between sovereign states that is subject to the vagaries of international law. International expansion is a factor in American business. It is the primary object of *International Dimensions of the Legal Environment of Business* to study the legal problems that arise when business activities and organizations cross national boundaries and become multinational in structure, operation,

and scope. As a business moves beyond a single country and extends its operations to more countries, its need for legal awareness grows proportionately. This volume in the *International Dimensions* series is designed to analyze the primary sources of the legal problems confronting a multinational business venture.

The goal of *International Dimensions of the Legal Environment of Business* is to present in an orderly sequence legal materials that apply to decisions made and implemented in international business. Emphasis is placed on the business enterprise as it conducts its commercial activity in environments that are different in their economic, political, social, and cultural aspects from the firm's corresponding domestic environment. Various aspects of conflicts of law, constitutional law, contracts, sales, finance, insurance, corporations, tax, anti-trust, civil procedure, and administrative law make up the contents of this volume. Specific attention has been paid to the legal effects of international business decisions, the impact of governmental authority, the legal status of treaties and tariffs, and the difficulties of international dispute settlement procedures.

International Dimensions of the Legal Environment of Business is an ambitious undertaking because at present there are no uniformly accepted international norms of business law. That does not mean that there is no international business law recognized by so-called civilized nations. However, it is a body of law in which few decisions have been rendered by international tribunals. The controlling principles, therefore, are the general principles of international law. The field is further complicated by the private law made by parties to international transactions, which involves sales, contracts, financing, and dispute settlement.

International Dimensions of the Legal Environment of Business has been written in order to internationalize courses in business law and also as a core volume that will permit an instructor, through supplements, to develop an independent first course in the international legal environment of business.

I am grateful for the constructive comments made by the reviewers of the manuscript: Mark B. Baker, The University of Texas at Austin; and Carolyn Hotchkiss, Babson College.

Michael Litka

About the Author

Mike Litka is currently Professor of Business Law at the University of Akron, where he developed a course in international business law and serves as a member of the International Business Committee of the College of Business Administration. He received a Master's degree in history and his J.D. from the University of Iowa and has authored several texts on business law and the legal environment of business. He has presented a number of papers on international law to the American Business Law Association, the Midwest Business Law Association, and the Tri-State Business Law Association. In 1985, he received the outstanding paper award as co-author of "Taxation of the Multijurisdictional Corporation." His casebook in international law was published in 1987 and numerous articles have appeared in *The Oil and Gas Quarterly*, *The Midwest Law Review*, and the *Journal of Legal Studies*. Professor Litka is a past president of the American Business Law Association and past president and current executive secretary of the Tri-State Regional Business Law Association.

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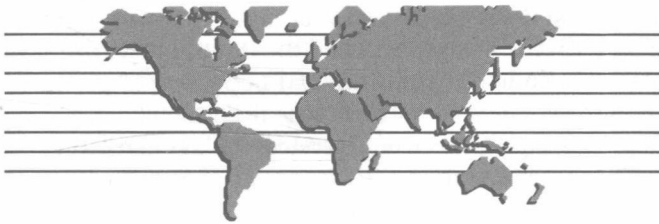
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CHAPTER 1



World Business and International Law: An Overview



Although world trade has been an economic fact for centuries, today the world is in an age of unprecedented economic activity. Opportunity awaits the domestic firm and the individual willing to study and understand the rules of world trade. In fact, many firms earn more in world than in domestic operations. There is little doubt, however, that world trade involves complications not found in domestic transactions. In addition to differences in climate, language, and social, political, and business customs, for example, there are differences in the laws governing commercial transactions.

All countries exert extensive control over trade taking place with other countries, and all countries act in their own self-interest. These facts, perhaps more than any other, distinguish world trade from domestic. Also, trading between government-controlled economies and those dominated by the laws of supply and demand often involves differences. Their rules may be different, and they may have different rea-

sons for trading. Before one can understand these differences or the basic legal principles affecting world trade, an overview of the legal and domestic environment of world trade is necessary. The term *environment* encompasses those factors that influence the life and development of world trade.

THE NATURE OF WORLD BUSINESS

The term *business* includes all the activities of organizations that provide the goods and services that satisfy a state's material needs. The domestic business system operates within geographic constraints, whereas worldwide activities have no fixed territorial boundaries. Sometimes the activity occurs between only two sovereign nations, at other times, between one country and the rest of the world. World business activities include the exporting and importing of goods; exploiting natural resources; direct investment; the licensing of processes, patents, or trademarks; supplying personal services such as marketing, financial, technological, transportation, or managerial expertise; and related activities, such as shipping and insurance.

The Reasons for World Business

In *The Schooner Exchange v. McFaddon*, 7 Cranch 116 (1812), Chief Justice Marshall wrote: "The world [is] composed of distinct sovereignties . . . whose mutual benefit is promoted by intercourse with each other, and by an interchange of those good offices which humanity dictates and its wants require. . . ." This observation alludes to a fact of world trade: a mutual benefit in the exchange of goods, or the principle of **comparative advantage**. For example, one nation may be able to produce a good more efficiently than another because of an economic advantage in labor, technology, or raw materials. It will be to its advantage to export that good. The importing nation can, therefore, concentrate on producing other goods more efficiently in order to have them available for export. Thus, each nation will export those goods in which it has an advantage and import those goods in which it has a disadvantage, which results in a degree of interdependence among the economies of the world that will vary among the several nations. For example, for years the American farmer has produced great surpluses,

which have been absorbed in part by the foreign market. At the same time, the American steel industry depends on imports of lead, manganese, nickel, tin, and zinc.

Differences Between Domestic and World Business

Domestic Environments

Business organizations may be either privately owned or they may be government enterprises (or a combination of the two). In the case of the private organization, business activities are carried out for profit, whereas government-sponsored activities may or may not be profit motivated. Contrary to the capitalist doctrine of private ownership of the basic means of production, distribution, and exchange, the socialist doctrine advocates government ownership or control of these functions. Profit is not a primary goal.

The basic difference in trading with nonmarket, or socialist, countries as opposed to capitalist nations is the idea of state trading. That is, world trade is conducted through the instrumentality of the state rather than by private traders. In these economies, there is a near total monopoly of all trading institutions by the state. The government is either the principal in each transaction or it delegates that responsibility to an institution. In most nonmarket countries, this institution is usually a foreign trade corporation.

In addition to the fact that these institutions are less independent than businesses in capitalistic countries, the market forces that operate in a free market economy are absent in a nonmarket economy. For example, all other interests are subservient to a central economic plan. Thus, the world trader must concern itself with whether the activity of a foreign trade corporation is an administrative and political activity of the government or whether the activity amounts to a commercial venture.

Legal Environments

Since no single international commercial legal system exists, the legal environment for international business consists primarily of the laws and courts of the many nations of the world. These national systems vary in philosophy and practice, and each nation maintains a court system that is independent of those in every other nation.