

Understanding

INTERNATIONAL BUSINESS AND FINANCIAL TRANSACTIONS

THIRD EDITION



Jerold A. Friedland

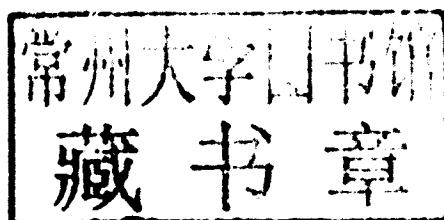
UNDERSTANDING INTERNATIONAL BUSINESS AND FINANCIAL TRANSACTIONS

Third Edition

Jerold A. Friedland

Professor of Law

DePaul University College of Law



Library of Congress Cataloging-in-Publication Data

Friedland, Jerold A.

Understanding international business and financial transactions / Jerold A. Friedland. — 3rd ed.

p. cm.

Includes index.

ISBN 978-1-4224-7841-7 (soft cover)

1. Business law—United States. 2. Foreign trade regulation—United States. 3. Export sales contracts. 4. Foreign exchange—Law and legislation. I. Title.

KF390.B8F75 2010

346.7307—dc22

2010004069

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

LexisNexis and the Knowledge Burst logo are registered trademarks and Michie is a trademark of Reed Elsevier Properties Inc., used under license. Matthew Bender and the Matthew Bender Flame Design are registered trademarks of Matthew Bender Properties Inc.

Copyright © 2010 Matthew Bender & Company, Inc., a member of the LexisNexis Group.
All Rights Reserved.

No copyright is claimed in the text of statutes, regulations, and excerpts from court opinions quoted within this work. Permission to copy material exceeding fair use, 17 U.S.C. § 107, may be licensed for a fee of 25¢ per page per copy from the Copyright Clearance Center, 222 Rosewood Drive, Danvers, Mass. 01923, telephone (978) 750-8400.

NOTE TO USERS

To ensure that you are using the latest materials available in this area, please be sure to periodically check the LexisNexis Law School web site for downloadable updates and supplements at www.lexisnexis.com/lawschool.

Editorial Offices

121 Chanlon Rd., New Providence, NJ 07974 (908) 464-6800

201 Mission St., San Francisco, CA 94105-1831 (415) 908-3200

www.lexisnexis.com

MATTHEW  BENDER

UNDERSTANDING
INTERNATIONAL
BUSINESS AND
FINANCIAL
TRANSACTIONS

Third Edition

LexisNexis Law School Publishing Advisory Board

William D. Araiza

Professor of Law

Brooklyn Law School

Lenni B. Benson

Professor of Law & Associate Dean for Professional Development

New York Law School

Raj Bhala

Rice Distinguished Professor

University of Kansas, School of Law

Ruth Colker

Distinguished University Professor & Heck-Faust Memorial Chair in Constitutional Law

Ohio State University, Moritz College of Law

Richard D. Freer

Robert Howell Hall Professor of Law

Emory University School of Law

David Gamage

Assistant Professor of Law

UC Berkeley School of Law

Craig Joyce

Andrews Kurth Professor of Law & Co-Director, Institute for Intellectual Property and Information Law

University of Houston Law Center

Ellen S. Podgor

Professor of Law & Associate Dean of Faculty Development and Electronic Education

Stetson University College of Law

David I. C. Thomson

LP Professor & Director, Lawyering Process Program

University of Denver, Sturm College of Law

Dedication

This book is dedicated first to my wife Jan and sons David and Brian for their patience and understanding and then to my colleagues at DePaul University College of Law for their advice and support.

Jerold A. Friedland

Preface to Third Edition

This third edition reflects recent developments relating to international business and finance with particular emphasis on the global financial crisis that reached full force in 2008. This crisis, which began with the failure of many well-known global financial institutions, precipitated the worst economic downturn since the Great Depression of 1929. The text discusses the causes of the crisis and the response of governments and international organizations. Hopefully, the fourth edition will describe the success of these responses and the resurgence of global economic activity.

As with prior editions, this book is designed to provide an overview of many topics relating to international business and finance, and serve as a guide to the basic issues that confront attorneys and businesspeople in international transactions. My thanks to Pali Chheda for her assistance and patience.

Jerold A. Friedland
Wilmette, Illinois
March, 2010

TABLE OF CONTENTS

Chapter 1	MONEY, CURRENCY AND FINANCE IN INTERNATIONAL TRADE	1
§ 1.01	FOREIGN EXCHANGE TRANSACTIONS	3
[1]	Money and Currency	3
[2]	Foreign Exchange	4
[3]	Foreign Exchange Markets	5
[4]	Eurodollars	6
[5]	Regulating Foreign Exchange Rates	7
[a]	The Gold Standard	8
[b]	The Bretton Woods Agreement	9
[c]	The Contemporary Floating Rate System	11
[6]	Managing Foreign Exchange Risk	11
[a]	Forward Contracts	12
[b]	Currency Futures Contracts	14
[c]	Currency Options	15
§ 1.02	REGULATION OF INTERNATIONAL FINANCIAL TRANSACTIONS	16
[1]	Overview	16
[2]	The Global Financial Crisis of 2008	17
[a]	Causes	18
[b]	International Response	20
[c]	Recovery and Reform	21
[2]	Financial Derivatives	23
[a]	Futures and Swaps	24
[b]	Swaps	24
[i]	Interest Rate Swaps	25
[ii]	Currency Swaps	27
[c]	Credit Derivatives	29
[3]	Asset Securitization	30
[a]	Collateralized Debt Obligations (CDOs)	32
[b]	International Securitization	33
[4]	International Banking Regulation	34
[a]	The Basel Accords	35
[b]	Basel II	36
[5]	International Securities Regulation	38
[a]	U.S. Securities Regulation	38
[i]	Public Offerings	38
[ii]	American Depositary Receipts (ADRs)	40
[iii]	Private Placements	41

TABLE OF CONTENTS

[iv]	Hedge Funds	42
[v]	Accounting Standards	43
[b]	The Sarbanes-Oxley Act	44
[c]	Enforcement	46
[7]	The Financial Stability Board (FSB)	47
[8]	Electronic Systems	50
[a]	Wholesale Electronic Funds Transfer (EFT)	50
[b]	Herstatt Risk	51
[c]	SWIFT Payment Instructions	52
[d]	Fedwire	52
[e]	Clearing House Interbank Payment System (CHIPS)	54
[f]	Foreign Funds Transfer Systems	57
[9]	Countertrade	58
[a]	Barter	58
[b]	Counterpurchase	58
[c]	Buyback, Offset and Swap Transactions	59
§ 1.03	THE INTERNATIONAL MONETARY FUND	60
[1]	Organization	60
[2]	Contributions and Quotas	60
[3]	Loans and Exchange Transactions	61
[a]	Lending Criteria	62
[b]	Conditionality	62
[c]	Criticisms of Conditionality	64
[4]	Other IMF Functions	66
[a]	Currency Exchange Rate Surveillance	66
[b]	Technical Training and Assistance	67
§ 1.04	THE WORLD BANK	68
[1]	General Structure and Operation	68
[2]	Lending Activities	68
[3]	Criticisms of World Bank Activities	70
Chapter 2	THE RULES OF INTERNATIONAL TRADE	73
§ 2.01	GENERAL CONSIDERATIONS	74
[1]	Free Trade and Comparative Advantage	74
[2]	Tariffs	75
§ 2.02	THE WORLD TRADE ORGANIZATION (WTO)	76
[1]	History — GATT to WTO	76
[2]	Membership and Organization	77
[a]	Membership	77
[b]	Joining the WTO	78
[c]	The Accession Process — China	78
[d]	The Accession Process — The Russian Federation	80

TABLE OF CONTENTS

[e]	Organization	80
[3]	The Basic Agreements	82
[4]	Specific Agreements	83
[a]	GATT and Tariff Bindings	84
[b]	Uruguay Round Agricultural Agreement (URAA)	84
[c]	Agreement on Sanitary and Phytosanitary Measures (SPS)	86
[d]	Agreement on Textiles and Clothing (ATC)	90
[e]	The General Agreement on Trade in Services (GATS)	91
[f]	Trade Related Aspects of Intellectual Property Rights (TRIPS) ...	93
[5]	Unfair Trade Practices and Safeguards	97
[a]	Anti-Dumping Agreement	97
[b]	Agreement on Subsidies and Countervailing Measures (SCM)	98
[c]	Agreement on Safeguards	102
[6]	Non-Tariff Barriers	103
[a]	Technical Barriers to Trade (TBT)	105
[i]	Customs Valuations	105
[ii]	Rules of Origin	106
[iii]	Import Licensing and Pre-shipment Inspection	106
[7]	Dispute Resolution Mechanism	107
[a]	Dispute Resolution Procedure	107
[b]	Concerns About the Dispute Resolution Mechanism	110
§ 2.03	ENVIRONMENTAL PROTECTION AND TRADE	111
[1]	Multilateral Environmental Agreements	111
[2]	The WTO Committee on Trade and Environment	113
[3]	WTO Environmental-Trade Disputes	114
[4]	NAFTA Chapter 11 Disputes	119
[5]	The WTO and Labor Standards	123
§ 2.04	INTERNATIONAL INTELLECTUAL PROPERTY RIGHTS	124
[1]	The World Intellectual Property Organization (WIPO)	125
[2]	Trade Related Intellectual Property Agreement (TRIPS)	125
[3]	Patents	126
[4]	Trademarks	127
[5]	Copyrights	128
[6]	Trade Secrets	130
Chapter 3	UNITED STATES TRADE LAWS	131
§ 3.01	IMPORT RESTRICTIONS	133
[1]	General Considerations	133
[2]	Tariffs	134
[a]	The Harmonized Tariff Schedule	134
[b]	Country of Origin Rules	135
[c]	Special Entry Status	136

TABLE OF CONTENTS

[3]	Preferential Tariff Rates	136
[a]	Most Favored Nation (MFN) or Normal Trade Relations (NTR) .	136
[b]	Special Tariff Reduction Programs	137
§ 3.02	TRADE REMEDY LAWS	138
[1]	Interaction of U.S. and WTO Rules	138
[2]	Subsidies and Countervailing Duties (CVD)	140
[a]	CVD Investigations	141
[b]	Countervailable Subsidies	141
[3]	Anti-Dumping Law	142
[a]	AD Proceedings	143
[b]	Third Country Dumping	145
[4]	CVD and AD Procedures	146
[a]	Investigations	146
[b]	Preliminary Determinations	146
[c]	Final Determinations	147
[d]	Determining Material Injury for CVD and AD Purposes	147
[e]	Termination or Suspension of Investigations	148
[f]	The AD or CVD Order	149
[g]	Administrative Review	150
[h]	Sunset Review	150
[i]	Anti-Circumvention Authority	151
[j]	Appeals	152
[5]	<i>Safeguard</i> Import Relief	153
[a]	Petitions and Investigations	153
[b]	Action Decisions	155
[c]	Monitoring, Modification, and Termination	155
[6]	Unfair Import Practices — Section 337	156
[a]	Procedure	157
[b]	Remedies	158
[7]	Section 301 Proceedings	159
[a]	Petitions and Investigations	160
[b]	Mandatory and Discretionary Action	160
[c]	Implementation of Action	162
[d]	Special 301: Intellectual Property Rights Disputes	162
[8]	The Court of International Trade	163
§ 3.03	EXPORT CONTROLS	164
[1]	Multi-Lateral Export Control Regimes	164
[a]	Background	164
[b]	Wassenaar Arrangement	165
[2]	U.S. Export Controls	166
[a]	Regulatory Agencies	166
[b]	Department of Commerce Export Controls	167

TABLE OF CONTENTS

[c]	Items and Activities Subject to Export Control Rules	168
[d]	Deemed Exports	169
[e]	End-Use or End-User Restrictions	169
[f]	Restricted Persons	170
[g]	Country Controls	170
[h]	Penalties	171
[3]	Economic Sanctions	171
[4]	Anti-Boycott Laws	173
[a]	Prohibited Activities	174
[b]	Reporting Requirements	176
[c]	Penalties	176
[d]	Anti-Boycott Tax Legislation	176
[5]	Foreign Corrupt Practices Act	177
[a]	Coordination with the OECD Bribery Convention	177
[b]	Accounting Rules	178
[c]	Bribery Rules	179
[d]	Penalties	180
[e]	Company Compliance Programs	180
Chapter 4	INTERNATIONAL SALES	183
§ 4.01	INTERNATIONAL CONTRACTS FOR THE SALE OF GOODS . . .	185
[1]	In General	185
[2]	The Convention on Contracts for the International Sale of Goods (CISG)	186
[a]	“Opting out” of the CISG	187
[b]	Scope of Application of the CISG	188
[c]	Contract Formation	189
[d]	Battle of the Forms	191
[e]	Statute of Frauds and Parol Evidence	192
[f]	Assurances of Performance	193
[g]	Buyer’s and Seller’s Obligations and Remedies	193
[h]	Seller’s Right to Cure	196
[i]	Risk of Loss	197
[j]	<i>Force Majeure</i>	197
§ 4.02	INCOTERMS	198
[1]	Group E — Departure	199
[a]	EXW (Ex Works, Factory, . . . [name of place])	200
[2]	Group F — Carriage Unpaid	200
[a]	FCA (Free Carrier . . . [name of place])	200
[b]	FAS (Free Alongside Ship . . . [name of port of shipment])	200
[c]	FOB (Free Onboard Ship . . . [name of port of shipment])	201
[3]	Group C — Carriage Paid	201

TABLE OF CONTENTS

[a]	CFR (Cost & Freight . . . [name of destination port])	201
[b]	CIF (Cost, Insurance, & Freight . . . [name of destination port]) . .	201
[c]	CPT (Carriage Paid To . . . [name of destination])	202
[d]	CIP (Carriage & Insurance Paid To . . . [name of destination]) . .	202
[4]	Group D — Arrival	202
[a]	DAF (Deliver At Frontier . . . [name of place])	202
[b]	DES (Delivered Ex Ship . . . [name of destination port])	202
[c]	DEQ (Delivered Ex Quay . . . [name of destination port])	203
[d]	DDU (Delivered Duty Unpaid . . . [name of destination])	203
[e]	DDP (Delivered Duty Paid . . . [name of destination])	203
§ 4.03	DISPUTE RESOLUTION	203
[1]	In General	203
[2]	Litigation and Forum Selection	204
[3]	Alternate Dispute Resolution	204
[a]	International Commercial Mediation	205
[b]	International Commercial Arbitration	205
[c]	Arbitration Treaties	206
[d]	Arbitration Clause	208
[e]	Advantages and Disadvantages of Arbitration	209
§ 4.04	TRANSPORT DOCUMENTS	211
[1]	Bill of Lading	211
[2]	Other Documents	212
[3]	Carrier's Liability Under the Carriage of Goods by Sea Act (COGSA)	213
§ 4.05	PAYMENT METHODS	214
[1]	In General	214
[a]	Cash in Advance	215
[b]	Open Account	215
[c]	Consignment	215
[d]	Documentary Collection — Document Against Payment	215
[e]	Documentary Collection — Trade Acceptance	216
[f]	Documentary Letter of Credit	216
[2]	The Letter of Credit	217
[a]	Commercial Letter of Credit	218
[b]	Issuance of Letter of Credit	219
[c]	Payment on Letter of Credit	220
[d]	Law Governing Commercial Letter of Credit	220
[e]	Drafting a Letter of Credit	221
[f]	Issuer's Obligations	222
[g]	Fraud	223
[h]	Confirmed Letter of Credit — Sample	224
[i]	Standby Letter of Credit	225

TABLE OF CONTENTS

[j]	Standby Letter of Credit — Sample	225
§ 4.06	ELECTRONIC CONTRACTS AND DOCUMENTS	226
[1]	UNCITRAL Model Law on Electronic Data Interchange (EDI)	227
[a]	Legal Requirements Applicable to Data Messages	227
[b]	Electronic Signatures	228
[c]	Communicating Data Messages	229
[2]	Uniform Electronic Transactions Act (UETA)	230
[a]	Electronic Signatures	231
[b]	Errors in Transmission	232
[c]	Automated Contract Formation	232
[d]	Electronic Records	232
[3]	Electronic Signatures in Global and National Commerce Act (E-sign)	234
[a]	E-sign Operating Provisions	234
[b]	E-sign Preemption of UETA	236
[4]	Electronic Commerce in the EU	237
[a]	Directive on Distance Contracts	237
[b]	Directive on Electronic Commerce	238
[c]	Directive on Digital Signatures	239
[5]	Electronic Transport Documents	240
[a]	CMI Rules for Electronic Bills of Lading	242
[b]	The Bolero (Bills of Lading for Europe) System	242
Chapter 5	OPERATING IN FOREIGN MARKETS	245
§ 5.01	ENTERING A FOREIGN MARKET	247
[1]	General Considerations	247
[2]	Direct Sales	248
[3]	Sales Representative	248
[4]	Sales Agency	248
[5]	Distributorship	251
[6]	Licensing	252
[a]	Technology Licenses	253
[b]	License Contracts	253
[7]	Franchising	254
[a]	Franchise Contracts	255
[b]	Master Franchise Arrangements	256
[8]	Joint Ventures	259
[a]	Disadvantages of Joint Ventures	260
[b]	Joint Venture Agreements	261
[c]	Termination of Joint Ventures	262
[9]	Foreign Direct Investment	263
[a]	FDI in Developing Economies	264

TABLE OF CONTENTS

[b]	Bilateral Investment Treaties (BITs)	265
[c]	Multilateral Agreement on Investment (MAI)	267
[d]	Trade Related Investment Measures (TRIMs)	267
[10]	Financing International Transactions — The Export Import Bank . .	268
§ 5.02	MANAGING INTERNATIONAL INVESTMENT RISK	270
[1]	Risks of Foreign Investment	270
[a]	Credit Risk	271
[b]	Political Risk	271
[c]	Currency Risk	272
[d]	Expropriation and Government Action	272
[e]	Political Violence and Instability	273
[2]	Insuring Risks	273
[a]	Overseas Private Investment Corporation (OPIC)	274
[b]	Export-Import Bank of the U.S.	276
[c]	Multilateral Investment Guarantee Agency (MIGA)	277
[d]	Cooperative Underwriting Program	278
§ 5.03	CHOOSING THE APPROPRIATE BUSINESS ENTITY	279
[1]	U.S. Business Entities	279
[2]	Characteristics of Business Entities	280
[a]	Limited Liability	280
[b]	Management and Control	280
[c]	Capital Structure	281
[d]	Transferability of Interests	281
[e]	Death or Other Withdrawal of Owner	282
[3]	The Multinational Enterprise (MNE)	283
[4]	Incorporating Offshore — Corporate Inversions	285
§ 5.04	INTERNATIONAL COMPETITION LAW	287
[1]	Comparing Competition Law Regimes	287
[a]	Selected Regimes — The U.S., E.U., and Japan	288
[b]	Extraterritorial Effect	289
[2]	U.S. Antitrust Laws	290
[a]	Sherman Act	290
[b]	Clayton Act	291
[c]	Federal Trade Commission Act	292
[d]	Hart-Scott-Rodino Act	292
[e]	Export Trading Company Act of 1982	294
[f]	Wilson Tariff Act	295
[g]	National Cooperative Research and Production Act	295
[h]	Webb-Pomerene Act	295
[3]	U.S. International Antitrust Enforcement	295
[a]	Antitrust Jurisdiction Over Imports	297
[b]	Non-Import Jurisdiction	297

TABLE OF CONTENTS

[c]	Personal Jurisdiction	298
[d]	Foreign Government Involvement	299
[e]	Comity	300
[f]	International Competition Policy Agreements	301
[g]	Restrictions on Foreign Investment — The Exon-Florio Amendment	301
[4]	EU Competition Law	303
[a]	Anticompetitive Agreements (Article 81)	304
[b]	Abuse of Dominant Position (Article 82)	305
[c]	Government Action	306
[d]	Enforcement	307
[5]	Japan's Competition Law	308
[6]	China's Competition Law	310
§ 5.05	SPECIFIC NATIONAL AND REGIONAL MARKETS	313
[1]	The European Union	313
[a]	Governing Institutions and Law-Making	316
[b]	The Single Market	318
[c]	Economic and Monetary Union (EMU)	320
[d]	The Treaty of Lisbon	322
[2]	China	323
[a]	A Short History of Modern China	323
[b]	The Chinese Economy	325
[3]	East Asia	327
[4]	Africa	329
[5]	Free Trade Agreements and Customs Unions	330
[6]	NAFTA	332

Chapter 6

TAXATION OF INTERNATIONAL TRANSACTIONS

335

§ 6.01	BASIC INCOME TAX RULES	336
[1]	Policy Considerations	336
[a]	Capital Export Neutrality	337
[b]	Capital Import Neutrality	337
[c]	National Neutrality	337
[d]	Illustrations	338
[e]	Value Added Tax (VAT)	338
[2]	Tax Havens	339
[3]	U.S. Taxation of International Transactions — Basic Principles . . .	341
[4]	Outbound Transactions — Taxation of U.S. Persons with Foreign Source Income	342
[a]	The Foreign Tax Credit	342
[b]	Taxation and Business Structure	343

TABLE OF CONTENTS

[c]	Anti-Deferral Rules	345
[i]	Foreign Personal Holding Companies	346
[ii]	Passive Foreign Investment Companies	346
[iii]	Controlled Foreign Corporations	346
[d]	Tax Classification of Business Entities	347
[e]	Hybrid Branches	348
§ 5	Inbound Transactions — Taxation of Foreign Persons Having U.S. Source Income	349
[a]	Trade or Business Income	350
[b]	The Branch Profits Tax	351
[c]	Investment Income	351
[d]	Income from U.S. Real Property Interests	352
[e]	Disposition of Interests in Real Property	352
§ 6.02	TAXATION OF INTERNATIONAL ELECTRONIC COMMERCE (E-COMMERCE)	353
[1]	Determining the Source of Income	353
[2]	Compliance Issues	355
§ 6.03	TAX TREATIES	356
[1]	General Provisions	356
[2]	Residence Requirements	356
[3]	Taxation of Income	357
[4]	Treaty Foreign Tax Credit	357
[5]	Limitation on Treaty Benefits for <i>Hybrid</i> Entities	358
[6]	Competent Authorities	361
[7]	Negotiations	361
§ 6.04	TRANSFER PRICING	362
[1]	Transaction Between Related Entities	362
[2]	General Transfer Pricing Rules	363
[a]	Reallocation Under I.R.C. Section 482	363
[b]	Transfers of Tangible Property	364
[c]	Transfers of Intangibles	365
[d]	Penalties and Records	366
[e]	Advance Pricing Agreements (APA)	366
[3]	OECD Rules	367

TABLE OF CASES	TC-1
----------------------	------

INDEX	I-1
-------------	-----
