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INTERNATIONAL BUSINESS LAW AND ITS ENVIRONMENT

Schaffer
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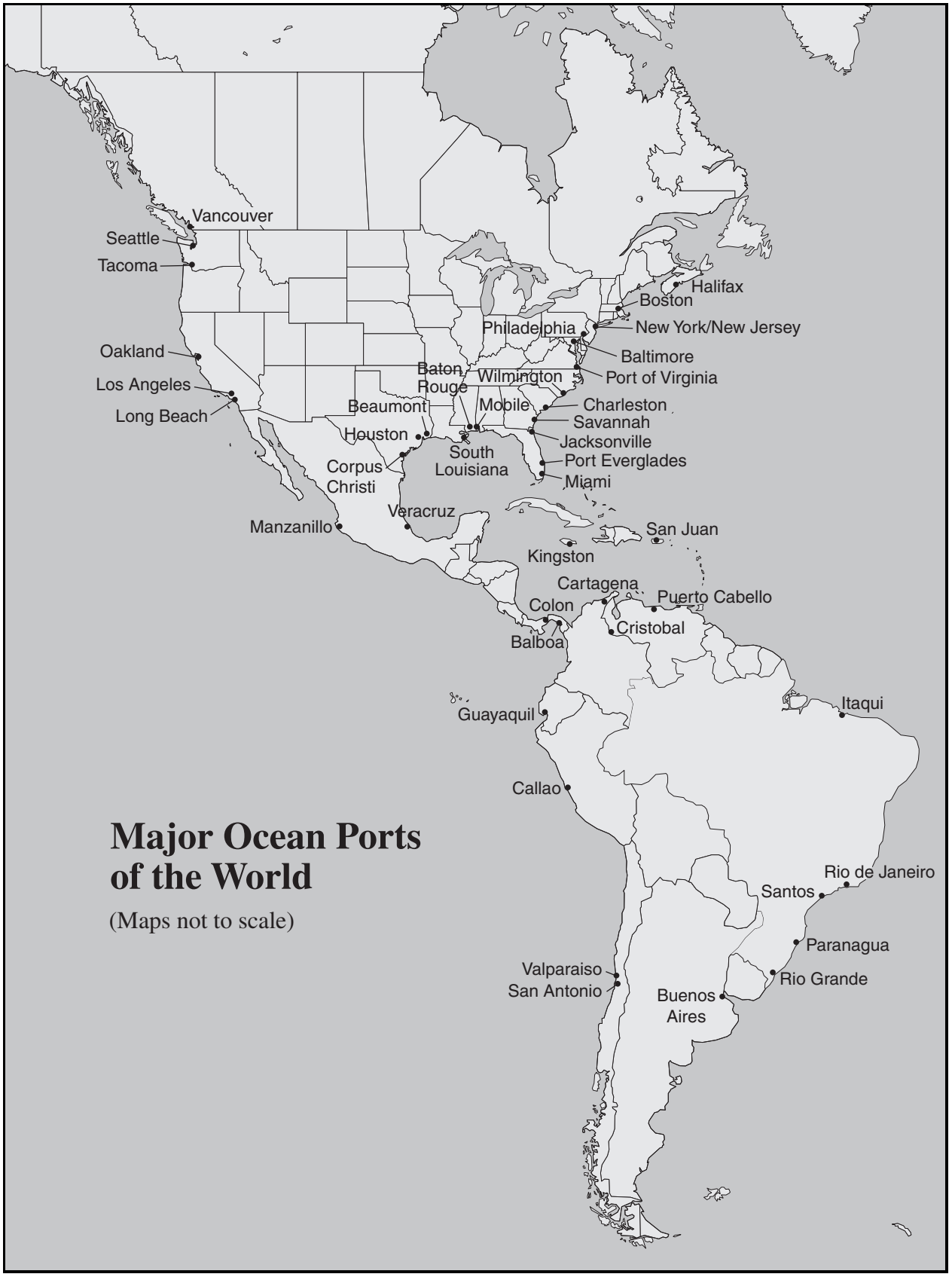
Dhooge

NINTH EDITION



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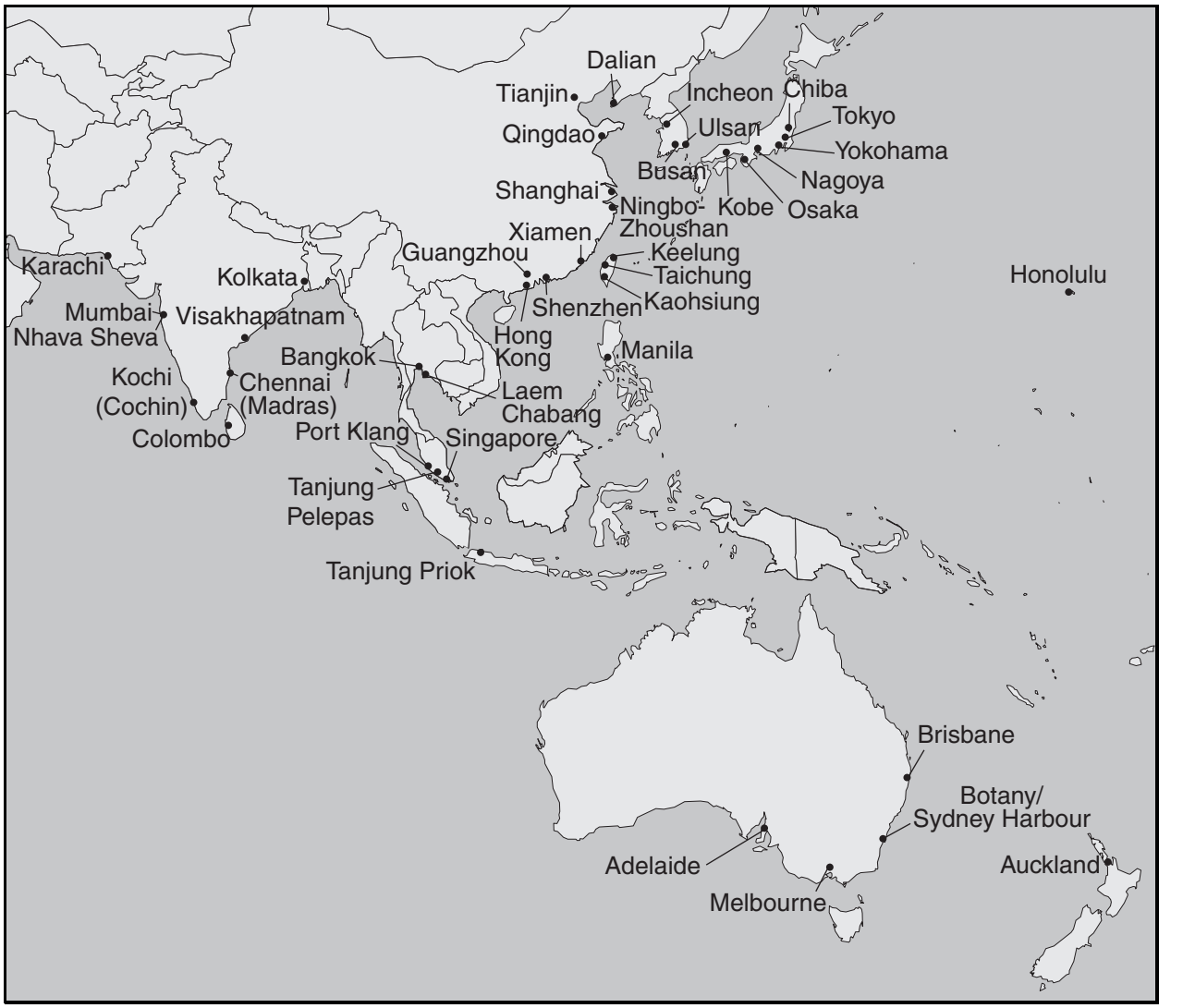

Asia, Australia and the South Pacific region

International Business Law and Its Environment

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R. S.

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

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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 America's great multinational corporations but also the successes of the many small and medium-sized companies that today do business internationally.

Among nations, the spirit of free trade has become contagious. Examples can 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 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 GATT agreements, the agreements of the World Trade Organization, and NAFTA are prime sources of public international law. Public international law provides the basis for government regulation of international business. It affects the environment within which a firm develops its international business strategies, and establishes the firm's responsibility under national laws and administrative regulations. 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 compare civil law, common law, socialist law, labor and employment law, Islamic law, and concepts from different legal systems. Examples include comparative sales law, labor and employment law, advertising law, agency law, and competition law. For instance, our discussion of Chinese law provides U.S. readers with many interesting comparisons, because the United States and China are in different stages of development, with very different political systems. We discuss European law throughout the book, and frequently use Japan for comparison purposes as well. Of course, we treat U.S. law in greater detail. However, the text focuses on relevant international agreements, uniform codes, and the decisions of international tribunals. Moreover, its focus on international law, the legal environment in developing countries, and a comparative view of national laws, makes the text perfect for use anywhere.

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.

Commercial transactions are thoroughly examined and explained. This includes negotiating contracts for the sale of goods and services, negotiating contractual terms of trade, handling shipping contracts and cargo insurance, making agency contracts, dealing with letters of credit and other banking arrangements, considering alternatives for dispute settlement, and much more. Many sample forms and documents are included. Methods for protecting one's intellectual property are closely considered, as are the handling of international investment arrangements, employing persons abroad, and other issues. Similarly, we take readers through many thorny problems of dealing with the government, such as learning how to use the harmonized tariff code when entering goods and "clearing customs," or when licensing exports.

A BUSINESS AND MANAGERIAL PERSPECTIVE

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.

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.

In discussing trade issues, it is almost impossible to separate politics, foreign policy, and trade. This is evident in our coverage of 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 opportunities, colored by the realities of disease, poverty, and environmental degradation that threaten much of our planet.

Trade and investment issues in developing 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 environmental issues in developing countries, and U.S. trade initiatives for Latin America, the Caribbean, and Africa. Many special issues related to doing business in the independent republics of the former Soviet Union are covered. The integration of China, Vietnam, and other countries into the world's economic system 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 Two, 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*
- *Protection of the environment and of fish and wildlife*
- *Prison and forced labor*

- *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*
- *The ban on asbestos products*
- *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 is contributing 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. Cases from countries other than the United States appear throughout the book, as do 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 NINTH EDITION

Despite many changes in content in the ninth edition of *International Business Law and its Environment*, surely our greatest challenge was to make it more readable and manageable. To this end, we have tried 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 ninth edition.

Part One: The Legal Environment of International Business

- *Chapter 1 has been largely rewritten to better prepare readers for the remainder of the book. The statistical data on international trade and investment has been eliminated and non-core areas condensed. The chapter now focuses on introducing the legal environment of international business and on key concepts and definitions needed in later reading. Chapter 1 contains four cases new to this edition.*
- *Chapter 2 on international law has been greatly revised, with two case replacements plus a significantly re-edited version of* Nottebohm. *The chapter is even more relevant to business readers: A new section looks at the nature and sources of international business law, and international criminal law and human rights issues now focus on international business issues. Any duplication of subjects in Chapter 2 (on international law) and Chapter 8 (national lawmaking powers) has been eliminated.*
- *Chapter 3 on dispute resolution now has a greater emphasis on key areas: Arbitration and alternative dispute resolution, jurisdiction in the Internet age, including the Ninth Circuit's* Pebble Beach *decision, personal jurisdiction and the recognition of judgments in China and India. It consolidates and includes new sections on sovereign immunity, abstention, act of state, comity, and political question doctrines.*

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

- *Chapter 4 has been retitled as* The Formation and Performance of Contracts for the Sale of Goods, *and has a new focus on contract formation, performance, breach, and damages, as reflected in the new title.*
- *Chapter 5 on documentary sales has an updated discussion of international commercial terminology governing the use and interpretation of trade terms.*
- *Chapter 6 is now titled* Legal Issues in Transportation *to reflect its broader coverage. Aviation law has been fully updated post-Montreal. It includes all-new presentations of general maritime law (including a discussion of the historical development of maritime law) and admiralty jurisdiction. The carriage of goods by sea sections have been condensed and updated. A challenging but fun ethics case related to maritime fraud has been added to the chapter.*
- *Chapter 7 has been updated.*

Part Three: International and U.S. Trade Law

- *Chapter 8 on national lawmaking powers has been reorganized and focuses on core subjects, including U.S. trade agreements and key U.S. trade legislation. The role of the Department of Treasury in regulating international transactions has been added. The U.S. Supreme Court decision in* Arizona v. U.S. *is used to discuss federal preemption, while also introducing readers to immigration issues in the United States. The section on presidential powers in the war on terror has been eliminated.*
- *Chapter 9 on the WTO has also been completely reorganized to focus on basic WTO principles. New subjects include overview of trade preferences and free trade, which has been removed from Chapters 12 and 15 and consolidated here. Most other sections have been completely rewritten to simplify and condense. Materials on* Jackson-Vanik, *normalization of relations with China, Russia, and Vietnam were eliminated; historical materials on GATT reduced; materials on import licensing, custom procedures, quotas and other non-tariff barriers have been rewritten for clarity.*
- *Chapter 10 on market access updated throughout, and includes new WTO* U.S.-Clove Cigarettes *case on technical barriers to trade.*
- *Chapter 11 on import competition has been significantly rewritten for clarity, the WTO* Argentina-Footwear *decision has been re-edited for easier reading, the dumping section greatly simplified, subsidies and nonmarket economies updated, and the China safeguard materials eliminated reflecting end of that program.*
- *Chapter 12 on imports and customs has been condensed, simplified, and reorganized with a greater focus on the foundations of customs and tariff law. Sections on U.S. administration of customs law and enforcement issues has been moved to later in the chapter. The three major subject areas — classification, valuation, and rules of origin — are largely rewritten. Other changes include: Rules for using the harmonized tariff code are simplified, complex rules of origin for textiles eliminated, materials on electronic entry processing updated, trade preference material removed from this chapter. Other additions include the frequently cited* Carl Zeiss *customs classification case, and a new managerial case question provides a more realistic experience.*
- *Chapter 13 has been retitled,* Export Controls and Sanctions *to more accurately describe the material covered. It has been significantly rewritten,*

condensed, and updated, with non-essential material eliminated or reduced. New sections on today's export environment, policy issues related to balancing national security with competitiveness, ongoing reform of export controls, and the automated export system. The sanctions material has been simplified but strengthened, with the elimination of narrower issues related to the war on terror. Chapter 13 also has a new case selection, with two cases removed and three shorter cases added.

- *Chapter 14 clarifies the distinctions between economic integration in federal models, free trade agreements, customs unions, and common markets; contains updated general and sectoral North American trade information.*
- *Chapter 15 now focuses entirely on the EU and includes key updates on the accession process, expansion, the financial crisis, and monetary issues, with new and updated cases on the supremacy doctrine and free movement of goods.*

Part Four: Regulation of the International Marketplace

- *Chapter 16 has been significantly revised to reflect changes in enforcement of the corrupt practices statute in the United States and by the EU of the OECD bribery convention. The chapter includes several new cases, including* World Duty Free *on bribery.*
- *Chapter 17 has been completely revised to emphasize intellectual property as a company asset. New material on IPR litigation, standard essential patents, strategic use of cross-licensing agreements, legal implications of IPR transfer, and U.S.-China relations. The chapter includes cases on software inventions, China IPR protection (WTO), and discusses international issues related to recent changes in U.S. patent legislation. The 2013* Apple v. Samsung *decision is included.*
- *Chapter 18 materials on foreign direct investment has been entirely revised, and includes litigation over recent expropriations in Latin America, revised material on U.S. taxation of international transactions (including new material on transfer pricing), and addresses both legal and illegal methods used by multinational companies to reduce global taxes. Also includes a new ICSID case involving remedies for expropriation.*
- *Chapter 19 expands its comparative legal view of different employment laws and practices, and now includes the "Chinese Approach" (as well as U.S., EU, and Japanese approaches) to the subject. Additions to the chapter include the new role of the WTO as a multilateral tool for dealing with labor conditions in developing countries, institutional discrimination in China, discrimination against women (particularly in emerging economies), and includes the Supreme Court decision in* Kiobel v. Royal Dutch Petroleum.
- *Chapter 20 new topics include: Environmental litigation at the International Court of Justice, international law implications of "swine flu," new rulings by the NAFTA environmental commission, the EU ban on GMOs, updates on global warming treaty issues and U.S. legislation.*
- *Chapter 21 now expands the discussion of competition law from the U.S. and EU to include a larger perspective of competition laws around the world, including those of Japan and China. Includes new Animal Science decision on extraterritoriality of U.S. antitrust laws.*

OUR GREATEST CHALLENGE

Perhaps the greatest challenge in preparing any edition is simply to keep up with the rapid pace of political, economic, and legal changes around the world. We had to make revisions almost daily to keep abreast of current developments. There are countless topics that had to be included or revised at the last moment. Other issues are still outstanding. Will the U.S. Congress renew the president's trade promotion authority? Will the *Doha Development* rounds conclude successfully? Will there be progress toward a free trade area of the Americas? How will the future U.S. response to international terrorism affect U.S. business interests? Will American consumers pressure U.S. clothing and apparel retailers and firms in their global supply chain to increase wages and provide safe working conditions in developing country factories? These and many other questions must await the next edition.

PEDAGOGICAL FEATURES OF THE NINTH 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. Examples include:

- *Bribery and corruption*
- *Environmental litigation in Ecuador and India*
- *Sales law and "ethically tainted" goods*
- *Insurance coverage in the wake of September 11*
- *The use of* maquiladoras *in Mexico*
- *The HIV epidemic in sub-Saharan Africa*
- *Gender discrimination in the global marketplace*
- *Sewing contractors in India*
- *Sales commissions on arms sales in the Middle East*
- *Exports of outdated pharmaceuticals to Africa*
- *Letter of credit fraud*
- *Free trade vs. cultural diversity*
- *Trade in genetically modified foods*
- *Chinese dumping: Is low cost selling unfair?*
- *Fair trade products—will paying a higher price for coffee eradicate poverty?*
- *Lobbying to decontrol exports of dual-use chemical*
- *Maritime fraud*

Other end-of-chapter features include *Managerial Implications*, which provides case problems suitable for extended discussions and end-of-chapter questions, many of which are based on actual cases (citations provided).

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

- *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 to align 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.*

Student Guide to the Sarbanes-Oxley Act. This brief overview for undergraduate business students explains the Sarbanes-Oxley Act, describes its requirements, and shows how it potentially affects students in their business life. The guide is available as an optional package with the text.

Business Law Digital Video Library. Featuring more than seventy-five video clips that spark class discussion and clarify core legal principles, the Business Law Digital Video Library is organized into five series: Legal Conflicts in Business (includes specific modern business and e-commerce scenarios); Ask the Instructor (presents straightforward explanations of concepts for student review); Drama of the Law (features classic business scenarios that spark classroom participation); Real World Legal (presents legal scenarios encountered in real businesses); and Business Ethics (presents ethical dilemmas in business scenarios). For more information about the Digital Video Library, visit **www.cengagebrain.com**.

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- *A thorough overview and timeline of events leading up to the global economic crisis*
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PART 1
The Legal Environment of International Business

Part One 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 One 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, country financial and political risk, the risks of trade controls or restrictions on investment, and the risks of foreign laws and foreign litigation. By illustrating some of the risks of international business, Chapter One sets the stage for the remainder of the book, which teaches that the law is an important tool for managing international business risk.

Chapter Two 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 humanitarian issues such as the ethical treatment of labor in developing countries, laundering of drug money through the international banking system, 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 facing businesses 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 Three 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 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) licensing of intellectual property, 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 contract to let others distribute it, license it to users, and then protect it from infringement. However, the greatest risks come with owning and operating 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 foreign 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 use **indirect exporting**. They may be unable to locate foreign buyers or are not yet ready to handle the mechanics of a transaction on their own. By indirect exporting, the firm can use specialized intermediaries that can take on many of the export functions—marketing, sales, finance, and shipping. Two types of intermediaries include export trading companies and export management companies.

International Trading Companies. These are firms that specialize in all aspects of import/export transactions by either 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 in 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 certificates from the U.S. Department of Justice that waive the application of U.S. antitrust laws to their 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 that 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.

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 2000 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 the 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 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

continues

continued

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. Foreign market research, 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 2010 there were more than 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 new-found 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**, 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 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 intellectual property 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

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, re-engineering, 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
- Re-evaluating 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

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 intellectual property 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 intellectual property will grant certain rights (the "license") in that property to another party under specified conditions and for a specified time, in return for 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 that they had authorized Krupny Plan to reproduce and

continues

continued

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 intellectual property.

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.

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