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INTERNATIONAL BUSINESS TRANSACTIONS

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CHAPTER I.
FORMS OF INTERNATIONAL BUSINESS

72. There are three main forms of doing business internationally: (a) trade, (b) technology transfer, and (c) foreign direct investment.
73. **(a) Trade**. Trade consists of the import and export of goods and services. *Importing* is the entering of goods into the customs territory of a country or the receipt of services from a foreign provider. *Exporting* is the shipment of goods out of a country or the rendering of services to a foreign buyer located in a foreign country.
74. **(b) Technology transfer**. We use the term "*technology*" to refer broadly to *intellectual property* (IP). IP refers to creations of the mind, such as inventions, symbols, names and images used in commerce, literary and artistic works, or designs. IP laws enable people to earn recognition or financial benefit from what they invent or create, by granting to the IP holder the *exclusive* legal right to use the IP for a specified period of time. In this sense, *intellectual property rights* (IPRs) are a grant from a government to an individual or firm of the *exclusive* legal right to use a particular form of IP and represent ownership rights over that IP. According to the World Intellectual Property Organization (WIPO), examples of IP include: patents, trademarks, copyrights, industrial designs, geographical indications and appellations of origin. We also include in the term "technology" trade secrets and know-how. Because technology has value, it represents (intangible) substantial business assets of many domestic and international companies, which can be transferred (sold or licensed) for use to others through a variety of agreements (for example, licensing agreements and franchising agreements).
75. **(c) Foreign direct investment**. Foreign direct investment (FDI) refers to the creation or acquisition by a business entity resident in one country of a lasting ownership interest in a business entity resident in another country, with the intent of having an effective voice in the management of the foreign entity. In this sense, FDI comes in two main forms: (i) greenfield investments whereby a foreign investor sets up a brand new business entity in a foreign country and (ii) mergers and acquisitions (M&A) of existing foreign businesses. As defined, FDIs are contrasted with both equity investments that do not seek control ("foreign indirect investment") and debt investments whereby the foreign investor becomes a mere lender, not an owner.
76. Each form of doing business internationally 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 the firm to a different set of business and legal risks.
77. Trade usually represents the least involvement, and thus the least political, economic, and legal risk, especially if the exporting firm is not soliciting business

overseas or maintaining sales agents or inventories there. The ownership of a foreign firm (FDI) 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), therefore carrying the highest risk.

78. Considerable overlap occurs among these different forms of doing business. A business plan for the production and marketing of a single product may contain elements of each form. To illustrate, a U.S. firm might purchase the rights to a trademark for use on an article of high-fashion clothing made from fabric exported from China and assembled in offshore plants in the Caribbean for shipment to the U.S. and Europe. Here, a business strategy encompasses 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 product or services, its commitment of capital resources, and the amount of risk it is willing to bear.

A. Trade

79. Trade is as old as the oldest civilization. Throughout history, countries traded to obtain needed items that were not readily available in their country. The marketplaces of Europe, Africa, Asia, and the Middle East had been the scene of trade for hundreds of years before seaborne trade became established. By the sixteenth century, the first international sea trade routes were established by the Europeans. With the advent of great naval power, Portugal and Spain opened the Americas, India, and the Pacific to trade. Portuguese was the language of the ocean traders. Portugal purchased textiles from India and China with gold taken from Africa. They traded Chinese porcelain to Spain for gold that Spain had taken from Mexico. By the eighteenth century, the Dutch had created a great trading empire based on pepper and spices, and England relied on America for tobacco, corn, and cotton. For more than three hundred years, trade in horses, weapons, and slaves thrived.

1. Trade in goods

80. Traditionally, states engaged in international business and trade principally through trade in goods. Since the end of the Second World War, international trade has been driving the process of globalization and integration of the world's economies.

81. International trade statistics show that global trade is expanding in both relative and absolute terms, and that the global share of developing countries is increasing. Another interesting trend is that while the U.S. share of world export has been declining, China's has been increasing.

82. The traditional measure of trade competitiveness has been determined by share of world exports. Under this criterion, until the 1990s, 20 economies, consisting

primarily of developed countries led by the U.S., Germany, and Japan, maintained shared about two-thirds of world trade. However, starting from about 1990, developing countries, led by China, have emerged to take a leading role in world exports. In 2009, China became the world's largest exporter of goods. This trend foreshadows a greater role for developing nations in international business and trade in the future. It also indicates that international trade is an increasingly important part of every nation's economic activity and well-being.

83. Another significant trend is that the growth in exports is tied directly to the level of technology involved. In this context, technology refers to knowledge (often protected by IPRs). Exports grow faster the higher the level of technology involved in the product and the lesser the reliance on natural resources as a source for the product. In the area of technology-intensive exports, developing countries are growing faster than their developed counterparts. High-technology products are now the largest source of foreign exchange for developing countries. The role of technology (IP) as an engine of international business and economic development for developing nations is another emerging world trend.

2. Trade in services

84. Unlike trade in goods, international trade in services involves no packages crossing a national boundary and a customs frontier. This form of trade covers sea and air transportation, travel, communications, insurance, financial, computer and information, legal, and other business services.

85. The intangible nature of trade in services makes it inherently more difficult to measure in concrete terms. Some trade in services can be defined by a physical activity such as transport, hotel, or insurance services, but other types of services such as consultancy or education are more intangible and may be more difficult to define and measure. While the measurement of trade in services is subject to greater difficulties than the measurement of trade in goods, trade in services has been growing rapidly, and a faster rate than trade in goods.

86. Lawyers have a large stake in the liberalization of trade in services, because they have long been barred by regulations forbidding transborder legal services. Although some of these barriers have been eliminated, many still remain.

87. As the tradeability of services increases as a result of modern information and communication technologies, it can be expected that the production of a growing number of services will shift to developing countries as was the case with manufacturing. The growth in foreign direct investment fueled primarily by MNEs, further discussed below, may foreshadow an expansion in the export of services. As companies expand their operations on a global basis, they will also move research and development, marketing, sales, accounting, human resources, and other services abroad as well. A number of MNEs are relocating these services to lower-cost sites and are exporting them back to the main corporate headquarters. In the developing

world, Asia appears to be more advanced than other regions in attracting the relocation of services.

B. Technology transfer

88. As discussed above, technology or IP includes patents, trademarks, copyrights, industrial designs, geographical indications and appellations of origin, trade secrets and know-how.
89. *Patents* are governmental grants to inventors ensuring them the exclusive legal right to produce and sell their inventions for a certain period of time (typically, 20 years). A patent provides the patent owner with the right to decide how or whether the invention can be used by others. In exchange for this right, the patent owner makes technical information about the invention publicly available in the published patent document.
90. *Trademarks* represent the exclusive right to use a name or symbol that identifies a company and/or its goods or services (by distinguishing the company and its products from other companies) for a certain period of time (typically, 10 years).
91. *Copyrights* represent exclusive rights to artistic or written works, including books, software, films, music, paintings, sculptures, computer programs, databases, advertisements, maps and technical drawings, granted to the author for a certain period of time (typically, the life of the author plus 50-100 years).
92. *Industrial designs* represent exclusive rights over the ornamental or aesthetic aspect of an article. A design may consist of three-dimensional features, such as the shape or surface of an article, or of two-dimensional features, such as patterns, lines or color.
93. *Geographical indications and appellations of origin* represent exclusive rights over signs used on goods that have a specific geographical origin and possess qualities, a reputation or characteristics that are essentially attributable to that place of origin. Most commonly, a geographical indication includes the name of the place of origin of the goods.
94. *Trade secrets* refers to confidential information that has commercial value and which may be sold or licensed. The unauthorized acquisition, use or disclosure of such information in a manner contrary to honest commercial practices by others is regarded as an unfair practice and a violation of the trade secret protection.
95. *Know-how* can be defined as confidentially or closely held information in the form of unpatented inventions, formulae, designs, drawings, procedures and methods, together with accumulated skills and experience of a company's professional personnel which could assist a transferee/licensee of the company's IP and bring to it a competitive advantage.
96. In the modern era, technology serves a vital role in international business, trade, and economic development. For developed nations, this means improved productivity and higher standards of living. For developing nations, this means

modernization and industrialization in order to overcome backwardness and poverty. For all nations, technology is critical to achieving these goals.

97. Because of their importance in promoting economic development, IPRs that protect and regulate the use of technology are the source of some of the sharpest disagreements between developed and developing nations. Developed countries dominate in the creation of technology. Developing nations tend to be importers and consumers of technology created in developed countries. Many developing nations believe that IPRs are unduly restricting their access to technology by denying access altogether or only through the payment of burdensome royalties and licensing fees. On the flip side, developed nations argue that strong IP laws are needed to protect their innovations.

98. As we have seen in the discussion of exports, the higher the level of technology, the faster the growth in exports. In the area of FDI, in many instances the most important contribution of the FDI that is critical to its success is not the capital investment but the technology contributed in the form of intellectual property such as patents, trademarks, copyrights, trade secrets, and know-how.

99. As an indication of the growing importance of IP in international business and trade, technology transfer, as measured by payments for royalties and licensing fees, increased dramatically at about the same rate as FDI since the 1990s. For example, technology payments rose from $92 billion in 2000 to $289 billion in 2012. It should not be surprising that developed countries dominate in the area of technology transfer. In 2012, 85% of all of the royalties and licensing fees on a worldwide basis were received by the U.S. (43%), the leading states of the EU (31%), and Japan (11%).

C. Foreign direct investment

100. Up to the mid-l980s, trade in goods was the most significant channel of international trade between countries. Exports grew much faster than FDI in the 1950s, 1960s, and 1970s. In the 1980s, however, this pattern began to change and the growth rates in FDI began to exceed the growth rates of trade in goods. Coinciding with the disintegration of the Soviet Union and its satellites, FDI began to rise dramatically in the 1980s and has now become the principal impetus behind the deepening of world economic integration. FDI reached an historic peak in 2007, touching a record almost $3 trillion, before falling back to about $1.2 trillion in the global recession year 2009. Since 2009, global FDI has again steadily increased. The rebound of FDI is widespread, covering all three groups of economies: developed, developing, and economies in transition.

101. The following forces are the main drivers behind the surge in FDI. The first is policy liberalization: opening up national markets and allowing all kinds of FDI and non-equity arrangements, following (i) changes in FDI laws made by many countries aimed at making the investment climate more favorable to inward FDI, (ii) conclusion of new bilateral investment treaties, and (iii) conclusion of new double

taxation treaties. The second force is rapid technological change, with its rising costs and risks, which makes it imperative for companies to tap world markets and to share these costs and risks. On the other hand, falling transport and communication costs have made it economical to integrate distant operations and ship products and components across the globe in the search for efficiency. The third force, a result of the previous two, is increasing competition. Heightened competition compels firms to explore new ways of increasing their efficiency, including by extending their international reach to new markets at an early stage and by shifting certain production activities to reduce costs.

CHAPTER II.
LEGAL FRAMEWORK FOR IBT

102. The modern law that applies to IBTs is a blend of: (a) domestic private and public laws, (b) certain portions of public international law, and (c) a variety of non-binding harmonizing instruments that have no legal force as such. Before we analyze them in turn, it is useful to illustrate the evolution of this framework over time.

103. In medieval times, before the rise of the nation-state, business transactions were carried on by European merchants from different European kingdoms based on common rules that they have developed among themselves through usage and custom. This body of rules was known as the *lex mercatoria* or medieval law merchant, and was the successor to the ancient *jus gentium* of Roman law. By the nineteenth century, this *lex mercatoria* was either codified in (or replaced by) domestic laws adopted by nation-states to govern commercial transactions. At that time, IBTs became largely governed by domestic laws, such that some legal theorists rejected the very notion of a supranational law merchant altogether, noting that the ancient *lex mercatoria* had ceased to exist as such, and, consequently, that all IBTs were necessarily governed by domestic laws.

104. However, in the latter part of the twentieth century, and continuing today at an accelerating pace, a new *lex mercatoria* has developed, which functions in a similar fashion to the *lex mercatoria* of old. This new *lex mercatoria* encompasses modern practices by merchants worldwide, which do not cease to evolve (reflected in a variety of binding and non-binding harmonizing instruments), as well as common rules stemming from international arbitration practice. As we will discuss in detail later, the availability and popularity of arbitration as a dispute resolution technique (alternative to litigation in front of domestic courts) means that many disputes are now resolved by international bodies, not by domestic courts. These international bodies are more comfortable operating outside the parameters of domestic laws and to seek to harmonize the rules applicable to IBTs. Consequently, both arbitration institutions and domestic courts still refer today to long-standing rules of international commerce that differ somewhat from domestic laws.

A. Domestic public and private laws

105. As discussed in the introductory chapter of this book, IBTs concern both private and public domestic laws, and frequently of more than just one country. Domestic public laws regulate rights affecting the public as a whole, such as antitrust, tax, securities regulation, customs control, exchange control, and general economic regulation (quotas, tariffs, unfair trade practices, etc).

Domestic private law deals with rights of private persons (individuals and companies), such as contracts, torts, property and commercial law. Public laws are mandatory. Private laws can generally be derogated from.

106. Moreover, an IBT will concern several domestic laws (for example, the domestic laws of both the buyer and the seller to a contract for the sale of goods between parties situated in different countries). When parties enter into a contract that has connections with more than one country, the question of which set of legal rules governs the transaction necessarily arises. The answer to this question is obviously important to a court or arbitral tribunal that must resolve a dispute between the parties but it is also important for the parties themselves, in planning the transaction and performing the contract, to know the set of rules that governs their obligations. This is why parties to IBTs are strongly encouraged to carefully negotiate and include in their contracts express provisions regarding the substantive law that will govern their contract.

1. Applicable law clauses

107. Such clauses are called "applicable law clauses" or "governing law clauses" and are typically drafted as follows: "This agreement shall be governed in all respects, including, without limitation, as to its validity, interpretation and effect, by the laws of [name of country], [excluding the application of the United Nations Convention on Contracts for the International Sale of Goods] and excluding the choice of law rules of [name of country previously selected to govern]".

108. As we will discuss in more detail below, the first exclusion, of the United Nations Convention on Contracts for the International Sale of Goods (CISG) might be necessary when the CISG would automatically apply as part of the domestic law of the selected country. We will see that the CISG has a dual nature: it is an international treaty (and, as such, part of international public law) which, upon its ratification, becomes part of the domestic law of the ratifying country.

109. The second exclusion (of the choice of law rules of the country whose laws are selected as the applicable law) is related to the fact that, as discussed in the introductory chapter of this book, private *international* law is a part of each country's *domestic* law that consists of rules used by domestic courts (or arbitral tribunals) to resolve issues of conflicts of laws that arise in an international context (*i.e.*, to determine the applicable law among the potentially applicable laws of different nations where the parties have not made a choice).

110. For example, in a contract between a French seller and a U.S. buyer, if the parties had negotiated and agreed on the application of French law to govern their contract, that exclusion clarifies to the future judge (or arbitrator) called to resolve a dispute between the parties that their intent was not for the judge to perform a conflict of laws analysis (under French *private international law*) in order to determine the applicable law (which analysis could, for example, result

in the application of U.S. law), but rather to apply only French domestic contract law.

111. One final cautionary statement. For reasons that we will explore later in this book when we study international dispute resolution, it is preferable not to include the applicable law clause in the dispute resolution clause, because such an inclusion can lead to confusion regarding whether the intent of the parties was that the law selected in the dispute resolution provision (i) would govern only the procedural aspects of dispute resolution or (ii) would also govern the substantive provisions of the parties' entire contract (*i.e.*, the substantive rights and obligations of the parties under the contract). Nothing prevents parties from selecting different laws to govern different portions of the same contract.

2. Application of private international law to determine the applicable law

112. In a situation where the parties themselves have not made an choice of law in a contract by including an applicable law clause (or their choice is not effective), or where the transaction is not governed by a superseding law such as an international treaty, the choice of law among the substantive domestic law of country A, country B, or a combination of the two, to govern the transaction will need to be made by the forum called to resolve a dispute between the party, which can be either a domestic court (of country A or country B) or an arbitral tribunal (perhaps even located in country C). This can be a complicated task in an IBT because a number of different laws from both national and international sources may apply. Moreover, various aspects of a single transaction may be governed by different laws. How is the choice of law determination made in an international context and what principles govern this choice? The answer to this question is "private international law" consisting, as we have seen, of domestic conflict of laws rules.

113. The outcome of a dispute sometimes dramatically depends on the law governing the matter. For example, in a breach of contract case involving a non-compete clause, the law of one jurisdiction may be more permissive than another regarding the temporal or geographic scope of non-compete clauses, or, conversely, might have a public policy that frowns on restrictive covenants.

114. **General overview**. Private international law rules come in many shapes and sizes. Each country (and sometimes each judicial jurisdiction within a country) adopted the rules or approach it believed best suited to resolving the difficult issues presented by choice of law cases. Generally, and with much simplification, absent an applicable law clause whereby the parties to a contract expressly state the law that will govern any disputes, the private international law rules of most jurisdictions provide that the law of the country *most closely connected* to the agreement will govern. The country of closest connection is often the country of the *residence of the performing party*. Sometimes, courts (and even more so

arbitral tribunals) apply different governing laws to different parts of the contract, because different parts of the contract have closer connections to different countries (this particular technique is called "*dépeçage*" and can also be employed by parties in their contracts). We will take a closer look at the private international law rules applicable in the EU and in the U.S., before reviewing the progress made at the international level within the Hague Conference on private international law and then discussing general issues of enforceability of applicable law clauses based on international practice of courts and arbitral tribunals.

a. EU private international law

115. Private international law rules for countries within the EU are set forth in Regulation (EC) 593/2008, known as the Rome I Regulation, and which works alongside two other regulations, Regulation (EC) 864/2007, known as the Rome II Regulation, and Council Regulation (EU) 1259/2010, known as the Rome III Regulation, to determine the applicable law in different types of civil and commercial matters. Rome I applies to contractual obligations, Rome II applies to non-contractual obligations and Rome III applies to divorce and legal separation. All three regulations have a self-executing nature.
116. The Rome I and Rome II Regulations sets out EU-wide rules for determining which national law should apply to *contractual and noncontractual obligations* in civil and commercial matters involving more than one country. They first provide that parties are entitled to submit both contractual and noncontractual obligations to the law of their choosing provided that such choice of law is valid and either expressed or is demonstrated with reasonable certainty by the circumstances of the case. The freedom of choice provided for by the Rome I and Rome II Regulations is not absolute but subject to certain exclusions, restrictions, and limitations.
117. For example, the parties cannot select the law applicable to non-contractual obligations arising from unfair competition, acts restricting free competition, or infringement of IPRs. Instead, such obligations are governed by the law selected on the basis of the connecting factors.
118. The freedom of choice of the parties also manifests, with respect to contractual obligations, in that the selected governing law may be applied to only a part or the whole of the contract and can be changed at any time as long as all parties agree.
119. After stipulating the freedom of choice of the parties, the Rome I Regulation then provides that, in the absence of a choice made by the parties in the contract, the *type of contract* will determine the applicable law. A contract for the *sale of goods* will be governed by the law of the country where the *seller* has his habitual residence (except for sale of goods by *auction*, to which the law of the country of the auction will apply). A contract for the provision of *services* will be governed by the law of the country where the *service provider* has his habitual residence.

A franchise or a distribution contract will be governed by the law of the country where the *franchisee* or the *distributor* has his habitual residence. Contracts concerning *immovable property* will be governed the law of the country where the property is located applies, except in the cases of temporary and private tenancy (maximum 6 consecutive months) when the applicable law will be that of the *landlord's* residence.

120. If none, or more than one, of the above rules apply to a contract, the applicable law will be determined based on the country of residence of the *party carrying out the principal part of the contract*. Moreover, if the contract is related more closely to another law than that provided by the above rules, that law will apply. The *most closely connected law* will also apply when no applicable law can be determined pursuant to the above rules.

121. Lastly, for certain specific types of contracts, the Rome I Regulation sets out options that the parties may choose from and determines the applicable choice where no choice is made. These include: contracts for the carriage of goods and passengers, insurance contracts, contracts between consumers and professionals (subject to the law where the *seller* has his habitual residence), and employment contracts (subject to the law where the *employee* has his habitual residence).

b. U.S. private international law

122. In the U.S., the rules of private international law have been synthetized in the Restatement on Conflict of Laws published by the American Law Institute. The first series of the Restatement was published in 1934. The second series of the Restatement was published in 1971 and revisions were published in 1989. The third series of the Restatement is currently in development.

123. The Restatement (Second) on Conflict of Laws commands a quest for the country with the "most significant relationship" to the parties and the issues of a particular case. To guide this quest, the Restatement provides three levels of principles of increasing specificity.

124. First, the broadest principles are stated in Section 6: "[T]he factors relevant to the choice of the applicable rule of law include (a) the needs of the interstate and international systems, (b) the relevant policies of the forum, (c) the relevant policies of other interested states and the relative interests of those states in determination of the particular issue, (d) the protection of justified expectations, (e) the basic policies underlying the particular field of law, (f) certainty, predictability, and uniformity of result, and (g) ease in the determination and application of the law to be applied. Section 6 applies to analysis of all substantive areas of law.

125. The second level principles focus on specific substantive areas, such as torts, contracts, and property. These general substantive provisions provide additional factors for consideration along with the factors listed in Section 6. For example, Section 188 lists the following additional factors in contract cases: (i) the place of contracting, (ii) the place of negotiation of the contract, (iii) the place of

performance, (iv) the location of the subject matter of the contract, and (v) the domicil, residence, nationality, place of incorporation and place of business of the parties. If the place of negotiating the contract and the place of performance are the same, there is a strong presumption in favor of the application of the law of that (same) place. These additional factors are to be weighed with the Section 6 factors in determining the law with "the most significant relationship to the transaction and the parties".

126. (i) The place of contracting. This is the place where the last act occurred that was necessary to give the contract binding effect. The place of contracting carries more weight if it also takes place in the parties' common domicile or place of negotiation. It carries less weight if the place of contracting is merely fortuitous and bears no relation to the parties and the contract, for example, when a letter of acceptance is mailed from a certain location during an unrelated business trip.

127. (ii) The place of negotiation. This is the place where the parties negotiate and agree on the terms of their contract. The place of negotiation is a significant contact, but any one state has less of an interest in the transaction if the parties conduct their negotiations in multiple places by email or by telephone or other electronic means.

128. (iii) The place of performance. This is the place where the parties perform their obligations under the contract. The place of performance is a significant contact, especially if both parties perform their obligations in the same state and are domiciled in the same state. However, any one state has less of an interest in the transaction if: (1) at the time of contracting the place of performance is either uncertain or unknown, or (2) performance by a party can be divided more or less equally among two or more states with different local law rules on the particular issue.

129. (iv) The location of the subject matter of the contract. For example, the state of the location of the equipment in an equipment lease or sale of equipment transaction is a significant contact because the parties would expect that the local law of the state where the equipment is located would be applied to determine many of the issues arising under the contract.

130. (v) The domicile, residence, nationality, place of incorporation, and place of business of the parties. A company's principal place of business generally is a more important contact than the place of incorporation, especially if the company does little or no business in its state of incorporation.

131. A forum will typically give greater weight if the transaction or the parties have multiple contacts in the same state. For example, if the place of negotiating the contract and the place of performance are in the same state, the forum typically applies the local law of that place.