GLOBAL EDITION

The Legal Environment of Business

A Critical Reasoning Approach

SEVENTH EDITION

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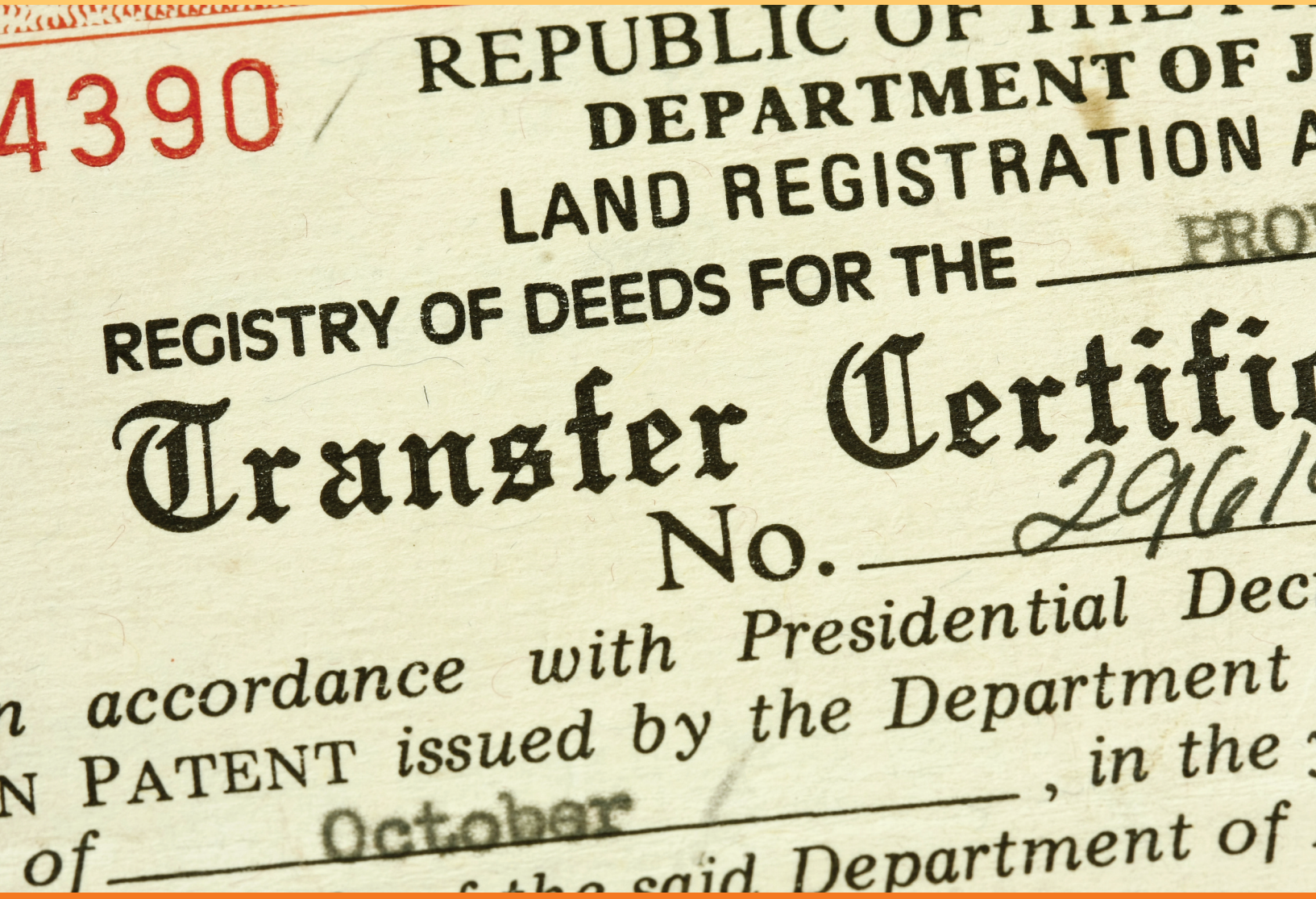

ALWAYS LEARNING

PEARSON

THE LEGAL ENVIRONMENT OF BUSINESS

Bombay engineering firm of Humphreys and Glasgow. The preliminary process design information furnished by UCC could not have been used to construct the plant. Construction required the detailed process design and engineering data prepared by hundreds of Indian engineers, process designers, and subcontractors. During the ten years spent constructing the plant, the design and configuration underwent many changes.

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

The vast majority of material witnesses and documentary proof bearing on causation of and liability for the accident is located in India, not the United States, and would be more accessible to an Indian court than to a United States court. The records are almost entirely in Hindi or other Indian languages, understandable to an Indian court without translation. The witnesses for the most part do not speak English but Indian languages understood by an Indian court but not by an American court. These witnesses could be required to appear in an Indian court but not in a court of the United States. India's interest is increased by the fact that it has for years treated UCIL as an Indian national, subjecting it to intensive regulations and governmental supervision of the construction, development, and operation of the Bhopal plant, its emissions, water and air pollution, and safety precautions. Numerous Indian government officials have regularly conducted on-site inspections of the plant and approved its machinery and equipment, including its facilities for storage of the lethal methylisocyanate gas that escaped and caused the disaster giving rise to the claims. Thus India has considered the plant to be an Indian one and the disaster to be an Indian problem. It therefore has a deep interest in ensuring compliance with its safety standards.

Affirmed in favor of Defendant, Union Carbide.

CRITICAL THINKING ABOUT THE LAW

Please refer to Case 8-3 and consider the following questions:

1. **Highlight the importance of facts in shaping a judicial opinion by writing an imaginary letter that, had it been introduced as evidence, would have greatly distressed Union Carbide Corporation (UCC).**

   Clue: **Review the first part of the decision, in which Judge Mansfield discussed the extent of UCC's involvement in the plant where the accident occurred. What facts would counter his statement that the parent company had only "limited" involvement?**

2. **Suppose a U.S. plant exploded, resulting in extensive deaths in the United States. Further, suppose that all the engineers who built the plant wrote and spoke German only. Could Judge Mansfield's decision be used as an analogy to seek dismissal of a negligence suit against the owners of the plant?**

   Clue: **Review the discussion of the use of legal analogies in Chapter 1 and apply what you read to this question.**

3. **What additional information, were it to surface, would strengthen Union Carbide's request for a dismissal of the case described?**

   Clue: **Notice the wide assortment of facts that Judge Mansfield organized to support his decision.**

COMMENT: The Bhopal victims filed their claims in U.S. courts against UCC because the parent company had more money than the subsidiary (UCIL). Also, suing the parent made it more likely that the case would be heard in U.S. courts, which are considered to be far better forums for winning damages in personal injury actions than Indian courts are. After the lawsuits were removed to an Indian court, UCC agreed to pay $470 million to the Bhopal disaster victims. Union Carbide's stock substantially decreased in value, and UCC was threatened by a takeover (though the attempt was thwarted in 1985). More than half of UCC was subsequently sold or spun off, including the Indian subsidiary (UCIL). In 1989, the Indian Supreme Court ordered UCC to pay $470 million to compensate Bhopal victims; criminal charges against the company and its officials were dropped. About 12,000 people worked for UCC in 1995, in contrast to the 110,000 employed by the company a decade earlier. In 2001, Dow Chemical acquired Union Carbide. (*See Wall Street Journal,* August 12, 2009, p. B-10.)

On June 7, 2010, a district court in Bhopal found seven former Union Carbide India, Ltd. officials guilty of "causing death by negligence" for a gas leak at the plant that killed approximately 3,000 people some 25 years before. This was the first criminal conviction. All convicted were Indian citizens. They were sentenced to 2 years in prison and fined 100,000 rupees ($2,130). The former Union Carbide subsidiary was convicted of the same charges and fined 5,000 rupees. All seven defendants were freed on bail. As of June, 2010, no cleanup has taken place in the affected area (*see* Lydia Polgreen and Hari Kumar, "8 Former Executive Guilty in '84 Bhopal Chemical Leak," *New York Times,* June 8, 2010, p. A-8; T. Lahiri, "Court Convicts Seven in Bhopal Gas Leak," *Wall Street Journal,* June 8, 2010, p. A-11).

Joint ventures, which involve a relationship between two or more corporations or between a foreign multinational and an agency of a host-country government or a host-country national, are usually set up for a specific undertaking over a limited period of time. Many developing countries (such as China) allow foreign investment only in the form of a joint venture between host-country nationals and the multinationals. Recently, three-way joint ventures have been established among United States–based multinationals (e.g., automobile companies such as Chrysler and General Motors), Japanese multinationals (e.g., Mitsubishi and Honda), and Chinese government agencies and Chinese nationals. Joint ventures are also used in host countries with fewer restrictions on foreign investment, often to spread the risk or to amass required investment sums that are too large for one corporation to raise by itself. Some of these joint ventures are private associations, with no host-government involvement.

joint venture Relationship between two or more persons or corporations or an association between a foreign multinational and an agency of the the host government or a host country national set up for a business undertaking for a limited time period.

Risks of Engaging in International Business

Unlike doing business in one's own country, the "rules of the game" are not always clear when engaging in business in a foreign country, particularly in what we have classified as middle- and low-income economies. Here we set out three primary risks that managers engaged in international business may face: (1) expropriation of private property by the host foreign nation, (2) the application of the sovereign immunity doctrine and the act-of-state doctrine to disputes between foreign states and U.S. firms, and (3) export and import controls.

EXPROPRIATION OF PRIVATE PROPERTY

Expropriation—the taking of private property by a host-country government for either political or economic reasons—is one of the greatest risks companies take when they engage in international business. Thus, it is essential for business managers to investigate the recent behavior of host-country government officials, particularly in countries that are moving from a centrally planned economy toward one that is market oriented (e.g., Russia and Eastern European nations).

expropriation The taking of private property by a host country government for political or economic reasons.

One method of limiting risk in politically unstable countries is to concentrate on exports and imports (trade) and licensing and franchising. Another method is to take advantage of the low-cost insurance against expropriation offered by the Overseas Private Investment Corporation (OPIC). If a U.S. plant or other project is insured by OPIC and is expropriated, the U.S. firm receives compensation in return for assigning to OPIC the firm's claim against the host-country government.

Bilateral investment treaties (BITs), which are negotiated between two governments, obligate the host government to extend fair and nondiscriminatory treatment to investors from the other country. A BIT normally also includes a promise of prompt, adequate, and effective compensation in the event of expropriation or nationalization.

bilateral investment treaty (BIT) Treaty between two parties to outline conditions for investment in either country.

SOVEREIGN IMMUNITY DOCTRINE

sovereign immunity doctrine States that a foreign-owned private property that has been expropriated is immune from the jurisdiction of courts in the owner's country.

Another risk for companies engaged in international business is the **sovereign immunity doctrine**, which allows a government expropriating foreign-owned private property to claim that it is immune from the jurisdiction of courts in the owner's country because it is a government rather than a private-sector entity. In these cases, the company whose property was expropriated often receives nothing because it cannot press its claims in its own country's courts, and courts in the host country are seldom amenable to such claims.

The sovereign immunity doctrine has been a highly controversial issue between the United States and certain foreign governments of developing nations. To give some protection to foreign businesses without impinging on the legitimate rights of other governments, the U.S. Congress in 1976 enacted the Foreign Sovereign Immunities Act (FSIA), which shields foreign governments from U.S. judicial review of their public, but not their private, acts. The FSIA grants foreign nations immunity from judicial review by U.S. courts unless they meet one of the FSIA's private exceptions. One such exception is the foreign government's involvement in commercial activity. Case 8-4 clarifies the U.S. Supreme Court's definition of commercial activity under the FSIA. Note how the Court emphasizes the nature of the Nigerian government's action by asking whether it is the type of action a private party would engage in.

CASE 8-4

Keller v. Central Bank of Nigeria
United States Court of Appeals
277 F.3d 811 (6th Cir. 2002)

Prince Arthur Ossai, a government official in Nigeria, entered into a contract with Henry Keller (plaintiff), a sales representative for H.K. Enterprises, Inc., a Michigan-based manufacturer of medical equipment. They agreed that, among other things, Ossai would have an exclusive distribution right to sell H.K. products in Nigeria, which would buy $4.1 million of H.K. equipment for $6.63 million, plus a $7.65 million "licensing fee." Before the deal closed, though, Ossai demanded that $25.5 million on deposit in the Central Bank of Nigeria (CBN) be transferred into an account set up by Keller. CBN employees charged Keller $28,950 in fees for the transaction, but the funds were never transferred. Keller and H.K. filed a suit in a federal district court against the CBN and others, asserting in part a claim under the Racketeer Influenced and Corrupt Organizations Act (RICO). The defendants filed a motion to dismiss under the Foreign Sovereign Immunities Act. The court denied the motion, concluding that the claim fell within the FSIA's "commercial activity" exception. The defendants appealed to the U.S. Court of Appeals for the Sixth Circuit.

Justice Norris

[The defendants] claim that the illegality of the deal alleged precludes a finding that it is a commercial activity. The FSIA defines "commercial activity" as "either a regular course of commercial conduct or a particular commercial transaction or act." The commercial character of an activity shall be determined by reference to the nature of the course of conduct or particular transaction or act, rather than by reference to its purpose. [W]hen a foreign government acts, not as regulator of a market, but in the manner of a private player within it, the foreign sovereign's actions are commercial within the meaning of the FSIA.

In the instant case, the conduct was a deal to license and sell medical equipment, a type of activity done by private parties and not a "market regulator" function. The district court correctly concluded that this was a commercial activity, and that any fraud and bribery involved did not render the plan non-commercial.

Defendants claim that plaintiffs cannot establish another element of the commercial activity exception, namely, that there was a direct effect in the United States. [A]n effect is "direct" if it follows as an immediate consequence of the defendant's activity.

In this case, defendants agreed to pay but failed to transmit the promised funds to an account in a Cleveland bank. Other courts have found a direct effect when a defendant agrees to pay funds to an account in the United States and then fails to do so. The district court in the instant case correctly concluded, in accord with the other [courts], that defendant's failure to pay promised funds to a Cleveland account constituted a direct effect in the United States.

Affirmed for Plaintiff.

CRITICAL THINKING ABOUT THE LAW

Context plays a vital role in any legal decision. The existence or nonexistence of certain events directly affects the court's verdict. In Case 8-4, the court applies the strictures of the FSIA to the specific facts of the case. If certain facts exist, the federal statute protects the plaintiff, and the court should appropriately reject the defendant's motion to dismiss. Otherwise, the CBN is immune, and the statute does not protect the plaintiff.

Understanding the facts is the starting point for legal analysis. The following questions encourage you to consider the significance of the facts in Case 8-4.

1. **What facts are critical in the court's ruling in favor of the plaintiff?**

   Clue: **Reread the introductory paragraph.**

2. **Look at the facts you found. To illustrate the importance of context, which fact, if it had not been included in the case, might have resulted in the court's granting the defendant's motion to dismiss?**

   Clue: **Find the elements of the federal statute that the judge discusses and use these elements as a guide to highlight the most significant facts.**

Act-of-State Doctrine

The **act-of-state doctrine** holds that each sovereign nation is bound to respect the independence of every other sovereign state and that the courts of one nation will not sit in judgment on the acts of the courts of another nation done within that nation's own sovereign territory. This doctrine, together with the sovereign immunity doctrine, substantially increases the risk of doing business in a foreign country. Like the sovereign immunity doctrine, the act-of-state doctrine includes some court-ordered exceptions, such as when the foreign government is acting in a commercial capacity or when it seeks to repudiate a commercial obligation.

act-of-state doctrine A state that each nation is bound to respect the independence of another and the courts of one nation will not sit in judgment on the acts of the courts of another nation.

Congress made it clear in 1964 that the act-of-state doctrine shall not be applied in cases in which property is confiscated in violation of international law, unless the president of the United States decides that the federal courts should apply it. As Case 8-5 demonstrates, the plaintiff has the burden of proving that the doctrine should not apply—that is, the courts should sit in judgment of public acts of a foreign government, in this case, a former government.

CASE 8-5

Republic of the Philippines v. Ferdinand E. Marcos
United States Circuit Court of Appeals
862 F.2d 1355 (9th Cir. 1988)

The Republic of the Philippines (plaintiff) brought a civil suit against its former president, Ferdinand Marcos, and his wife, Imelda (defendants), asserting claims under the Racketeer Influenced and Corrupt Organizations Act and other applicable U.S. law. The Republic alleged that the Marcoses (and other defendants) arranged for investments in real estate in Beverly Hills, California, of $4 million fraudulently obtained by the Marcoses; that the Marcoses arranged for the creation of two bank accounts in the name of Imelda Marcos at Lloyds Bank of California totaling more than $800,000, also fraudulently obtained by the Marcoses; and that the Marcoses transported into Hawaii fraudulently obtained money, jewels, and other property worth more than $7 million. The key to the Republic's entire case is the allegation that the Marcoses stole public money. The federal district court entered a preliminary injunction enjoining the Marcoses from disposing of any of their assets except to pay attorneys and their living expenses. The Marcoses appealed.

Justice Noonan

Before determining whether issuance of an injunction was appropriate we must consider two defenses which, if accepted, would block trial of the case the

Marcoses maintain. First, that their acts are insulated because they were acts of state not reviewable by our courts, and second, that any adjudication of these acts would involve the investigation of political questions beyond our court's competence. The classification of certain acts as "acts of state," with the consequence that their validity will be treated as beyond judicial review, is a pragmatic device, not required by the nature of sovereign authority and inconsistently applied in international law. The purpose of the device is to keep the judiciary from embroiling the courts and the country in the affairs of the foreign nation whose acts are challenged. Minimally viewed, the classification keeps a court from making pronouncements on matters over which it has no power; maximally interpreted, the classification prevents the embarrassment of a court defending a foreign government that is "extant at the time of suit." The "continuing vitality" of the doctrine depends on its capacity to reflect the proper distribution of functions between the judicial and political branches of the government on matters bearing upon foreign relations.

As a practical tool for keeping the judicial branch out of the conduct of foreign affairs, the classification of "act of state" is not a promise to the ruler of any foreign country that his conduct, if challenged by his own country after his fall, may not become the subject of scrutiny in our courts. No estoppel exists insulating a deposed dictator from accounting. No guarantee has been granted that immunity may be acquired by an ex-chief magistrate invoking the magic words "act of state" to cover his or her past performance.

In the instant case the Marcoses offered no evidence whatsoever to support the classification of their acts as acts of state. The burden of proving acts of state rested upon them. They did not undertake the proof.

Bribetaking, theft, embezzlement, extortion, fraud, and conspiracy to do these things are all acts susceptible of concrete proof that need not involve political questions. The court, it is true, may have to determine questions of Philippine law in determining whether a given act was legal or illegal. But questions of foreign law are not beyond the capacity of our courts. The court will be examining the acts of the president of a country whose immediate political heritage is from our own. Although sometimes criticized as a ruler and at times invested with extraordinary power, Ferdinand Marcos does not appear to have had the authority of an absolute autocrat. He was not the state, but the head of the state, bound by the laws that applied to him. Our courts have had no difficulty in distinguishing the legal acts of a deposed ruler from his acts for personal profit that lack a basis in law.

Affirmed for Plaintiff, Republic of the Philippines.

CRITICAL THINKING ABOUT THE LAW

1. **At the outset of Case 8-5, Justice Noonan acknowledges a key ambiguity in this case that will require clarification before announcing his decision. How does that ambiguity affect the reasoning?**

   Clue: **Notice the key concept in the first of the two defenses used by the Marcoses.**

2. **What behavior of the Marcoses made it highly unlikely that the first defense would be effective?**

   Clue: **Review Justice Noonan's rationale for not honoring the defense.**

3. **What ethical norm is implicit in the Marcoses' struggle against the preliminary injunction?**

   Clue: **Look back at the discussion of the ethical norms and eliminate those that seem inconsistent with the Marcoses' behavior and interests.**

EXPORT AND IMPORT CONTROLS

Export Controls. Export controls are usually applied by governments to militarily sensitive goods (e.g., computer hardware and software) to prevent unfriendly nations from obtaining these goods. In the United States, the Department of State, the Department of Commerce, and the Defense Department bear responsibility, under the Export Administration Act and the Arms Export Control Act, for authorizing the export of sensitive technology. Both criminal and administrative sanctions may be imposed on corporations and individuals who violate these laws.

Export controls often prevent U.S. companies from living up to negotiated contracts. Thus, they can damage the ability of U.S. firms to do business abroad.

Import Controls. Nations often set up import barriers to prevent foreign companies from destroying home industries. Two such controls are tariffs and quotas. For example, the United States has sought historically to protect its domestic automobile and textile industries, agriculture, and intellectual property (copyrights, patents, trademarks, and trade secrets). Intellectual property has become an extremely important U.S. export in recent years, and Washington has grown more determined than ever to prevent its being pirated. After several years of frustrating negotiations with the People's Republic of China, the U.S. government decided to threaten imposition of 100 percent tariffs on approximately $1 billion of Chinese imports in 1995, and again in 1996 and 1997. In retaliation, the Chinese government has threatened several times to impose import controls on many U.S. goods. Washington took action only after documenting that hundreds of millions of dollars' worth of "pirated" computer software and products (including videodiscs, law books, and movies) was being produced for sale within China and for export to Southeast Asian nations in violation of the intellectual property laws of both China and the United States, as well as international law. The documentation showed that 29 factories owned by the state of Communist Party officials were producing pirated goods. A last-minute settlement in which the Chinese government pledged to honor intellectual property rights prevented a trade war that would have had negative implications for workers in import–export industries in both countries. American consumers would also have suffered because Chinese imports would have become twice as expensive had the 100 percent tariff taken effect—though the effect on consumers would have been offset by an increase in imports of the affected goods from other foreign countries (e.g., English and Japanese bikes would have replaced Chinese bikes in demand).

Another form of import control is the imposition of antidumping duties by two U.S. agencies, the International Trade Commission (ITC) and the International Trade Administration (ITA). The duties are levied against foreign entities that sell the same goods at lower prices in U.S. markets than in their own in order to obtain a larger share of the U.S. market (i.e., entities that practice "dumping").

Legal and Economic Integration as a Means of Encouraging International Business Activity

Table 8-2 summarizes a number of groups that have been formed to assist businesspeople in carrying out international transactions. These groups range from the WTO (formerly the General Agreement on Tariffs and Trade), which is attempting to reduce tariff barriers worldwide, to the proposed South American Common Market, which would form a duty-free zone for all the nations of South America. The most ambitious organization is the EU, which is in the process of forming a Western European political and economic community with a single currency and a common external tariff barrier toward nonmembers.

Multinational corporations are learning that doing international business is much easier when they are aware of the worldwide and regional groups listed in Table 8-2. We will describe three of these groups: the WTO, the EU, and NAFTA. We chose to examine these three because they represent three different philosophies and structures of legal and economic integration, not because we do not appreciate the major effects of other integrative groups outlined in the table.