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# An Anti-Unfair Competition Law Without a Core: An Introductory Comparison Between U.S. Antitrust Law and the New Law of the People's Republic of China

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## I. INTRODUCTION

On September 2, 1993, China's legislative body, the National People's Congress, passed the Anti-Unfair Competition Law of the People's Republic of China (hereinafter "the New Law"), which came into effect on December 1, 1993.[1] This Article provides a thorough introduction to the New Law and makes both structural and conceptual comparisons between the New Law and key United States antitrust laws. This introduction and comparison will not only help American companies doing, or planning to do, business in China understand the New Law and its impact on their business operations in China, but will also help American lawyers understand the New Law for the benefit of their international practice.

The New Law is the first statute China has promulgated in the anti-unfair competition/antitrust law area. In contrast, the United States has enacted a number of key antitrust statutes, including the Sherman Act, the Clayton Act (as amended by Robinson-Patman Act), and the

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1. The New Law has not been codified. All citations to the New Law in this Article are from the PEOPLE'S DAILY (OVERSEAS EDITION), September 7, 1993, which published the New Law. No citation will be provided hereinafter except article numbers of the New Law. Also, there will be no official translation in English of the New Law. The English provisions cited in this Article are the Author's translation, and are only excerpts of the New Law. In case that such translation varies in meaning from the official version in Chinese, the latter shall control.

Federal Trade Commission Act ("FTC Act").[2] China has been in the process of economic reform since the late 1970s, converting the old "planned economy" system, copied from the former Soviet Union in the early 1950s, into the so-called "socialist market economy" system. Although no ideal definition has been developed as to what the "socialist market economy" should really look like, it has been widely perceived as an economy in which the market mechanism plays a crucial role. Under the old planned economy system, competition made little sense because everything, theoretically, was to be planned (although "planned" does not necessarily mean "achieved"). However, in the newly introduced market economy system, nothing seems more important than fair competition and its protection. Article 1 of the New Law clearly states: "This law is enacted in order to ensure the healthy development of the socialist market economy, encourage and protect fair competition, crack down on acts of unfair competition, and protect the legal rights and interests of business owners and consumers."

The New Law is significant for many reasons: (1) It is China's first legislation recognizing fair competition; (2) it provides necessary protection for the development of a market mechanism, although such protection under the New Law is very primary and limited; and (3) the New Law also means additional legal protection for the interests of foreign investors in China, especially those with investments related to trademarks and trade secrets. It is expected that the enactment of the New Law will improve China's overall environment for foreign investment..

The United States is the third largest investor in China, with total direct investment of nearly 7 billion U.S. dollars as of the end of 1993. Therefore, it is important for American companies which are doing or intend to do business in China to know both the similarities and the differences between the New Law and U.S. antitrust laws. With the promulgation of the New Law, questions which may arise among such American companies include: (1) Does the New Law prohibit unfair practices similar to United States antitrust laws? (2) Does the New Law provide similar remedies or penalties for violations? (3) Who will be the enforcing agency? (4) How is the New Law enforced?

This Article answers these questions through an introduction to the New Law and a comparison with U.S. antitrust laws. This Article primarily focuses on examining the meaning of unfair acts and the

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2. The Sherman Act, 15 U.S.C. §§ 1-7; The Clayton Act, 15 U.S.C. §§ 12-27; F.T.C. Act, 15 U.S.C. §§ 41-58.

respective categories listed under the New Law. In addition, this Article also examines the primary legal remedies and penalties imposed under the New Law, the power of the government agencies which enforce the New Law (hereinafter the "enforcing agencies"), and the procedures used by the enforcing agencies. At each stage, comparisons will be made to relevant parts of the U.S. antitrust laws.

## II. UNFAIR COMPETITIVE ACTS DEFINED AND ENUMERATED

The New Law defines acts of unfair competition as "those which are in violation of the provisions of the New Law, cause damage to the legal rights and interests of other business operators, and disrupt the socio-economic order."[3] This definition contains three elements: violation of the New Law, damage to other parties, and disruption to the socio-economic order.

The first element is most important because it defines the precise scope of application of the law. In other words, only those acts which are listed in, and clearly declared unlawful by, the New Law will be treated as unfair acts. The New Law does not apply to acts not enumerated in, and therefore not prohibited by, the New Law, no matter how unfair the act might seem.

The second element provides a ground for civil damage recovery for business operators whose legal rights and interests are invaded by the unfair acts. However, this element is not a prerequisite for holding some acts to be unfair. As will be discussed below,[4] the enforcing agencies may declare that certain actions constitute unfair practices and may impose sanctions without any proof of damages to other parties.

The third element, disruption to the socio-economic order, does not provide any practical guidance in determining whether certain conduct constitutes unfair competition. Virtually any conduct which is in violation of the provisions of the New Law and/or causes damage to other business operators' legal rights and interests can readily be labeled as conduct which disrupts the socio-economic order.

Under U.S. antitrust laws, there seems to exist no comprehensive definition as to what constitutes an unfair act. Rather, specific types of unfair practices are defined in statutes such as the Sherman Act, the Clayton Act, the Robinson-Patman Act, and the FTC Act. Nevertheless, the following language of Section 5 of the FTC Act appears to serve as a general definition for anti-competitive behavior: "Unfair

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3. New Law, art. 2, para. 2.
4. *See infra* Part IV.

methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce . . . ."[5]

Unlike the definition in the New Law, Section 5 of the FTC Act distinguishes "unfair methods of competition" from "unfair (or deceptive) acts or practices." The former refers to those practices which are specifically prohibited by the Sherman, Clayton and Robinson-Patman Acts, including horizontal and vertical price fixing, horizontal market allocations, anti-competitive group boycotts, competitively unreasonable exclusive dealing, monopolization, attempted monopolization, and conspiracies to monopolize. The latter refers primarily to unfair or deceptive marketing techniques, including fraudulent advertising and misleading product promotions.

The New Law specifically prohibits several unfair practices. The following provides a sketch of those prohibitions.

A. *Acts Relating to Trademark Infringement*

Article 5 of the New Law reads:

> Business operators may not cause damages to its competitors by utilizing the following unfair methods to conduct business transactions:
>
> A. counterfeiting others' registered trademarks;
> B. causing confusion between their products with well-known products and making a buyer mistake one commodity for said well-known products by using the names, packaging or decoration of well-known products without authorization, or by using names, packaging or decoration closely similar to the well-known products;
> C. causing consumers to mistake one's commodity for another's by using the names of other enterprises or individuals;
> D. making misleading or fraudulent representations on a commodity's quality by forging or counterfeiting quality marks including certified quality marks and famous/excellent quality marks, by fabricating the origin of production, or by making fraudulent and/or misleading representation about the quality of the commodities.

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5. 15 U.S.C. § 45(a)(1).

Trademark infringements and other related conduct are prohibited primarily under China's Trademark Law.[6] Article 5 of the New Law repeats this prohibition. By listing trademark infringement and other related acts as unfair conduct, the New Law provides additional protection to the party whose trademark is infringed.

B. *Certain Acts by Public Utilities Enterprises and Exclusive Dealers*

Article 6 of the New Law provides in pertinent part:

> Public utilities enterprises and other business operators which enjoy the status of exclusive dealing privileges under the laws shall not force others to purchase goods/services from the business operators designated by them in order to push out other business operators' fair competition.

The enterprises referred to in this Article of the New Law include those in the industries of energy, transportation, telecommunications, water supply, and others which are critical to the national economy and people's daily life. In the past, these industries were substantially monopolized by the government or by agencies directly authorized by the government. However, since the late 1980s, the Chinese government has gradually opened some of these industries to the private sector and to foreign investment as part of its foreign investment inducement policy. As a result, there have emerged some "competitors" in some of these areas, including joint venture railroad ownership, joint venture power stations, joint venture highways, and joint venture wharfs. Article 6 of the New Law reflects such transitional changes, and intends to protect the interests of the new competitors, including American investors, in these areas. However, good intentions do not always square with reality.

Article 6, with its ambiguous wording, will become one of the most difficult articles in the New Law to be enforced. The reality in China seems to be that substantial parts of the public utilities industries are still under the control of either the central or local government, that free market mechanisms, especially with respect to the prices of the products or services in those industries, have not yet been playing the dominant role, and that most of the Chinese entities in utilities industries are merely government agencies with a business or corporate outfit. In such circumstances, fair competition for the new competitors is merely a hope rather than a reality. In the United States, since

6. People's Republic of China Trademark Law, art. 38.

utilities industries have never been in the same position as the Chinese utilities industries have, there are no legislative provisions in U.S. antitrust laws comparable to Article 6 of the New Law.

C. *Acts Related to Administrative Functions*

Article 7 of the New Law states:

> The government and its subordinated offices shall not abuse their administrative power to force others to purchase goods or services of the business operators designated by the government, or to impose limits upon the business activities of other business operators.
>
> Government and its subordinated offices shall not abuse its administrative power to limit the entry of goods or services from outside regions into local markets, or vice versa.

This is another Article which is unique in the Chinese anti-unfair competition law system. Like Article 6, Article 7 reflects certain transitional changes. On one hand, Article 7 demands the free flow of goods or services and limits administrative interference with free competition. On the other hand, the word "abuse" sets the tone, implying that as long as government and its subordinated offices do not abuse their administrative power, they may still, to a certain extent, force others to purchase goods or services of business operators designated by the government, impose limits upon the business activities of other business operators, and/or limit the free flow of goods or services.

While any provision like Article 7 in U.S. antitrust laws would be unthinkable, the restriction under Article 7 may still seem to be a reasonable step in the transition from a fully-planned economy toward a market economy. Free competition and the market mechanism cannot be established overnight simply by abandoning the old economic system, regardless of how unreasonable it may have been.

D. *Acts Related to Commercial Bribery, Kickbacks, and Discounts*

Article 8 of the New Law declares:

> Business operations shall not promote the sale or purchase of goods or services by using bribery in the form of property or otherwise. It should be treated as bribery when one business operator pays secret kick-backs outside the accounting records; it should be treated as acceptance of bribery if the entity or individual of the other side receives the secret kick-backs outside the accounting records.

> During the sale or purchase of goods or services, a business operator may expressly give the other party a discount, or pay a commission to broker, to the extent that such discount and commission must be recorded for accounting purposes. The business operator who accepts such discount or commission must also record it for accounting purposes.

Article 8 clearly prohibits commercial bribery, including secret kick-backs. However, this Article does not prohibit discounts and commissions if the discount or commission is recorded for accounting purposes. Commercial bribery and secret discounts or commissions are common practice in China, especially among entities in the private sector, which often use them as efficient techniques to compete with state-owned enterprises. Therefore, Article 8 of the New Law will have much more impact upon the business entities in the private sector.

E. *Acts Related to Advertisements*

Article 9 of the New Law provides:

> Business operators shall not, by advertisement or other means, make fraudulent or misleading descriptions of a commodities' quality, ingredients, function, use, manufacturer, expiration limit or production place.
>
> Advertisers, having knowledge or having reason to know, shall not represent such business operators in designing, producing and releasing to the public such fraudulent or misleading advertisements.

Article 9 aims to crack down on unfair product promotion techniques, which are also common practices in China. It is important to note that Article 9 not only prohibits business operators from making fraudulent or misleading advertisements, but also prohibits advertisers from knowingly making such fraudulent or misleading advertisements.

F. *Acts Infringing Trade Secrets*

Article 10 of the New Law provides:

> Business operators shall not infringe trade secrets in the following means:
>
> A. obtaining trade secrets of others through theft, inducement, duress, or other unfair means;
> B. disclosing, utilizing or franchising trade secrets of others which are obtained in the manner described in the preceding paragraph;

> C. disclosing, utilizing or franchising the trade secrets under its control, in breach of an agreement or a confidentiality demand by the trade secret owner.

Acts of a third party who obtains, utilizes, or discloses others' trade secrets with the knowledge that such acts as listed above are unlawful should be treated as infringing those trade secrets.

Article 10 further defines trade secrets as "technological information or business information which is unknown to the public, may generate economic benefit to the owner, is practical, and is protected by the owner with certain measures."

### G. *Acts Related to Commodity Distribution*

The New Law prohibits three types of acts which are related to commodity distribution. Article 11 of the New Law provides: "Business operators shall not, for the purpose of pushing out competition, sell goods or services at a price which is lower than cost." However, Article 11 lists the following as exceptions; selling fresh and live goods, disposing of goods whose time limit is to expire or which has been in inventory for a long time, seasonal discounts, or selling goods for the reasons of paying debt, changing the line of production, or winding up.
Article 12 of the New Law provides: "In selling commodities, a business operator shall not, against the buyer's will, tie one commodity's availability to the purchase of another, or put unreasonable conditions upon purchasing."

Article 13 of the New Law provides:

> Business operators shall not sell commodities in the following forms of sweepstake:
>
> A. deceptive sweepstake sale in which there virtually exists no sweepstake awards, or in which the winners of the awards are predecided;
> B. using sweepstake sale to sell low quality commodities at high prices;
> C. sweepstake sale in which the highest prize exceeds 5,000 Yuan.[7]

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7. The current exchange rate between the U.S. dollar and the Chinese Yuan is 8.699 yuan per U.S. dollar. WALL ST. J., April 18, 1994, at C6.

H. *Acts Detrimental to Competitors' Business Reputation*

Article 14 of the New Law provides: "Business operators shall not fabricate or spread false rumors to damage the business trustworthiness and reputation of its business competitors."

I. *Concerted Acts in Bidding*

Article 15 of the New Law provides:

> Bidders shall not make tenders in conspiracy for the purpose of increasing or decreasing the bidding price.
>
> Bidder and bid inviter shall not conspire with each other to push out other parties' fair competition.

## III. COMPARISON OF VIOLATIONS UNDER THE NEW LAW AND U.S. ANTITRUST LAWS

Reviewing the above anti-competitive acts established by the New Law, and comparing what exists under the U.S. antitrust laws, several significant differences should be noted.

A. *The Core Part of Antitrust Law Violations Is Missing in the New Law*

The traditional violations under U.S. antitrust laws include (1) horizontal and vertical price fixing, as prohibited under Section 1 of the Sherman Act;[8] (2) tying arrangements and exclusive dealing as prohibited under Section 1 of the Sherman Act and Section 3 of the Clayton Act;[9] (3) anti-competitive group boycotts as prohibited under Section 1 of the Sherman Act;[10] (4) anti-competitive monopolization, attempted monopolization and conspiracies to monopolize as prohibited under Section 2 of the Sherman Act;[11] (5) discriminatory pricing and illegal brokerage payments as prohibited under the Robinson-Patman Act, as amended to Section 2 of the Clayton Act;[12] and (6) anti-competitive mergers and acquisitions as prohibited under Section 7 of the Clayton Act.[13] Compared with these traditional antitrust law viol-

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8. 15 U.S.C. § 1.
9. *Id.* §§ 1, 14.
10. *Id.* § 1.
11. *Id.* § 2.
12. *Id.* § 13(a),(c).
13. *Id.* § 18.

ations existing in U.S. antitrust laws, the New Law lists only a few such traditional antitrust violations with significant conceptual variations.

1. *Tying and Conditioned Dealing*

Tying arrangements and certain conditioned sales/purchases are prohibited by the New Law under Article 12. However, the language of Article 12 seems to imply that this violation is a unilateral offense on the seller's or service provider's part, rather than a bilateral violation as defined under both Section 1 of the Sherman Act and Section 3 of the Clayton Act.[14] Also, Article 12 of the New Law does not distinguish concepts such as goods, services, and commodities, and generally prohibits any tying or conditioned purchases or sales. Unlike Article 12 of the New Law, U.S. antitrust laws treat goods, services, and commodities tying arrangements differently under Section 1 of the Sherman Act and Section 3 of the Clayton Act. Finally, as will be discussed in more detail below, the New Law does not provide any specific remedy or penalty for acts in violation of Article 12.

2. *Commercial Bribery*

Paragraph 1 of Article 8 of the New Law clearly prohibits bribery in commercial transactions. In addition, secret kick-backs outside the accounting records are treated as bribery. Under China's Criminal Law, both giving and accepting a bribe is a crime.[15]

Paragraph 2 of Article 8 deals with secret discounts and commissions in commercial transactions. The New Law does not generally prohibit discounts and commissions, as long as they are reflected in both the payor's and the payee's accounting records.

U.S. antitrust laws treat commercial bribery, illegal brokerage, and discount payments as price discrimination. Section 2(c) of the Clayton Act, which was amended by the Robinson-Patman Act, provides:

> It shall be unlawful for any person engaged in commerce, in the course of such commerce, to pay or grant as to receive or accept, anything of value as a commission, brokerage, or other compensation, or any allowance of discount in lieu thereof, except for services rendered in connection with the sale or purchase of goods, wares or merchandise, either to

14. *Id.* §§ 1, 14.

15. People's Republic of China Criminal Law, art. 185.

the other party to such transaction or to an agent, representative, or other intermediary therein.[16]

Comparing Article 8 of the New Law with Section 2(c) of the Clayton Act, as amended by the Robinson-Patman Act, one will find that under Article 8 of the New Law, price discrimination will occur when a seller gives a discount or pays a commission or brokerage only to certain buyers. However, since Section 2(c) of the Clayton Act prohibits any kind of commission, brokerage, discount or other compensation between the buyer and seller, except when services are involved with the sale or purchase of goods or exchanged for other services, it is much less likely that price discrimination will occur.

3. *Conspiracy Violations*

Article 15 of the New Law provides only two types of violations; those which relate to concerted price fixing among bidders, and bilateral conspiracy between bidder and bid invitor against fair competition. Unlike such prohibitions in the narrow scope, U.S. antitrust laws forbid conspired or concerted acts in much broader scope, including price fixing, market allocation, and conspired monopolization.[17] In fact, most violations occurring under U.S. antitrust laws are bilateral or concerted acts among two or more parties.

4. *Exclusive Dealing*

As indicated above, exclusive dealing is not absolutely prohibited by the New Law. Instead, the New Law only tries to restrict government agencies, public utilities enterprises, and other entities which enjoy the status of exclusive dealing privileges, from *abusing* their economic power to impair the competition mechanism which is at the beginning stage of its development in China. Unlike the exclusive dealing provisions in the New Law, exclusive dealing in any form is clearly prohibited under Section 3 of the Clayton Act.[18]

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16. 15 U.S.C. § 13(c).

17. *Id.* §§ 1-3.

18. *Id.* § 14. "It shall be unlawful . . . to lease or make a sale or contract for the sale of goods, wares, merchandise, machinery, supplies or other commodities, whether patented or unpatented, for use, consumption or resale, . . . or fix a price charged thereof or discount from, or rebate upon, such price, on the condition, agreement or understanding that the lessee or purchaser thereof shall not use or deal in the goods, . . . where the effect of such lease, sale, or contract for sale or such condition, agreement or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce."

5. *Summary*

The New Law does not contain most of the offenses or violations which are prohibited under U.S. antitrust laws and which are regarded as the principal parts of traditional U.S. antitrust laws. Therefore, it seems fair to conclude that the New Law is an anti-unfair competition law without a core.

The logical explanation seems to be that it is premature or unrealistic to have a truly effective antitrust law in China when the pricing system is still substantially regulated by the government and the economy is still substantially monopolized by the government. Traditional antitrust laws, like those which exist in the United States, prohibit any form of price fixing. Under the basic theory of the free market system, the prices of goods or services shall be the result of fair competition. However, under China's current economic system, despite the price system reform taking place, the prices for substantial numbers of commodities are still subject to government regulations. In other words, it is the government which continues "fixing" these prices. Therefore, it is unthinkable to have anti-price fixing laws on one hand and to let the government "lawfully" fix the prices on the other.

Similarly, with respect to monopolization, while a decentralization process has been underway in China, it is still the government which controls most of the major industries and industrial enterprises. In such circumstances, it is impossible to have a meaningful anti-monopolization law. Although it is said that anti-monopolization laws and other related legislation have been under consideration, it is almost certain that such legislation will not be in force in the near future.

B. *Violations Unique Under the New Law*

While the New Law does not contain most of the traditional violations found in U.S. antitrust laws, it does prohibit certain acts which are not found in U.S. antitrust laws. For example, some violations by public utilities enterprises and entities which enjoy exclusive dealing privileges, and acts by certain government agencies abusing administrative power are prohibited. Also, the New Law applies to other acts which are normally not regarded as the subject of U.S. antitrust laws. These violations include infringement of trademarks and trade secrets, acts causing damage to a competitor's business reputation, and illegal sweepstake sales. In the United States, such activities are normally governed by other laws, although it is quite likely that the Federal Trade Commission may still have jurisdiction under the authority vested by Section 5 of the FTC Act against such acts on the broad ground of "unfairness."

C. *Exhaustive List of Anti-Competitive Acts*

As mentioned at the beginning of this Article, the New Law applies only to specific anti-competitive acts, and does not reach other acts, no matter how unfair they may seem. Although U.S. antitrust legislation also targets specific acts as provided under the Sherman, Clayton, and other key U.S. antitrust laws,[19] the legislative mechanism adopted in the New Law is totally different from that of Section 5 of the FTC Act. Section 5 of the FTC Act not only empowers the Federal Trade Commission to crack down on violations prohibited under other antitrust laws on the ground that they are "unfair" and "affect interstate commerce," but also empowers the Commission to reach far beyond what the antitrust laws prohibit. There is no exhaustive list in U.S. antitrust law of acts or practices which are expressly prohibited or declared unlawful.

The advantage of having an exhaustive scope, as in the New Law, is that it seemingly makes the enforcing agencies' job much easier when determining what constitutes "unfair" conduct in a given situation. The risk, however, is that some unfair acts could be outside the scope of the law. It is widely recognized that Section 5 of the FTC Act functions partially to fill legislative gaps because it does not have an exhaustive scope with respect to "unfairness." Section 5 gives the Federal Trade Commission the power to reach conduct which is not a clear violation under other antitrust laws. On the other hand, the limit of the FTC's power under Section 5 of the FTC Act has been a controversial issue.

D. *Common Law Influence*

China is a civil law country in which legislation and regulations are the primary sources of law, and the decisions or rulings by courts at any level are not normally regarded as a source of binding law as they are in the United States. Therefore, it is foreseeable that further development in the area of anti-unfair competition/antitrust law can be accomplished only by revising the New Law or enacting other new legislation or regulations. By contrast, although enacted statutes play dominant roles in the American antitrust law area, court decisions have contributed tremendously in its development. In some instances, American courts directly create new legal concepts which are unseen in the antitrust statutes, but are essential to the enforcement and development

19. *Supra* note 2.

of American antitrust law. One good example is the invention by courts of the concepts of the "rule of reason" and the "per se" rule. The language of Section 1 of the Sherman Act, which seems to prohibit *all* concerted activities in restraint of trade, does not even imply such a distinction. However, in an early case, the U.S. Supreme Court held that the Sherman Act only prohibits *unreasonable* restraints of trade.[20] In another case decided in 1918, the Court first used the term "rule of reason" as opposed to the "per se" rule.[21]

## IV. THE REMEDIES AND PENALTITES FOR VIOLATIONS

The New Law provides different remedies and penalties for different types of unfair competitive acts as discussed in Part I. The New Law provides only one type of remedy which is available to a private party. Article 20 of the New Law provides that any "[b]usiness operator, whose legal rights and interests are injured by unfair acts, may sue for damages in the people's courts." The same Article also provides the manner by which damages are calculated. Under Article 20, damages should normally be the actual loss incurred by the injured party. However, where it is impossible to calculate the actual loss, the recovery amount should be equal to the actual profit gained by the violator from the illegal conduct. In addition, the injured party may also be entitled to recover reasonable expenses incurred during its investigation of the unfair acts.

The following sections illustrate the penalties which the New Law sets forth for each unfair act.

### A. *Penalties for Trademark Infringement Related Acts*

Article 21 of the New Law provides different penalties for trademark infringements as defined under Article 5.

#### 1. *Violations of Article 5, Paragraph A*

For violations of Article 5, Paragraph A, the penalties include injunctive orders, civil fines, and/or criminal punishment of persons directly responsible.[22] Under China's law, such criminal punishment includes up to three years of imprisonment and/or criminal fines.[23]

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20. Standard Oil Co. of New Jersey v. U.S., 221 U.S. 1 (1911) (emphasis added).

21. Chicago Board of Trade v. U.S., 246 U.S. 231 (1918).

22. People's Republic of China Trademark Law, art. 40.

23. People's Republic of China Criminal Law, art. 127.

2. *Violations of Article 5, Paragraph B*

For violations of Article 5, Paragraph B, the penalties set forth under Article 21, Paragraph 2 include one or more of the following: injunctive orders from the enforcing agencies, confiscation of all property and proceeds generated by the violation, fines ranging from one to three times the property value generated by the violation, cancellation of business licenses in case of severe violation, and/or criminal punishment if the violations involve selling commodities with false names and low quality.

3. *Violations of Article 5, Paragraphs C and D*

For violations of Article 5, Paragraphs C and D, Article 21 states that penalties shall be imposed according to the Trademark Law of PRC. Under the PRC Trademark Law, the penalties for acts in violation of the above paragraphs include injunctive orders from the enforcing agencies and/or fines.[24] Under Section 43 of the Implementing Rules of the PRC Trademark Law, the amount of the fines may be up to 20 percent of the gross gain from the violator's operations, or up to two times the profit generated from the violations.

B. *Penalties for Commercial Bribery*

Bribery is criminal conduct under Chinese law, both for the briber and the person accepting the bribe. Article 22 of the New Law provides penalties for acts of commercial bribery. The punishments range from criminal punishment if the violation constitutes a crime, to fines ranging from 10,000 to 200,000 yuan if the violation does not constitute a crime. Confiscation of all the property and proceeds generated from the violations is also possible.

C. *Penalties for Violations by Public Utilities Enterprises and Exclusive Dealers*

Article 23 of the New Law provides the following penalties for violations of Article 6 as discussed in Part II: Injunctive order from the enforcing agencies at a provincial level, or municipal level if such municipality consists of districts; and/or fines ranging from 50,000 to 200,000 yuan.

As Article 6 of the New Law indicates, a third party will be involved in an Article 6 violation, i.e., the party which is designated

24. People's Republic of China Trademark Law, art. 39.

by the utilities company or an exclusive dealer. Normally, the designated third party is not in the position of violating the New Law. However, if the third party takes advantage of such designation by selling low quality commodities at high prices or charging customers unreasonable fees, it will be subject to similar penalties. Under Article 23 of the New Law, such penalties include confiscation of illegal profits attributable to the violations, and/or fines ranging from one to three times the profit value generated from the violations.

D. *Penalties for Fraudulent Advertisement*

Article 24 of the New Law provides different measures that impose penalties upon business operators and advertisers who violate Article 9 of the New Law. For business operators who violate Article 9, Paragraph 1, the penalties include: Injunctive orders from the enforcing agencies; an order to reduce the impact caused by the fraudulent and misleading advertisements; and/or fines ranging from 10,000 to 200,000 yuan. For advertisers violating Article 9, paragraph 2 of the New Law, the penalties include injunctive orders; confiscation of illegal profits from the violations; and/or fines, for which Article 24 does not specify the amount.

E. *Penalties for Trade Secret Infringement*

The penalties for trade secret infringement as defined in Article 10 of the New Law include injunctive orders by the enforcing agencies and/or fines ranging from 10,000 to 200,000 yuan.[25]

F. *Penalties for Illegal Sweepstake Sale*

The penalties for commodities sales in the form of sweepstakes as defined in Article 13 of the New Law include injunctive orders by the enforcing agencies and/or fines ranging from 10,000 to 100,000 yuan.[26]

G. *Penalties for Conspired Acts in Bidding*

Under Article 27 of the New Law, conspiracies in bidding as defined in Article 15 will render the contract between the parties void. In addition, the parties may also be fined an amount ranging from 10,000 to 200,000 yuan.

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25. New Law, art. 25.
26. New Law, art. 26.

### H. *Penalties for Government Agencies' Violation*

Under Article 30 of the New Law, the immediate superior office shall order its subordinate office to correct any violations of Article 7 of the New Law. If the violation is severe, the individuals who are directly responsible for the violation should receive administrative disciplinary penalties.

### I. *Summary*

In summarizing the above eight categories, the penalties provided under the New Law against specific unfair acts include injunctive orders, fines, property confiscation, business license cancellation, and/or criminal punishment. With the exception of criminal punishment, all of the penalties are administrative in nature and are under the discretion of the enforcing agencies. The enforcing agencies have tremendous discretion in considering whether, and to what extent, certain types of penalties are to be imposed.

Although the New Law provides specific punitive measures for most of the acts of unfair competition enumerated under the New Law, it leaves out two categories without explanation. Specifically, no punishments are listed for selling commodities at prices lower than cost, as defined in Article 11, and the tying arrangements and conditioned sale of commodities as defined in Article 12. Coincidentally, these two types of violations are among those for which it is unlikely that an injured party may successfully invoke Article 20 of the New Law to sue for damages, because both situations make it extremely difficult or even impossible for the injured party's actual losses or the profit gain generated from such violations to be calculated. It appears that the mere prohibition of certain unfair practices without providing any remedies or penalties for the violation will make such prohibition practically unenforceable.

## V. COMPARISON OF REMEDIES AND PENALTIES UNDER U.S. ANTITRUST LAWS AND THE NEW LAW

We now turn to review the remedies and penalties provided under U. S. antitrust law and compare them with those provided under the New Law.

### A. *Remedies Under U. S. Antitrust Laws*

The remedies provided under U. S. antitrust laws take mainly two forms: injunctive relief and damages.

1. *Injunctive relief*

Section 16 of the Clayton Act, which is the primary statutory source for private injunctive relief, provides in relevant part that "[a]ny person, firm, corporation, or association shall be entitled to sue for and have injunctive relief, in any court of the United States having jurisdiction over parties, against threatened loss or damage by a violation of the antitrust laws."[27]

In addition to the injunctive relief initiated by a private party, the Clayton Act also provides two additional injunctive proceedings. First, Section 15 of the Clayton Act empowers the Justice Department to institute proceedings in equity to prevent and restrain violations of antitrust laws by way of petitioning the district court.[28] Second, Section 11 of the Clayton Act empowers the Federal Trade Commission to issue cease and desist orders against an entity or an individual whom the Commission has found in violation of antitrust laws.[29] The Federal Trade Commission may also bring court action to enforce injunctive orders.[30]

In comparison to the injunctive relief available under U.S. antitrust laws, the injunctive relief provided under the New Law is different in two respects. First, there is no private injunctive relief available under the New Law. According to the relevant provisions of the New Law, it seems to be the enforcing agencies' discretion to issue injunctive orders. This is the main reason injunctive orders by the enforcing agencies are treated as punitive measures, rather than a remedy available to private parties. However, under U.S. antitrust laws, as mentioned above, injunctive relief can be sought either by an individual party or by the Justice Department.

Secondly, the New Law vests the power to issue injunctive orders solely in the enforcing agencies, although subject to judicial review. Under the U. S. antitrust laws, however, such power is within the federal courts' jurisdiction, with the exception that the Federal Trade Commission may issue its own injunctive orders according to Section 11 of the Clayton Act.[31] Such injunctive orders by the Federal Trade Commission are similar to those of the enforcing agencies under the New Law to the extent that both of them are administrative in nature, and both are subject to judicial review.

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27. 15 U.S.C. § 26.
28. *Id.* § 25.
29. *Id.* § 21.
30. *Id.*
31. *Id.* § 21(b).

2. *Damages*

Section 4 of the Clayton Act, which is the primary statutory source for damage relief for violation of U. S. antitrust laws, provides in relevant part that:

> Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefore in any district court of the United States . . . and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorneys' fee.[32]

In comparing this statutory language with that of Article 20 of the New Law, there are two main differences between the New Law and U.S. antitrust laws regarding damages. First, U.S. antitrust laws provide treble damages, while the New Law only permits recovery of actual losses, or the amount of the profit generated from the violations in case the actual loss cannot be calculated. While the "actual loss" standard is consistent with the fundamental Chinese civil law principle that an aggrieved party shall not be enriched from other people's wrongdoing, it seems that this measure will not be as efficient in deterring violations as the treble damage measure in the U.S. antitrust laws. Second, U.S. antitrust laws also allow recovery of the costs of suit, including reasonable attorney's fees, while Article 20 of the New Law allows only reasonable expenses incurred by the injured party during its investigation of the violation.

B. *Penalties Under the U. S. Antitrust Laws*

U.S. antitrust laws provide two main types of criminal penalties for violations: fines and imprisonment. Sections 1 and 2 of the Sherman Act respectively provide fines for violations up to ten million dollars by corporations, and up to $350,000 for other entities or individuals.[33] The same sections also provide up to three years of imprisonment with or without fines. In addition to the criminal fines provided in the Sherman Act, civil fines may be levied under the Clayton Act, as well. For example, the Clayton Act imposes fines of up to $10,000 per day on individual officers and directors who fail to comply with Section 7A.[34]

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32. *Id.* § 15.
33. *Id.* §§ 1-2.
34. *Id.* § 18a.

As discussed above, the New Law also provides both fines and criminal penalties for violations of certain provisions of the New Law. However, differences exist between the fines and criminal penalties provided under the New Law and U.S. antitrust laws. First, all of the fines provided directly under the New Law are civil in nature, and are imposed under the full discretion of the enforcing agencies, which are administrative agencies. Under U.S. antitrust laws, the court is ultimately empowered to determine and impose fines for violations. Moreover, unlike the U.S. antitrust laws, the New Law does not provide separate fines for corporate and individual violations. Any business operator violating the relevant provisions of the New Law is subject to the same fines, regardless if it is a corporation, a non-corporate business entity, or an individual. Finally, unlike the U.S. antitrust laws, the New Law provides different fines for different violations, ostensibly according to their detrimental impact. Such fines include up to 20 percent, or two times, the profit from the violation;[35] 10,000 to 100,000 yuan;[36] 10,000 to 200,000 yuan;[37] 50,000 to 200,000 yuan;[38] or from one to three times the profit from the violation.[39]

Second, the New Law does not directly provide any criminal punishment for any of the unfair acts listed thereunder. Rather, criminal penalties (including imprisonment and/or criminal fines) are to be imposed under the New Law only when such violations have constituted violations of China's criminal law or other laws which specifically impose criminal penalties.[40]

In addition to the foregoing remedies and penalties, the U.S. antitrust laws also empower the Justice Department and the Federal Trade Commission to take other remedial measures. Such potential measures include forced divestiture of acquired stock or assets, corporate spinoffs, compulsory purchase or sale of needed materials, compulsory sharing of technology, and temporary restrictions upon the defendant's output.[41] In addition to injunctive relief, damage recovery, fines, and criminal penalties, the New Law provides for other penalties, including confiscation of gain from violations, compulsory elimination of the

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35. New Law, art. 21; People's Republic of China, Implementing Rules of the Trademark Law, art. 43.

36. New Law, art. 26.

37. *Id.* art. 22, 24, 25 and 27.

38. *Id.* art. 23.

39. *Id.* art. 21, 23, 28 and 30.

40. *Id.* art. 21, 22, 31 and 32.

41. *See* WILLIAM C. HOLMES, ANTITRUST LAW HANDBOOK 453 (1993).

detrimental impact from the violations, and cancellation of business licenses.

These comparisons regarding the legal remedies and penalties under the New Law and U.S. antitrust laws are intended only to be general and introductory, since some of the remedies and penalties provided in the law of one country (especially those under the U.S. antitrust laws) are applicable to certain specific violations which may not exist in the other country.

## VI. THE ENFORCING AGENCIES AND PROCEDURES

Article 3 of the New Law designates the Industry and Commerce Administration offices at county or higher levels as the enforcing agencies. However, Article 3 also provides that if other laws or administrative regulations specifically designate other law enforcing agencies, such agencies shall function as required. One example of such an agency is the prosecutor's offices, which have the power to initiate criminal investigations or file suits if a violation of the New Law constitutes a crime.

In addition to designating specific agencies to enforce the New Law, the New Law also operates to "encourage, support and protect any organization or individual to provide social superintendence against unfair competitive acts."[42] This language seems to imply that any organization or individual may file a violation complaint or report to the enforcing agencies, regardless of whether the organization or individual is a victim of the violation or not.

In addition to the power to impose penalties as discussed in Part II, the New Law also vests investigative power in the enforcing agencies. Under the law, the enforcing agencies may specifically use the following investigative powers in handling cases of unfair competition:

1. In accordance with certain procedures, questioning business operators whose conduct is under investigation, other interested parties and witnesses, and requesting to provide evident material, or other materials which are related to the unfair conduct.
2. Inspecting and copying agreements, accounting books, invoices, documents, records, business communication notes and/or other materials which are related to the unfair conduct.

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42. New Law, art. 4.

3. Inspecting property or other items which are related to the unfair acts as defined in Article 5 of the Law. When necessary, the agencies may order the business operators under investigation to explain the source and amount of the goods in question, to suspend selling, to be prepared for inspection and to stop transferring, hiding or destroying the property or item under investigation.[43]

Although the New Law gives the enforcing agencies tremendous power to crack down on unfair competition, the decisions made by such agencies are subject to both administrative and judicial review. Under the New Law, a party who declines to accept the agency's decision may petition its immediate competent superior authorities for review of the decision within 15 days of receiving the decision from the agency. If the party further declines to accept the review decision by its superior authorities, it may bring an action in court for judicial review.[44] However, the superior level administration review is not a necessary step for judicial review. The party who declines to accept the initial decision by the enforcing agency may bring an action directly in court.[45]

Article 29 of the New Law may cause administrative problems due to its confusing wording. According to the language of Article 29, the administration review agency seems to be the immediate competent superior authority of the *petitioner*, instead of that of the *enforcing agency* which makes the initial decision. If this reading is correct, the reviewing authorities may not be in a position to alter or overrule the initial decision made by the enforcing agencies at certain levels, because they are parallel government agencies.

Both similarities and differences exist between the New Law and U.S. antitrust laws with respect to law enforcement initiatives and procedures. Under the Sherman Act, the Justice Department has exclusive jurisdiction to seek injunctive relief or criminal penalties against conduct in violation of the Act. Unlike the enforcing agencies, the Justice Department may not issue an injunctive order. Instead, the Justice Department must petition the court to issue an injunctive order. However, the Federal Trade Commission may directly issue civil injunctive orders under Section 11 of the Clayton Act.[46] Also, under the

43. *Id.* art. 17.
44. *Id.* art. 20.
45. *Id.* art. 29.
46. 15 U.S.C. § 21.

Sherman Act, the Justice Department may initiate a criminal complaint for violations, or threatened violations, in court.[47] However, under the New Law, the enforcing agencies may not directly make criminal complaints in court. Rather, it is the function of another government agency, the People's Prosecution Offices, to initiate criminal prosecution. Finally, under both the Clayton Act and the FTC Act, the Justice Department Shares authority with the Federal Trade Commission to enforce Sections 2, 3, 7 and 8 of the Clayton Act. In contrast, under the New Law, the enforcing agencies have exclusive power to enforce the New Law.

Under section 5 of the FTC Act, the Federal Trade Commission has the power not only to crack down on unfair methods of competition which are prohibited under the Sherman and Clayton Acts, but also to reach those unfair or deceptive acts or practices, such as fraudulent advertising and misleading product promotion techniques, and other acts or practices which the Federal Trade Commission may deem "unfair." However, under the New Law, the enforcing agencies' power over unfair acts is explicit and definite, and it may not be extended to any acts beyond those enumerated in the New Law.

The power vested in the Federal Trade Commission under the Sherman Act, the Clayton Act and the FTC Act is supplemental to the power vested in the Justice Department in various antitrust statutes. The Justice Department enforces the laws through the courts, regardless of whether the proceeding is civil or criminal in nature. Under the FTC Act, the proceeding pursued by the Federal Trade Commission is always administrative and purely civil in nature. Furthermore, the Federal Trade Commission may issue civil injunctive orders against any party it deems to have violated the FTC Act, although such injunctive orders are subject to judicial review. Finally, both the Sherman and Clayton Acts may be enforced by private parties, whereas the FTC Act can only be enforced by the Federal Trade Commission. Like the enforcing agencies under the New Law, the Federal Trade Commission has extensive investigative powers under the FTC Act, such as: (1) Issuing subpoenas to order individuals to attend hearings, giving testimony, and producing documentary evidence;[48] (2) directing individuals or entities to file reports or answer specific questions;[49] and

47. *See generally* Sherman Act §§ 1-3; CARLA HILLS, ANTITRUST ADVISER (1985).
48. 15 U.S.C. § 49.
49. *Id.* § 46.

(3) obtaining documents related to investigation for examination and copying.[50]

## VII. CONCLUSION

The above discussion leads to the conclusion that the New Law symbolizes the beginning of fair competition protection legislation in China. As China's first anti-unfair competition/antitrust law statute, the New Law does not prohibit most traditional antitrust law violations, which constitute the core part of the U.S. antitrust laws. The New Law does list certain violations which are not seen in, or normally considered part of, U.S. antitrust laws. In addition, the New Law provides remedies and penalties for violations which are different from those provided under U.S. antitrust laws. Such differences show both in the degree of imposing penalties and in the variety of remedial or punitive measures. Finally, differences exist between the New Law and the U.S. antitrust laws regarding law enforcing agencies and procedures.

The New Law reflects the transitional changes taking place in China. On one hand, the New Law seeks to encourage and protect fair competition, and to prohibit government agencies and certain enterprises with administrative functions from abusing their powers and privileges vested by the law. On the other hand, the New Law fails to define what constitutes "abuse." The transitional setting in China will make it extremely difficult to enforce certain provisions in the New Law, such as Article 6 and Article 7, relating to acts by public utilities and exclusive dealers, and acts related to administrative functions, respectively.

Finally, since the New Law only applies to those acts expressly enumerated, the enforcing agencies may not reach beyond those acts. Such rigid legislative tactics make the New Law very inflexible in China's fast-changing economy. There must be revision of the New Law or enactment of other new laws for the enforcing agencies to be able to reach any type of new unfair competitive conduct which might occur. To solve this problem, it seems that a provision filling the legislative gap like Section 5 of the FTC Act needs to be added to the New Law or to be created through separate legislation.

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50. *Id.* § 49.

# International Trademark Law: A Pathfinder and Selected Bibliography

*by Minde Glenn Browning**

## I. INTRODUCTION

A trademark is any "word, slogan, design, picture, or any other symbol used to identify and distinguish goods."[1] These symbols are used by businesses and consumers in the marketplace. Consumers associate trademarks with the quality of a product (either low or high) and use this information to identify desired goods, distinguish competing products, and make informed decisions regarding merchandise.[2] Businesses rely on trademarks to establish their reputation, distinguish competitor's products, advertise, and market goods.[3]

A trademark is a creative endeavor and is considered intellectual property with protectable rights.[4] In the United States, trademarks are protected by state common law, federal and state statutes, and by

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1. J. THOMAS MCCARTHY, MCCARTHY'S DESK ENCYCLOPEDIA OF INTELLECTUAL PROPERTY 339 (1991). In the United States, trademark protection also includes service marks, certification marks and collective marks. Service marks identify and distinguish services. Certification marks are marks used by persons other than their owners to certify regional or other origin, material, mode of manufacture, quality, accuracy, or other characteristics of goods or services, or that the work or labor on goods or services was performed by members of a union or other organization. Collective marks are trademarks or service marks used by members of a cooperative, an association, or other collective group or organization, and include marks indicating membership in a union, association, or other organization. United States Trademark (Lanham) Act, 15 U.S.C. § 1127 (1988 & Supp. IV 1992). Service marks, certification marks and collective marks may not be recognized or registerable in foreign jurisdictions. The term "trademark" as used in this article includes any trademark, service mark, collective mark or certification mark.

2. J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION, § 2.01(2) (3d ed. 1992) [hereinafter MCCARTHY].

3. MCCARTHY'S DESK ENCYCLOPEDIA OF INTELLECTUAL PROPERTY, *supra* note 1, at 340.

4. *Id.* at 166.

federal and state registrations. As businesses expand beyond national borders, trademarks help to efficiently open markets and gain consumer recognition of products or services. Because protection is based on the laws of each individual country, the scope of trademark protection is geographically limited.[5] Foreign trademarks are usually procured by filing applications in national trademark offices with the help of foreign associates.[6] Several international systems simplifying administrative procedures are in place through international agreements, although they create neither a worldwide trademark system nor a worldwide trademark.

International trademark systems are evolving to meet new multinational economic challenges. The latest worldwide developments in trademark law are found in new multinational treaties.[7] These new treaties are dramatic steps forward in creating a uniform system despite the difficulties that have been encountered in developing multinational agreements thus far.

## II. LITERATURE ON TREATIES, CONVENTIONS, AGREEMENTS

### A. *Multilateral Agreements*

#### 1. *Paris Convention for the Protection of Industrial Property*

The Paris Convention for the Protection of Industrial Property (Paris Convention) is the principal international treaty protecting intellectual property rights, including patents and copyrights as well as trademarks.[8] The Paris Convention has been revised at Brussels, Washington, The Hague, London, Lisbon, and Stockholm.[9] The United

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5. "Under the territoriality doctrine, a trademark is recognized as having a separate existence in each sovereign territory in which it is registered or legally recognized as a mark." MCCARTHY, *supra* note 2, § 29.01(1).

6. JEROME GILSON, 1A TRADEMARK PROTECTION AND PRACTICE § 9.05 (1993) [hereinafter GILSON].

7. John B. Pegram, *Europe, Trademarks and 1992*, 72 J. PAT. [& TRADEMARK] OFF. SOC'Y 1060 (1990)[hereinafter Pegram].

8. *Paris Convention for the Protection of Industrial Property, July 7, 1884, Reprinted in* MARSHALL LEAFFER, INTERNATIONAL TREATIES ON INTELLECTUAL PROPERTY 17 (1990); 3 DIGEST OF COMMERCIAL LAWS OF THE WORLD, DIGEST OF INTELLECTUAL PROPERTY LAWS (1990); GILSON, *supra* note 6, App. 9a.

9. Revised at Brussels on Dec. 14, 1900, 32 STAT. 1936, T.I.A.S. No. 411, 1 BEVANS 296; Washington revision of 1911, 37 STAT. 1645, T.I.A.S. No. 579, 204 OFFICIAL GAZETTE 1011, July 21, 1914; The Hague revisions of 1925, 47 STAT. 1789, T.I.A.S. No. 834, 2 BEVANS 524, 407 OFFICIAL GAZETTE 23, June 9, 1931; London revision of 1934, 53 STAT. 1748, T.I.A.S. No. 941, 2 BEVANS 223, 613 OFFICIAL

States became a signatory to this international treaty in 1887.[10]

The Paris Convention establishes that member countries provide national protection to trademark owners from other countries who apply for trademark protection, and that member countries afford intellectual property a minimum level of protection.[11] The Paris Convention also established the organizational structure for administering the treaty, including an International Bureau, which is the Secretariat for the Treaty[12] and the Paris Union (the group name for the member countries).[13] The International Bureau was incorporated into the World Intellectual Property Organization (WIPO) when WIPO took over administration of the Paris and Madrid Unions.[14]

As a member of the Paris Union, the United States is bound by the principle of territoriality: a trademark has a separate existence in each sovereign territory in which it is registered or legally recognized as a mark.[15] Paris Union trademark owners must therefore obtain national protection through the laws of each Paris Union country in which they intend to do business. United States trademark law provides equivalent protection for Paris Union trademark owners and United States citizens.[16]

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GAZETTE 23, August 3, 1948; Lisbon revision of 1958, 53 STAT. 1748, 13 U.S.T. 1, T.I.A.S. No. 4931, 775 OFFICIAL GAZETTE 321, February 13, 1962; Stockholm revision of 1967, 21 U.S.T. 1583, T.I.A.S. No. 6923, 852 OFFICIAL GAZETTE 511, July 16, 1968.

10. 33 INDUS. PROP. 10 (1994). A revised list of treaty participants is published in the first yearly issue of INDUSTRIAL PROPERTY. Additional changes are published throughout the year.

11. MCCARTHY, *supra* note 2, at § 29.10(1). *See also* GILSON, *supra* note 6, § 9.07. In addition, the Paris Convention established a nationally-based priority filing date. Foreign trademark registration applications filed within twelve months of the national application retain the filing priority of the date of the home country trademark registration application. *Id.*

12. *Paris Convention, supra* note 8. *See, e.g.*, Article 13 (Assembly of the Union), Article 14 (Executive Committee), Article 15 (International Bureau), and Article 16 (Finances).

13. *Id.* Article 1 (Establishment of the Union).

14. *Convention Establishing the World Intellectual Property Organization,* July 14, 1967, 21 U.S.T. 1749, *reprinted in* LEAFFER, *supra* note 8, at 563. *See infra* Part V.A. of this Article.

15. MCCARTHY, *supra* note 2, § 29.01(1).

16. The mechanism of United States protection of foreign trademarks is outlined in MCCARTHY, *supra* note 2, § 20.04.

2. *Selected Bibiography on the Paris Convention*

*Convention of the Union of Paris for the Protection of Industrial Property,* 48 TRADEMARK REP. 1320 (1958) (Including the revisions adopted at Lisbon).

L.A. Ellwood, *Industrial Property Convention and the "Telle Quelle" Clause,* 46 TRADEMARK REP. 36 (1956).

Stephen P. Ladas, *The Lisbon Conference for Revision of the International Convention for the Protection of Industrial Property,* 48 TRADEMARK REP. 1291 (1958).

Allan Zelnick, *Shaking the Lemon Tree: Use and the Paris Union Treaty,* 67 TRADEMARK REP. 329 (1977).

3. *The Madrid Agreement Concerning the International Registration of Marks of 1891*

Under the Paris Convention, trademark owners must obtain separate trademark protection in each Paris Union country. The Paris Convention does not provide trademark protection across Paris Union members' borders. Foreign trademark registration was made easier through an international trademark system established by The Madrid Agreement Concerning the International Registration of Marks of 1891 (Madrid Agreement).[17] Although it is a separate agreement, the Madrid Agreement flows from the Paris Convention. Therefore, countries wishing to participate in the Madrid Agreement must be members of the Paris Union.[18] The United States is not a signatory to the Madrid Agreement.[19]

The Madrid Agreement extends the Paris Convention's territoriality principal through a centralized registration filing system that ultimately results in individual national registrations in Madrid Agreement member countries (Madrid Union). Through a trademark owner's home country trademark office, the owner of a trademark registration may file a single international registration application that designates some or all of the individual countries within the Madrid Union. This single

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17. *The Madrid Agreement Concerning the International Registration of Marks, Apr. 14, 1891,* 828 U.N.T.S. 389; *reprinted in* LEAFFER, *supra* note 8, at 229; *Text of Act of Nice, Madrid Agreement, Ratified December 15, 1964,* 55 TRADEMARK REP. 758 (1965).

The system established in 1891 is relatively unchanged despite revisions at Brussels in 1900, at Washington in 1911, at the Hague in 1925, at London in 1934, at Nice in 1957 and at Stockholm in 1967. Arpad Bogsch, *The First Hundred Years of the Madrid Agreement Concerning the International Registration of Marks,* 30 INDUS. PROP. 389 (1991).

18. RUDOLF CALLMANN, CALLMANN ON UNFAIR COMPETITION, TRADEMARKS AND MONOPOLIES § 26.03 (4th ed. 1981).

19. 33 INDUS. PROP. 12 (1994).

application is then forwarded to WIPO, which publishes the mark in the international register *Les Marques Internationales* and forwards the registration to the trademark offices of the designated countries. The trademark offices of the designated countries then determine the validity of each WIPO registration under the trademark laws of the designated countries. The single Madrid Agreement application therefore culminates in a series of national registrations unless national registration is denied by the trademark office of any designated country.[20]

Many aspects of the Madrid Agreement have prevented United States adherence to this treaty. United States objections primarily regard the central attack feature (a dependency provision),[21] the lack of trademark use provisions,[22] the requirement of a national registration as a basis for the WIPO international application (instead of a national application only), and the short length of time allowed to examine international applications.[23] Other United States concerns include dif-

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20. GILSON, *supra* note 6, § 9.02(2); CALLMANN, *supra* note 18, § 26.03. *See also* STEPHEN P. LADAS, 2 PATENTS, TRADEMARKS AND RELATED RIGHTS: NATIONAL AND INTERNATIONAL PROTECTION §§ 758-795 (1975)(Providing extensive detail). Although there are consistent references to a WIPO "international registration," it is neither international nor a registration. The WIPO system merely provides a single point to apply for individual national trademark registrations and no legal effect is given to the WIPO registration unless and until the individual foreign national trademark offices recognize the trademark as valid under national laws. INTERNATIONAL TRADEMARK ASSOCIATION, MADRID PROTOCOL: A PRACTITIONER'S GUIDE (1993).

21. Central attack permits a third party to cancel or amend the WIPO registration and all national registrations obtained therethrough, via an attack on the home trademark owners' national registration. Since the WIPO registration is dependent on an effective home registration, a successful third party attack on the home registration cancels or amends the WIPO registration as well. This provision may result in the invalidation of national trademark registrations which are based on the WIPO registration even in countries where the third party has no trademark rights. David Tatham, *'Central Attack' and the Madrid Agreement,* 4 EUR. INTELL. PROP. REV. 91 (1985). Also, United States law provides grounds for attacking United States trademark registrations not recognized in other countries, thus rendering United States trademark owners more vulnerable under the Madrid Agreement than are other Madrid Union members. GILSON, *supra* note 6, § 9.07(2).

22. To obtain United States trademark protection, a trademark must be used in commerce that Congress may regulate, *e.g.*, interstate commerce. Roger E. Schechter, *Facilitating Trademark Registration Abroad: The Implication of U.S. Ratification of the Madrid Protocol.* 25 GEO. WASH. J. INT'L L. & ECON. 419, 421 (1991). *See also* MCCARTHY, *supra* note 2, § 16.

23. Given the length of time generally required for a United States trademark registration application to become a registration, United States trademark owners are disadvantaged because the basis for the WIPO international application registration is

ferences over the breadth of goods and services descriptions in trademark registrations, increases in the numbers of registrations, and the increasing number of abandoned trademark registrations creating deadwood on a national register.[24]

The arguments surrounding United States non-adherence to the Madrid Agreement are nicely laid out as point, counter point, and rejoinder by Robert J. Patch in *The Arrangement of Madrid for the International Registration of Trademarks,* 50 J.P.O.S. 603 (1968). The issue of adherence to the Madrid Agreement was the source of extensive debate in the United States trademark community in the 1960s.[25] While the United States trademark community did not advocate adherence to the Madrid Agreement, there was general support for developing a workable international trademark registration system.[26]

4. *Selected Bibliography on the Madrid Agreement*

Gabriel M. Frayne, *A Few More Thoughts on Possible United States Adherence to the Madrid Arrangement,* 57 TRADEMARK REP. 477 (1967).

Andrew R. Klein, *Report on the Conference on International Trademark Problems (Held on May 19, 1965 at the Department of Commerce),* 55 TRADEMARK REP. 752 (1965).

*Madrid Agreement,* 55 TRADEMARK REP. 758 (1965).

Robert J. Patch, *The Arrangement of Madrid for the International Registration of Trademarks,* 50 J.P.O.S. 603 (1968).

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a home national registration. United States businesses could file a trademark application directly with foreign offices and obtain more timely and better trademark protection. Similarly, the time for refusing an international application is too short for the lengthy examination process required by United States trademark law. GILSON, *supra* note 6, § 9.02(2).

24. STEPHEN P. LADAS, 2 PATENTS, TRADEMARKS AND RELATED RIGHTS: NATIONAL AND INTERNATIONAL PROTECTION § 761 (1975). *See also* Gabriel M. Frayne, *History and Analysis of TRT,* 63 TRADEMARK REP. 422, 423 (1973) (Proliferation of trademark applications, deadwood on the national register, national registration as the basis of international registration application, and limitations on the number of classes in filing); Schechter, *supra* note 22 (National registration as basis for filing, central attack; administrative burdens for the United States Trademark Office, working language French, deadwood on the national register).

25. LADAS, *supra* note 24, § 795. This debate came about as a result of a Commerce Department conference on international trademark problems. *See* Andrew R. Klein, *Report on the Conference on International Trademark Problems (Held on May 19, 1965 at the Department of Commerce),* 55 TRADEMARK REP. 752 (1965). In 1967, Stephen P. Ladas advocated that the United States propose a new agreement rather than adopt the Madrid Agreement and attempt to amend either United States law or the Agreement itself. *See* Ladas, *Proposal for a New Agreement for International Registration of Trademarks,* 57 TRADEMARK REP. 433 (1967).

26. Anthony R. DeSimone, *In Support of TRT,* 63 TRADEMARK REP. 492 (1973).

Special Issue: *Should the United States Adhere to the Madrid Agreement?*, 56 TRADEMARK REP. 289 (1966):

The Position For Adherence:
David B. Allen, *A Report on the Madrid Agreement* 289;
Anthony R. DeSimone, *United States Adherence to the Agreement of Madrid*, 320;
Edward G. Fenwick, *United State Participation—Madrid Agreement*, 323;
Gerald D. O'Brien, *The Madrid Agreement Adherence Question*, 326;
Norman St. Landau, *Some Comments on Possible Adherence to the Madrid Agreement*, 337.
The Position Against Adherence:
Stephen P. Ladas, *The Madrid Agreement for the International Registration of Trademarks and the United States,* 346 & *Additional Memorandum* 361;
Eric D. Offner, *The Madrid Agreement and Trends in International Trademark Protection* 368.

David Tatham, *Central Attack and the Madrid Agreement*, 7 EUR. INTELL. PROP. REV. 91 (1985).

5. *Trademark Registration Treaty*

Striving for better participation in an international trademark registration system, WIPO held a conference in 1971.[27] Madrid Union members in attendance did not want to make radical amendments to the Madrid Agreement; therefore a new treaty, the Trademark Registration Treaty (TRT),[28] was developed.[29]

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27. *See, e.g., Madrid Arrangement—BIRPI Proposed Changes,* 60 TRADEMARK REP. 129 (1970); Eric D. Offner, *A New Proposal for the International Registration of Trademarks*, 61 TRADEMARK REP. 8 (1971); Jeremiah D. McAuliffe, *Prospects for Improved Protection of Trademarks in International Trade*, 61 TRADEMARK REP. 82 (1971); Gabriel M. Frayne, *Report on the International Registration of Trademarks—Revision of the Madrid Arrangement*, 61 TRADEMARK REP. 95 (1971).

28. *Trademark Registration Treaty, (TRT) Vienna, June 12, 1973,* 63 TRADEMARK REP. 640 (1973), *Reprinted in* LEAFFER, *supra* note 8, at 293; Draft Trademark Registration Treaty, 902 OFFICIAL GAZETTE U.S. PAT. & TRADEMARK OFF. TM105 (Sept 19, 1972).

29. Gabriel M. Frayne, *History and Analysis of TRT,* 63 TRADEMARK REP. 422, 423 (1973).

The TRT was the first attempt to develop an international system for all Paris Union members, including the United States. The TRT was a filing treaty designed to reduce the complexity of registration application filing and of administering trademark registrations. It was not designed to change substantive trademark law. The TRT did not create a true multinational registration, but did provide for direct filing with WIPO.[30] The TRT also required a three year suspension of the trademark use requirement, which would have substantively affected United States trademark law.[31]

The TRT went to a diplomatic conference in Vienna on May 12, 1973. It was signed by the United States on June 12, 1973,[32] but inherent conflicts with United States trademark law prevented ratification despite proposed amending legislation.[33] The TRT is considered a failure since it was only ratified by the five Paris Union countries which brought the treaty into force.[34]

6. *Selected Bibliography on the Trademark Registration Treaty*

David B. Allen, *The Trademark Registration Treaty: Its Implementing Legislation,* 21 IDEA 161 (1980).

D.C. Maday, *A European Perspective on the Proposed New Trademark Registration Treaty,* 62 TRADEMARK REP. 353 (1972).

Beverly W. Pattishall, *Proposed Trademark Registration Treaty and Its Domestic Import,* 62 TRADEMARK REP. 125 (1972).

Beverly W. Pattishall, *Use Rationale and the Trademark Registration Treaty,* 61 A.B.A. J. 83 (1975).

Symposium, *The Trademark Registration Treaty (TRT), Vienna June 12, 1973,* 63 TRADEMARK REP. 421 (1973):

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30. CALLMANN, *supra* note 18, § 26.04. A detailed discussion of all aspects of the TRT is found in STEPHEN P. LADAS, 3 PATENTS, TRADEMARKS AND RELATED RIGHTS: NATIONAL AND INTERNATIONAL PROTECTION §§ 804-827 (1975).

31. MCCARTHY, *supra* note 2, § 29.10(3).

32. CALLMAN, *supra* note 18, § 26.04.

33. Trademark Registration Treaty Implementing Legislation, 973 Official Gazette U.S. Pat. & Trademark Off. T.M.O.G. 3 (Aug. 1, 1978)(Summary of TRT and proposed legislative changes in the Lanham Act).

34. Arpad Bogsch, *The First Hundred Years of the Madrid Agreement Concerning the International Registration of Marks*, 30 INDUS. PROP. 389, 406 (1991). The five countries which ratified the TRT were Burkina Faso, Congo, Gabon, the Soviet Union, and Togo. 30 INDUS. PROP. 15 (1991). Although the January issue of INDUS. PROP. contains listings of the various intellectual property treaty participants, the TRT has not been listed since 1991.

Gabriel M. Frayne, *History and Analysis of TRT,* 422;
*Canadian Joint Committee Report—AIPPI and The Patent and Trademark Institute,* 448;
Shigeru Otsuka, *Where Will Japan Go with the TRT?,* 465;
*The Association of Swedish Patent Agents—Position on TRT,* 471;
William E. Schuyler, *TRT, A Chance to Modernize Our Trademark Statute,* 478;
Anthony R. DeSimone, *In Support of TRT,* 492;
Robert C. Cudek, *TRT Impact on United States Statutory and Common Law,* 501;
Walter J. Derenberg, *The Myth of the Proposed International Trademark "Registration" Treaty (TRT),* 531;
Stephen P. Ladas, *What Does the Vienna Trademark Registration Treaty Mean to the United States?,* 551;
Eric D. Offner, *TRT—A Lemon Tree?,* 563, 569;
William Page Montgomery and Roger A. Reed, *Constitutionality Report on Proposed Trademark Registration Treaty,* 575.

*Trademark Registration Treaty: Clearing the Path to International Protection,* 6 LAW & POL'Y INT'L BUS. 1133 (1974).

7. *Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks*

After the failure of the Trademark Registration Treaty, WIPO began work on yet another registration treaty[35] by establishing The Committee of Experts on the Registration of Marks.[36] The Committee developed a draft Trademark Cooperation Treaty,[37] but eventually abandoned the planned development of an entirely new treaty system, instead advocating improvements in existing treaties for worldwide trademark administration.[38] Even though the Madrid Agreement pro-

35. Gerd F. Kunze, *The Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks of June 27, 1989,* 82 TRADEMARK REP. 58 (1992).

36. Paris Union, Committee of Experts on the International Registration of Marks, *First Session (Geneva, February 11 to 14, 1985),* 24 INDUS. PROP. 165 (1985); Paris Union, Committee of Experts on the International Registration of Marks, *Second Session (Geneva, December 11 to 13, 1985),* 25 INDUS. PROP. 56 (1986); Paris Union, Committee of Experts on the International Registration of Marks, *Third Session (Geneva, November 11 to 14, 1986),* 26 INDUS. PROP. 56 (1986).

37. *Detailed Outline of a Proposed New Treaty on the International Registration of Trademarks,* 25 INDUS. PROP. 92 (1986).

38. Paris Union, Committee of Experts on the International Registration of Marks, *Third Session (Geneva, November 11 to 14, 1986),* 26 INDUS. PROP. 56 (1986).

vides a cost effective and convenient multinational trademark system, increased membership and participation was desired by WIPO. For example, four European Community countries (Denmark, Greece, Ireland, and the United Kingdom) are not Madrid Union members, nor are other countries such as Japan and the United States. It also seemed important to the Committee of Experts to establish a cross-over between the Madrid Agreement and the Community Trade Mark then being developed by the European Community.[39] To accomplish these objectives, WIPO initially developed two Protocols for the Madrid Agreement, but the two were collapsed into a single Protocol that provides for an international trademark registry for individual member nations and for intergovernmental organizations.[40]

The Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks[41] (Madrid Protocol)[42] was adopted by the Diplomatic Conference for the Conclusion of a Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks in June 1989,[43] but is not yet in force.[44] The Protocol is similar to the Madrid Agreement, but includes significant changes that give it more universal appeal.[45] The Madrid Protocol differs from the Madrid Agreement in four major areas: 1) the international application is based on either an issued national registration or a registration

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39. Gerd F. Kunze, *The Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks of June 27, 1989*, 82 TRADEMARK REP. 58, 62 (1992).

40. *Diplomatic Conference for the Conclusion of a Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks (Madrid, June 12 to 28, 1989)*, 28 INDUS. PROP. 253 (1989).

41. *Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks*, 28 INDUS. PROP. 253, 254 (1989); *reprinted in* LEAFFER, *supra* note 8, at 251.

42. Sometimes referred to as Madrid II.

43. *Diplomatic Conference for the Conclusion of a Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks (Madrid, June 12 to 28, 1989)*, 28 INDUS. PROP. 253 (1989).

44. Under Article 14, the Protocol requires four instruments of ratification, one of which must be in a Madrid Agreement country and another in a non-Madrid Agreement country. As of December 1993, there were 27 signatory states: Austria, Belgium, Democratic People's Republic of Korea, Denmark, Egypt, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Liechstenstein, Luxembourg, Monaco, Mongolia, Morocco, Netherlands, Portugal, Romania, Russian Federation, Senegal, Spain, Sweden, Switzerland, United Kingdom, and Yugoslavia. Spain is the only country that has ratified the treaty. 33 INDUS. PROP. 20 (1994).

45. GILSON, *supra* note 6, § 9.07(3).

application; 2) national trademark offices are given a longer time period for issuing a refusal notification; 3) the fee structure is revised; and 4) the effects of central attack are diminished because an attacked international WIPO registration can nevertheless be converted into separate national registrations.[46]

These changes seemed to address the major objections to the Madrid Agreement.[47] However, there are still some concerns about United States adherence, namely: the administrative burdens on the United States Trademark Office (both in the increased number of applications and the time limits for refusing an international application); the disadvantages arising from the difficulty in obtaining a United States registration vis-a-vis registrations in countries with either less stringent or no effective examination; the fact that central attack can be used more effectively against United States trademark owners; and the increased deadwood on the national registers will result in an increase in opposition and cancellation proceedings.[48]

If the Madrid Protocol is adopted, trademark owners in the United States will be able to reduce the time, efforts, and costs of obtaining multiple foreign trademark registrations.[49] However, these cost benefits will not be realized if United States trademark owners encounter objections in foreign national offices.[50]

The Madrid Agreement and the Madrid Protocol will operate simultaneously and independently,[51] although organizationally there will

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46. *Id.* § 9.07(3). *See also* Ian Jay Kaufman, *The Madrid Protocol: Should the U.S. Join?*, N.Y. L.J., 5 (October 9, 1992), (Describing the differences between the Agreement and the Protocol); Pegram, *supra* note 7, at 1060 (Describing the four distinctions). *Cf.* Kunze, *supra* note 35, at 62. However, this change in the central attack provision may not be an improvement. If the cancelled registrations are pursued for the purpose of converting them to national trademark registrations independent of the WIPO registration, the third party (attacking) trademark owner must defend the trademark defeated through a central attack in other foreign venues.

47. Schechter, *supra* note 22, at 433.

48. Norm J. Rich, Comment, *United States Participation in the Madrid Protocol: What Is the Price of Admission?*, 5 TEMP. INT'L & COMP. L.J. 93 (1991)(Actual Protocol regulations may require changes in United States trademark law; Protocol participants have varying filing requirements; determining filing date and priority); Ian Jay Kaufman, *Madrid Protocol: Should the United States Be Swept up in the Rising Tide?*, TRADEMARK WORLD, October 1991, 27 (1993).

49. Ian Jay Kaufman, *Madrid Protocol: Should the United States Be Swept up in the Rising Tide?*, TRADEMARK WORLD, 27 (1993).

50. *Id.*

51. Rich, *supra* note 48.

be one Union for both treaties.[52] A safeguard clause governs the interaction of the two treaties and situations arising in countries with dual membership.[53] Because of the parallel existence of the Madrid Agreement and Madrid Protocol, trademark owners and practitioners will face increased complexity in their businesses. Identifying a registerable trademark may be more difficult because of problems in interpreting search results due to the potential increases in the volume of registrations and applications. Registrations under national law, the Madrid Agreement, or the Madrid Protocol may each have different rights and procedures for renewal, cancellation, and assignment.[54] Details of the planned Madrid Protocol processes are well explained by Gerd F. Kunze in *The Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks of June 27, 1989,* 82 TRADEMARK REP. 58 (1992). Draft regulations are now being developed.[55]

In 1993, legislation entitled the Madrid Protocol Implementation Act was introduced in both the United States House of Representatives (H.R. 2129)[56] and the United States Senate (S. 977).[57] These bills will provide for the administrative procedures needed to file Madrid Protocol applications in the United States Patent and Trademark Office,[58] and make it possible for the United States to become a member of the Madrid Protocol. The House Bill was highly endorsed at hearings that took place in May 1993.[59] The opinions expressed in the literature both endorse adherence and advise a cautious approach.[60]

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52. Kunze, *supra* note 35.

53. *Id.* at 80.

54. Ian Jay Kaufman, *Protocol Impact on Trademark Office and Trademark Lawyers,* N.Y. L.J. 5 (November 6, 1992).

55. *Reprinted in* 1991 CURRENT DEVELOMENTS IN TRADEMARK LAW AND UNFAIR COMPETITION 57. For discussions of the provisions of the draft, see *Madrid Union, Working Group on the Application of the Madrid Protocol of 1989, Fourth Session (Geneva November 11 to 18, 1991),* 31 INDUS. PROP. 62 (1992); *Madrid Union, Working Group on the Application of the Madrid Protocol of 1989, Third Session (Madrid May 21 to June 17, 1991),* 30 INDUS. PROP. 280 (1991); *Madrid Union, Working Group on the Application of the Madrid Protocol of 1989, Second Session (Geneva November 26 to 30, 1990),* 31 INDUS. PROP. 62 (1992).

56. 139 CONG. REC. E1259 (May 17, 1993).

57. *Id.* at 6026 (May 18, 1993)(Including the text of the bill and extensive comments by Senator DeConcini in support of the bill).

58. *Id.* at 6027.

59. Although the hearings were not yet available at the time of this printing, a Clinton Administration representative announced their strong "support of U.S. accession to the Protocol." The International Trademark Association representative

8. *Selected Bibliography on the Madrid Protocol*

International Trademark Association, *Madrid Protocol: An Opportunity for United States Trademark Owners* (1993).

International Trademark Association, *Madrid Protocol: A Practitioner's Guide* (1993).

Ian Jay Kaufman, *Draft Regulations, Like Protocol, Lack Answers,* 208 N.Y. L.J., 5 (November 13, 1992).

Ian Jay Kaufman, *How the Madrid Agreement Differs from the Protocol,* 208 N.Y. L.J., 5 (October 23, 1992).

Ian Jay Kaufman, *Madrid Protocol: Should the United States Be Swept up in the Rising Tide?,* TRADEMARK WORLD 27 (1993).

Ian Jay Kaufman, *The Madrid Protocol: Should the U.S. Join?,* 208 N.Y. L.J., 5 (October 9, 1992).

Ian Jay Kaufman, *The Madrid Protocol: Step Toward "Harmonization,"* 208 N.Y. L.J., 5 (October 16, 1992).

Ian Jay Kaufman, *Modifications, Application Can Further Backlog Agency,* 208 N.Y. L.J., 5 (October 30, 1992).

Ian Jay Kaufman, *Protocol Impact on Trademark Office and Trademark Lawyers,* 208 N.Y. L.J., 5 (November 6, 1992).

Ian Jay Kaufman, *Treaties and Trademarks,* 19 INT'L BUS. LAW. 531 (1991).

Gerd F. Kunze, *The Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks of June 27, 1989,* 82 TRADEMARK REP. 58 (1992).

Norm J. Rich, Comment, *United States Participation in the Madrid Protocol: What Is the Price of Admission?,* 5 TEMP. INT'L & COMP. L.J. 93 (1991).

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announced support with reservations. Jeffery M. Samuels and Linda B. Samuels, *The U.S. Position on the Madrid Protocol,* 13 EUR. INTELL. PROP. REV. 418, 420 (1993).

60. *See, e.g.*, Ian Jay Kaufman, *Draft Regulations, Like Protocol, Lack Answers,* N.Y. L.J. 5 (November 13, 1992)(United States should not join until the implications of the problems have been demonstrated or addressed); Allan Zelnick, *The Madrid Protocol—Some Reflections,* 82 TRADEMARK REP. 651 (1992)(Madrid Protocol will be counterproductive to United States trademark owners unless United States trademark law is substantively changed); Schechter, *supra* note 22 (Facilitates commercial expansion, speedy adherence is advised).

Jeffery M. Samuels and Linda B. Samuels, *The US Position on the Madrid Protocol,* 13 EUR. INTELL. PROP. REV. 418 (1993).

Roger E. Schechter, *Facilitating Trademark Registration Abroad: The Implication of U.S. Ratification of the Madrid Protocol,* 25 GEO. WASH. J. INT'L L. & ECON. 419 (1991).

9. *New Developments*

With an expected proliferation in the volume of international trademark registration applications, WIPO continues its work toward simplified trademark registrations procedures.[61] The latest WIPO initiative is the Treaty on the Simplification of Administrative Procedures Concerning Marks (Trademark Law Treaty),[62] which is designed to address the present complexities of trademark administration. The Trademark Law Treaty will streamline processes by regulating the elements comprising a trademark registration and the filing procedures for registration applications, renewals, and assignments.[63] It also regulates electronic communication between national trademark offices, establishes minimum filing requirements, and requires standardized forms, a single application for multiple class trademarks, and a general power of attorney (not a separate power of attorney for each member country). The treaty avoids procedural issues such as oppositions or substantive examination, and is not an attempt to harmonize trademark law worldwide.[64] The treaty is expected to be adopted by the Diplomatic Conference for the Conclusion of the Trademark Law Treaty which is scheduled to meet from October 10 to 28, 1994 in Geneva, Switzerland.[65]

B. *Trademark Treaties on Limited Topics*

1. *Geographic Indications*

Geographic names utilized as trademarks have been the subject of international controversy, and two treaties were developed to deal with

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61. Arpad Bogsch, *Trademarks in 2017: Their Creation and Protection,* 82 TRADEMARK REP. 880 (1992).

62. Treaty on the Simplification of Administrative Procedures Concerning Marks or the Trademark Law Treaty, 32 INDUS. PROP. 180 (1993)(Meeting of five consultants to review draft treaty and draft regulations); *Draft Trademark Law Treaty,* 32 INDUS. PROP. 339, 340 (1993); *Draft Regulations Under the Trademark Law Treaty,* 32 INDUS. PROP. 339, 340 (1993).

63. GILSON, *supra* note 6, § 9.03.

64. Richard J. Taylor, *Proposed Treaty Would Streamline International Trademark Procedure,* 15 NAT'L L.J., § 13 (May 17, 1993).

65. 33 INDUS. PROP. 61 (1994).

this issue. There are two types of geographic indication of origin. First, a trademark may indicate that the product originates in a referenced geographic location. Second, the trademark may be an appellation of origin that indicates that the product possesses certain qualities, characteristics or features associated with a geographic place.[66]

a. *The Madrid Agreement for the Repression of False or Deceptive Indications of Origin*

The Madrid Agreement for the Repression of False or Deceptive Indications of Origin[67] requires seizure of imported goods falsely indicating geographic origin. Through this treaty, geographic names in trademarks were given substantive protection until the 1958 revisions to the Paris Convention incorporated the false indications of origin.[68] The United States is not a member.[69]

b. *The Lisbon Arrangement for the Protection of Appellations of Origin and Their International Registration*

The Lisbon Arrangement for the Protection of Appellations of Origin and Their International Registration[70] provides absolute protection for registered geographic denominations. A geographic name cannot be used as a trademark if it is protected in the country of origin.[71] The United States is not a member.[72]

c. *Selected Bibliography on Geographic Indications*

Lee Bendekgey and Caroline H. Mead, *International Protection of Appellations of Origin and Other Geographic Indications,* 82 TRADEMARK REP. 765 (1992).

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66. Lee Bendekgey and Caroline H. Mead, *International Protection of Appellations of Origin and Other Geographic Indications,* 82 TRADEMARK REP. 765 (1992).

67. *Reprinted in* LEAFFER, *supra* note 8, at 270. *See also International Convention: Arrangement of Madrid for the Prevention of False or Misleading Indications of Origin as Amended at Lisbon on October 31, 1958,* 57 PAT. & TRADEMARK REV. 225 (1959).

68. MCCARTHY, *supra* note 2, § 29.10(5)(a). *See also* LADAS, *supra* note 24, § 847. *Cf.* Bendekgey, *supra* note 63 (Paris Convention does not apply to geographic indications that are likely to mislead).

69. 33 Indus. Prop. 11 (1994).

70. *Reprinted in* LEAFFER, *supra* note 8, at 278.

71. MCCARTHY, *supra* note 2, § 29.10(4). *See also* LADAS, *supra* note 24, § 861.

72. 33 INDUS. PROP. 16 (1994).

M.G. Coerper, *The Protection of Geographical Indications in the United States of America, with Particular Reference to Certification Marks*, 29 INDUS. PROP. 232 (1990).

J. Thomas McCarthy and Veronica Colby Devitt, *Protection of Geographical Demoninations: Domestic and International,* 69 TRADEMARK REP. 199 (1979).

Lori E. Simon, *Appellations of Origin: The Continuing Controversy,* 5 NW. J. INT'L L. & BUS. 132 (1983).

L. Sordelli, *The Future Possibilites of International Protection for Geographical Indications,* 30 INDUS. PROP. 154 (1991).

2. *Classification Treaties*

Trademark registrations require a description of the goods and services to be protected by the registration. The national laws of many countries vary in the particularity of their description requirements. In an environment where trademarks are being registered internationally, uniformity in description requirements is desirable because it facilitates filing of registration applications and eliminates questions regarding infringement or confusion.

a. *The Nice Agreement on the International Classification of Goods and Services for the Purposes of the Registration of Marks*

The International Classification system was developed by the International Bureau to facilitate the trademark searching process and the international description of goods and services covered by trademark registrations. The classification system of the International Bureau was adopted in June 1957[73] as The Nice Agreement on the International Classification of Goods and Services for the Purposes of the Registration of Marks.[74] The classifications are changed and revised by a Committee of Experts.[75] The United States became a signatory to this treaty in 1972.[76]

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73. LADAS, *supra* note 24, § 800.

74. *Reprinted in* LEAFFER, *supra* note 8, at 499.

75. In December 1992, the Preparatory Working Group of the Committee of Experts of the Nice Union met and approved classification changes and considered a proposal to restructure certain classes. *Nice Union: Preparatory Working Group of the Committee of Experts, Twelfth Session (Geneva, November 2 to 6, 1992)*, 32 INDUS. PROP. 109 (1993).

76. 33 INDUS. PROP. 15 (1994).

The Nice Agreement requires that each trademark published or registered indicate the International Classification. However, there is no requirement that the classification system become the principle national trademark classification scheme.[77]

b. *The Vienna Agreement Establishing an International Classification of the Figurative Elements of Marks*

The Vienna Agreement Establishing an International Classification of the Figurative Elements of Marks[78] covers designs or figurative elements of trademarks. Twenty-nine classes of figurative elements (e.g. Human Beings, Animals, Plants, Landscapes, and Geometric Figures.) were developed in the draft. As in the goods and services classification system, adopting countries do not have to adopt the same figurative classifications as the national scheme, but figurative registrations must include the classification information.[79] The United States is not a member of this treaty.[80]

c. *Selected Bibliography on Classification Treaties*

STEPHEN P. LADAS, PATENTS, TRADEMARKS AND RELATED RIGHTS: NATIONAL AND INTERNATIONAL PROTECTION (1975) §§ 800-802 (Nice Agreement on the International Classification of Goods and Services); § 803 (Vienna Agreement on the International Classification of Figurative Elements).

Jessie N. Marshall, *Classification of Services Under the International (Nice) Agreement*, 82 TRADEMARK REP. 94 (1992).

Daniel L. Skoler, *Trademark Identification—Much Ado About Something?*, 76 TRADEMARK REP. 224 (1986).

C. *Regional and Other Limited Agreements*

1. *Types of Regional Agreements*

Other treaties have been entered into by numerous countries or by more limited groups of countries. These agreements have a limited scope which may or may not impact United States trademark owners. These treaties fall into two categories: those providing for a single

77. LADAS, *supra* note 24, § 801.
78. *Reprinted in* LEAFFER, *supra* note 8, at 546.
79. LADAS, *supra* note 24, § 803.
80. 33 INDUS. PROP. 15 (1994).

registration for a group of countries (a true multinational trademark)[81] and those which create some economic integration or harmonization among countries.[82] An example of a single registration treaty is the Benelux Treaty providing for one registration for Belgium, the Netherlands, and Luxembourg.

Harmonization treaties include the Pan American Convention of 1929[83] and the Andean Pact Convention.[84] The Pan American Convention of 1929[85] consists of two separate parts: A Convention for Trade Mark and Commercial Protection, and a Protocol on Inter-American Registration of Trade Marks. The United States is a member of the Pan American Convention, but renounced the Protocol in the mid-1940s. The Bureau administering the treaty has closed.[86] The Pan American Convention is one of three Inter-American Conventions that are still in effect to some degree. The Convention's parties are only bound by the latest agreement signed.[87] These Conventions have little significance in view of the Paris Convention.[88]

Trademark rights can also be internationally protected through bilateral agreements between individual countries. The United States has agreements of this nature with China, Ethopia, the German Democratic Republic, Greece, Ireland, Italy and Japan.[89] For an historical listing of individual treaties see P. Federico, *Treaties Between the U.S.*

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81. Frayne, *supra* note 29, at 423.

82. William H. Ball, *Attitudes of Developing Countries to Trademarks*, 74 TRADEMARK REP. 160, 169 (1984).

83. Pan American Convention of 1929. Inter-American Convention for the Protection of Trade-marks, signed at Washington February 20, 1929; ratified by the President of the United States February 11, 1931; ratification of the United States deposited with the Pan American Union February 17, 1931; proclaimed February 17, 1931. Convention and protocol effective as to the United States February 17, 1931. 46 Stat. 2907; T.S. No. 833; IV Treaties (Trenwith) 4768; 380 OFFICIAL GAZETTE U.S. PAT. & TRADEMARK OFF. 245.

84. *Reprinted in* 3 DIG. OF COM. LAWS OF THE WORLD, DIG. OF INTELL. PROP. LAWS (L. F. Quevedo trans., 1990).

85. Pan American Convention of 1929, *supra* note 83.

86. GILSON, *supra* note 6, § 9.08.

87. MCCARTHY, *supra* note 2, § 29.10(2) (1929, 46 STAT. 2907: Columbia, Cuba, Guatemala, Haiti, Honduras, Nicaragua, Panama, Paraguay, Peru and the United States)(1923, 44 STAT. 2494: Brazil, Dominican Republic)(1910, 39 STAT. 1675: Ecuador and Uruguay).

88. MCCARTHY, *supra* note 2, § 29.10(2).

89. *Id.* (China, 63 STAT. 1299 (1948); Ethopia, 4 U.S.T. 2134 (1953); German Democratic Republic, T.I.A.S. No. 3593 (1956); Greece, 5 U.S.T. 1829 (1954); Ireland, 1 U.S.T. 550 (1950); Italy, 63 STAT. 2255 (1949); Japan, 4 U.S.T. 2063 (1953)).

*and Other Countries Relating to Trade-Marks,* 39 TRADEMARK REP. 1 (1949) (Supp.).

2. *Selected Bibliography on Regional and Other Limited Agreements*

a. *Andean Pact*

Stephen P. Ladas, *Latin American Economic Integration and Industrial Property,* 62 TRADEMARK REP. 1 (1972).

Jerimiah D. McAuliffe, *Reacting to Trademark Developments in Latin America,* 65 TRADEMARK REP. 503 (1975).

Peter Schliesser, *Restrictions on Foreign Investment in the Andean Common Market,* 5 INT'L LAW. 586 (1972).

Antonio R. Zamora, *Andean Common Market—Regulation of Foreign Investments: Blueprint for the Future?,* 10 INT'L LAW. 153 (1976).

b. *Benelux*

Richard Ebbink, *'Other Use' of Trade Marks: A Comparison Between U.S. and Benelux Trade Mark Law,* 14 EUR. INTELL. PROP. REV. 200 (1992).

C. Gielen, *Better Protection of Service Marks in the Benelux?,* 8 EUR. INTELL. PROP. REV. 79 (1986).

Eric D. Offner, *Benelux Trademark Convention,* 54 TRADEMARK REP. 102 (1964).

Dirk Pieter Raeymaekers, *Assignments, Licenses and Abandonment of Trademarks in the Benelux,* 68 TRADEMARK REP. 15 (1978).

Jan T. Van't Hoff, *Benelux Treaty and Uniform Law on Trademarks—a General Description* , 60 TRADEMARK REP. 595 (1970).

c. *Pan American Treaties*

Walter J. Halliday, *Inter-American Conventions for Protection of Trade-Marks,* 32 J.P.O.S. 661 (1950).

Stephen P. Ladas, *Pan American Conventions on Industrial Property,* 22 AM. J. INT'L L. 803 (1928).

Jeremiah D. McAuliffe, *Consideration of Inter-American Conventions,* 52 TRADEMARK REP. 25 (1962).

### D. *Trademark Provisions in Non-Intellectual Property Treaties*

#### 1. *Examples of Non-Intellectual Property Treaties*

Other multilateral treaties have provisions covering trademarks and other intellectual property. The Uruguay Round of the General Agreement on Tariffs and Trade[90] (GATT) includes trademark and other intellectual property issues. The GATT intellectual property provisions are also known as The Agreement on Trade-Related Aspects of Intellectual Property Rights, Including Trade in Counterfeit Goods or TRIPS. Trademark protection through GATT is desirable because developing countries resist following the Paris Convention, and GATT offers an established, enforceable system of trade protection.[91] The North American Free Trade Agreement (NAFTA)[92] is one of the latest examples of this type of trade agreement. TRIPs and NAFTA both establish minimum standards of protection for intellectual property and retain the principle of territoriality.[93]

The European Community was established by several treaties with the intent of removing geographic barriers between European countries. The principal EC intellectual property law developments have included an erosion of the independence of national trademark rights when in conflict with EC treaty provisions, as well as restrictions on a trademark owner's ability to prevent imports of its own goods legitimately using the trademark in another member county (also known as "gray market goods").[94]

The EC is actively developing laws to eliminate trademark barriers: a draft regulation has proposed a new Community Trade Mark System (CTM), and a directive on the harmonization of national trademark laws was adopted in December 1988.[95] The CTM provides trademark owners with a single trademark enforceable in all EC countries, but

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90. TRIPs (Annex III), DRAFT FINAL ACT EMBODYING THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS, MTN.TNC/W/FA, 20 Dec. 1991, GATT Secretariat UR-91-0185.

91. R. Michael Gadbaw and Timothy J. Richards, *Intellectual Property Rights in the New GATT Round,* INTELLECTUAL PROPERTY RIGHTS: GLOBAL CONSENSUS, GLOBAL CONFLICT?, (1988).

92. Article 1708: Trademarks. 1 NORTH AMERICAN FREE TRADE AGREEMENT BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA, THE GOVERNMENT OF CANADA AND THE GOVERNMENT OF THE UNITED MEXICAN STATES 17-5 (1993).

93. GILSON, *supra* note 6, § 9.10.

94. Pegram, *supra* note 7, at 1060.

95. GILSON, *supra* note 6, § 9.09.

does not override already-established national trademark rights.[96] The development (and adoption) of the Madrid Protocol may have an impact on EC trademark law because Article 14 of the Protocol allows regional organizations to become members of the Protocol.[97]

2. *Selected Bibliography on Non-Intellectual Property Treaties*

a. *North American Free Trade Agreement (NAFTA)*

Daniel R. Bereskin, *Comparison of the Trademark Provisions of NAFTA and TRIPs*, 83 TRADEMARK REP. 1 (1993).

b. *General Agreement on Tariffs and Trade (GATT)*

Daniel R. Bereskin, *Comparison of the Trademark Provisions of NAFTA and TRIPs*, 83 TRADEMARK REP. 1 (1993).

Peter Crockford, *GATT Considerations,* 8 TRADEMARK WORLD 24 (1993).

D. Peter Harvey, *Efforts Under GATT, WIPO and Other Multinational Organizations Against Trademark Counterfeiting*, 15 EUR. INTELL. PROP. REV. 446 (1993).

Eleanor K. Meltzer, *TRIPs and Trademarks, or GATT Got Your Tongue?*, 83 TRADEMARK REP. 18 (1993).

c. *European Community*

The trademark in the European Community has generated a large volume of literature. Below is a selected bibliography of recent articles.

*European Community Harmonization: Common Denominator—Now or Ever?*, TRADEMARK WORLD 26 (1993).

Michael Fawlk, *Trademark Delimitation Agreements Under Article 85 of The Treaty of Rome,* 82 TRADEMARK REP. 223 (1992).

Charles Gielen, *Harmonization of Trade Mark Law in Europe: The First Trade Mark Harmonization Directive of the European Council,* 14 EUR. INTELL. PROP. REV. 262 (1992).

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96. *Id.*

97. J. Rosini and C. Roche, *Trademarks in Europe 1992 and Beyond*, 13 EUR. INTELL. PROP. REV. 404, 408 (1991). The Madrid Protocol may eliminate the need for a separate CTM, but also would allow many other nations access to a CTM.

Richard Jenkins, *To Examine or Not to Examine for Prior Rights in the Community Trademark Office,* TRADEMARK WORLD (1993).

Thomas Ardel Larkin, *Harmony in Disarray: The European Community Trademark System,* 82 TRADEMARK REP. 634 (1992).

Doris E. Long,. *Survey of Recent Development in Trademark Law in the European Communities*, 18 INT'L LAW. 163 (1984).

Dinah Nissen and Ian Karet, *The Trademarks Directive: Can I Prevail if the State Has Failed?,* 15 EUR. INTELL. PROP. REV. 222 (1990).

John B. Pegram, *Europe, Trademarks and 1992*, J. PAT. [& TRADEMARK] OFF. SOC'Y 1060 (1990).

John Richards, *Recent Developments Concerning Trademark and the European Economic Community*, 74 TRADEMARK REP. 146 (1984).

Adrian Y. Spencer, *European Harmony: Confusion or Conflict,* TRADEMARK WORLD 23 (1993).

David C. Wilkinson, *The Community Trade Mark Regulation and Its Role in European Economic Integration,* 80 TRADEMARK REP. 107 (1990).

## III. CONDUCTING ADDITIONAL RESEARCH IN INTERNATIONAL TRADEMARK LAW

### A. *Research Aids*

#### 1. *General Works on Trademark Treaties*

THE INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW[98] provides a general overview of the entire spectrum of intellectual property treaties. Of special note are section 76 on the international registration of trademarks, section 77 regarding indications of source and appellations of origin, and section 82 covering European trademark law developments. Basic information on trademark treaties and developments in international trademark law can be also be found in the major trademark treatises, although coverage varies. J. MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION, (3d ed. 1993)[99] and J. GILSON, TRADEMARK PROTECTION AND PRACTICE (1993)[100] provide overviews of the philosophies and general principals of the treaties. R.

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98. 14 THE INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW Ch. 1 (Copyright and Industrial property; General Questions—The International Conventions).

99. Section 29.10 covers International Trademark treaties.

100. Chapter 9 covers Foreign Trademark Protection.

CALLMANN, CALLMANN ON UNFAIR COMPETITION, TRADEMARKS AND MONOPOLIES (4th ed. 1981),[101] and S. LADAS, PATENTS, TRADEMARKS AND RELATED RIGHTS: NATIONAL AND INTERNATIONAL PROTECTION (1975) have more detailed information on trademark treaty provisions and working mechanisms.

Interesting historical accounts of treaty development are included in the discussion of the multilateral trademark treaties in conjunction with the European Community treaties and trademark directives by J. Pegram in *Europe, Trademarks and 1992*, J. PAT. [& TRADEMARK] OFF. SOC'Y 1060 (1990). Developments leading up to the Madrid Agreement are recounted by A. Bogsch in *The First Hundred Years of the Madrid Agreement Concerning the International Registration of Marks*, 30 INDUS. PROP. 389 (1991). Gerd F. Kunze traces trademark treaty evolution from the Madrid Agreement to the Madrid Protocol in *The Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks of June 27, 1989*, 82 TRADEMARK REP. 58 (1992)

2. *General Works on International Trademark Law and Practice*

International trademark law is dependent on the laws of the individual countries. Sources for the trademark laws of individual countries include DIGEST OF COMMERCIAL LAWS OF THE WORLD, DIGEST OF INTELLECTUAL PROPERTY LAWS (1990); and TRADEMARKS THROUGHOUT THE WORLD (1979). In MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION (3d ed. 1992), the author covers the process of United States protection of foreign trademarks and many other aspects of international trademark law. International competition law is generally detailed by Callmann in CALLMANN ON UNFAIR COMPETITION, TRADEMARKS AND MONOPOLIES § 27 (1981).

B. *Databases*

There are two types of trademark databases, those containing the actual registered trademarks (on national and international registers) and those containing information about trademark issues. National register search strategies and databases are detailed by N. Thompson in *Intellectual Property Materials Online/CD-ROM; What and Where*, 15 DATABASE 14 (1992). Registry databases are international in scope although the most readily available to United States researchers are

101. Section 26 focuses on International Trademark conventions and the intricacies of international protection.

primarily North American and European. The database reviews focus on British and United States services. CD-ROM resources are database-like because the access through machine search can be superior to book indexing. The United States Patent and Trademark Office materials on CD-ROM are also reviewed.

Mathew Bender & Co., Inc. publishes all of its intellectual property treatises on one CD-ROM entitled SEARCH MASTER. This service provides better indexing than most book sources, but access is limited to publications for which subscriptions exist.

WIPO has made pertinent data from the Madrid Agreement international register available on ROMARIN CD-ROM (*R*ead-*O*nly-Memory of the *M*adrid *A*ctualized *R*egistry *IN*formation).[102]

Information about trademark issues is available on both LEXIS and WESTLAW. LEXIS compiles trademark material in the TRDMRK library (Trademark and Unfair Competition Law Library), which primarily covers United States national trademark information. International aspects are pulled in through publications with an international scope such as TRADEMARK REPORTER, BNA's PATENT, and TRADEMARK COPYRIGHT LAW DAILY. The LEXIS TRDMRK Library also includes customs administration rulings and ITC decisions, as well as the text of intellectual property treaties. The ITRADE (International Trade Law Library) and EURCOM (European Community) libraries may also include items of interest, but their broader coverage will bring in extraneous materials.

WESTLAW provides information primarily in the topical databases labeled with the prefix FIP. The Practicing Law Institute (PLI) course handbooks are a unique source with practical information and reprints of some primary source material. The WESTLAW gateway to DIALOG provides access to national registry databases such as TRADEMARKSCAN (produced by Thompson & Thompson) which contains United States trademark registrations and applications for registration.

C. *Periodicals*

TRADEMARK REPORTER5, New York: International Trademark Association, 1911-present.

EUROPEAN INTELLECTUAL PROPERTY REVIEW, Oxford, Oxfordshire: ESC Publications, Ltd., 1978-present.

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102. *Madrid Union*, 32 INDUS. PROP. 141, 142 (1993).

INDUSTRIAL PROPERTY: MONTHLY REVIEW OF THE WORLD INTELLECTUAL PROPERTY ORGANIZATION, Geneva: WIPO, 1961-present.

IIC: INTERNATIONAL REVIEW OF INDUSTRIAL PROPERTY AND COPYRIGHT LAW. Munich, West Germany: Max Planck Institute for Foreign and International Patent, Copyright and Competition Law, 1969-present.

WORLD INTELLECTUAL PROPERTY REPORT, London: BNA International, 1988-present.

TRADEMARK WORLD, London: Intellectual Property Pub., 1986-present.

## IV. SELECTED BIBLIOGRAPHY ON SPECIFIC ISSUES IN INTERNATIONAL TRADEMARK LAW

### A. *Counterfeiting*

J. Joseph Bainton, *Reflections on the Trademark Counterfeiting Act of 1984: Score a Few for the Good Guys,* 82 TRADEMARK REP. 1 (1992).

J. Joseph Bainton, *Seizure Orders: An Innovative Judicial Response to the Realities of Trademark Counterfeiting,* 73 TRADEMARK REP. 459 (1983).

James A. Carney, *Setting Sights on Trademark Piracy: The Need for Greater Protection Against Imitation of Foreign Trademarks*, 81 TRADEMARK REP. 30 (1991).

DONALD KNOX DUVALL, UNFAIR COMPETITION AND THE ITC: ACTIONS BEFORE THE INTERNATIONAL TRADE COMMISSION UNDER SECTION 337 OF THE TARIFF ACT OF 1930 (1993).

D. Peter Harvey, *Efforts Under GATT, WIPO and Other Multinational Organizations Against Trademark Counterfeiting*, 15 EUR. INTELL. PROP. REV. 446 (1993).

Edward Kania, *International Trademark and Copyright Protection,* 8 LOY. L.A. INT'L & COMP. L.J. 721 (1986).

Perla M. Kuhn, *Remedies Available at Customs for Infringement of a Registered Trademark*, 70 TRADEMARK REP. 387 (1980).

Clark W. Lacker, *International Efforts Against Trademark Counterfeiting,* 1988 COLUM. BUS. L. REV. 161 (1988).

Elizabeth J. Lintini, Note, *Commercial Trademark Counterfeiting in the United States, the Third World and Beyond: American and International Attempts to Stem the Tide,* 8 B.C. THIRD WORLD L.J. (1985).

Diane E. Preblude, Note, *Countering International Trade in Counterfeit Goods,* 12 BROOK. J. INT' L. 339 (1986).

William N. Walker, *A Program to Combat International Commercial Counterfeiting,* 70 TRADEMARK REP. 117 (1980).

B. *Developing Nations*

William H. Ball, *Attitudes of Developing Countries to Trademarks,* 74 TRADEMARK REP. 160 (1984).

W.R. Cornish and Jennifer Phillis, *The Economic Function of Trade Marks: An Analysis with Special Reference to Developing Countries,* 13 I.I.C. 41 (1982).

Louis M. Gibson, *The New Game—Trademark Handicapping,* 69 TRADEMARK REP. 74 (1969).

Eva Csiszar Goldman, Note, *International Trademark Licensing Agreements: A Key to Future Technological Development,* 16 CAL. W. INT'L L.J. 178 (1986).

Raymer McQuiston, *Developing Countries Are Undermining Corporate America's Capacity to Market Its Creativity: A Call for a Reasoned Solution by the United States Government in Light of the Continuing Deterioration of the International Trademark System,* 14 SYRACUSE J. INT'L L. & COM. 237 (1987).

Peter F. O'Brien, *The International Trademark System and the Developing Countries,* 19 IDEA 89, 93 (1978).

John P. Spitals, *The UNCTAD Report on the Role of Trademarks,* 11 N.Y. L. SCH. J. INT'L & COMP. L. 369 (1981).

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, THE ROLE OF TRADEMARKS IN DEVELOPING COUNTRIES, U.N. Doc TD/B/C.6/Ac.3/3/Rev. 1 (1979).

C. *Gray Market Goods/Parallel Imports*

Scott R. Bough, Note, *The Seven Billion Dollar Gray Market: Trademark Infringement or Honest Competition?,* 18 PAC. L.J. 261 (1986).

Baila H. Caledonia, *Trademarks in the European Communities from an American Perspective,* 18 BROOK. J. OF INT'L. L. 751 (1993).

Brian D. Coggio *et al.*, *The History and Present Status of Gray Goods,* 75 TRADEMARK REP. 433 (1985).

E. John Krumholtz, *The United States Customs Service's Approach to the Gray Market: Does It Infringe on the Purposes of Trademark Protection?*, 8 J. COMP. BUS. & CAP. MARKET L. 101 (1985).

SETH E. LIPNER, THE LEGAL AND ECONOMIC ASPECTS OF GRAY MARKET GOODS (1990).

Pierrette Alyssa Newman, *The United States Customs Service's Regulation of Gray Market Imports: Does It Preserve the Broad Protections Afforded by Section 516 of the Tariff Act of 1930?,* 5 DICK. J. INT'L L. 293 (1987).

Linda S. Paine-Powell, *Parallel Imports of Materially Different Grey Goods: Obtaining Customs Blockage or an Injunction*, 15 EUR. INTELL. PROP. REV 122 (1993).

N. David Palmeter, *Gray Market Imports: No Black and White Answer*, 22 TRADE 89 (1988).

J. Thomas Warlick IV, Comment, *Of Blue Light Specials and Gray Market Goods: The Perpetuation of the Parallel Importation Controversy*, 39 EMORY L.J. 347 (1990).

John A. Young, Jr., Note, *The Gray Market Case: Trademark Rights v. Consumer Interests,* 61 NOTRE DAME L. REV. 838 (1986).

D. *Harmonization*

Charles Gielen, *Harmonization of Trade Mark Law in Europe: The First Trade Mark Harmonization Directive of the European Council,* 14 EUR. INTELL. PROP. REV. 262 (1992).

Brian J. Letten and Gerd Kunze, *Harmonization (Uniform Systems). Making History: Trademarks in 2017*, 82 TRADEMARK REP. 912 (1992).

Allan S. Pilson and Peter Siemensen, *Centralization (Uniform Systems). Making History: Trademarks in 2017*, 82 TRADEMARK REP. 919 (1992).

E. *Licensing*

ROBERT GOLDSCHEIDER, ECKSTRON'S LICENSING IN FOREIGN AND DOMESTIC OPERATIONS: THE FORMS AND SUBSTANCE OF LICENSING. (1978).

*International Trademark Licensing Agreements: A Key to Future Technological Development,* 16 CAL. W. INT'L L.J. 178 (1986).

R. Joliet, *Trademark Licensing Agreements Under the EEC Law of Competition*, 5 NW. J. INT'L L. & BUS. 755 (1983-84).

H. Kinkeldey, *Pitfalls of Trademark Licensing in the EEC*, 72 TRADEMARK REP. 145 (1982).

F. *Miscellaneous*

Thomas J. Hoffman & Susan E. Brownstone, *Protection of Trademark Rights Acquired by International Reputation Without Use or Registration*, 71 TRADEMARK REP. 1 (1981).

Joseph M. Lightman, *Protection of Generic Words Against Trademark Registration Abroad*, 54 TRADEMARK REP. 80 (1964).

Jeremiah D. McAullife, *Dilution Concept in International Trade*, 61 TRADEMARK REP. 76 (1971).

Virginia R. Richard, *Management of Foreign Trademark Litigation*, 7 COM. & L. 3 (1985).

G. *Uniform Trademark Laws*

Friedrich-Karl Beier and Arnold Reimer, *Preparatory Study for the Establishment of a Uniform International Trademark Definition*, 45 TRADEMARK REP. 1266 (1955).

Hugo Mock, *Is an International Trade-Mark Law Desirable Now?*, 40 TRADEMARK REP. 3 (1950).

Edward D. Rogers & Stephen P. Ladas, *Proposals for Uniform Trademark Laws*, 61 TRADEMARK REP. 8 (1950).

## V. INTERNATIONAL ORGANIZATIONS

### A. *World Intellectual Property Organization (WIPO)*

Established by a multinational treaty in 1967,[103] WIPO is the international body charged with promoting worldwide intellectual property protection through cooperative efforts and by coordinating the activities of the International Unions (Paris, Madrid, etc.).[104] The secretariat, or governing body, was originally known as the International Bureau (BIRPI).[105] When WIPO became a United Nations agency in

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103. *Convention Establishing the World Intellectual Property Organization, July 14, 1967*, 21 U.S.T. 1749, *Reprinted in* LEAFFER, *supra* note 8, at 563.

104. *Id.* art. 3

105. United International Bureau for the Protection of Intellectual Property, or *Bureaux Internationaux Internaux Reunis pour la Protection de la Propriete Intellectuelle.*

1974,[106] the International Bureau became a part of the overall structure.[107]

There are two groups within the committee structure of particular interest to the area of international trademark law. The Permanent Committee on Industrial Property Information ad hoc Working Group on Trademark Information (PCIPI/TI) was established to explore various aspects of trademark information collection and storage. The working group surveyed trademark search systems, examination methods and application numbering systems. It is also in the process of developing a definition of a figurative trademark.[108] The Committee of Experts on the Harmonization of Laws for the Protection of Marks is developing a trademark administration treaty to facilitate worldwide trademark filing.[109]

B. *Selected Bibliography on the World Intellectual Property Organization*

Eugene M. Braderman, *The World Intellectual Property Organization and the Administrative Reorganization,* 12 IDEA 673 (1968).

Harry Goldsmith, *WIPO: A Noble Idea Whose Time Has Come,* 12 IDEA 691 (1968).

STEPHEN P. LADAS, PATENTS, TRADEMARKS AND RELATED RIGHTS: NATIONAL AND INTERNATIONAL PROTECTION §§ 92-100 (1975).

C. *Other Organizations and Associations*

As part of the WIPO entry, the YEARBOOK OF INTERNATIONAL ORGANIZATIONS provides a long list of related associations and organizations. Below is a sampling:

American Bar Association
Patent, Trademark & Copyright Section (PTC Section)
750 N. Lake Shore Dr.
Chicago, IL 60611

American Intellectual Property Law Association (AIPLA)

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106. CALLMANN, *supra* note 18, § 26.01.

107. *See supra* note 103, art. 9.

108. First Session reported at 31 INDUS. PROP. 218 (1992), Second Session 32 INDUS. PROP. 133 (1993), Third Session held October 1993. *See supra* Part II.A.5 of this Article for further discussion of this treaty.

109. *See* First Session, 29 INDUS. PROP. 101 (1990); Second Session, 29 INDUS. PROP. 375 (1990); Third Session, 31 INDUS. PROP. 244 (1992); Fourth Session, 32 INDUS. PROP. 89 (1993); Fifth Session, 32 INDUS. PROP. 289 (1993); Sixth Session, 32 INDUS. PROP. 339 (1993). *See supra* Part II.A.5 of this Article for further discussion of this treaty.

2001 Jefferson Davis Hwy., Suite 203
Arlington, VA 22202

European Communities Trademark Association (ECTA)
SG Florence Gevers
c/o Bureau Gevers NV
Buekenlaan 12
B-2020, Antwerpen
Belgium

Inter-American Association of Industrial Property (ASIPI)
Maipu 1300
1006 Buenos Aires
Argentina

International Anti-Counterfeiting Coalition (IACC)
818 Connecticut Ave. N.W., Suite 1200
Washington, D.C. 20006

International Association for the Protection of Industrial Property (AIPPA)
Bleicherweg 58
CH-8029 Zurich
Switzerland

International Intellectual Property Association (IIPA)[110]
1255 23rd St. NW, Suite 850
Washington, D.C. 20037

International Trademark Association (INTA)[111]
1133 Avenue of the Americas
New York, NY 10036-6710

Licensing Executives Society International (LES)
71 East Ave., Suite 5
Norwalk, CT 06851

## VI. CONCLUSION

From the Paris Union to the Madrid Protocol and beyond, international trademark law continues to evolve.[112] From a seemingly

110. Formerly the International Patent and Trademark Association.

111. Formerly the United States Trademark Association (USTA).

112. A timeline of important trademark developments is found in *Preserving History*, 82 TRADEMARK REP. 1021 (1992).

immovable position in the mid-Twentieth century, the Madrid Protocol has been realized. However, some problems, such as centralization, trademark systems, and harmonization, which were identified then[113] are still problems today.

In 1992 at Cannes, France, the International Trademark Association[114] held a symposium entitled Making History: Trademarks in 2017,[115] to discuss the evolution of trademarks in the next 25 years. The issues identified at that symposium for the next 25 years include harmonization, centralization, enforcement and dispute resolution, confusion, trademark registration filing systems, and counterfeiting.

113. David B. Allen, *Protection of Product Identity Abroad: Some New Light on an Old Problem?*, 55 TRADEMARK REP. 707, 715 (1965) (Multiplicity of jurisdictions results in high protection costs; the disparity of use requirements causes confusion and inequities.).

114. *See supra* note 111 and accompanying text.

115. Symposium, *Making History: Trademarks in 2017*, 82 TRADEMARK REP. 829 (1992).

# Modern Russian Secured Transaction Law and Foreign Investors' Rights Thereunder

## I. INTRODUCTION

Modern Russian commercial law was born in 1985 by *Perestroika*[1] and reached adolescence six years later when the Soviet Union collapsed. The statist, centrally-commanded Soviet economy obviated the need for commercial law or concepts. The explosion of reform gives Russian commercial law teenager-like qualities: it has the energy and desire to develop into *something*, but lacks experience or character, and therefore is crude and unsophisticated.

There are great opportunities for profitable, long-term investing in Russia.[2] The need for capital to strengthen the Russian economy

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1. MIKHAIL S. GORBACHEV, PERESTROIKA: NEW THINKING FOR OUR COUNTRY AND THE WORLD (1987). Prior to Mikhail Gorbachev's ascendancy to power and his publication of Perestroika, there was no foreign investment in the Soviet Union. That changed during the late 1980s, as Gorbachev began instituting economic reforms in the Soviet Union. Perestroika promised more reform than it delivered, but it broke inertia and set reform in motion.

2. Russia's potential for economic growth over the next generation is staggering. It is a nation of 6,592,800 square miles of largely untapped mineral, forestry, and agricultural resources. WORLD ALMANAC AND BOOK OF FACTS 1993 693 (Mark S. Hoffman, ed. 1993). However, the most important of its resources is its people. Russia is a nation of 148.5 million people, many of whom are highly educated. The Russian

is unquestioned by the government. For this reason, the Russian leadership has taken many steps to build a legal framework for capitalistic transactions. However, potential investors are inherently fearful of investing money and effort in the unknown. Many foreign investors who are ready and able to invest are not willing. Some are frightened by the political climate in Russia. Boris Yeltsin's power as President is challenged continually, but this analysis proceeds on the belief that his political success to date demonstrates the commitment of the Russian people to economic reform.[3] Hence, an improved understanding of Russian law by Western businesspeople will increase the likelihood of successful investing, regardless of the political leadership.

Perhaps an investor's most basic concern when transacting business is predictability of outcome. It is imperative that a market participant act with confident expectations. Damage control is a major factor when predicting and producing reliable expectations. Therefore, it is vital to know what may happen when damage occurs and the party dealt with defaults or goes bankrupt.

Secured lenders in the United States rely on a solid body of commercial and bankruptcy law to improve the predictability of outcomes. It was judicially developed in the Common Law and is now

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literacy rate is 99 per cent. *Id.* The skill level of the Russian people should enable its economy to grow at a much faster rate than the growth economies of third world nations, and the people's sophistication also should enable Russia to develop a thriving consumer market.

3. As President of the Russian Federation, Boris Yeltsin has outperformed Gorbachev in keeping his reform promises, but not without many fights from the conservative forces that hastened Gorbachev's fall from power. Throughout 1992 Yeltsin issued many decrees affecting business in Russia. In 1993 Yeltsin withstood the greatest challenges to his authority—and the path of reform—when he won a decisive vote of confidence by the general electorate and succeeded in the constitutional coup that disbanded the non-democratic Parliament.

The December 1993 elections resulted in major setbacks to the radical reformers in Russia, but did not signal the peoples's desire to return to Soviet-style government. Since the Soviet era ended, the Russian people have tasted freedom spiritually, economically, and politically. They have more choices available than ever before. If choice is power, it is unlikely that the laws encouraging foreign investment will be reversed, even if Yeltsin were ousted. "The reforms begun in 1992 have enabled us to blunt the crisis. . . . After several years of pointless dispute over words, privatization is going full steam ahead. The rapid growth of the private sector, which already embraces not just trade and finances, but also production, has become a reality of economic life." *Sergey Filatov Marks 1991 Coup Anniversary*, RUSSIA-CIS INTELLIGENCE REPORT, INTERNATIONAL INTELLIGENCE REPORT, Sept. 2, 1993, *available in* WESTLAW, PTS-NEWS Database.

codified in the Uniform Commercial Code and the Federal Bankruptcy Code.[4] Lenders in Russia do not enjoy the same common law foundation, but the new laws are an attempt to introduce many of these principles to Russian commerce. In addition, due to Russian inexperience with capitalistic commercial law concepts and practice, there is not yet a developed vocabulary in commercial practice. This increases miscommunication and unpredictability. The foreign investor considering lending in Russia must therefore be prepared to grow with her as the economy and law develop.

The purpose of this Comment is to aid the American practitioner and investor in the reduction of risk when lending in Russia by illuminating its nascent secured transaction law and related commercial statutes. Part II focuses on the Law of the Russian Federation "On Mortgage,"[5] as the first Post-Soviet era step at codifying a law of secured transactions. It exposes the rules governing (A) the scope of legal mortgage relations, (B) attachment and rights and duties in mortgage contract, (C) creditor priority and perfection of security interests, and (D) the contracting parties' rights and remedies upon default. The examination compares important provisions of Article 9 of the UCC to the Mortgage Act. Part III addresses the bankruptcy law passed and implemented in 1993. Part IV focuses on the enforceability of cross-border secured interests by looking at other laws significantly impacting a foreign secured party's rights. Part IV.A inquires into foreign investor's rights under Russian property law, and Part IV.B looks into foreign investment law and treaties. Part V briefly describes domestic American resources that aid in securing private Russian debt. In the conclusion, Part VI, some sociological issues likely to confront a foreign investor doing business in Russia are also discussed.

It is important to note that the form of the foreign investment enterprise is important to the decision to extend credit in Russia. This is because citizenship and legal personhood[6] impact the way property rights, and thus security interests, are determined in Russian law. However, this Comment does not purport to be a guide to optimal investment enterprise forms. That decision is individual and involves

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4. UNIFORM COMMERCIAL CODE, (1972) [*hereinafter* UCC]; United States Bankruptcy Code 11 U.S.C. §§ 101-1330, 28 U.S.C. §§ 151-155.

5. Law of the Russian Federation "On Mortgage," Law No. 2872-1 of May 29, 1992, 23 Ved.S'ezda Nar. Dep. R.F. Item 1239 (1992)(hereinafter "the Mortgage Act" or "the Act").

6. Legal personhood in Russia means the capacity to possess legal rights and duties. It includes individuals, corporations, and other business associations.

many non-legal factors. Instead, this inquiry maps the legal landscape the investor must travel to protect its credit investment in Russia by securing the debt.

## II. "ON MORTGAGE": THE NEW RUSSIAN LAW OF SECURED TRANSACTIONS

On May 29, 1992, Russia's Parliament passed the Mortgage Act for the purpose that "[m]ortage shall be a way of creating security for obligation under which the mortgagee (creditor) acquires the right, in the event of non-performance by debtor of the obligation, to receive satisfaction out of the mortgaged property in preference to other creditors, barring statutory exemptions."[7] The word "mortgage" has a broader meaning in Russian than in English, as evidenced by its description of mortgage as a "way of creating security."[8] The term "mortgage" in Russian law refers not only to transactions where an obligation is secured by real property, but to any contract where performance is secured by a property interest.

This sheds light on the most significant distinction between the UCC and the Mortgage Act. The Mortgage Act's purpose and scope is to permit the creation of all types of secured transactions. In contrast, the Code limits the scope of secured transactions it addresses to personal property, both tangible and intangible.[9] Thus, the Russian Mortgage Act reveals both its promise and its weakness: intended as a comprehensive law, it is mainly a relational framework to guide parties through the formation of private contracts securing obligations. Lacking specific definitions of terms and rights, the Mortgage Act does not provide the certainty and protection of the UCC. Rather, the burden is on the parties, especially the lender, to provide certainty and protection in contract.

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7. RF Mortgage Act Art. 1.

8. Two excellent treatments of the Mortgage Act are available. Christopher Osakwe, *Modern Russian Law of Banking and Security Transactions: A Biopsy of Post-Soviet Russian Commercial Law*, 14 WHITTIER L.R. 301 (1993). The author provides a "clinical analysis," *id.*, that examines the Act over the course of its articles and provides the Russian words for key terms. For a more general, practical overview of the Act, see William G. Frenkel, *New Russian Secured Transactions Regime: Analysis of the Law on Pledge*, 4 SURVEY OF EAST EUROPEAN LAW No.2 (Parker School, Columbia University, March 1993). The author does not cite specific provisions of the Act in most of his analysis, but offers a practitioner's perspective that includes references to property relations defined elsewhere in Russian law.

9. U.C.C. § 9-104.

### A. *Scope Of The Russian Mortgage Act*

The baseline features of the mortgagee,[10] mortgagor, and mortgageable property are spelled out in the Act's first section. The Act states that where its terms conflict with those of Russian Federation treaties, treaty rules govern.[11] Hence, the first burden the foreign investor bears is discovery of whether his particular industry or business association is governed by a separate treaty with Russia. The second burden faced is to specify and include the governing law in the contract. The Mortgage Act states that the law of the debtor's domicile will be the governing law unless contracted otherwise.[12] This is different than under the UCC, where there is no right to specify the governing law and the law of debtor's domicile governs.[13]

#### 1. *Statutory Liens*

The Mortgage Act states that a mortgage can be created by contract or operation of law.[14] Even though circumstances where a mortgage will arise by law are narrow, statutory liens are regulated by the Act.[15] The Mortgage Act is silent as to the relationship between statutory liens and other security interests. In contrast, Article 9 does not regulate statutory liens, which generally take priority over perfected security interests in American jurisdictions.[16] The perilous result may be that a well-executed security agreement could be thwarted by local interference and arbitrary applications of law.[17]

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10. In this Comment the following terms are interchangeable: debtor and mortgagor; and secured party, creditor, and mortgagee. In Russia, mortgagees are always secured. References to unsecured creditors will be modified by the term "unsecured" or described as ordinary or competitive creditors.

11. RF Mortgage Act Art. 2.

12. *Id.* Art. 10(6).

13. U.C.C. § 9-103(3)(b).

14. RF Mortgage Act Art. 3(1).

15. *Id.* Art. 3(2). "Statute providing for origination of mortgage must contain indication in virtue of which obligation and which specified property must be deemed pledged in mortgage." *Id.* Thus, the circumstances where a mortgage will arise by operation of law relate directly to the property "pledged" and the nature of the transaction. An example of this type of statutory mortgage is the deferral of customs payments for up to thirty days from the date freight clears customs. RF Procedure for Application of RF Interim Import Customs Tariff, s. 3.3-3.4 (RF State Customs Committee Instruction No. 01-20/3243, RF Ministry of Finance No. 46, RF Central Bank No. 5), RF President's Edict No. 630, 14 June, 1992.

16. U.C.C. §§ 9-203(4), 9-310.

17. Local Russian officials, many carrying over from the Soviet era, still wield

2. *Owner's Power to Mortgage Property*

Under the Mortgage Act, a mortgagor may be any person who has either full ownership or "full business management"[18] of the collateral. Apparently, only the mortgage of property interests over which the debtor has full control and power of disposal are recognized.[19] This is different from the UCC rule, which allows a debtor to give a security interest in any property interest he owns, subject to encumbrances.[20] The practical effect of the Russian provision narrows the scope of mortgageable relations. Furthermore, it places a heavy burden on the lender to determine that the mortgagor actually has the power to mortgage the subject property. The lender who fails to ascertain this fact assumes a tremendous risk because a contract dispute would probably result in avoiding the agreement.

3. *Mortgageable Property*

The range of contracts which may be secured by a mortgage is virtually unlimited under the Mortgage Act. Examples include contracts

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considerable power. Some may be prone to self-interested, arbitrary application of the law. It is therefore imperative that foreign investors have a well-connected and trustworthy Russian representative handling local affairs.

A prime example of political interference in transnational business affairs at the local level, though not secured transaction, is Financial Matters, Inc. v. Pepsico, Inc., 806 F.Supp. 480 (S.D.N.Y. 1992). Monsieur Henri, a subsidiary of Pepsico, held the exclusive license to import *Stolichnaya* vodka into the United States for nearly 20 years. The Russian Federation, in a privatization decree intended to foster exports, stated generally that manufacturing entities now had export rights for their products. Sensing opportunity, a distillery in one of the autonomous republics declared itself the exclusive exporter of Stolichnaya vodka.

The distillery entered into "exclusive" import contracts with three American importers. The Deputy Prime Minister of the republic then issued a decree stating that all export and trademark rights belonged to the local distillery. *Id.* at 483. Monsieur Henri succeeded in obtaining a declaratory judgment holding it to be the exclusive owner of the Stolichnaya mark in the United States and won an injunction against a competing importer, but not without significant legal costs and headaches. *Id.*

18. "Full business management" is undefined in the Mortgage Act, but a reasonable inference drawn therefrom is that it refers to directorship or management of a business enterprise.

19. RF Mortgage Act Art. 19. The Act permits a lessee to mortgage leasehold rights so long as the mortgage is not prohibited by the contract for lease. *Id.* Art. 19(4).

20. U.C.C. § 1-201(37).

for loans (including bank loans), sales, property leases, carriage of goods, and "other contracts."[21] However, mortgage contracts cannot be for "claims of a personal character," presumably meaning personal servitude, or others statutorily prohibited.[22] Property subject to mortgage includes "chattels, securities, other property and property rights, and future rights."[23] Any property which the owner is free to alienate, subject to Russian Federation legislation, may be mortgaged.[24] The Act covers mortgages where the creditor retains possession of the mortgaged property and mortgages of real property and "[e]nterprises, buildings, structures, flats, transport vehicles, space objects, and other properties specified in Article 6."[25]

The Mortgage Act states that a security interest will attach to the accessories and "usufruct thereof" of mortgaged property unless statutorily or contractually mandated otherwise.[26] However, the "severable fruits thereof" will attach only "within the limits, and in the manner provided for by statute or contract."[27] In effect, this means that some mortgageable property may have the income producing characteristics of a trust for the mortgagor, unless modified by contract. As to after acquired property, a mortgage may attach in situations where the parties provide for attachment in contract.[28]

4. *Hypothecation*

The Mortgage Act utilizes both title and lien theories as the grounds upon which secured transactions are built.[29] Although the Russian Code

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21. RF Mortgage Act Art. 4(1).

22. *Id.* Art. 4. An example of a statutorily prohibited mortgage is the hypothecation of jointly owned property where the mortgage is not given with the consent of all owners. *Id.* Art. 7(1).

The RF Mortgage Act does not prohibit many transactions. Therefore, in situations where there is a question about the security interest or the mortgage relationship, the Russian Code of Civil Procedure should be checked for prohibitions, as well as other laws and treaties.

23. *Id.* Art. 19(2). Where full business management of assets have been assigned, the managers or officers shall mortgage the entire enterprise as a "property complex," or mortgage individual buildings and structures, with consent of the owner or by authorized power of agency. *Id.*

24. *Id.* Art. 6.

25. *Id.* Art. 35. The property "specified in Article 6" is "[p]roperty which the mortgagor is free to alienate, under RF legislation." *Id.* Art. 6(1).

26. *Id.* Art. 6(2).

27. *Id.*

28. *Id.* Art. 10(3). *Cf.* U.C.C. § 9-204.

29. Osakwe, *supra* note 8, at 355-56.

of Civil Procedure provides for nine types of security devices, the types of devices intended under the Mortgage Act are hypothecation and pledge.[30] A real property mortgage is referred to as an "hypothecation" (*ipoteka*).[31] All mortgages that touch the land must be hypothecated, and are governed by lien theory. Although most mortgages of personal property utilize title theory, discussed below, some may be hypothecated.[32]

Following lien theory, an hypothecation more closely parallels real property law than the UCC. For example, the Mortgage Act provides the mortgagor the right to retain possession of the mortgaged property after default until all redemptive rights are exhausted.[33] Therefore, though the secured party's rights in the collateral are triggered at default, the secured rights are not enforceable until foreclosure is complete.[34] A creditor's rights may be further limited by other Russian Federation Acts governing property rights in land.[35] However, the debtor's right of redemption where property has been hypohecated does not appear to be for mortgages of land only.

The mortgage of an "enterprise, structure, building, permanent installation or objects directly connected with land, along with the land on which the object stands" also will be considered an hypothecation.[36] In this relationship, special rights accrue to the creditor. The Mortgage Act gives the secured party the right to take affirmative steps to improve the performance of the enterprise, i.e., a right to direct managerial intervention (including replacement), and the power to restrict the disposition of product and other assets of the enterprise.[37] However, it is unclear whether these hypothecation rights are immutable, must be opted into, or may be opted out of the contract. The lender would be wise to specifically delineate its right of intervention in contract.

The notion that an enterprise may be equivalent to its "permanent installation" is unusual and may have severe ramifications. Exercise of the rights of management intervention or asset disposition could

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30. The Civil Code names the nine devices in Articles 192-202. For detailed explanation, see CHRISTOPHER OSAKWE, SOVIET BUSINESS LAW, v.1, § 9.19 (1991).

31. *Id.* Art. 41; Frenkel, *supra* note 8, at 12.

32. *See* RF Mortgage Act Art. 48.

33. *Id.* Arts. 41, 42, 45.

34. *Id.* Art. 24.

35. *Id.* Art. 41.

36. *Id.* Art. 42.

37. *Id.* Art. 44(3). The right of managerial intervention is discussed more fully in Part II.D.4, *infra*.

conceivably harm the secured party. Plus, in foreclosure, the enterprise must be sold as an entity.[38] Because the rights to possession and use of real property are necessarily involved in the enterprise, the creditors' right to satisfaction ultimately is not enforceable until all the mortgagee's rights of redemption are foreclosed.[39] The result is a Russian law that is very protective of the debtor's rights in mortgage contracts where the debtor pledges its interest in real property.

5. *Goods in the Flow of Commerce*

The mortgage relationship for "goods in the flow of commerce" is akin to a chattel mortgage, and is treated as an hypothecation.[40] The mortgagor retains the right to possession, use, and disposal of the mortgaged property[41] and is permitted to alter the property's form when it is "raw and other materials, semifinished products, finished products, and the like."[42] The mortgagor may reduce the value of mortgaged goods, relative to the value of the obligation partially performed.[43] However, the Mortgage Act makes no references to creditor's rights in this regard other than adding a requirement that when substitute goods are described in detail, then the security interest will attach to the substitute[44].

6. *Pledge, Generally*

Mortgages of personal property, including intangible property and future rights, can be tailored by contract to meet the business and security needs of the parties. The Mortgage Act treats transactions where mortgaged property is physically delivered as a pledge under modern title theory. The articles principally deal with the creditor's duties, and thus are principally aimed at the pawn business.[45] The

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38. *Id.* Art. 44(4). This section of the article stipulates that "[o]n application of foreclosure to enterprise in hypothecation, it shall be sold at auction as a *single complex* in the manner provided for by RF legislation" (emphasis added). As a result, the enterprise cannot be liquidated piecemeal to pay secured creditors. *Id.* However, if an action is brought in bankruptcy, *see infra* Part III, then the enterprise may be liquidated.

39. *Id.* Arts. 41, 42, 45.

40. *Id.* Art. 46; U.C.C. § 9-205.

41. RF Mortgage Act Art. 48.

42. *Id.* Art. 46(1).

43. *Id.*

44. *Id.* Art. 47.

45. *Id.* Art. 50-51.

contractual agreement may vary possessory rights; i.e., whether the property is pledged by physical conveyance to creditor or the debtor retains possession.[46] If the pledgor keeps possession, the mortgaged property must be kept under the pledgee's lock and seal, or the mortgagor must give the collateral "earmarks testifying to pledge."[47] Otherwise, when the pledgee has possession, it has the right to use the pledged object according to the terms of the pledge agreement.[48]

### 7. *Pledge of Rights*

The rules governing the pledge of rights hold great interest for a foreign investor seeking to finance debt by taking a security interest in accounts receivable or other intangible right. Unfortunately, security interests in rights are not addressed in detail. The Act states "[P]ledgor's rights of possession and use, including leaseholder's rights, other rights arising from obligations, and other property rights may be the object of pledge," which should include accounts receivable, options, and other rights.[49] Rights that have no present monetary value (e.g., patents, trademarks, copyrights, or the like) may be pledged at a value set by agreement.[50]

Legitimizing the giving and taking of security interests in rights is a major leap forward for the Russian economy. In this regard, the Mortgage Act now parallels the UCC by virtually eliminating limits on the scope of personal property that may be pledged. The freedom granted by the Mortgage Act to design a contractual relationship that accommodates the needs of modern business practice opens a window of opportunity which never existed before.

## *B. Attachment And The Rights And Duties Of Debtors And Creditors*

### 1. *Drafting Requirements*

The Mortgage Act has higher drafting requirements than required under the UCC.[51] A contract for mortgage in Russia must be in writing,

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46. *Id.* Art. 49(2).
47. *Id.*
48. *Id.* Art. 51.
49. *Id.* Art. 54(1).
50. *Id.* Art. 54(3).
51. *Compare* RF Mortgage Act, Art. 10; U.C.C. § 9-203(1). For a security interest to become enforceable and attach, section 9-203(1) requires only that
(a) the collateral is in the possession of the secured party pursuant to agreement, or the debtor has signed a security agreement which con-

and "must recite the terms providing for type of mortgage, substance of the claim secured by mortgage, its amount, time period for performance of obligation, makeup and value of mortgaged property, and also any other terms on which agreement must be reached, as required by either party."[52] The mortgage contract may be included in the contract for the principal obligation.[53] If it is included in the contract for the principal obligation, then the contract for the principal obligation must conform to rules of the Mortgage Act.[54] The formal requirements of the mortgage contract are governed by the rules of the jurisdiction where it is consummated.[55] However, failure to comply with the particular statutory requirements of a jurisdiction outside of Russia cannot be claimed as a defense to excuse performance when the contract's form complies with Mortgage Act.[56] Hence, to be safe when taking a pledge of Russian property, the secured party should ensure that the mortgage contract complies with Russian law.

2. *Notarization*

Notarization in Russia is much different than in the United States. It is a quasi-judicial function that is far more complicated than an American notarization, and may take weeks to accomplish.[57] Under the Mortgage Act, whenever the obligation being secured is notarized,

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tains a description of the collateral and in addition, when the security interest covers crops growing or to be grown or timber to be cut, a description of the land concerned;

(b) value has been given; and

(c) the debtor has rights in the collateral.

*Id.* Note that the UCC requirements are for a valid security agreement to attach, not for the financing statement to perfect the security interest against other parties. *Cf.* U.C.C. §§ 9-302, 9-402.

52. RF Mortgage Act, Art. 10(1)-10(2).

53. *Id.* Art. 10(2).

54. *Id.* Art. 10(4).

55. *Id.* Art. 10(5).

56. *Id.* However, all mortgages of buildings, structures, enterprises, land parcels and other objects found on Russian territory, including railroad rolling stock, civilian air, sea and river vessels, and space objects must comply with Russian mortgage contract form, without regard to the requirements of any other jurisdiction. *Id.*

57. John N. Hazard, *Notaries Resume Private Practice*, 4 SURVEY OF EAST EUROPEAN LAW No. 5 (Parker School, Columbia University, June 1993) at 14. In 1993, the State partially privatized the notary function. (Law of Feb. 11, 1993, RF *Vedemosti* (1993) No. 10, item 357).

the mortgage contract must also be notarized.[58] This provision seems to mandate notarization for nearly all mortgages. Because of the requirement to certify by the same agency where the parties notarized their principal contract, it will often be necessary to certify mortgages in multiple locations, especially in the case of hypothecation of property associated with interests in land. Not only does this complicate attachment of the security interest, but multiple notarization also complicates the process of taking notice of prior security interests when deciding to extend credit.

3. *Mortgage Registration*

Under the Mortgage Act, state registration is required for all mortgages of corporations and other properties at the agency where the property is registered (e.g., land ownership, mineral and mining operations, etc.).[59] In cases where the mortgage must be registered, the contract will not be deemed concluded and the security interest will not attach until it is properly registered.[60] Failure to accomplish this may have disastrous consequences for the unwitting lender. First, failure to attach the security interest would probably result in the mortgagee being held to possess no rights against the mortgagor on a default. Second, failure to attach the security interest would probably result in the mortgagee holding no rights against third parties. Until the new court system and jurisprudence are entrenched, the wise lender should append to the mortgage contract copies of the rules and attaching and perfecting documents to prove Mortgage Act compliance and protect against misunderstanding and arbitrary judicial conduct.

On the surface, the requirement of registering mortgages of certain classes of property may not appear as confusing as the UCC's filing requirements, which vary by jurisdiction. However, the Mortgage Act does not give uniform direction as to where to register, which the UCC provides.[61] The lack of direction may cause confusion for the foreign

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58. RF Mortgage Act Art. 10(3).

59. *Id.* Art. 11. In these circumstances, where the mortgage contract must be registered pursuant to the property's registration, the security interest will not attach until the mortgage is registered. *Id.*

60. *Id.*

61. The Mortgage Act does not name the appropriate agencies where parties to a mortgage contract must register. This omission contrasts starkly with UCC in two major ways. First, it is not necessary for any registration to be made in order for the security interest to attach. U.C.C. § 9-203(1). Second, the UCC provides the lender, and thus third parties dealing with the debtor, with the proper place to file financing statements in order to perfect or take notice of a security interest. U.C.C. § 9-401.

lender who does not understand Russia's local governmental structure. As a result, the likelihood of improper registration is magnified, with potentially draconian consequences. For protection, the foreign lender must necessarily rely on a representative with sound "local knowledge" and good contacts in order to facilitate mortgage registration and attachment of its security interest.

The Mortgage Act provides that individuals "having an interest" may appeal a denial of registration or a wrongful registration of mortgage in a court in the jurisdiction of the registering agency.[62] The mortgagee, mortgagor, and "other interested persons" have the right to receive from the registering agency, upon request, a certificate and abstract of registration.[63] To protect against abuse by the state registering agency, the agency will be liable for damage caused by breach of the registration rules by its agents.[64] The registering agency also owes a duty to the debtor to register documents confirming either full or partial performance of the secured obligation.[65] There is no analog in the UCC for these provisions, but American lenders have legal protection through established recording systems, state laws on misfiling, and state funds that cover anticipated damages.[66]

4. *Mortgagor's Rights*

The Mortgage Act provides the mortgagor the right of having the security interest insured by the mortgagee when the mortgaged property is in the mortgagee's possession, but allows the parties to opt out of this allocation of risk in the mortgage contract.[67] However, it places

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62. RF Mortgage Act Art. 13. This article is very vague. There is not a definition of parties "having an interest." Consequently, the number of parties who may have standing to challenge acts of the registering agency is quite broad and uncertain.

63. *Id.* Art. 14. However, the land use committee, notary, or other authorized agency is compelled to refuse registration of a mortgage contract where the parties do not demonstrate proof of payment of the state duty. *Id.* Art. 15. The comparable UCC section is U.C.C. § 9-407 ("Information From Filing Officer").

64. RF Mortgage Act Art. 16.

65. *Id.* Art. 17(2); *cf.* U.C.C. § 9-404.

66. U.C.C. § 9-407 is not concerned with the Filing Officer's duties owed to the *debtor* regarding its performance of the obligation, just the Officer's duties to the secured party and third parties.

67. *Id.* Art. 9(1). This provision corresponds to U.C.C. § 9-207.

responsibility on the Russian debtor to insure against its insolvency or acts of the government (*force majeure*) which may impair the security interest.[68]

The mortgagor has the right to demand that the mortgagee issue documents confirming partial and full performance of the secured obligation for entry into the state register where the mortgage is recorded.[69] The closest corresponding section in Article 9 is the "Request for Statement of Account or List of Collateral".[70] The strongest similarities between the provisions are the types of information that must be contained in the accounting or list, which includes the aggregate amount of the mortgagor's indebtedness and identification of the collateral (if applicable), and that the secured party must correct and return it to the debtor within a reasonable time.[71]

There are two major distinctions between the Russian and American accounting statements, however. Under the American provision, the debtor must not only request the information, but must initiate the process by submitting what it believes to be accurate information to the secured party, who must then correct it, or later be estopped from denying its accuracy.[72] Second, there is no obligation to file the accounting with an official agency, whereas the accounting addressed in the Mortgage Act is intended to be filed (registered).[73] As a consequence, the Mortgage Act appears to have a reverse filing requirement: it is filing on demand of the debtor, presumably to protect it against the secured party, rather than as a responsibility of the secured party to protect itself against third parties.

When the mortgagor retains possession of the collateral, it also retains the right to dispose of mortgaged property, unless otherwise agreed.[74] The closest analog in the UCC is section 9-205, which permits the debtor the right to dispose of the mortgaged property without accounting to the secured party.[75] However, the focus in section 9-205

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68. RF Mortgage Act Art. 9(2).

69. *Id.* Art. 17(1).

70. U.C.C. § 9-208.

71. *Id.*

72. *Id.* § 9-208(2). The secured party bears the risk of liability for inaccuracies not only to the debtor, but to third parties who are misled by his reply. *Id.*

73. RF Mortgage Act Art. 17(1).

74. *Id.* Arts. 37, 20.

75. U.C.C. § 9-205. U.C.C. § 9-205 is as follows:

A security interest is not invalid or fraudulent against creditors by reason

is on the validity of the security interest as to third parties when the debtor has the power to use or dispose of the collateral in the operation of its business, principally in cases where the security interest is in accounts receivable or inventory.[76] In contrast, the focus of the Mortgage Act appears to be on the debtor's right to sell mortgaged property to a third party who assumes the mortgage.[77]

Under the Mortgage Act, the mortgagor's exercise of its right to transfer the collateral does not extinguish the mortgagor's original obligation unless it is also transferred.[78] The mortgagor may subsequently mortgage the collateral, subject to the terms of the mortgage contract.[79] In any case, the original security interest in the collateral remains in force where there is a transfer by the mortgagor of the original obligation or debt to a third party.[80]

The mortgagor also has limited, but statutorily protected, rights in cases of foreclosure.[81] Where the mortgagor has performed its obligation prior to sale of the collateral in foreclosure, the mortgagor has the right of terminating the foreclosure.[82] The language is unclear as to whether this means a duty to perform the obligation completely, or just to bring it up to date. The lack of statutory clarity may create problems when there is contractual ambiguity, thereby emphasizing the need for thorough drafting. After foreclosure, the mortgagor has the right to any surplus proceeds received from the sale of the collateral.[83]

5. *Mortgagee's rights*

The Mortgage Act states that mortgaged property may be substituted only with the consent of the mortgagee.[84] The mortgagee, on

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of liberty in the debtor to use, commingle or dispose of all or part of the collateral (including returned or repossessed goods) or to collect or compromise accounts or chattel paper, or to accept the return of goods or make repossessions, or to use, commingle or dispose of proceeds, or by reason of the failure of the secured party to require the debtor to account for proceeds or replace collateral.

*Id.*

76. *Id.* § 9-205 Official Comments.

77. RF Mortgage Act Art. 20.

78. *Id.* Transfer of the original obligation to a third party must be consented to by secured party. *Id.*

79. *Id.* Art. 21.

80. *Id.* Art. 33.

81. Default rights are discussed in detail in Part II.D *infra*.

82. *Id.* Art. 31(1).

83. *Id.* Art. 30.

84. *Id.* Art. 8.

the other hand, has the right to sell or assign to third parties its interest in the pledged property without terminating the mortgage, thereby permitting trade in secured notes.[85]

In cases where the collateral remains in the mortgagor's possession, the mortgagee has the right of having it insured "to its full value" by the mortgagor.[86] The mortgagee is also entitled to have the collateral preserved and maintained while in the debtor's possession.[87] In addition, the mortgagee is entitled to verification of the condition and value of the collateral, notice of leases of the collateral, and replacement of it when there is accidental loss of the collateral.[88] Failure of the mortgagor to honor these rights may result in the mortgagee acquiring the right to accelerate performance of the secured obligation.[89]

As to a pledge of intangible rights, the mortgagee has additional rights under the Mortgage Act. Unless modified by contract, the mortgagee holding a security interest in intangible rights is entitled to have the debtor protect its interest by the statutory requirement (1) to perform required acts to secure the right, (2) not to assign the pledged right, (3) not to do any act that will reduce the value or terminate the pledged right, (4) to protect the right against infringement by third persons, and (5) to give the secured party notice of alterations, infringement by third persons, or claims against the pledged right.[90] If the mortgagor of intangible rights fails to perform these duties, then the mortgagee has the right (1) to claim transfer of the pledged right to himself, irrespective of the maturity of the secured obligation, (2) to intervene in any lawsuit in which the pledged right is in issue, and (3) to take independent action to protect the pledged right against infringement by third parties.[91]

### 6. *Proceeds*

When the debtor has performed its obligation prior to the maturity of the obligation, the proceeds received in satisfaction become the object

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85. *Id.* Art. 32, 33.

86. *Id.* Art. 38(1).

87. *Id.* Art. 38(2).

88. *Id.* Arts. 36, 38.

89. *Id.* Arts 36, 39. However, the failure to give the mortgagee notice of a lease of the collateral (Art. 38(3)) is an exception to the rule, and will not result in the mortgagee acquiring the right to accelerate performance of the mortgage obligation. *Id.* Art. 39.

90. *Id.* Art. 56.

91. *Id.* Art. 57.

of pledge and notice of receipt must be given to the mortgagee without delay.[92] Proceeds received "by way of redemption (of the collateral)" require the mortgagor to remit to the creditor on demand.[93] This seems to parallel the UCC Rule that a specific reference in the security agreement to proceeds from the sale of the collateral is not necessary for the security interest to attach.[94] However, it is not the same.

Under the UCC, the substitution of proceeds for the original security interest is a baseline rule, but under the Mortgage Act the mortgagor owes affirmative duties to the mortgagee upon the receipt of proceeds. These duties may effectively convert proceeds received to a pledge of personalty. If this is an accurate interpretation, then the debtor may bear the burden of keeping the proceeds in escrow until disposition is directed by the creditor. Such conduct may be mandatory insofar as it would comport with the pledgor's statutory duty "to preserve and maintain" the security interest and "to take measures required for protection of pledged right against infringement by third persons."[95]

Furthermore, the word "required" is not defined with specificity in the Mortgage Act.[96] "Required" could be interpreted to impose a statutory duty on the pledgor, or it could mean "required by the terms of the contract." Hence, it is necessary to explicitly stipulate in contract the pledgor's duties to notify and remit in order to avoid disputes.

The contractual requirements place a very high burden on the lender to ensure attachment of a security interest in proceeds. Although substitution of the mortgaged property is permissible only with the consent of the mortgagee, substitution procedure mandates that the object of substitution be described in detail.[97] It may be wise, when taking a security interest in property or rights likely to be converted

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92. *Id.* Art. 58(1).

93. *Id.* Art. 58(2).

94. U.C.C. § 9-203(3).

95. RF Mortgage Act Arts. 38(2), 56(4). It is important to note the language requiring immediate notification to the pledgee of the receipt of proceeds. *Id.* Art. 58(1). It appears as though notification of the mortgagee is mandatory ("shall") because there is no opt-out language, whereas Article 58(2) is less forceful in its language as to remittance of proceeds ("unless contract of pledge provides otherwise"). The lack of clarity underscores the Mortgage Act's weakness by not providing key gap-filling provisions to allocate risks in the event contract drafting fails.

96. *Id.* Art. 58(1)-58(2).

97. *Id.* Art. 47. This article specifies what must be defined in the contract: "type and other generic features of mortgaged goods, total value of object of object place where it is located, and also the types of goods which could be substituted for object of mortgage." *Id.*

into proceeds, to specify in contract the currency and rate of exchange of the anticipated proceeds as a matter of course. An extremely weighty burden is on the lender's shoulders if such specificity is necessary for a security interest to attach. While there may be a hint of statutory protection for the mortgagee in some Mortgage Act language,[98] the only safe conclusion is that all risk of non-attachment is borne by the lender.

### C. *Priority and Perfection of Security Interests*

#### 1. *Creditor priority*

Priority of lien in the Mortgage Act apparently is established by first-in-time.[99] This is simpler than the regime established in the UCC, although the core doctrines are the same.[100] The principal difference is that the Russian Act focuses on the time of attachment, whereas the UCC determines priority by the time of perfection.

"Priority satisfaction" is granted to the secured party from insurance compensation paid on claims for damage to the mortgaged property.[101] Second and subsequent mortgages shall be satisfied from the remaining value in pledged property after the first mortgage is satisfied.[102] All such "junior" mortgagees have the right to receive notice from the mortgagor of any existing liens and the value of the obligations secured.[103] The mortgagor must indemnify junior mortgagees for injuries resulting from the mortgagor's failure to perform these duties.[104]

#### 2. *Perfection, Generally*

The difference in focus between American secured transaction law and the new Russian law reveals itself in many ways. Perhaps the most

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98. *See id.* Art. 46(1).

99. RF Mortgage Act Art. 22.

100. U.C.C. §§ 9-312. Specifically, § 9-312(5) codifies the first-in-time rule, but there are many other influencing factors. These are not included in the Russian rule.

101. RF Mortgage Act Art. 9(3). *Cf.* U.C.C. § 9-306(1). The UCC treats insurance monies as ordinary proceeds, "except to the extent that it is payable to a person other than a party to the security agreement." *Id.* Because of the parties' duty to insure the collateral, depending on who possesses it (RF Mortgage Act, Arts. 9, 38), the likelihood of some other party being the beneficiary of the insurance proceeds should be extremely low and the security interest would probably attach to the proceeds.

102. RF Mortgage Act Art. 22(1).

103. *Id.* Art. 22(2).

104. *Id.*

glaring shortfall of the Mortgage Act is its scant provision for perfection of security interests.[105] Both laws address the secured party's rights *vis a vis* the debtor, but American law is directed toward the parties' rights in relation to third parties who may impair the security interest. As a result, Article 9 specifies the steps that both the secured party and the debtor must take to perfect and protect the security interest. Article 9 also provides procedural structure for cases where remedial action is needed after secured rights are triggered. In contrast, the Mortgage Act provides fundamental debtor-creditor rights, but is distinguished by the fact that fundamental rights are all it provides.

3. *Notice*

The Mortgage Act devotes little attention to protecting the mortgagor's rights against third party claims over the collateral. In contrast, the UCC "primarily sets out rules defining rights of a secured party against persons dealing with the debtor."[106] Whereas the UCC is built on a solid foundation of state agencies and recording procedures, the Mortgage Act has no such foundation and thus lacks firm guidelines for communicating the existence of secured rights to third parties.[107] Even though the Act requires registration of some types of mortgage,[108] registration affects attachment. Instead, the Mortgage Act takes a general approach that relies on the parties to record alterations and notify potential buyers via a mortgage book.[109]

It is impossible to physically convey intangible rights or give them earmarks of ownership, so, in the absence of a recording system to give third parties notice of existing security interests, it appears as though the mortgagee necessarily foregos this important purpose of perfection. By not providing the lender with guidelines for notifying and perfecting its security interest against third parties, the Mortgage

105. This is the view held by most commentators who have addressed the Act. *See* Osakwe, *supra* note 8; *see also* Frenkel, *supra* note 8, at 1.

106. U.C.C. § 9-102.

107. The UCC provides detailed guidelines for perfecting security interests when the goods are consumer goods, fixtures, accounts, farm equipment, investment securities, pledge, or proceeds. U.C.C. §§ 9-302—9-306.

108. RF Mortgage Act Art. 17. The Russian law makes no provision for registering a formal financing statement as a means of perfecting a security interest, only to attach it. However, the mortgage contract itself may be used at registration or notarization as a form of financing statement and thus serve the purpose of notifying third parties of the existing security interest.

109. *Id.* Art. 18.

Act requires the lender to rely on the debtor. This places a heavy burden on the lending party to monitor the mortgagor's performance, especially when the security interest is in intangible rights.

4. *The Mortgage Book*

The mortgagor must protect the mortgagee, and any potential subsequent mortgagees, by keeping a book of mortgage records.[110] The mortgage book is the only device named in the Act which serves as a universal perfecting device. It is intended to protect both the mortgagee and third parties dealing with the mortgagor by giving notice of prior interests in the subject property, and it must be available for inspection by any interested person.[111] The mortgagor is required under the Act to update the book within ten days of all new obligations secured by mortgage.[112]

The duty to keep a book of mortgage records is unclear in the Mortgage Act. There is no description of the actual mortgage book in the Act, including the important questions of whether the book is issued officially by the government, must conform to certain specifications, or where it must be kept. Nor does the Act specify if an enterprise must keep only one mortgage book, in which all secured obligations are recorded, or whether a book must be kept for each mortgage individually. These omissions are problematic because the law trusts the debtor to insure the accuracy and maintenance of the book's recordation.[113] Despite the mortgagor's statutory liability for maintaining both the availability of the mortgage book and the accuracy and timeliness of its entries, the opportunity for forgery, fraud, or accidental loss creates a tremendous, unnecessary risk that could be avoided if there existed a neutral, central recording system.

Furthermore, in the case of the pledge of rights, it is even more important that the mortgagor maintain a detailed, up-to-date mortgage book. The issues raised are more acute because intangible property cannot be marked to give third parties notice, and even the most diligent monitoring still relies on the debtor's trustworthiness. Consid-

110. *Id.*

111. *Id.* Art. 18(1).

112. *Id.* This provision applies to legal persons and natural persons registered as businesses. The information that must be entered into the book of mortgage records includes the type and object of the mortgage, and the extent to which the obligation is secured by the mortgage. *Id.*

113. *Id.* Art. 18(2).

ering the opportunity for a debtor's fraud or negligence, or, in contrast, whether a mortgagee's inspection is an unwarranted intervention, the mortgage book is likely to be the focal point of much dispute.

Ultimately, reliance on the mortgage book places too much responsibility on the debtor to police itself and protect the security interest of the lender. The Mortgage Act is too new and complex to be implemented without growing pains. For the foreign lender who has the resources to monitor the debtor and thus protect its security interest, the use of a mortgage book to perfect its security interest may not be an unsurmountable hurdle. For many other investors, though, reliance on the debtor to monitor itself through the book may be too great a leap of faith.

### *D. Default Rights of the Creditor and Debtor*

#### 1. *Triggering Default Rights*

Mortgage rights are derivative of the non-performance of the secured obligation.[114] If the secured obligation is satisfied, then the mortgage is terminated and rights will not be triggered. A mortgage terminates in five enumerated circumstances: (1) termination of the secured obligation, (2) destruction of the mortgaged property, (3) expiration of the right in cases where the secured interest is a right, (4) transfer of right in the security interest to the mortgagee, and (5) other cases specified by law.[115] The named circumstances are types that ordinarily are defined in an American security agreement. Thus, the Mortgage Act is not substantively different from American secured transaction practice in this respect.

There are probably two reasons for listing terminating conditions in the Mortgage Act. The first is that this type of detail is typical of European civil codes, and thus a carryover from earlier Russian and Soviet Civil Codes. Second, due to Russian inexperience in secured transactions, the Mortgage Act must necessarily provide vocabulary and rules to aid the debtor and creditor in both the formation and termination of a secured obligation contract.

#### 2. *Remedial Rights*

The Mortgage Act appears to provide a vastly different bundle of remedial rights than American law. The UCC provides secured parties

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114. *Id.* Arts. 23, 24. This is essentially the same rule as U.C.C. § 9-501(1).
115. RF Mortgage Act Art. 34.

with a wide array of legal tools,[116] including rights to judicial remedy, self-help, and simultaneous actions in multiple fora. Under the Mortgage Act, however, remedies are more limited.

In event of default on a mortgage of intangible rights, the mortgagee has the right in an Arbitration Court to claim transfer of the pledged right when the debtor has failed to perform its statutory duties.[117] The secured party may intervene in lawsuits concerning the pledged right, and may also take independent action to protect the pledged right against infringement by third persons when the debtor has failed to perform its duty.[118] These are default rights the secured party may opt to waive its rights in the security agreement.[119]

The mortgagee has the right to complete satisfaction of the secured obligation out of the collateral.[120] Partial performance of an obligation will not partially extinguish the obligation without an agreement to that effect.[121] In cases where the secured interest is in several things or rights, the mortgagee retains the right to seek satisfaction out of either the entirety of collateral or the particular components thereof.[122] In choosing the latter course, the mortgagee does not waive its interest in the remaining property.[123]

A right analogous to the common law doctrine of subrogation is provided in circumstances where a third party satisfies the obligation.[124] In such a case, the mortgagee's security interest and his right of claim transfer to the third party.[125]

### 3. *Self-help*

The Mortgage Act prohibits self-help remedies for defaults on an hypothecation, but is silent regarding pledges. Under true title theory,

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116. U.C.C. §§ 9-501—9-505.

117. RF Mortgage Act Art. 57.

118. *Id.*

119. *Id.*

120. *Id.* Art. 23. This right is determined by the "time of actual satisfaction, including interest, losses caused by delayed performance, and penalty, in the cases specified by statute or contract; [and] necessary costs in maintenance of mortgaged property and costs incidental to satisfaction of mortgage-secured claim shall also be subject to indemnification." *Id.*

121. *Id.* Art. 25.

122. *Id.* Art. 26. Like most rights granted in the Mortgage Act, this right can also be modified by contract.

123. *Id.*

124. *Id.* Art. 27.

125. *Id.*

self-help (e.g., the sale of the pledged object) would be permissible on the ground that title passed to the pledgee on the pledgor's giving a security interest. However, in light of the pervasive governmental control of property during the Soviet Era, the seizure and sale of assets may be considered as virtually criminal acts when the pledged object is valuable. As a result, it is unclear whether seizure of certain assets will be distinguished from others, or whether the act of seizure would be distinguished from other self-help remedies under Russian law.

4. *Secured Party's Right to Managerial Intervention*

Nowhere in the UCC is there language permitting managerial takeover of a defaulting debtor.[126] The Mortgage Act's provision of this right opens the door to many problematic issues with respect to lender liability. If a mortgagee exercised its right to intervene in the management of the debtor-enterprise and then failed to satisfy the principal obligation (or at least make it current), it is conceivable that it might be estopped from exercising its statutory rights to attach other property or seek a judicial solution. The debtor's theory would essentially assert that the mortgagee's assumption of control equates to a voluntary assumption of risk. As a result, the mortgagee may be held to have waived other rights by exercising this one.

The secured party's remedial rights when lending to an enterprise and taking a security interest in enterprise property are unclear under the Russian law, especially with regard to this novel remedy. The lack of clarity is one of the Mortgage Act's most glaring weaknesses because it effectively raises the cost, and thus slows, foreign lending to Russian enterprises. In addition, the risk potentially imposed on the secured party by intervention in the management of the debtor-enterprise may vitiate the protection it offers.

5. *Foreclosure*

Russian law, like Anglo-American law, views foreclosure as the extinguishment of the mortgagor's rights to possession or ownership of the collateral. Foreclosure may be declared by a court of law, arbitration court, or mediation court, unless otherwise provided by law.[127] The

126. It is not contended that parties to a secured transaction in the United States could not contract for management intervention—they could. However, management intervention would then be triggered by the occurrence of a condition, and not a statutory remedy.

127. *Id.* Art. 28(1). This clause adds that some foreclosures "shall be made in

right to foreclose vests once the agreed date for "redemption of the mortgage-secured obligation" is reached.[128] This is somewhat different from Article 9, which states that the secured party's rights are cumulative.[129] In this context, "cumulative" means that the secured party has the right to exercise any recognized remedy when the debtor defaults, which includes pursuing alternate remedies simultaneously. The Mortgage Act, however, takes a more "linear" approach that seeks to ensure that the defaulting debtor will not be dispossessed of his property until all other legal avenues are exhausted. Under Russian law, the rights of the mortgagor in the mortgaged property are jealously guarded.

In cases where the proceeds from the sale of pledged property are insufficient to satisfy the mortgagee's claims, the mortgagee shall have the right to attach other property of the debtor.[130] If the opposite should occur, and a sale of the collateral brings more value than necessary to satisfy the obligation, the mortgagor is entitled to the excess.[131]

### 6. *Mortgagor's Redemptive Rights*

The Mortgage Act provides a right of redemption, mandating that the debtor may at any time perform the obligation and terminate the foreclosure.[132] However, this is not the same right expressed in U.C.C. § 9-506, where the debtor is provided a redemptive right to extinguish in full (accelerate) the secured obligation and to pay any expenses incurred by the lender.[133] The right of redemption also extends to

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no-recourse procedure, on the basis of notarized execution clauses." *Id.* Presumably, this applies to pledges where the mortgaged property is in the possession of the mortgagee already, and the notarization clause acts as a quitclaim of the mortgagor's interest in the collateral.

128. *Id.* Art. 24.

129. U.C.C. § 9-501(1).

130. RF Mortgage Act Art. 29. This right may be waived in contract and is subject to statutory limitation. It seems unusual that this article does not mention auction or foreclosure. The inference should follow that the broad language was intended to cut a wide swath, vesting the secured party with remedial rights even in cases where the collateral is sold without judicial intervention.

131. *Id.* Art. 30. *Cf.* U.C.C. § 9-504 ("Secured Party's Right to Dispose of Collateral After Default; Effect of Disposition").

132. RF Mortgage Act Art. 31(1). Under the Mortgage Act, the date for redemption may be affected by other Russian Federation statutes. *Id.* Art. 24. *See also id.* Art. 41 (providing statutory deference to Russian land laws).

133. U.C.C. § 9-506 reads as follows:

At any time before the secured party has disposed of collateral or entered

agreements where the obligation is performed in installments by allowing the defaulting mortgagor to bring the obligation up to date and terminate the foreclosure.[134] No such right exists under the UCC, lest the debtor have no motive to pay on time.

It is possible for the contracting parties to opt out of some Russian foreclosure procedures.[135] However, the Mortgage Act forbids contractually opting out of (1) the mortgagor's statutory rights to redeem the mortgaged property prior to the completion of foreclosure or (2) the mortgagor's right to make current its performance when performance is due in installments.[136] The Act states that any agreement restricting the mortgagor's redemptive rights is void.[137] This conflicts with the article allowing the parties to opt out of Russian foreclosure procedures, at least insofar as absence of such procedures restricts the mortgagee's redemptive rights. Effectively, then, the power to opt out of foreclosure procedures may be illusory.

### 7. *Judicial Enforceability*

The ultimate remedial issue is the judicial enforceability of the secured obligation. The legal devices of mortgage, foreclosure, and bankruptcy are newly created. There is very little published material available in translation pertaining to the application of these laws. Whether the Arbitration Courts[138] will follow a common or civil law model in deciding commercial cases is not clear.

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> into a contract for its disposition under Section 9-504 or before the obligation has been discharged under Section 9-505(2) the debtor or any other secured party may unless otherwise agreed in writing after default redeem the collateral by tendering fulfillment of *all obligations* secured by the collateral *as well as the expenses reasonably incurred* by the secured party in retaking, holding and preparing the collateral for disposition, in arranging for the sale, and to the extent provided in the agreement and not prohibited by law, his reasonable attorney's fees and legal expenses.

*Id.* (emphasis added).

134. RF Mortgage Act Art. 31(2).

135. *Id.* Art. 28(2).

136. *Id.* Art. 31(3).

137. *Id.*

138. A brief explication of the changing Russian legal system may be helpful to the American investor lending to a Russian enterprise. Prior to the passage of the new constitution, plans were made to draft 2000 new judges for the Arbitration Courts, but it is not clear whether these were implemented. Carey Goldberg, *As legal System Blossoms, Russians Belly Up to the Bar; Law: After Decades of a Totalitarian System, Fledgling Attorneys are Capitalizing on Confusing New Statutes*, L.A. TIMES, Jan. 10, 1993, at A1.

Under the new Constitution, economic disputes are settled in the Arbitration

It is important to note that much of the Mortgage Act's language tracks the Code of Civil Procedure closely. Although an oversimplification, generally, civil law judges are not bound by precedent. In contrast, Anglo-American businesspeople rely on Common Law precedents to give certainty to their business decisions. The Common Law provides certainty because precedents give contracting parties notice of their rights and duties under the law. In Russia, uncertainty is magnified because many judges are not experienced at making commercial law decisions.[139] Additionally, the law may still be in the hands of conservative judges, so the Mortgage Act's progressiveness cannot be assumed. Until the Act is interpreted and applied uniformly, the uncertainty with which it is cloaked will constitute a significant impediment to American investment in the Russian economy. To be safe, before a Russian commercial jurisprudence is developed, foreign lenders probably should stipulate a law and forum other than Russia to govern their contract.

### *E. Brief Conclusion On the Russian Mortgage Act*

There are many distinctions between the Mortgage Act and the UCC. The most important point to remember, though, is that the Russian law was enacted to facilitate the flow of capital into the economy by providing legal rights legitimizing the debtor-creditor relationship. As a result, the Mortgage Act recognizes the devices of hypothecation and pledge as legal means of creating enforceable secured transactions.

The Mortgage Act's generalized treatment of many complex transactions imposes a heavier burden on the contracting parties than if they could rely on gap-filling default rules in a Common Law codification, such as the UCC. The net result is that the responsibility of creating an enforceable agreement is squarely on the shoulders of the creditor. Contract formation requires intense specificity to provide what the law does not, and it must remove any vestiges of doubt regarding the contract's meaning.

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Courts. KONTSTITUTSIIA RF Chap. 7, Art. 127 (1993). The Superior Court of Arbitration is the highest Arbitration Court. *Id.* at Chap.3, Art. 71(n). A literal reading of this subsection mandates that the entire judicial system is federal, although the power to appoint judges is the joint jurisdiction of the Russian Federation and the local "components of the Russian Federation." *Id.* at Chap. 3, Art 72(k). However, the Constitution is not specific about the organization of lower Arbitration Courts. Whether every jurisdiction will have an Arbitration Court is a decision left to the new legislature.

139. Many Russians complain that their judges have a highly formalistic view of law, implementing it stiffly, rather than in its spirit. VALENTIN STEPANKOV, PUBLIC PROSECUTOR OF THE RUSSIAN FEDERATION, INTERVIEW DURING OFFICIAL KREMLIN INTERNATIONAL NEWS BROADCAST, February 11, 1993 (Federal Information Systems Corp.), *available in* LEXIS, News library, Omni File.

## III. RUSSIAN BANKRUPTCY LAW

### A. *Background*

The introduction of free market reforms in the former Soviet Union created a need for new laws, the kinds of which the Russian people had never known. Although the vital role of bankruptcy law in a market economy is not necessary for discussion here, an overview of the first Russian bankruptcy law is important for the foreign lender to see the whole picture of secured transaction law.

Russian enterprises are emerging from a history of governmental monopoly and subsidy. State banks routinely issued new credits to cover old debts. Repeated issuance of new credits created many problems for Russia's economy. Among these are hyper-inflation, inefficiency, poor product quality, and corruption. To promote economic growth, many old and inefficient State-run enterprises must close or reorganize under new management rather than sustained on the life support of government credits. The Supreme Soviet, which had staunchly resisted letting State institutions collapse, finally relented and passed the Law on Bankruptcy in late 1992.[140]

### B. *Security Interests and the Bankruptcy Estate*

Secured obligations enjoy special protection under the Bankruptcy Law. Secured parties are assured priority at bankruptcy because the Bankruptcy Law mandates that the bankruptcy estate, named the "competitive mass," excludes property subject to a lien.[141] The competitive mass does not include property over which the debtor is not an owner with complete disposal rights.[142] Therefore, the competitive mass should exclude hypothecated property because the mortgagor has less than full disposal power of encumbered property. It should follow that pledged property also cannot be attached under this definition as well.

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140. RF Law on Insolvency (Bankruptcy) of Enterprises, Supreme Soviet, Nov. 19, 1992, VSND&VS RF No. 1 (1993), item 6; ROSS. GAZETA, Dec. 30, 1992; RF Decree on Implementation of the Law on Bankruptcy, Supreme Soviet, Nov. 19, 1992, No. 3930-1, ROSS. GAZETA, Dec. 30, 1992.

It is important to note that, as the title suggests, this law only applies to enterprises. Personal bankruptcies are not yet available in Russia, and it is unknown what preference, if any, would be given to secured lenders in that situation.

141. *Id.* Art. 26(4). The definition of "competitive mass" is not found within an article of the Law, but in a definitional section preceding Article 1.

142. *Id.* Art. 26(5).

The Bankruptcy Law further states that the debtor's obligations secured by liens will be repaid from the debtor's property outside the "competitive proceedings."[143] The rule that appears to result is that competitive creditors[144] cannot reach mortgaged property to satisfy their unsecured claims. This is different than American bankruptcy jurisprudence, which permits the seizure and sale of mortgaged property so that general creditors can seek satisfaction from a bankruptcy estate that includes the debtor's equity.[145] As a consequence, under the Russian Bankruptcy Law, secured creditors may be unaffected by a mortgagor's bankruptcy.

Many potential problems exist for secured parties when their mortgagor is in bankruptcy, however. It is unlikely that a mortgagor's bankruptcy would leave its mortgagee uninjured, especially if the debtor-enterprise is liquidated. First, after liquidation an enterprise would no longer exist to generate cash to pay the secured obligation. Second, in the case that the mortgaged property is an intangible right, e.g., accounts receivable, the mortgagee's problem is magnified because there will not be hard assets remaining to attach or seize if the proceeds are insufficient. Thus, if the right is no longer worth enough to satisfy the obligation, or the cost of collection is prohibitive, the loss could pass to the secured lender without recourse.

### C. *Creditor Priority at Bankruptcy*

The Bankruptcy Law is not as detailed as the United States Bankruptcy Code when outlining creditor priority, but additional detail probably is not necessary at this early point in its jurisprudential development.[146] First-in-line at the bankruptcy window are tort victims: "citizens to whom the debtor is responsible for causing harm to their life and health."[147] Next are workers' wages, pension funds, and "au-

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143. *Id.* Art. 29. "Competitive proceedings" are defined as "a procedure aimed at compulsory or voluntary liquidation of an insolvent enterprise, as a result of which the competitive mass is distributed among the creditors." *Id.* at definitions (*hereinafter* "competition").

144. "Competitive creditor" is the name given to general creditor under the Bankruptcy Law, and is defined as "a natural person of legal entity with property claims against the debtor who does not have a lien." *Id.* at definitions.

145. 11 U.S.C. § 541(a)(1). "Such estate is comprised of all the following property, wherever located and by whomever held: (1) . . . all legal or equitable interests of the debtor in property as of the commencement of the [bankruptcy] case." *Id.*

146. 11 U.S.C. § 507.

147. RF Bankruptcy Law Art. 30(2).

thorial and licensing obligations."[148] Third are on-budget and non-budget "obligatory payments," the language of which appears to indicate that the obligatory payment is directed toward the government.[149] Competitive (ordinary) creditors are fourth on the list and not privileged.[150]

If a foreclosure proceeding does not satisfy a secured obligation, it is conceivable that a secured party holding a judgment may become an ordinary creditor, and thus join the competition for its share of the mass. The Bankruptcy Law is silent on this point. It declares only the three types of creditors to be privileged, and does not mention judgment creditor in the list of privileged creditors. If the judgment is held to put a lien on property of the debtor, then the lien should be held to be a claim outside the competition, as though it were an hypothecation. However, there is no rule stating that this would happen.

If a money judgment does not put a lien on the debtor's property, however, then it is arguable that a judgment based on a secured obligation should still enjoy privilege over competitive claims. The basis for this argument is that a court-rendered judgment is given by a body of the government in the administration of its governmental duty. Public policy should dictate that the court's judgment for satisfaction of a secured claim is a privileged, obligatory payment on the grounds that the Bankruptcy Law recognizes the sanctity of the mortgage contract as a matter of law by protecting mortgaged property from the bankruptcy competition. In addition, failure to provide secured lenders preferential treatment at this point would discourage lending to Russian enterprises by depriving lenders of the knowledge that their security interest in the collateral is still protected even though the debtor is bankrupt.

### *D. Automatic Stay*

One of the most important features of American bankruptcy law is the automatic stay of legal proceedings against either the debtor or property of the bankruptcy estate.[151] The automatic stay protects the creditors from judgments in collateral proceedings which could impair the fair distribution of the estate property, and it protects the debtor

148. *Id.*
149. *Id.*
150. *Id.*
151. 11 U.S.C. § 362.

from multiple litigation. There is no provision in the Russian Bankruptcy Law that provides an equivalent level of protection for any of the parties.

In cases where the debtor-enterprise is to be liquidated, the Russian law states:

> From the time the debtor is declared insolvent (bankrupt) and a decision is made to initiate competitive proceedings:
> it is prohibited to transfer or otherwise alienate the property of the debtor (except in cases when the decision for alienation is given by the meeting of the creditors).. . . .
> From that time on all property claims may be submitted to the debtor only within the framework of the competitive proceedings.[152]

The last sentence of this rule may be interpreted to mean that once a debtor-enterprise is declared bankrupt, initiation of other claims against it must be in the competitive proceedings only, or else they are void. If this true, then there is a sort of stay attaching at the point of insolvency.

However, this interpretation does not answer the question regarding the status of claims initiated earlier, but not yet decided. Perhaps if a creditor initiates a separate legal proceeding to "conceal" or shield certain property from the competitive mass in anticipation of the debtor's bankruptcy, it may violate the Bankruptcy Law.[153] Not only may its claim then be stayed from adjudication, but the creditor may also be liable under other Russian laws.[154] If the creditor who made the prior claim was not acting fraudulently, then the claim should be submitted to the competition and the prior litigation dropped, effectively "staying" the prior litigation. Nevertheless, whether there is an effective "stay" in Russian Bankruptcy jurisprudence is unclear at this point in time.

### *E. Initiation of Bankruptcy Proceedings*

It is conceivable that a secured party could wind up in the position of general creditor if foreclosure proceedings do not satisfy the mortgage obligation and the balance of the debtor-enterprise's property is in the competitive mass. Hence, it is important to understand the procedure for initiating bankruptcy proceedings. There are two ways that a bank-

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152. RF Bankruptcy Law Art. 18.
153. *Id.* Art. 47.
154. *Id.* Art. 48.

ruptcy will come to exist: (1) by a decree of insolvency by an arbitration court, if an involuntary bankruptcy action, or (2) by the official declaration of the debtor, if voluntary.[155] Bankruptcy cases are heard in essentially two fora: the Supreme Arbitration Court of the Russian Federation or the local Arbitration Court where the founding documents of the enterprise are located.[156] All bankruptcy cases are heard by a panel of three judges.[157] The sum of the claims presented to the arbitration court must exceed 500 times the Russian minimum wage for the court to hear the case.[158]

Bankruptcy proceedings may be instituted by three parties, each under different circumstances: the debtor, creditor, and the procurator (Russia's "attorney general").[159] Under the Bankruptcy Law, secured parties are not general creditors.[160] Facts giving rise to a perceived bankruptcy are, first, nonpayment of public or private obligations for three months and, second, the enterprise does not provide for, or is incapable of, meeting the demands of creditors.[161] For creditors to initiate bankruptcy proceedings, the debtor must have refused to pay its obligations without excuse (either by law or agreement) for more than three months.[162]

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155. *Id.* Art. 1.

156. *Id.* Art. 3(1). The local arbitration courts recognized are those of the jurisdiction where the enterprise was formed.

157. *Id.* Art. 9.

158. *Id.* Art. 3(3).

159. *Id.* Arts. 4-8. The debtor may institute proceedings when application is made by either the owner of the enterprise or its authorized agents thereof. The debtor may apply for bankruptcy protection if it anticipates insolvency, but its application is irrevocable. *Id.* Arts. 5(2), 5(6).

The procurator may apply for bankruptcy proceedings to be taken against an enterprise it suspects of deliberate or fraudulent bankruptcy. *Id.* Art. 7(1). The procurator's application is revocable up to the time that the arbitration court begins proceedings. *Id.* Art. 7(2).

160. *Id.* at Definitions. "Competitive creditor - a natural person or legal entity with property claims against the debtor who does not have a lien." *Id.*

161. *Id.*

162. The creditor must send, via certified mail, (1) a notice to the debtor of its intention to apply to the Arbitration Court for institution of bankruptcy proceedings and (2) a demand for fulfillment of the obligation within one week of receipt of the notice. *Id.* Art. 6(1). After receiving confirmation of delivery of the notice and demand, but not before the deadline specified therein, the creditor may apply to the Arbitration Court to begin the bankruptcy proceedings. *Id.* The application may also contain a petition for institution of receivership. Requirements for properly completing the application to the arbitration court are in Article 6(2). These include appendices confirming claims against the debtor that were not certified during the three month "grace period",

### *F. Reorganization and Bailout*

If the debtor seeks reorganization under an outside administrator, it must petition the arbitration court in conjunction with a creditor, and the petition must contain (1) justification for the need and expediency of reorganization and (2) nomination of a suggested administrator.[163] An arrangement (bailout) may be sought by the debtor, owner of the debtor, or the creditor of the enterprise.[164] Unlike reorganization, an arrangement does not require agreement between both creditor and debtor.[165] Parties given preferential rights to participate in an arrangement are the owner of the enterprise, the creditors, and the members of the work collective.[166] Foreign legal persons may also participate in an arrangement.[167] Both reorganization and arrangement have 18 month periods to return the bankrupt enterprise to solvency.[168]

### *G. Brief Conclusion on the Russian Bankruptcy Law*

There are many more details in the Bankruptcy Law, but their explication here is not necessary. It is sufficient to say that even though the Law is incomplete by American standards, it is a good first step at creating a legal structure for an important legal, economic, and social issue. Though there are few bankruptcy cases in the Arbitration

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certification of delivery of the notice to the debtor, and certification of sending copies of the application and appendices to the debtor. The creditor may withdraw its application at any time prior to the arbitration court's commencement of proceedings. *Id.* Art. 6(4).

163. *Id.* Art. 12(1). The debtor and creditor have until a decision is issued by the Arbitration Court to petition for outside reorganization. Justification for reorganization is defined as the "existence of a real possibility of restoring the solvency of the debtor enterprise in order for it to continue its activity by selling some of its property or conducting other organizational and economic measures." *Id.* 12(2). The administrator to be suggested to the Court must be either an "economist or jurist" *Id.* 12(4). The finer points of reorganization are found in the balance of Article 12.

164. *Id.* Art. 13(1).

165. *Id.* Art. 13, para. 1, 2. The time for petitioning for arrangement extends up to the point where a decision is issued by the Arbitration Court. The petition for arrangement is not very different than the petition for reorganization in that it must show justification for the arrangement on the basis of "real possibility of restoring the solvency of the debtor enterprise for continuing its activity" and a nominate list of consenting participants.

166. *Id.*

167. *Id.* Art. 13, para. 4. This section also details the parties' rights in auctioning the enterprise among the parties who have consented to participate in the competition.

168. *Id.* Art. 12(2); Art. 13(9). In addition, a subsequent arrangement may not be sought within 36 months of a prior arrangement. *Id.* Art. 13(3).

Courts, in 1993 the Ministers of Finance and Privatization took steps for "launching bankruptcies."[169] The primary concerns for the foreign secured lender are the knowledge that the law is now in place, the Russian government is actively promoting its implementation, and it protects secured parties, even though there are scenarios in which secured parties may be exposed to unintended risk.

The secured creditor would be wise to include in the mortgage contract specific definitions of events comprising default well before insolvency. In the least, a clause should be included in the mortgage contract stating that (1) the mortgagee's solvency is a condition of the obligation and (2) the institution of bankruptcy proceedings, whether voluntary or involuntary, is an automatic default. This should provide a mortgagee with enough protection to keep it in front of unsecured creditors. Additional conditions requiring regular financial statements according to an agreed accounting norm or periodic audits should also help the mortgagee keep its priority interest by monitoring the mortgagor's performance.

## IV. OTHER LAWS OF THE RUSSIAN FEDERATION IMPACTING THE ENFORCEABILITY OF TRANSNATIONAL SECURED TRANSACTIONS

Merely understanding the Mortgage Act will not provide enough of a legal basis for achieving financial security when transacting business in Russia. Russian property and foreign investment laws and treaties, factor into the enforceability of the secured lending contract. These laws impact questions that must be answered before the contracting phase. The major laws substantially affecting foreign secured transactions, (A) property law and (B) foreign investment law, are discussed in this section.

### *A. Property Law Issues Affecting Secured Transactions*

#### 1. *Law on Ownership of Property*

The first major steps away from state ownership of property under the Communist regime were taken in December 1990 when the "Law

169. Russia Express-Perestroika: Executive Briefing, June 7, 1993, No. 103, International Industrial Information, Ltd. (Westlaw, Copr. 1991 Predicasts, Inc.) *See also* YURI TYUNKOV, ED. IN CHIEF, THE FIRST BANKRUPTCIES: A QUIET SENSATION?, VESTIK VYSSHEVO ARBITRAZHNOVO SUDA ROSSIISKOI FEDERATSII [JOURNAL OF THE RUSSIAN FEDERATION HIGHER COURT OF ARBITRATION], ROSSIISKIYE VESTI, Sept. 3, 1993 (CURRENT DIGEST OF THE SOVIET PRESS, Sept. 29, 1993, *available in* LEXIS, News Library, Omni File).

on Ownership in the RSFSR" was adopted.[170] The Ownership Act guarantees citizens the right of property ownership, granting the right to "possess, use, and dispose of the property which belongs to him," including real and personal property.[171] The State retained ownership of many types of property, including most natural resources, cultural and historical artifacts, state banks, and necessary means of production.[172] The Ownership Act also guaranteed that the State would not appropriate property without just compensation.[173] It shields private citizens from attachment of their property for obligations created by juridical persons in which the property owner is a participant.[174] Joint ventures that have foreign participants are permitted to own property "necessary for the effectuation of the activity provided by the constitutive documents."[175] However, foreign juridical persons are excluded from direct ownership of land.[176]

2. *Law on Ownership of Land*

Nearly three years later, on October 27, 1993, President Yeltsin issued a decree "[O]n the Regulation of Land Relations and the Development of Agrarian Reform in Russia"[177] which promised free alienation and ownership of land by all Russian citizens. Mainly intended to impact agricultural land and collectivized farms, the Decree grants to all citizens the right to freely own, use, and transfer land.[178]

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170. "Law on Ownership in the RSFSR", Adopted by the RSFSR Supreme Soviet, Dec. 24, 1990, *Ekonomika i zhizn'*, No. 3, (1991) (*hereinafter* "Ownership Act").

171. *Id.* at Art. 2(2).

172. *Id.* at Art. 21.

173. *Id.* at Art. 31.

174. *Id.* Art. 8(2), (3). Juridical persons are corporations, collectives, partnerships, enterprises and other like entities created as owners of property. The property of a juridical person could be levied against for obligations it created. *Id.*

175. *Id.* Art. 26.

176. *Id.* Art. 28. Foreign citizens and juridical persons can own "industrial and other enterprises, buildings, installations, and other property [for its business purpose]," *id.*, but apparently not the land under it. The exclusion of land in this article, which is devoted expressly to foreign parties' rights, leads to the conclusion that direct foreign land ownership is not permitted under Russian law.

177. "Decree By the President of the Russian Federation on the Regulation of Land Relations and the Development of Agrarian Reform in Russia," Decree No. 1767 of Oct. 27, 1993, The British Broadcasting Corporation, Summary of World Broadcasts, ITAR-TASS News Agency (World Service), *available in* LEXIS, News Library, Omni file).

178. *Id.* Art. 2. "[C]itizens and legal persons who are landowners have the right to sell, bequeath, gift, mortgage, rent out and exchange land, and also transfer land or part of it as an investment in the capital funds of joint-stock companies, associations and cooperatives, including ones which have foreign investments." *Id.*

However, it is silent as to whether foreign individuals or juridical persons could own land apart from joint stock companies. The failure to include foreign citizens and legal persons on the list of legitimate landowners probably means that they are not entitled to own land.[179] The result is that the issue is at best unsettled.[180]

3. *Impact of Property Laws on Security Interests*

Property laws silent as to foreign ownership of land effectively remove real estate from the range of securable property for a foreign lender. If land cannot be taken in mortgage by a foreign lender, then the lender's risk increases. This is unfortunate because security interests in land put a foreign lender in a stronger position at foreclosure; it could sell the enterprise more easily if there were a larger pool of potential buyers and the transfer would not be hampered by the potential interference of the landowner-debtor. Other options that could be available to the lender include retaining land ownership and leasing the enterprise to a new management team or installing its own management and then mortgaging the land to acquire additional capital. A change in Russian property law giving foreign investors the right to take title, and thus security interests, in real property would reduce risk and transaction costs in cross-border lending, with the likely effect of increasing the flow of foreign capital into the Russian economy.

*B. Foreign Investment Law And Treaties*

1. *Foreign Investment Law*

A foreign investment law in the Russian Federation was first adopted in 1991, while still part of the USSR.[181] Even though it was

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179. This interpretation was bolstered in recent remarks by the Chief Legal Expert at Russia's Committee for Land Tenure and Land Resources, Vladimir F. Mogusev. Mogusev explained Russia's hesitation about letting foreigners own land, saying "Rich foreigners could buy up all of Russia, while priority should be given to Russian citizens. The interests of Russia should come first." "Yeltsin Decree Will Let Joint Venturers, Legal Entities, Citizens Own Russian Land," INT'L BUS. & FIN. DAILY (BNA), November 1, 1993.

180. *See* "Yeltsin's Speech to American Business Circles," THE BRITISH BROADCASTING CORPORATION, SUMMARY OF WORLD BROADCASTS, June 19, 1992, *available in* LEXIS, News Library, Omni File. The law is unsettled mainly because of the conflicting signals sent by the Russian leadership. On one hand, the new law appears not to sanction the ownership of land by foreign investors. On the other, President Yeltsin told a conference of Russian and American businessmen, "I signed a decree on the sale of plots of land to foreign private investors as private property during the privatization of state enterprises. . . . In this way rights to real estate are being transferred to the new private owners of privatized enterprises or enterprises under construction, and it is unimportant whether they are foreign citizens or our own." *Id.*

181. RF Law on Foreign Investment in the Russian Federation, July 4, 1991.

passed under the prior regime, it is still good law in Russia. The Foreign Investment Law is primarily directed toward equity investing, but its provisions impact all forms of foreign investments in Russia. In some areas it is not clear, and in others appears to conflict with the Bilateral Investment Treaty with the United States.[182] In this light, the Foreign Investment Law and BIT require general explication before analyzing their combined impact on secured transactions.

The Foreign Investment Law recognized four classes of foreign investors: (1) foreign juridical persons (corporations), (2) foreign citizens and persons without citizenship, (3) foreign states, and (4) international organizations.[183] Foreign investors were given the right to participate in partnership with other Russian juridical persons and citizens, to create new, wholly foreign-owned enterprises (including branch offices), to purchase permits for the right to use land and natural resources, and to purchase other property and property rights.[184] A foreign investment enterprise ("FIE") also has the right to give mortgages secured by property and other property rights.[185]

The Foreign Investment Law mandates that the State guarantee protection and compensation to foreign investors for harmful government actions.[186] Fora for the settlement of conflicts are the Supreme Court of the Russian Federation, the Supreme Arbitration Tribunal, or another forum permitted by treaty.[187] Under the Foreign Investment Law, the Ministry of Finances regulates FIEs.[188] Other authorized departments of the Federation may also have jurisdiction over the transaction.[189] In Free Enterprise Zones, FIEs enjoy the same rights and privileges accorded Russian citizens.[190] Most importantly, after paying taxes and duties, FIEs have the right to repatriate profits.[191]

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182. The Bilateral Investment Treaty, also known as the Most Favored Nation Trade agreement went into effect on September 1, 1992 (*hereinafter* BIT).

183. RF Foreign Investment Law, *supra* note 181 Art. 1.

184. *Id.* at Art. 3.

185. *Id.* at Art. 31.

186. *Id.* at Arts. 7-8.

187. *Id.* Art. 9. For cross-border disputes, BIT expands the list to include the International Centre for the Settlement of Investment Disputes, the Additional Facility of the Centre, an arbitral tribunal established under UNCITRAL rules, or a mutually agreed upon arbitral facility. BIT, *supra* note 182 Art. IV § 3(a).

188. RF Foreign Investment Law, *supra* note 181 Arts. 15-18. Article 16 details the State registration requirements for the foreign investment enterprise. *Id.*

189. *Id.*

190. *Id.* Art. 42.

191. *Id.* Art. 10. Article 10 reads as follows:

Foreign investors, after paying taxes and duties, are guaranteed the right

However, this right is not unfettered.[192] Essentially, profits to be repatriated must be covered either by accumulating hard currency profits or by keeping hard currency on deposit in Russia.[193]

2. *Bilateral Investment Treaty*

The provision that profits may be repatriated pursuant to certain requirements conflicts with BIT in a particularly important aspect. Article IV of BIT mandates that "[e]ach Party [nation] shall permit all transfers related to an investment to be made freely and without delay into and out of its territory."[194] However, BIT language following

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to freely remit payments connected with their investments, if these payments are received in foreign currency, and including:
- revenues for investments received as profits, share of profits, dividends, interest, license and brokerage payments, technical assistance and service payments and others;
- sums paid on the basis of money demands and demands to meet one's agreement commitments that have economic value;
- sums received in connection with partial or complete liquidation or sale of investments;
- compensations provided in Article 8 of this law [compensation and reimbursement of losses to foreign investors for nationalized or requisitioned investments].

*Id.*

192. *Id.* at Art. 26. Article 26 reads as follows:
All hard currency expenses connected with different kinds of economic activities of FIEs on the territory of the RSFSR, including remittance of the foreign investor's share of profits abroad, must be covered by hard currency profits for these activities and from other sources of foreign currency allowed by the law. FIEs must conduct foreign currency operations in the order provided by the current legislation of the RSFSR.

*Id.*

193. *Id.*

194. BIT, *supra* note 182. Art. IV, § 1 is as follows:
Each Party shall permit all transfers related to an investment to be made freely and without delay into and out of its territory. Such transfers include:
(a) returns;
(b) compensation pursuant to [expropriation or nationalization];
(c) payments arising out of an investment dispute (as defined in Article VI);
(d) payments made under a contract, including amortization of principal and accrued interest payments made pursuant to a loan agreement;
(e) proceeds form the sale or liquidation of all or any part of an investment; and
(f) additional contributions to capital for the maintenance or development of an existing investment. Companies or nationals of each Party shall be

shortly thereafter seems to give supremacy to the domestic laws and regulations of the nations in the "equitable, nondiscriminatory and good faith application of its law."[195] As a result, the Russian requirement that "hard currency expenses . . . including remittance of the foreign investor's share of profits," including interest, be covered by hard currency probably does not contravene the treaty.[196] The net effect is that BIT probably does not offer American lenders all the protection it promises, and thus lowers return on investment because of the apparent requirement of keeping additional capital in Russia over the life of the transaction.

### 3. *Foreign Lender's Profits Earned from Interest*

The fact that profits earned as interest are covered by the Foreign Investment Law increases the foreign lender's risk in two significant ways. First, failure to maintain requisite deposits in Russia could possibly be argued in defense of a debtor's default.[197] Conceivably, it could be held against the creditor that (1) the debtor had no place to remit the interest and (2) the creditor had no right to the interest earned until it complied with Russian law. If the Russian enterprise was formerly state run, and its managers former party functionaries, acceptance of these arguments may not be surprising.

The second major risk flowing from the inclusion of interest in the list of covered profits is that upon default the foreign secured party may not be able to effectuate foreclosure proceedings against the debtor without first covering the expected profit and/or anticipated legal expenses with hard currency. This interpretation comes from language in the Foreign Investment Law.[198] The added burden this requirement would put on the secured party is extremely heavy. Not only might the foreign lender need to cover the full value of the loan, despite the likelihood of a loss, the lender may need to cover the legal and ad-

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permitted to convert such transfers into the freely convertible currency of their choice.

*Id.*

195. *Id.* Art. IV, § 3(b).

196. RF Foreign Investment Law, *supra* note 181 Art. 26.

197. The probable reason a lender needs to keep additional foreign currency deposits covering the expected profit on account in a Russian bank is to guarantee payment of taxes and duties. Non-compliance may be interpreted as an intent to evade taxes, weakening the foreign claimant's position in court.

198. RF Foreign Investment Law, *supra* note 181 Art. 26. Article 26 is vague in not defining what "expenses connected with different kinds of economic activities

ministrative costs before entering court. Hence, a foreign secured party could tie up huge sums of money just to get out of a bad deal, let alone earn profit from it.

Through negotiation a lender possibly could gain the right to substitute the secured property itself for the required hard currency coverage. The agreement would need to be creative and thorough, so as not to run afoul of other Russian laws. One possible solution is that the secured party could give a subsequent mortgage of its secured interest to a Russian bank in return for the hard currency necessary to cover the interest, expenses, and taxes. Then it could keep the funds in escrow during the life of the transaction, identifying them as the coverage for the payments and interest repatriated from Russia. Of course, this arrangement necessitates additional transactions, which raises costs and lower returns.

## V. ALTERNATIVE SECURITY DEVICES FOR THE FOREIGN CREDITOR

American investors looking to lend to Russian enterprises need not explore the field on their own. The Overseas Private Insurance Corporation ("OPIC"), and the Export-Import Bank ("EXIM-BANK") are American agencies dedicated to providing financing, guarantees, and insurance to Americans investing in developmental Russian projects. Although securing financing debt through this type of organization technically is outside the scope of this discussion, these organizations are trailblazers in the field and information about them is valuable to investors and practitioners alike.

### *A. Overseas Private Insurance Corporation*

OPIC was created by federal statute in 1969.[199] It provides pre-investment services, risk insurance, and project financing for investment projects in developing nations around the world.[200] OPIC "both promotes economic growth in developing countries by encouraging U.S. private investment in those countries, and simultaneously build[s] U.S.

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of FIEs on the territory of the RSFSR." *Id.* It can be easily argued that legal expenses incurred in pursuit of a debt are connected with economic activity. The "connection" is arguably tenuous, but, insofar as the government may want deposits on account to insure payment of legal and administrative costs, such deposits could be required.

199. 1969, Pub. L. 87-195, Pt. I, § 231, 83 Stat. 231 (codified as amended at 22 U.S.C.A. §§ 2191-2200a (West Supp. 1992)).

200. "New Interagency Group Meeting Weekly on Export Promotion, EXIMBANK Chief Says", (*quoting* Ruth Harkin, President and Chief Executive Officer of OPIC), Int'l Trade Rep. (BNA), August 11, 1993.

economic strength by promoting U.S. exports and jobs."[201] Pioneering the field, OPIC has already registered 400 companies for insurance coverage on investment projects in the former Soviet Union.[202] Due to the difficulty in perfecting traditional security interests in Russia, OPIC has developed many alternative forms of security, including stock pledges, assignment of contract rights and licenses, contractual liens, direct payment agreements, and offshore escrow accounts.[203] OPIC is aggressively targeting environmental development in Russia and the other CIS states, having established an Environmental Investment Fund among its innovative projects.[204]

### *B. Export-Import Bank*

EXIMBANK is a federal agency created by Congress[205] for the purpose of providing financing and guarantees in deals for the exchange of American goods with developing countries.[206] Unlike OPIC, EXIMBANK generally accepts only foreign obligors who hold sovereign guarantees as security.[207] EXIMBANK also takes irrevocable letters of credit, which are secured by offshore escrow deposits of hard currency or direct assignment of hard currency profits.[208] EXIMBANK not only secures other private transactions, but finances its own.[209] Recently, EXIMBANK has set up a limited recourse project financing program that is geared for projects exceeding US$50m, and is heavily involved

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201. James D. Berg, Acting President and Chief Executive Officer, OPIC, statement before the Senate Committee on Armed Services, March 3, 1993, FEDERAL NEWS SERVICE, FEDERAL INFORMATION SYSTEMS CORP., *available in* WESTLAW, PTS-NEWS Database.

202. Merryl Burpoe, Regional Manager, OPIC, remarks to U.S.-CIS Business Leadership Strategy meeting, August 23, 1993 (Chicago), "U.S. Programs to Help Investment in CIS are Poorly Understood, Officials Say", Int'l Trade Rep. (BNA), August 25, 1993.

203. Berg, *supra* note 201.

204. Harkin, *supra* note 200.

205. The Export-Import Bank is codified as amended at 12 U.S.C.A. § 635 (West Supp. 1992).

206. Export-Import Bank, Newly Independent States (NIS) Fact Sheet as of Aug. 18, 1993. (On file at EXIMBANK branches. EXIMBANK has branch offices in Washington, Chicago, Houston, Los Angeles, Miami, and New York)(*hereinafter* "Fact Sheet").

207. *Id.*

208. *Id.*

209. *Id.*

in oil and gas projects.[210] Other areas in EXIMBANK's focus are consumable goods, raw materials, commodities, spare parts, and components.[211]

## VI. CONCLUSION

A "meeting of the minds" between the foreign lender and the debtor will be the key to success when lending in Russia because understanding and communication will probably provide more protection than the law in its early development. Communication is extremely important because many Russian entrepreneurs are unfamiliar with the language of credit or secured transactions. This is true for the simple reason that during the Communist regime there was no need to develop a vocabulary. As a result, an investor may find it more difficult to make a contract understandable to a Russian counterpart than to understand Russian law. The explication of concepts and terms taken for granted in Anglo-American commercial law will be an essential part of a successful deal.

The burden of teaching is inescapably borne by the experienced lender in this relationship. Making sure to use internationally recognized commercial language will raise the level of understanding between parties.[212] Furthermore, it is imperative that the lender learn about the thought processes and expectations of his Russian borrower/debtor.

Mistrustfulness is deeply imbedded in the Russian psyche.[213] Commercially, Russians are mistrustful of entrepreneurs mainly for two reasons. The first is that paranoia was part of the mentality of Soviet communism and it still survives.[214] The second is that during and since the Soviet regime, many Russians who have accumulated money are

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210. "EXIMBANK establishes guarantee/lending scheme for Soviet Republics", INTERNATIONAL TRADE FINANCE, July 7, 1993 (FINANCIAL TIMES BUSINESS INFORMATION, LTD.), *available in* WESTLAW, PTS-NEWS Database.

211. Fact Sheet, *supra* note 206 at 1.

212. Harvey Jay Cohen, Dinsmore & Shohl, remarks to the Midwest Conference on International Law, sponsored by the American Society of International Law and the American Bar Association Section of International Law and Practice, (October 8, 1993). *Incoterms* (International Chamber of Commerce Publication 1990) are an invaluable aid in improving understanding. *Incoterms* are internationally recognized and their use will reduce confusion, especially if a dispute arises. Cohen suggested appending a copy of *Incoterms* to the contract and citing to it to reduce the margin of error. *Id.*

213. ROY D. LAIRD, THE SOVIET LEGACY (1993).

214. *Id.* at 4. "Many of the leaders now contending for power, and most of the people, express distrust of pluralist, open, democratic institutions and practices."

dealers in the underground market.[215] This attitude is changing, but it will take time for Western free market ideas to become the norm.[216]

Though it may be difficult to gain the trust of a Russian partner, that hurdle will be small compared to gaining the trust of a Russian judge. Faced with a long, detailed contract containing foreign terms and concepts, an inexperienced Arbitration Court judge will be hard-pressed to deliver swift justice. As an outsider to the transaction, coupled with inexperience in commercial matters, the judge will have little understanding of the parties' expectations or the adequacy of remedies. Without the foundation of a strong common law, going to court in Russia will be a gamble. Soviet Civil Law notions may still color the perception of judges in the new courts.[217] It is therefore critical that the parties reach such a high level of understanding that any inferences of fraud, unfair advantage, or motive contrary to public policy are removed from the transaction.

Taking advantage of the newly created commercial rights in Russia is not easy. Though changes in the law enable foreign investors to take security interests in Russian property like never before, the transaction costs for creating a transnational deal are staggering. As important as clarity of understanding is to any deal generally, it is even more important to make expectations, rights, and duties clear to all parties from the beginning of this cross-border relationship.

The best solution for the lending party is to include as much law as necessary in the contract. Unlike a UCC jurisdiction, where the Code's default rules fill a contract's gaps, Russian laws lack this level of sophistication. The lender bears the burden of drafting an airtight contract that defines the terms, anticipates contingencies, provides an exit strategy, protects against default, and is easily understandable. The lender also must make sure that the contract complies with the requirements of the Mortgage Act and is registered in the right agencies. Then, to succeed, the foreign lender needs the contacts and "local

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215. Anne Imse, "A Housing Boom Remakes the Russian Landscape", N.Y. TIMES, section 3, p. 5, August 29, 1993. Ms. Imse quoted a 64 year old Russian retiree who exemplified this attitude "They're swindlers. Building such a huge house requires millions. People who work can't earn that much!"

216. Fred Kaplan, "Russia: The New Edition; School Texts Revise Children's Look at History, Economics", BOSTON GLOBE, section: National/Foreign, p. 1. Earnest attempts to plant free market ideas in the Russian psyche are being made through the introduction of new history books of the 20th Century in the Russian public schools. An intriguing children's book, CROCODILE GENA'S BUSINESS, is now being used to teach free market concepts to children in their tender years. *Id.*

217. W.E. BUTLER, SOVIET LAW 178 (2d ed. 1988).

knowledge'' of a reliable Russian partnerwho may need to be taught about sophisticated financing norms. Failure to educate the debtor to the lender's expectations, penalties for default, and governing law could doom an otherwise well planned debt contract.

Finally, the lender must monitor the performance and condition of the debtor throughout the life of the agreement. In the absence of an established body of law of secured transactions, monitoring takes on greater importance. Even though the Act requires notarization and registration of certain contracts and guarantees, these are not perfecting devices. The current want of a Russian commercial jurisprudence demands additional lender monitoring until the law's dependability is established.

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# Universal Health Care: Concerns For American Physicians, Using The Canadian Experience as a Model

> "Social, political and economic myths prevent us from learning from other countries' experiences in financing health care. Perhaps the only advantage of being the last industrial democracy without universal health insurance is that we can learn from the experience of others. We will learn little, however, if we credit the many myths about foreign experience regularly repeated by critics of national health insurance. If ever there was an obvious American opportunity for cross-national learning, it is Canada's path to and experience with universal health insurance."[1]

## I. INTRODUCTION

The health care problems facing America today are at a critical point. One out of four people, or approximately sixty-three million people, will lose health insurance coverage for some period during the next two years.[2] Thirty-seven million Americans have no insurance and another twenty-two million lack adequate coverage.[3] Polls suggest that a majority of Americans are insecure about their health care coverage and are discouraged about the soaring cost of health care, which rose from $250 billion in 1980 to more than $900 billion in 1993.[4] Health care costs have been expanding at a rate of ten percent a year, faster than the nation's overall economic growth.[5] As a percentage of gross domestic product, health care costs will grow from fourteen percent to nineteen percent during the next decade if left unchecked.[6]

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1. *Testimony Prepared For The Senate Committee on Finance, Health Care: The International Perspective*, FEDERAL NEWS SERVICE, October 14, 1993, *available in* LEXIS, NEWS Library. [hereinafter *Hearings*] (testimony of Prof. Theodore Marmor). Marmor is a Professor of Public Policy and Management at Yale University and is an expert on the Canadian health system.

2. *Clinton's Health Plan, Excerpts From Final Draft Of Health Care Overhaul Proposal*, N.Y. TIMES, September 11, 1993, at A8.

3. *Id.*

4. Karen Riley, *Health Plan's Fate Hinges on Who Benefits; Clinton Promises Plan Will Be Safety Net For Poor*, WASH. TIMES, September 20, 1993, *at* A1.

5. Edwin Chen and Robert A. Rosenblatt, *Clinton Promises Sweeping Coverage In Health Care Plan*, L.A. TIMES, September 11, 1993, at A1, A16.

6. *Clinton's Health Plan, supra* note 2.

The United States has the highest quality health care in the world and is envied by other countries for its technological and research capabilities.[7] Although the United States has the best health care, it has the worst health care delivery system in the industrialized world.[8] All other industrialized countries provide some form of universal and comprehensive health care to their citizens.[9] To improve its health care delivery system, the United States should critically review the experiences of other industrialized countries and implement cost-effective reforms that will reverse the rising cost of health care.

Canada's approach to health care is worthy of review. The Canadian health care system "offers the United States an opportunity for cross-national learning, with its path to and experience with universal health insurance."[10] The United States and Canada share a common language and political roots, a comparably diverse population with similar living standards, increasingly integrated economies, and similar political disputes.[11] Until Canada consolidated national health insurance in 1971, delivery of medical care in the United States and Canada was nearly identical.[12] Therefore, as the United States plans to implement some form of universal health care, the problems that faced health care providers during Canada's implementation of national health insurance should be reviewed.

This Comment focuses on the basic structures of President Clinton's universal health care proposal and the Canadian national health system. First, it provides a summary of how health care will be delivered and financed in President Clinton's plan in comparison to the Canadian system. Second, it offers an analysis of the issues that faced Canadian physicians after implementation of national health insurance and whether American physicians will encounter similar issues in a universal health system. Finally, the Comment includes several recommendations for Congress to consider as the public debate over universal health care evolves.

## II. PRESIDENT CLINTON'S PROPOSAL

On September 22, 1993, President Clinton proposed his plan for universal health care, which he entitled the American Health Security

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7. Frank Clemente, *Universal Health Care For Americans*, 40 HENRY FORD HOSPITAL MED. J. 38 (1992).

8. *Id.*

9. *Id.*

10. *Hearings, supra* note 1.

11. Theodore R. Marmor, *Commentary On Canadian Health Insurance: Lessons For The United States*, 23 INT'L J. HEALTH SERVICES 45, 47 (1993).

12. *Id.*

Act of 1993 (AHSA). The proposal guarantees comprehensive health coverage for all Americans regardless of health or employment status.[13] Health coverage would continue without interruption if an individual lost or changed his or her job, moved from one area to another, became ill, or confronted a family health crisis.[14] The plan's goal is to reform the current health care system by eliminating various discriminatory insurance-market practices and organizing consumers into giant "alliances."[15] The plan aims to achieve savings by encouraging the vast majority of Americans to move from traditional fee-for-service care to health care networks.[16] It pushes Americans away from private doctors into less expensive group medical practices, such as health-maintenance organizations (HMOs).[17] If enacted, the plan anticipates bringing the inflation of health care costs down to a manageable four percent.[18]

Under the plan, the federal government would set a basic standard of health insurance, insisting that all Americans have comprehensive coverage for doctor and hospital bills, mental health care, and prescription drugs.[19] No individual could be denied coverage because of a particular occupation or a pre-existing condition.[20] Each person would receive a national health security card that could be used at a hospital or doctor's office.[21] The guaranteed benefits package for hospital services includes in-patient bed and board, routine care, and laboratory, diagnostic and radiology services.[22] Other benefits include twenty-four-hour emergency room care, regular physical examinations, immunizations, and mental health treatment.[23] Extended care in nursing homes, outpatient prescription drugs, and routine eye, hearing exams and preventive dental services for children under eighteen are also provided.[24] Services that are not medically necessary, like cosmetic surgery, orthodontia, hearing aids, eyeglasses and contact lenses for adults, private duty nursing, and sex-change surgery, are excluded.[25]

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13. *Clinton's Health Plan, supra* note 2.
14. *Id.*
15. Chen, *supra* note 5, at A1.
16. *Id.* at A16.
17. Dan Goodgame, *Ready To Operate*, TIME, September 20, 1993, at 54.
18. *Chen, supra* note 5, at A16.
19. *Id.* at A1.
20. *Id.* An example of a pre-existing condition is heart disease.
21. *Id.*
22. *Id.* at A17.
23. *Id.* Mental health and substance abuse treatment may also be made available.
24. *Id.* Extended care in rehabilitative facilities is also covered.
25. *Id.*

A. *The Alliance Concept*

At the heart of President Clinton's plan is the concept of managed competition. Anyone who does not work for a large corporation would join a purchasing alliance to get their health insurance, either on their own or through their employer.[26] Specifically, health-insurance buyers would band together in large "alliances" to bargain with competing networks of doctors, hospitals, and other health care providers for the best service at the lowest price.[27] The alliances are "essentially purchasing pools through which people would obtain health insurance, similar to a consumer buying food by joining a consumer cooperative."[28]

President Clinton's proposal calls for two types of health care alliances. First, regional health alliances are to be created by the states.[29] Second, corporate health alliances could be established by large employers who have more than 5,000 workers.[30] However, such employers would have the option of joining the regional health alliances.[31]

Under President Clinton's plan, the alliances would offer several health care options. The most expensive would be the traditional fee-for-service plan obtained from an individual doctor.[32] Less expensive plans would include preferred-provider organizations (PPOs), which require workers to go to specified doctors and hospitals that are part of the plan.[33] An even cheaper option would be a health maintenance organization (HMO) that provides health care at a fixed price, with some waiting and rationing of specialists' services.[34] Since consumers will have a choice, health care economists believe that consumers will economize by shifting away from basic fee-for-service care toward HMOs and PPOs and drive down health care costs.[35]

B. *State and Federal Roles*

By 1997, every state would have to establish one or more health alliances.[36] Although there is a strong federal role, President Clinton's

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26. Mike Oliver, *Clinton Pledges Insurance For All; The Vision Is To Change How Health Benefits And Medical Care Are Bought And Sold*, ORLANDO SENTINEL, September 19, 1993, at A15.

27. Goodgame, *supra* note 17, at 55.

28. Susan Dentzer, *Who's In Good Hands?*, U.S. NEWS & WORLD REPORT, September 20, 1993, at 24, 27.

29. Clinton's Health Plan, *supra* note 2, at A8.

30. *Id.*

31. *Id.*

32. Goodgame, *supra* note 17, at 56.

33. *Id.*

34. *Id.*

35. *Id.*

36. Dentzer, *supra* note 28, at 27.

plan leaves the states enough flexibility to implement their own reform measures under the national framework.[37] Beyond the traditional approaches of fee-for-service, PPO, and HMO, a state may choose to implement a Canadian-style "single-payer" system, in which the state would pay its residents' medical bills from tax revenues.[38] Single-payer plans should be more prevalent in rural areas that have too few health care providers to allow for the managed-competition approach.[39]

States would also have the responsibility of certifying networks of doctors, hospitals, and other providers, who then would be able to bid for customers in the alliances.[40] The states would be responsible for the creation and governance of the consumer alliances, including developing mechanisms for selecting board members for various advisory boards.[41] Finally, states would oversee the administration of premium subsidies for low-income citizens, families, and businesses.[42]

At the federal level, President Clinton's plan establishes an independent National Health Board, responsible for setting national standards and overseeing the establishment and administration of the new health system by the states.[43] The Board's responsibilities would include establishing the requirements of the state plans, monitoring compliance with those requirements, interpreting and updating the nationally guaranteed benefit package, and establishing baseline budgets for the alliances.[44] In addition, the Board would monitor the quality of health care and investigate new drug prices to ensure they are not unreasonably high.[45] The National Health Board would consist of seven members, appointed by the President with the advice and consent of the Senate.[46] At least one member would represent the interests of the states.[47]

If a state fails to meet the deadline for establishing the health alliances or fails to operate the alliance system in compliance with federal requirements, the National Health Board would ensure that all eligible individuals have access to services covered in the comprehensive

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37. Chen, *supra* note 5, at A1.
38. Goodgame, *supra* note 17, at 56.
39. *Id.*
40. Chen, *supra* note 5, at A17.
41. *Id.*
42. *Id.*
43. *Clinton Administration Description Of President's Health Care Reform Plan, American Health Security Act Of 1993*, BNA-DLR, September 10, 1993, *available in* LEXIS, NEWS Library.
44. *Id.*
45. *Clinton's Health Plan, supra* note 2.
46. *Id.*
47. *See supra* note 43.

benefit package.[48] To induce a state to act, the National Health Board would inform the Secretary of the Department of Health and Human Services and the Secretary of the Treasury of a state's failure to operate an alliance properly.[49] The Secretary of Health and Human Services would have the authority to order the withholding of federal health appropriations to that state and the Secretary of the Treasury could impose a payroll tax on all employees in the non-complying state.[50]

C. *Financing*

All companies with fewer than 5,000 workers would join the alliance system.[51] As a result, approximately three quarters of all Americans would participate in the alliance system.[52] For each full-time worker, companies would pay an alliance eighty percent of the cost of the average insurance premium in that area, with a lesser, prorated share to cover part-time workers.[53] Workers contribute the rest of the cost, but would pay no more than 1.9 percent of their earnings.[54] For example, if the average cost of a comprehensive plan was $2,000 a year, the company would pay $1,600 and the worker $400.[55] If a worker chooses a more expensive plan, with an average cost of $2,400 a year, the company would still be responsible for the same amount ($1,600), and the employee would pay the difference for a total of $800.[56] Low-income individuals would be eligible for subsidies, and the self-employed would pay premiums based on a fixed percentage of their income, similar to the contributions of a small business.[57]

According to the Clinton administration, no business participating in the alliance system would spend more than 7.9 percent of its payroll on health coverage.[58] Smaller firms with fewer than fifty employees would be eligible for caps on their contributions.[59]

Federal subsidies, totalling $160 billion over six years, would be directed to the alliances in covering the costs of insuring workers in

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48. *Id.*
49. *Id.*
50. *Id.*
51. Dentzer, *supra* note 28, at 27.
52. *Id.*
53. *Id.*
54. *Id.*
55. Chen, *supra* note 5, at A16.
56. *Id.*
57. Denzter, *supra* note 28, at 27.
58. *Id.*
59. *Id.*

small businesses.[60] In addition, these subsidies would help fund the coverage of the unemployed and others who do not fall under any employer-supported plan.[61] These subsidies would be paid for by restraints on the growth of government health programs like Medicare, and $105 billion in new taxes.[62] This may include another $124 billion in Medicare cuts above the $56 billion included in President Clinton's 1993 budget package.[63] These cuts would come mainly by slowing inflation of payments to doctors and hospitals.[64] Providers would be unable to shift costs to non-Medicare patients due to new federal cost controls.[65] Moreover, new "sin taxes" would be introduced that would increase the price of cigarettes, while fees would be levied against large corporations who stay out of the regional alliances.[66]

Money that is now directly paid to private insurance companies would go to the health alliances instead.[67] The alliances would distribute the funds among health care providers it has approved for the area in which it operates.[68] Such providers might include nonprofit organizations like Blue Cross and Blue Shield, insurance companies, and health maintenance organizations.[69] The Clinton Administration did not want to sever the link between health coverage and employment, leaving the health alliances to collect health premiums from employers and individuals, and negotiate prices with health care providers.[70]

## III. THE CANADIAN UNIVERSAL HEALTH SYSTEM

Canada provides all of its citizens access to medical care, but it does not charge them directly for the services provided.[71] The responsibility for financing the comprehensive set of medical benefits is placed

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60. *Id.*
61. *Id.*
62. *Id.*
63. Riley, *supra* note 4.
64. Goodgame, *supra* note 17, at 57.
65. *Id.*
66. Dentzer, *supra* note 28, at 27.
67. Chen, *supra* note 5, at A16.
68. *Id.*
69. *Id.*
70. Dana Priest, *Central Health Care: "Undoable" But No Longer on Political Fringe*, WASH. POST, May 7, 1993, at A11.
71. John Iglehart, *The United States Looks At Canadian Health Care*, 321 NEW ENGLAND J. MED. 1767 (Dec. 21, 1989). Iglehart has published a series of articles analyzing the Canadian health system in THE NEW ENGLAND JOURNAL OF MEDICINE.

squarely on the federal and provincial governments.[72] Canadian patients are free to choose their physician and hospital.[73] Physicians can provide the treatment they recommend without having to obtain approval from administrators.[74] The system is an example of a single-payer system, in which one government entity collects taxes to pay for its residents' health care.[75] This single entity disburses the funds to doctors, hospitals, and other providers.[76] Health benefits are not linked to employment and the health insurance industry has no role.[77]

### A. *Basic Benefit Package*

To assure universal access, every Canadian is issued a card administered at the provincial level which allows them to seek care when they need it and from whom they need it, regardless of their economic or health care status.[78] The care is comprehensive, meaning that there are no co-payments, no deductibles, and no extra costs for services.[79] The services are primarily provided by private physicians, who operate on a fee-for-service basis and in not-for-profit hospitals.[80] The insured services of physicians include all medically required services rendered by licensed practioners in a hospital, doctor's office, or clinic.[81] The insured services of hospitals include all inpatient services provided at the standard ward level and all necessary drugs, biological products, supplies, and diagnostic tests, as well as a broad range of outpatient services.[82]

A good example of the basic benefits provided in a provincial plan is the Ontario Health Insurance Plan (OHIP). Benefits include physicians' services at home, at doctors' offices, in the hospital, or in other

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72. *Id.*

73. Theodore R. Marmor and Michael S. Barr, *America's Health Care: Which Road to Reform? Making Sense Of The National Health Insurance Reform Debate*, 10 YALE L. & POL'Y REV. 228, 242 (1992).

74. *Id.*

75. Priest, *supra* note 70.

76. *Id.*

77. *Id.*

78. Clemente, *supra* note 7, at 39.

79. *Id.*

80. R. G. Evans, *The Canadian Health-Care Financing and Delivery System: Its Experience And Lessons For Other Nations*, 10 YALE L. & POL'Y REV. 362, 369 (1992). Evans has been called Canada's foremost health economist.

81. John K. Iglehart, *Canada's Health Care System Faces Its Problems*, 322 NEW ENGLAND J. MED. 562, 563 (February 22, 1990).

82. *Id.*

eligible institutions.[83] This would include diagnosis and treatment of illness and injury, prenatal and postnatal obstetrical care, laboratory services, and clinical pathological services.[84] OHIP also covers occupational therapy, physiotherapy, speech therapy, audiological services, and psychological services, when prescribed by a physician.[85] Lastly, long-term care in nursing homes is covered, but patients are asked to make a small contribution.[86] Services not covered by the plan are visits solely for the administration of drugs, dental care, eyeglasses, cosmetic surgery, examinations for employment, acupuncture, and psychological testing.[87] The OHIP benefit package is similar to President Clinton's basic benefit package.

B. *Federal and Provincial Roles*

Canada's universal health insurance allows for flexibility at the local level.[88] The system is largely financed and wholly administered by the provincial governments, and each is adapted to reflect local preferences.[89] Public agencies in each of the ten provinces of Canada pay for all of the costs of "medically necessary" hospital and medical care received by their residents.[90] In order to receive federal funding, the provincial programs must "provide universal access to care with equal terms and conditions for all, cover all medically necessary services as determined by physicians, provide portable benefits . . ., and be publicly administered on a nonprofit basis."[91] The federal government provides funds only to provincial plans which comply with the federal terms and conditions.[92]

C. *Financing*

Before fully implementing universal health insurance in 1971, Canada financed its health care in a manner similar to the current American

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83. John K. Iglehart, *Canada's Health Care System*, 315 NEW ENGLAND J. MED. 778, 780 (September 18, 1986).

84. *Id.*

85. *Id.*

86. *Id.*

87. *Id.*

88. Marmor, *supra* note 73, at 243.

89. *Id.*

90. Evans, *supra* note 80, at 369. Canada also has two territories which participate in the national health system.

91. Iglehart, *supra* note 81, at 563. Portable benefits are those that are accessible throughout the whole country.

92. Raisa B. Deber, John E. F. Hastings, and Gail G. Thompson, *Health Care In Canada: Current Trends and Issues*, 12 J. PUBLIC HEALTH POLICY 72, 73 (1991).

system.[93] Currently, a Canadian patient will never be required to pay a fee or make any financial contribution.[94] Doctors and hospitals in Canada receive all payments from one source, a provincial ministry, which keeps track of eligibility requirements and administrative procedures.[95] Physicians bill provincial authorities on a fee-for-service basis.[96] The physician is reimbursed according to fee schedules negotiated at periodic intervals between the provincial ministry of health and the corresponding provincial medical association.[97] The schedule in each province is binding on all physicians working in that province, and physicians may not bill their patients additional fees above the scheduled rates.[98] However, hospitals do not receive reimbursement for particular services.[99] Instead, each hospital negotiates an annual global budget with the provincial reimbursement agency.[100] These global budgets are to cover operating costs only, including staff salaries, costs of equipment, and supplies.[101] The global budgets do not include capital costs, depreciation, or interest charges.[102]

The provincial plans are financed largely by general revenues provided by the federal government and the individual provinces.[103] Each contributes approximately fifty percent of the funding, although less wealthy provinces and territories receive more federal support.[104] In Canada's largest province, Ontario, individuals generally participate through their employers or on a direct-payment basis.[105] Employers pay the Ontario Health Insurance Plan premiums directly on behalf of fifty-nine percent of the plan's participants.[106] The remaining participants, the majority of whom are self-employed, pay their own premiums.[107]

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93. Marmor, *supra* note 73, at 244.

94. Evans, *supra* note 80, at 369. Instead, the Canadian health system is paid through federal and provincial tax revenues.

95. Hearings, *supra* note 1.

96. Marmor, *supra* note 73, at 242. Payment is usually received within three weeks.

97. Evans, *supra* note 80, at 370. The fee schedules are negotiated annually.

98. *Id.*

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.*

103. Iglehart, *supra* note 83. Most of the financing comes from income, payroll, and sales taxes. Marmor, *supra* note 73, at 243.

104. *Id.*

105. *Id.* at 779.

106. *Id.* at 779-80.

107. *Id.*

Individuals and families who lack the resources to pay premiums are eligible for government assistance.[108]

## IV. ISSUES THAT FACED CANADIAN PHYSICIANS AFTER UNIVERSAL HEALTH CARE WAS IMPLEMENTED AND THE LIKELIHOOD OF SIMILAR ISSUES IN AN AMERICAN SYSTEM

Public financing of medical care has worked in Canada, yet no system of health care financing is free of problems or is easily administered.[109] Because Canada and the United States are similar, many of the problems encountered in implementing universal health care in Canada are potential problems for an American system. The following discussion examines the issues and problems that faced Canada in implementing universal health care and the possibility of similar issues occurring in the United States. As Congress assesses the pros and cons of universal health care, it should look to the Canadian experience as a model and implement measures to prevent similar problems from happening in an American system.

### A. *Physician Payment Issues*

#### 1. *Physician Payment in the Canadian System*

##### a. *Fee Schedules*

Canada pays its health care providers based on the negotiation of physicians' fees and hospital budgets.[110] The federal government gives money to those provincial governments who comply with the national directives.[111] The provinces negotiate physician fees and costs for hospital services and then pay the bills.[112] Provincial health ministers are empowered to negotiate physicians' fee schedules, to set overall operating hospital budgets, and to approve hospitals' capital acquisitions.[113]

The provincial health plans wield their purchasing power through negotiation with provincial medical associations for binding physicians'

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108. *Id.*
109. *Hearings*, *supra* note 1.
110. Iglehart, *supra* note 71.
111. Clemente, *supra* note 7, at 38, 39.
112. *Id.*
113. Iglehart, *supra* note 84, at 781.

fee schedules.[114] Negotiations that establish physicians' fee schedules involve representatives of the provincial medical associations and representatives of the provincial plans.[115] The government has a fixed amount to spend each year and physicians receive only a specified amount for each service performed.[116] Physicians may not receive any more than the set fee and cannot bill their patients for extra services.[117] The "budget negotiations between Canadian medical care providers and provincial health care administrators are periodic, noisy, and contentious; but, unlike the negotiations between private insurance companies and providers of managed care in the United States, the negotiations are open to the public."[118] Therefore, the negotiations are subject to public influence.[119]

Negotiators concentrate on making fee increases on an aggregate basis.[120] This translates into a certain percentage increase in provincial payments for all physicians' services.[121] The provincial medical associations decide how those increases will be divided according to medical specialty.[122] The result is that the Canadian fee schedules provide little differentiation between types of office visits.[123] Practioners that perform long and detailed examinations are penalized.[124] In addition, fees are paid only for physician services, not for employees like nurses or secretaries.[125] Therefore, the possibility of generating increased income by delegating tasks to subordinates is limited.[126] The fee schedules are structured so that an increase in billings requires a physician to invest additional time in his or her practice; however, because the number of hours in a day is limited, the expansion of physicians' billings is constrained.[127]

b. *Extra-billing by Canadian Physicians*

A trend that existed between physicians, patients, and the Canadian provincial health plans was that in times of increased fee restraints,

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114. *Id.*
115. *Id.*
116. Clemente, *supra* note 7, at 39.
117. *Id.*
118. Marmor, *supra* note 73, at 243.
119. *Id.*
120. Iglehart, *supra* note 83, at 781.
121. *Id.*
122. *Id.* at 782.
123. *Id.*
124. *Id.*
125. *Id.*
126. *Id.*
127. *Id.*

doctors tended to "extra-bill."[128] Physicians would bill patients for amounts above those allowed by government fee schedules.[129] It provided physicians a way to opt out of the provincial plans and thereby gain the option to extra-bill their patients at rates of their own choosing.[130] Physicians received reimbursement from the government only at the insured fee schedule rates.[131] Physicians used extra-billing as a way to recoup the income they had lost under economic controls and to offset the provincial restrictions on fees.[132]

Some provinces permitted extra-billing because it shifted to consumers a share of the expense of medical services and reduced the pressure for sizable increases in physicians' fee schedules.[133] The provincial health ministries considered extra-billing to be an appropriate response to strict governmental limits on health spending, while the provincial medical associations considered it to be a necessary safety valve in response to the monopsony powers of the government.[134]

c. *The Canadian Health Act of 1984 and The Doctors' Strike of 1986*

Concern in Canada grew over the issue of whether the increase in the practice of extra-billing was eroding the access to care, particularly in the provinces of Ontario and Alberta.[135] The federal government created a commission to examine the question of whether extra-billing was limiting access to care.[136] The commission released a report in 1980 which criticized extra-billing for its harmful effects on the access to medical care.[137] The result was implementation of the Canada Health Act in 1984, which reasserted federal power over the provincial plans.[138] Namely, the Canadian Parliament directed that the provinces end the

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128. *Id.*

129. *Id.*

130. Richard M. Kravitz and Martin F. Shapiro, *Duration and Intensity of Striking Among Participants In The Ontario, Canada Doctor's Strike*, 30 MEDICAL CARE 737 (1992).

131. Judith Globerman, *Free Enterprise, Professional Ideology, And Self-Interest: An Analysis Of Resistance By Canadian Physicians To Universal Health Insurance*, 31 J. HEALTH & SOCIAL BEHAVIOR 11, 13 (1990).

132. John K. Iglehart, *Canada's Health Care System*, 315 NEW ENGLAND J. MED. 202, 207 (July 17, 1986).

133. *Id.*

134. Iglehart, *supra* note 83, at 782.

135. Iglehart, *supra* note 132, at 207.

136. *Id.*

137. *Id.*

138. Iglehart, *supra* note 83, at 782.

practice of extra-billing or forfeit a substantial portion of their federal funding.[139]

The Canadian Health Act provided that "any provincial government which either charged patients for covered services, or permitted anyone else to charge for them, would lose an amount from its federal grant equal to the estimated total amount of their direct charges."[140] Over the strong opposition of organized medicine, every province enacted legislation implementing a ban on extra-billing, fearing the loss of federal grants.[141] Ontario introduced legislation forcing physicians to accept the insured fees as full payment for their services.[142] Thus, if a doctor wanted to remain eligible for reimbursement by the provincial plans, he or she could not extra-bill patients by charging an amount in excess of the negotiated reimbursement rate.[143]

The move against extra-billing was viewed by the medical profession as a direct assault on its autonomy.[144] Physicians and their professional organizations condemned the Canadian Health Act as "an unwarranted intrusion on professional freedom that reduced the profession to a public service."[145] The Ontario Medical Association (OMA) claimed that the ban on extra-billing infringed upon the rights of physicians to contract directly with their patients.[146] Ultimately, physicians claimed that the Act undermined the quality of care by eliminating the safety valve for occasions when the government failed to provide adequate financial support to the system.[147]

Opposition to the ban on extra-billing culminated in the Ontario Medical Association's call for an unlimited strike, to begin on June 12, 1986.[148] In an effort to force the provincial government to abandon its plan to ban extra-billing by physicians,[149] the strike called for doctors to provide only emergency services and to cancel elective surgery.[150]

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139. Kravitz and Shapiro, *supra* note 130, at 737.

140. Evans, *supra* note 80, at 373.

141. Iglehart, *supra* note 81, at 565.

142. H. Michael Stevenson, A. Paul Williams, Eugene Vayda, *Medical Politics and Canadian Medicare: Professional Response to the Canada Health Act*, 66 MILBANK QUARTERLY 65, 70 (1988).

143. Marmor, *supra* note 73, at 242.

144. Stevenson, *supra* note 142, at 70.

145. *Id.*

146. Kravitz and Shapiro, *supra* note 130, at 738.

147. *Id.*

148. Stevenson, *supra* note 142, at 71. The Ontario Medical Association is the most powerful professional association in Canada. *Id.* at 70.

149. Iglehart, *supra* note 83, at 782.

150. Stevenson, *supra* note 142, at 71.

In addition, the OMA asked that all hospital chiefs-of-staff and chiefs-of-services resign.[151] The result was an Ontario strike that lasted for twenty-five days.[152] Overall, the strike failed in its fundamental political objective of obstructing the federal government's resolve to extend its control over health insurance.[153] The strike "not only failed to avert the ban on extra-billing, but was viewed as a public relations disaster for physicians."[154] Today, physicians sit with the government on a Joint Management Committee that tries to reach a consensus on fees.[155] If the two sides cannot agree, physicians have agreed to a process of mediation and independent binding arbitration.[156]

d. *Physicians' Ability to Privately Contract*

In most Canadian provinces, patients are not prohibited from paying privately for their medical or hospital care.[157] Physicians and hospitals, however, are prohibited from treating both patients whose care is financed by the provincial plans and patients who pay directly.[158] Thus, it is still technically possible for physicians to withdraw from the public plan and see patients on a purely private basis.[159] Neither the patient nor the physician are reimbursed by the public plan.[160] A group of physicians could set up a purely private hospital or diagnostic facility, but their patients would have neither public nor private insurance.[161] Therefore, a physician who is contemplating whether to contract privately with his patients must decide whether to be "all in" or "all out" of the provincial plans.[162] The provider "would have to be able to make a living purely in the private market, rather than playing both the private and public markets, like in countries with dual systems."[163]

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151. *Id.*
152. *Id.*
153. *Id.*
154. Richard L. Kravitz, Lawrence S. Linn, and Martin F.Shapiro, *Risk Factors Associated With Participation In The Ontario, Canada Doctors' Strike*, 79 AM. J. PUBLIC HEALTH 1227 (1989).
155. Clyde H. Farnsworth, *The Bill Comes Due: Canada's Health Care Costs—A Special Report*, N.Y. TIMES, March 7, 1993, at A18.
156. *Id.*
157. Iglehart, *supra* note 81, at 563.
158. *Id.*
159. Evans, *supra* note 80, at 371.
160. *Id.*
161. *Id.*
162. *Id.* at 372.
163. *Id.*

As a result, no private market has developed in Canada, even though it is permissible.[164]

e. *Canada's Movement Toward Caps as a Way to Control Rising Health Costs*

The Canadian fee schedules have moderated the growth of doctors' incomes at levels below what they would be in a free market.[165] Not only are physicians' fees set through consultation with the government, but some provinces have also placed annual limits or restrictions on how much a doctor can earn.[166] In Ontario, reimbursements after a doctor has grossed $320,000 are made at 75 cents on the dollar, and the province is threatening to reduce that ceiling for certain kinds of doctors who are perceived to be in oversupply.[167] In Quebec, the government has put an expenditure cap,[168] or ceiling, on certain kinds of income.[169] Expenditure caps are prospectively determined, fixed budgets that restrict further funding once the cap is reached.[170] Thus, in Quebec, any fees earned by a general practioner in excess of $164,108 (Canadian) a year will be reimbursed at a rate of twenty-five percent.[171] The province of British Columbia has capped the growth of physicians' payments at three percent per year.[172]

2. *Physician Payment Under President Clinton's Proposal*

a. *Negotiation of Premiums and Budget Controls*

President Clinton's plan seems to have more federal control in budgeting procedures than the Canadian system. In general, the national health care budget would be based on the weighted average premium for the guaranteed benefits package, which will act as a

164. *Id.*

165. Iglehart, *supra* note 83, at 782.

166. Anne Swardson, *Canada's National Health Plan; The Model Is Tempting, But . . .*, WASH. POST, June 22, 1993, at F10, F12.

167. *Id.*

168. Iglehart, *supra* note 71, at 1771.

169. Ronald Bronow, *A National Health Program; Abyss at the End of the Tunnel—The Position of Physicians Who Care*, 263 J. AM. MED. ASS'N 2488 (May 9, 1990).

170. Iglehart, *supra* note 71, at 1771.

171. Bronow, *supra* note 169.

172. *Id.*

benchmark for market action.[173] The budget procedure for the health alliances is somewhat complicated. First, a national per capita-based premium would be set by the National Health Board, with an adjustment at the alliance level for risk factors like age and other demographic information.[174] Alliances would then receive an average premium from the National Health Board.[175] Next, health plans would submit bids to the alliances, either blindly or with knowledge of the average premium target.[176] Finally, the alliances would submit their average premiums to the National Board, which would either approve or reject the average premium.[177] If not approved, the alliances would renegotiate their average premium.[178] Once accepted, if an alliance exceeds its average premium, it has a two year recoupment period to comply.[179] Corporate alliances would use an equivalent target, but would be terminated if the target is missed two out of three years.[180]

The American Medical Association (AMA) strongly opposes the setting of a national budget, claiming that "health care decisions based mainly on economics and not on patients' needs will not be in the best interests of patients."[181] Unlike the fee schedule negotiations in Canada, which occur between the provincial health ministries and provincial medical associations, no physician involvement occurs in President Clinton's proposal. The AMA believes "a participatory process that includes physicians' input might be useful to establish true goals that can be flexible and are based on patient needs."[182] The result of a Clinton-type budget process will be disgruntled physicians who have no voice in how the system works. In the end, the AMA thinks such a process will lead to the rationing of health care.[183]

Physicians may have other problems if an alliance becomes insolvent. According to President Clinton's plan, each state would operate a guaranty fund to provide financial protection to health care providers

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173. *An AMA Analysis of the Clinton Reform Plan*, AMERICAN MEDICAL ASSOCIATION, September 24, 1993, at 6.

174. *Id.*

175. *Id.*

176. *Id.*

177. *Id.*

178. *Id.*

179. *Id.*

180. *Id.*

181. *Id.*

182. *Id.*

183. *Id.*

and others if a health plan becomes insolvent.[184] These guaranty funds would pay health providers if a health plan is unable to meet its obligations.[185] The guaranty funds would cover liability for services rendered prior to the plan's insolvency for all services under the comprehensive benefits package.[186] However, when a health plan cannot meet its financial obligations to providers, the providers have no legal right to seek payment from patients.[187] Moreover, health providers must continue caring for the patients until they are enrolled in a new health plan.[188] Thus, physicians would be forced to provide care for patients without recourse for payment. Physicians again have been left out of the planning process and may suffer by providing services for which there is no recourse for payment.

b. *Prevention of Physician Fraud and Abuse Under President Clinton's Plan*

The practice of extra-billing in President Clinton's plan seems unlikely. In President Clinton's proposal, accountability standards are implemented which make provider fraud and other misbehavior automatic grounds for exclusion from all health plans.[189] The plan penalizes health care providers and institutions that impose excessive charges or engage in fraudulent practices.[190] Current federal authority would be amended to allow forfeitures of proceeds derived from health care fraud.[191] The federal government could use either criminal or civil remedies to seize assets derived from fraudulent or illegal activities.[192]

Tougher standards and stiffer penalties would be implemented to prevent the types of extra-billing that occurred in Canada. New criminal penalties would be directed at health care fraud, related to the payment of bribes and gratuities to influence the delivery of health services and coverage.[193] Civil monetary penalties would be assessed against providers who submit false claims.[194] In addition, tighter restrictions in the private

184. *Clinton Health Care Reform Plan*, *supra* note 43, at 23.
185. *Id.*
186. *Id.*
187. *Id.*
188. *Id.*
189. *Clinton's Health Plan*, *supra* note 2.
190. *Id.*
191. *Clinton Health Care Reform Plan*, *supra* note 43, at 87.
192. *Id.*
193. *Clinton's Health Plan*, *supra* note 2.
194. *Id.*

sector would eliminate financial kickbacks and new standards would prohibit physicians from prescribing services delivered at institutions where they hold financial interests.[195] The current anti-kickback statute would be expanded to include not only Medicare and Medicaid, but all health payers.[196] Overall, the plan stresses physician accountability for services provided and stiff consequences if fraudulent conduct occurs.

c. *Physicians' Ability to Privately Contract*

Under President Clinton's plan, physicians would still be able to bill for each procedure.[197] However, since fee-for-service plans are expected to be the most expensive options, planners believe most consumers will choose less expensive managed care plans,[198] like PPOs and HMOs. If doctors want patients, they will have to join the managed care plans.[199] In managed care plans, physicians team up with hospitals to compete against other plans, on both price and quality, to attract patients.[200] The patients pay fixed amounts per month, as capitation payments.[201] The end result is that physicians will lose the ability to privately contract on a fee-for-service basis with individual patients and will, instead, operate on fixed fees in managed care plans. This is similar to the Canadian system, where private contracting is permissible, but because of provincial coverage constraints put on consumers and physicians, it has not evolved.

d. *Salary Caps as a Way to Control Costs*

Although caps are not specifically stated in President Clinton's proposal, indirect caps may result. Drastic constraints on existing government health programs which cut Medicare's twelve percent growth rate roughly in half, would necessitate deep cuts in payments to doctors and hospitals.[202] Moreover, physicians in fee-for-service plans would be required to charge patients on the basis of a regional or state-established

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195. *Id.*

196. *Clinton Health Care Reform Plan*, *supra* note 43, at 86.

197. Ruth Sorelle, *Doctors Hesitant About Plan*, HOUSTON CHRON., September 11, 1993, at A15.

198. *Id.*

199. *Id.*

200. Joseph P. Newhouse, *Health Care Reform: A Reader's Guide*, N.Y. TIMES, September 12, 1993, at 32.

201. *Id.*

202. Dentzer, *supra* note 28, at 25.

fee schedule.[203] This, coupled with a ban on balance billing,[204] will cause physicians' fees to be fixed. Finally, under the Clinton plan, annual caps on private insurance premium increases and fee schedules for providers in fee-for-service plans would be established.[205] Combined with the ban on balance billing, premium caps will equate to price controls for physicians' services.[206] Therefore, physicians' salaries may eventually be capped if President Clinton's proposal is enacted without any changes.

### B. *The Standard of Health Care*

#### 1. *Availability of Services*

##### a. *Canadian Accessibility*

An important feature of Canada's approach to hospital budgeting is the separation of operating and capital expenditures.[207] Through this process, the provincial plans have contained the growth of hospital resources, including equipment and supplies.[208] Provincial governments limit the proliferation of hospital capacity and expensive diagnostic equipment by funding them separately through the hospital capital and operating budgets, instead of through fees per item of service.[209] For example, a hospital that wishes to acquire an expensive piece of equipment, like an MRI (Magnetic Resonance Imaging), must receive both planning approval and capital commitment from the provincial ministry of health.[210] Private physicians may purchase and use such equipment, but if no corresponding service is in the fee schedule, reimbursement for its use will not be provided.[211]

The result is that physicians claim a shortage of capacity.[212] There are considerably fewer MRIs and other high-technology items in Canada

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203. *Physicians And The Changing System: The Preliminary Clinton Reform Plan*, AM. MEDICAL ASS'N, September 24, 1993, at 1.

204. *Id.* Balance billing is the standard procedure physicians use in fee-for-service office visits.

205. *Id.*

206. *Id.*

207. Iglehart, *supra* note 81, at 565.

208. *Id.*

209. Evans, *supra* note 80, at 376.

210. *Id.*

211. *Id.*

212. *Id.*

compared to the United States.[213] Waiting lists have developed for services like open-heart surgery and MRIs.[214] Moreover, the diffusion of several major forms of technology have been slowed, including open-heart surgery, cardiac catheterization, organ transplantation, and radiation therapy.[215] This puts the Canadian physician in the position of having to provide care on the basis of most urgent medical need rather than rendering it to all who could benefit.[216] Recent government limits on medical spending have led to waiting lists for certain expensive non-emergency procedures.[217] In some provinces, patients have had to wait as long as eighteen months for a hip replacement, twelve months for cataract surgery, and three to six months for elective coronary bypass surgery.[218] In Ontario, hospital directors have responded to government cost freezes by reducing services and shrinking the number of beds available.[219]

b. *Accessibility Under President Clinton's Plan*

Currently, the United States has waiting lists for certain elective procedures and some essential ones.[220] In larger cities, patients who are being treated in emergency rooms often wait hours for critical care.[221] Private hospitals routinely turn away uninsured patients, leaving the already overburdened public sector to take care of them.[222] The goal of the Clinton plan is to end such discriminating insurance-market practices and provide each person with a national health security card that could be used at any hospital or doctor's office in their alliance area.[223] There would then be no denial of coverage because of a particular occupation or pre-existing condition.[224] In theory, such a plan should increase accessibility to services; however, it remains to be seen whether, in practice, the Clinton proposal can provide every American ready access to care.

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213. *Hearings*, *supra* note 1.
214. Marmor, *supra* note 73, at 243.
215. Iglehart, *supra* note 81, at 565.
216. *Id.*
217. Farnsworth, *supra* note 155.
218. *Id.*
219. Swardson, *supra* note 166, at F10.
220. *Hearings*, *supra* note 1.
221. *Id.*
222. *Id.*
223. Chen, *supra* note 5.
224. *Id.*

2. *Physician-Patient Relationship*

a. *Physician Choice in Canada*

Canadian citizens are guaranteed comprehensive care, whatever their economic status, while having the freedom to select their own physicians.[225] For physicians, the Canadian system offers the ease of billing a single provincial payer, with virtually no questioning of their clinical judgment.[226]

If a patient feels a need for care, he or she may seek out the services of any physician who is willing to accept him as a patient.[227] Patient and provider have complete freedom of choice.[228] Usually, a patient will contact a general practioner, who then acts in a "gate keeper" role.[229] The physician will either provide diagnostic and treatment services himself, or refer the patient to a specialist.[230] Specialists tend to discourage self-referral by patients through direct contact, because specialists receive a higher fee if a general practioner refers the patient. In addition, general practioners might resent a patient bypassing their services.[231]

b. *Physician Choice Under President Clinton's Plan*

Once a year, probably in a ten day open enrollment period, an alliance would mail a directory to all local residents offering a choice of certified health plans offered by approved providers.[232] A person would select a plan for that year and receive all medical care exclusively from that organization's network of doctors and hospitals.[233] If a person

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225. Iglehart, *supra* note 71, at 1767.
226. *Id.*
227. Evans, *supra* note 80, at 369.
228. *Id.*
229. *Id.*
230. *Id.*
231. *Id.*
232. Chen, *supra* note 5, at A16.
Consumers would receive useful information about each of the plans in the alliance. Quality performance reports would contain information on cost of premiums, out-of-pocket costs, and any restrictions on access to providers and services. This information would be subject to Labor Department audits. *Id.*
233. *Id.*

needs care outside the network, he or she would have to pay the full bill.[234] More costly fee-for-service plans would also be available as an option, offering a larger selection of doctors and hospitals.[235] However, there would be an out-of-pocket limit of $1,500 for an insured individual if a fee-for-service plan is selected.[236] Because the fee-for-service plans will be more costly than the managed care plans, most Americans will be forced to give up their choice of physician in favor of the cheaper HMOs and PPOs. Traditional physician choice will change if a managed care plan is chosen, because individuals will choose from a group of approved providers, not their own physician.

3. *Health Care Rationing*

a. *Canada's Position*

Critics of the Canadian health system warn that health care is rationed to its citizens.[237] Rationing is the effort to distribute scarce resources equitably.[238] Canada attempts to provide more uniform access to health care among its entire population.[239] As a result, medical care depends more on a professional assessment of health needs rather than on one's insurance status, as in the current American health care system.[240] Because Canada provides uniform access to health care, many non-essential services are not provided when financial resources are not available. Canada is faced with a system in which funding is finite and limited, while the demands of patients are not.[241] To cope with rising federal transfer payments for health care, Canadian politicians are restricting access to medical care.[242] To keep down the costs of health care, hospitals throughout Canada are taking beds out of service, limiting the number of operations they perform, and cutting back on other services.[243] For example, Ontario's hospital directors recently suggested that they will have no choice but to reduce services and

234. *Id.*
235. *Id.*
236. *Id.*
237. *Hearings*, *supra* note 1.
238. Daniel Callahan, *Symbols, Rationality, and Justice: Rationing Health Care*, 18 AM. J. LAW & MED. 1, 3 (1992).
239. Marmor, *supra* note 11, at 57.
240. *Id.*
241. Bronow, *supra* note 169.
242. *Id.*
243. *Id.*

shrink the number of available hospital beds.[244] Similarly, in Quebec, vision exams for those ages twenty to forty and dental treatments for all but low-income children are no longer covered services.[245] The reality is that not all health services can be covered in a universal health system and non-essential services are the first to be cut.

b. *Rationing Under an American System*

Presently, the United States limits services by ability to pay and accordingly shows a significant difference in access to health care by race, class, and employment circumstances.[246] This is a form of rationing health care. In addition, Americans who participate in HMOs and other systems of managed care face corporate rationing.[247] Participants in HMOs do not know whether they will be denied a referral to a specialist in the event of a rare disease or difficult procedure.[248] Because the thrust of President Clinton's plan is to shift Americans away from fee-for-service care towards less costly PPOs and HMOs, some form of rationing is certain to occur.

Under President Clinton's plan, the National Health Board would strictly enforce limits on health care spending by deciding when health care providers were spending too much.[249] Some providers think this may lead to the rationing of health care and result in the development of fewer new drugs.[250] One suggested rationing scenario is requiring an elderly patient in declining health to be denied such operations as hip replacements and cardiac bypasses.[251] President Clinton's proposal also calls for sharp limits on private health insurance premiums.[252] In theory, if health insurers raised premiums faster than the government allowed, the Treasury could tax away the increase.[253] Opponents of President Clinton's plan believe this will turn insurers into health services policemen, and result in the rationing of medical care.[254]

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244. Swardson, *supra* note 166, at F10.
245. *Id.* at F11.
246. Marmor, *supra* note 11, at 57.
247. *Id.* at 58.
248. *Id.*
249. Goodgame, *supra* note 17, at 55.
250. *Id.*
251. *Id.*
252. Dentzer, *supra* note 28, at 28.
253. *Id.*
254. *Id.*

## V. CONCLUSIONS AND RECOMMENDATIONS

Universal health care is a noble undertaking and President Clinton should be commended for possessing the leadership to confront our nation's health care problems. As discussed, if Congress adopts President Clinton's proposal for universal health care, physicians will face many changes in the way they practice medicine. Canada's experience with implementing universal health care exemplifies the problems American physicians may encounter. Mechanisms to deal with physician payment and measures to ensure that the standard of care remains high are not addressed in President Clinton's proposal. Because physicians were left out of the planning phase of President Clinton's proposal, their interests have not been represented. Instead of allowing the American Medical Association to participate in the closed-door hearings, other special interest groups were permitted to influence the plan. Decisions were based on economics and not on patient needs.[255] In the end, President Clinton's plan does not represent the needs of American health care consumers, but instead seems an effort to please special interest groups.

As Congress debates the merits of President Clinton's plan, three events should occur. First, if a national health budget is going to be established, a participatory process that includes representatives of the health insurance industry, hospitals, the medical profession, and the pharmaceutical industry should be established.[256] These groups will be the participants who will carry out any legislation that is passed. By doing so, a more realistic budget will result, and health care providers will feel that their interests have been represented. Moreover, by having a better informed health care industry, a smoother transition process may result once any legislation is put into action. Second, if all Americans are going to have access to health care, incentives to stay healthy need to be incorporated into the system. Otherwise, those that lead unhealthy lifestyles will overburden the system, leading to the rationing of, and limited accessibility, to health care discussed previously. Monetary incentives in the form of reduced insurance premiums could be established if an individual regularly exercises or refrains from tobacco and alcohol consumption. Ultimately, American physicians and the entire universal health system will be less burdened if Americans are more healthy. Third, preventive medicine should be stressed in the basic benefits package. Annual physicals for children and adults should

255. *The AMA Analysis of the Clinton Reform Plan*, *supra* note 173, at 6.
256. *Id.*

be mandatory so that medical complications and illnesses can be discovered before costly procedures are required. Moreover, physicians should be receptive to such a requirement, because it will result in consistent fees and more familiarity with their patients' medical histories.

President Clinton's proposal is a good start, but many issues are not addressed. Hopefully, our democratic system will create the best solution for our health care delivery problems. Congress should scrutinize the strengths and weaknesses of each of the major proposals with one goal in mind—do what is best for the patient.

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# Legal Disincentives to Japanese Direct Investment in the United States

## I. INTRODUCTION

The 1980s saw a massive increase in foreign direct investment (FDI) in the United States.[1] FDI in the United States increased by approximately 200 percent through the 1980s,[2] reaching its peak at nearly $73 billion in 1989.[3] This massive increase brought with it intense debate regarding the extent to which foreign countries should invest in the United States.[4] The cornerstone of this debate was the increasing Japanese role in the United States economy. The global success of the Japanese economy, combined with several highly publicized acquisitions in the United States, led many people to fear that Japan was buying our country.[5]

Since 1989, however, FDI in the United States has plummeted. The 1992 level of $13.5 billion marked the lowest since 1983, representing a 47 percent decline from 1991, and a 61 percent decline from 1990.[6] Japanese direct investment in the United States fell 57 percent

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1. EDWARD M. GRAHAM & PAUL R. KRUGMAN, FOREIGN DIRECT INVESTMENT IN THE UNITED STATES, 1991. Foreign Direct Investment is defined as ownership of 10 percent of the assets of a foreign resident for purposes of controlling the use of those assets. FDI, which is fundamentally distinct from international trade in that it deals solely with a long-term investment for the manufacture and marketing of goods and/or services in the foreign country, comes in two general forms: (1) creation of assets by foreigners, called "greenfield investments" and (2) purchase of existing assets by foreigners. *Id. See also* Deanne Julius, *Foreign Direct Investment: The Neglected Twin of Trade* (GROUP OF THIRTY, NO. 33, 1991) at 2.

2. *See* GRAHAM & KRUGMAN, *supra* note 1, at 2.

3. *See id.* at 21.

4. Robert T. Kudrle, *Good for the Gander? Foreign Direct Investment in the UnitedStates*, 45 INT'L ORG. 397 (1991). "The political issue of the '90's isn't going to be imports; its going to be the foreign invasion of the United States." *Id.* at 398 (quoting Paul R. Krugman, Massachusetts Institute of Technology Economist, *Foreign Firms Build U.S. Factories, Vex American Rivals*, WALL ST. J., July 24, 1987, at A6).

5. Ilana Debare, *Rising Sun, Generates Heated Debate on Japan's Power*, Sacramento Bee, August 1, 1993, at A1 (discussing Michael Crichton's novel and movie "Rising Sun" which illustrates the American fear and distrust towards the Japanese, based partially on Japanese purchases in the 1980s of American landmarks, such as Pebble Beach Golf Course and the Rockefeller Center).

6. Mahnaz Fahim-Nader, *U.S. Business Enterprises Acquired or Established by Foreign Direct Investors in 1992*, SURVEY OF CURRENT BUSINESS, May 1993, at 113.

in 1992, which followed a 73 percent decrease in 1991.[7] People are now asking themselves: "where has all the money gone?"

This analysis of the decrease of FDI in the United States will assume that FDI represents a value to America and should not be feared or avoided.[8] Japanese investment in particular has been and should continue to be a valuable source of investment capital, which, in the long run, translates into American jobs,[9] technological progress,[10] and the fostering of American competitiveness.[11]

### *A. Disturbing Trends*

When viewed from a global perspective, the recent decrease in Japanese direct investment in the United States reveals disturbing trends. First is the economic explosion of Southeast Asia. The 1980s, were considered by many to be the decade of Asia's economic ascendancy,[12] with Japanese investment reaching unprecedented levels in Southeast Asian countries.[13]

Another disturbing trend is the constant promulgation of laws and regulations passed in the United States which directly or indirectly increase the cost of doing business. While many of these laws represent positive social progress, oftentimes the threat of liability and subsequent enforcement of these laws causes frequent litigation and punitive dam-

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7. *Id.*

8. *Foreign Direct Investment in the United States, Hearings Before the Cong. Joint Econ. Comm.*, 102nd Cong., 2nd Sess., May 13, 1992. (hereinafter Hearings) (quoting Karl P. Sauvant, acting Asst. Dir., Research & Policy Analysis Branch, Transnational Corporations & Management Division, United Nations Dept. of Economic & Social Development). "Because of its absolute and relative importance to flows of trade, technology and training, FDI is today the most important form of international economic transaction." *Id.*

9. *See, e.g.*, GRAHAM & KRUGMAN, *supra* note 1, at 57-59.

10. *Hearings, supra* note 8, at 3 (arguing that Foreign Direct Investment is the principal source of technology transfer).

11. *See, e.g.*, GRAHAM & KRUGMAN, *supra* note 1, at 57-59; *cf.* TOLCHIN & TOLCHIN, BUYING INTO AMERICA: HOW FOREIGN MONEY IS CHANGING THE FACE OF OUR NATION, 1988 (arguing the negative side of FDI in the United States, claiming that the Japanese are stealing American jobs and threatening national security).

12. HAZEL J. JOHNSON, DISPELLING THE MYTH OF GLOBALIZATION: THE CASE FOR REGIONALIZATION 38 (1991).

13. *Id.* at 32; *see also* THOMAS ANDERSSON, THE ROLE OF JAPANESE FOREIGN DIRECT INVESTMENT IN THE 1990's (The Industrial Institute for Economic and Social Reform Working Paper No. 329, 1992).

ages, which has a negative effect on businesses operating in the United States.[14]

The recent trend of economic protectionism, commonly referred to as "Japan bashing" because of its xenophobic characteristics,[15] acts as another disincentive to Japanese direct investment.[16] From a legal perspective, Japanese investors fear harassment in the form of meritless claims, or in a worst case scenario, punitive damages imposed by a prejudiced American jury.[17] More fundamental than potential "legal costs", however, are the actual "business costs" of anti-Japanese rhetoric. Although there are legal loopholes for the Japanese corporation to escape liability, the social and political friction which results from a direct investment in the United States translates into real operating costs for breaking into the American market. The realistic Japanese investor understands the long-term effects of operating in the United States and therefore must anticipate future laws and regulations and execute strict compliance in order to overcome the inherent and sometimes unfair bias against Japanese business. These economic anti-Japanese biases stand in stark contrast to Southeast Asian nations which, not only welcome, but actively recruit Japanese direct investment.[18]

### *B. The Changing World Economy*

The economic dynamics of the world are changing almost daily. The United States is no longer the only market attracting international

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14. This Comment recognizes the social values of moderate business regulation and does not advocate the total elimination of environmental and employment discrimination laws. However, the negative effect of American laws on businesses operating in the United States is undeniable and mandates a closer look at the vast amount of regulations and the burdens placed on business.

15. This Comment does not discuss whether economically-based anti-Japanese rhetoric is an accurate reflection of the American market, or more a politically popular media creation. What is important for this discussion is the Japanese perception that Americans have an existing bias against Japanese business.

16. *See, e.g.*, Gerald Pascual, *State Buy American Laws in a World of Liberal Trade*, 7 CONN. J. INT'L L. 311 (1992) (describing purpose and effect of "buy American" statutes, which impose restrictions on the purchase of foreign goods when goods are purchased by or for the enacting state).

17. *See, e.g.*, Alfred W. Cortese Jr. & Kathleen L. Blaner, *Civil Justice Reform in America: A Question of Parity with Our International Rivals*, 13 U. PA. J. INT'L BUS. L. 1 (1992). Similarly, American businesses often complain about the existing tort and product liability systems, which arguably prevent them from competing internationally because of the increased legal and insurance costs. *See, e.g.*, Alfred W. Cortese & Kathleen L. Blaner, *The Anti-Competitive Impact of U.S. Product Liability Laws: Are Foreign Businesses Beating Us At Our Own Game?*, 9 J.L. & COMM. 167 (1990).

18. *See* Camellia Ngo, *Foreign Investment Promotion: Thailand as a Model for Economic Development in Vietnam*, 16 HASTINGS INT'L & COMP. L. REV. 67 (1992).

investors. Currently, many parts of the world are experiencing unprecedented economic opportunity; the fall of communism has opened up previously closed markets in Eastern Europe, and Southeast Asia is quickly moving from third world status to a world economic superpower.[19] Southeast Asia today represents a formidable competitor for Japanese investment. The traditional American laws and regulations inhibiting the flow of business, which were overlooked for years because of the superiority of the American market, now demand additional scrutiny. Those laws and regulations, which investors may have tolerated as necessary legal hassles ten years ago, have evolved into substantial legal disincentives to foreign direct investment in the United States.

This Comment focuses on two of the major legal disincentives to foreign investors operating businesses in the United States: environmental law and labor and employment law. Since much has already been written on these laws from the perspective of American business,[20] this Comment focuses on the perspective of the foreign investor, and in particular the Japanese investor.[21] The Comment begins with an analysis of recent trends of Southeast Asian regionalization and how Japan has redirected much of her investment focus toward the developing countries of Southeast Asia. These American legal disincentives and the economic regionalization of Southeast Asia have combined to deter valuable Japanese direct investment from the United States.

## II. JAPAN'S REGIONALIZATION OF SOUTHEAST ASIA

There are increasing signs of economic regionalization throughout the world.[22] The current world economy, often referred to as the "Triad," consists of the three major economic regions of the European Community (EC), the Americas, and Asia.[23] Although not formally involved with a regional trade group such as the EC or NAFTA, Japanese trade and investments over the past decade reveal strong trends of regionalization.[24]

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19. *Hearings*, *supra* note 8, at 13 (citing testimony of Edward J. Ray, Prof. of Econ. Ohio State Univ.).

20. *See* Cortese & Blaner, *Civil Justice Reform in America: A Question of Parity With Our International Rivals*, 13 U. PA. J. INT'L BUS. L. 1, 5 (1992) (discussing the President's Council on Competitiveness: Agenda for Civil Justice Reform).

21. *See, e.g.*, Fahim-Nader, *supra* note 6, at 7. Japan represents the largest single country source of foreign direct investment in the United States. *Id.*

22. *See* JOHNSON, *supra* note 12, at 1; *see also* Joseph L. Brand, *The New World Order of Regional Trading Blocks*, 8 AM. U. J. INT'L L. & POL'Y 155.

23. *Hearings*, *supra* note 8, at 9.

24. *See* JOHNSON, *supra* note 12, at 32.

### *A. The United States as a Declining Japanese Market*

Japan views the United States, and possibly the entire Western Hemisphere, as a trading partner of declining importance.[25] Total investments from Japanese investors to acquire or establish an American business decreased 57 percent in 1992, following a 73 percent decrease in 1991.[26] This substantial decrease resulted in part to a sluggish Japanese economy, whose declining stock prices and reduced corporate profits restrained many Japanese corporations from investing overseas.[27]

Of at least equal importance has been the sluggish American economy and the decreasing returns on Japanese investments in the United States, particularly in real estate.[28] In addition, the incentive to invest in the United States has decreased due to the constant political friction surrounding Japanese investments.[29] Japan's desire to establish a local presence is now confronted with an arguably realistic Japanese concern that they have been targeted as scapegoats for America's domestic problems.[30]

Existing Japanese companies in the United States have responded by attempting to "Americanize" their products and operations.[31] For certain Japanese products, such as high-tech consumer goods, the United States will remain the premier market due to the comparatively high wealth and the American consumer's willingness to spend. However, the Southeast Asian economy has exploded into the fastest growing economic region in the world and now represents a very real competitor for much of Japan's future FDI.[32]

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25. *Id.*

26. Fahim-Nader, *supra* note 6, at 113 and accompanying text.

27. *Id.*

28. *Id. See also* Debare *supra* note 5; GRAHAM & KRUGMAN, *supra* note 1, at 28 ("Of all the various aspects of Foreign Direct Investment in the United States, the ownership of U.S. real estate has emerged as one of the most sensitive."); *and see* DENNIS LAURIE, YANKEE SAMURAI: AMERICAN MANAGERS SPEAK OUT ABOUT WHAT IT'S LIKE TO WORK FOR JAPANESE COMPANIES IN THE U.S., 38 (1992) ("My God, came the cry of the 1980s, the Japanese are buying the United States! My God, comes the cry of the early 1990s, the Japanese are selling the United States!").

29. *See* ANDERSSON, *supra* note 13, at 17.

30. *Id.*; *see also* Donald D. Jackson, *Tilting the Playing Field: Japan's Unwarranted Advantage Under the Civil Rights Act of 1991 and Fortino v. Quasar Co.*, 28 TEX. INT'L L.J. 391 ("Tensions between the U.S. and Japan recently entered a new era after the demise of Soviet Communism eliminated traditional defense ties as an excuse to overlook Japanese 'sins'. Many now view Japan as a clear threat to United States business, and economic competition between the two nations has become a priority.").

31. *See* ANDERSSON, *supra* note 13, at 17.

32. *Id.* at 2. *See also Japanese Manufacturing; Asian Promise*, THE ECONOMIST, June

### *B. The Growing Southeast Asian Market*

The Pacific Basin has surpassed the Atlantic Basin as the core of world economic relations.[33] This dramatic upsurge in Asian prosperity is largely due to Japanese assistance and investment, which for years has been the main supply of direct investment capital in Asia.[34] This increasing flow of Japanese capital and investment has strengthened Japan's economic grip on Southeast Asia, giving it the form, appearance, and effects of a regional trading bloc.[35]

Japan's preference for Southeast Asia may be most apparent through its investment in developing countries such as Indonesia and Malaysia.[36] Japan increased its governmental loans to developing Asian countries by $23 billion from 1985-88, most of it specifically targeted for the building of infrastructure, such as roads and ports, in order to accommodate Japanese investors with a more efficient production and marketing of goods within Southeast Asia.[37] The location and purposes of these government loans are tailored to the plans of Japanese industry, and are largely influenced by the particular country's division of labor.[38] For example, Indonesia has been targeted for the production of textiles, forest products and plastics, while loans to Malaysia are earmarked for the manufacture of sneakers, photocopiers, and television picture tubes.[39]

The opening up of China's markets is another factor in Japan's trend toward Southeast Asian regionalization. Although the short-term future of China's economy remains a mystery, the potential size of the

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12, 1993, at 74. Although Japanese investment decreased worldwide, Japanese foreign direct investment in Southeast Asia rose from 12 percent in 1990 to currently 19 percent of its total foreign direct investment. *Id.*

33. *See* ANDERSSON, *supra* note 13, at 26; *see also* JOHNSON, *supra* note 12, at 42-43 ("Massive shifting of world wealth and by 1989, Japan, Taiwan, China, South Korea, Singapore, Malaysia, Indonesia and Thailand controlled close to 1/3 of the official financial resources of the world.").

34. *See* ANDERSSON, *supra* note 13, at 26. In 1989, Japanese investment in Asia was five times that of American investment in the area. *Id. See also* Johnson, *supra* note 11, at 29.

35. *See* JOHNSON, *supra* note 12, at 29; *see also* John Burgess, *Trade Blocks: Friend or Foe? In Asia, if it looks like a Trade Bloc . . . Some say Japan and its Neighbors Have the Earmarks of One*, WASH. POST, June 2, 1991, at H1 ("Even though the countries of Asia don't call themselves a trade bloc, Japanese trade and investment in the region suggests otherwise."); *and see Japan ties up the Asian market*, THE ECONOMIST, April, 24, 1993, at 33.

36. *See* Julius, *supra* note 1, at 9-11; *see also* JOHNSON, *supra* note 12, at 30.

37. *See* JOHNSON, *supra* note 12, at 14.

38. *Id.*

39. *Id.*

Chinese consumer market of over 1.2 billion people commands the attention of Japanese investors.[40] Japan has already invested heavily in China's coastal provinces, the principal areas of Chinese economic development.[41]

Japan's investment in China also promotes Asian regionalization due to China's high level of interaction with Taiwan, Hong Kong, Macao, and Singapore.[42] These countries, referred to as the "2-3 Chinas" illustrate the institutional and cultural similarity between the Southeast Asian nations.[43] Furthermore, this interaction should increase in 1997 when Hong Kong returns to Chinese sovereignty.[44]

A number of economic and political factors will continue to pull Japanese direct investment to Southeast Asian countries through the 1990s.[45] Favorable economic policies and conditions, including open trade, low taxes, and high growth potential, provide a profitable environment for investment.[46] In addition, the political policies of these countries make economic development a national priority and thus welcome Japanese investment.[47] Finally, the similar institutional and cultural conditions of Southeast Asia promote a work ethic easily managed and motivated by the Japanese.[48]

Two examples of this welcome attitude towards Japanese direct investment are Vietnam and Thailand.[49] Vietnam is widely recognized as the "next Asian tiger" due to its abundant and inexpensive labor force and its large energy reserves.[50] Vietnam correspondingly recog-

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40. *See* Murray Weidenbaum, *Greater China: A New Economic Colossus?*, WASH. QUARTERLY, at 71 (Autumn 1993) ("It is no exaggeration to state that greater China is a potential economic superpower.").

41. *Id.* at 72; *see also* Burgess, *supra* note 35 ("Tens of thousands of people in Singapore, Thailand and China's coastal cities report daily to Japanese owned factories.").

42. *See* Weidenbaum, *supra* note 40, at 71

43. *Id.*

44. *See, e.g.*, Matt Miller, *China pours cash into Hong Kong—Down payment on future of city it takes over in '97*, SAN DIEGO TRIB., July 25, 1993, at A-1.

45. *See* ANDERSSON, *supra* note 13, at 8. In the 1980s, the drastic increase of Japanese direct investment in Southeast Asia as shown through stock relative to GDP: Thailand from 1.2 to 5.1 percent; Hong Kong from 4.2 to 17.3 percent; Singapore from 7.6 to 22.2 percent; and Malaysia from 2.4 to 6.7 percent. *Id.*

46. *Id.* at 16.

47. *Id. See also* ELLIOTT J. HAHN, JAPANESE BUSINESS LAW AND THE LEGAL SYSTEM 113-29, (1984). Heavy cooperation between government and big business is a trademark of "Japan Inc.," and represents a fundamental difference between Japan and the United States.

48. *Id.*

49. *See* Ngo, *supra* note 18, at 67.

50. *Id.*

nized that foreign investment is an efficient and necessary vehicle for reaching economic prosperity, and to this end passed the Law on Foreign Investment (FIL) in 1987.[51] The FIL represents one of the most liberal foreign investment codes of any developing nation, although it still requires government approval prior to proposed FDI activity.[52]

Thailand's Investment Promotion Act is an even more liberal foreign investment code.[53] The Thai Act requires no prior government approval of foreign investment and encourages all such activity to begin immediately.[54] This Act, passed in 1977, is responsible for the massive influx of FDI into Thailand during the 1980s, which resulted in double digit annual economic growth rates.[55]

### C. *The EC as an Alternative*

During the recent slowdown of Japanese direct investment in the United States, the EC has evolved into another alternative for Japanese investors.[56] The harmonization of trade laws, German reunification, and the opening up of eastern European economies has resulted in a European consumer market with a potentially greater demand than the United States.[57] Furthermore, the establishment of a single common market makes the EC increasingly attractive to Japanese investors.[58] In addition, similar to the nations of Southeast Asia, the majority of EC member nations welcome FDI by offering investment incentives.[59]

### D. *Summary*

The recent trend of economic regionalization throughout the world, especially the regionalization of Southeast Asia, has begun to redirect Japanese investment focus. The recent decrease of Japanese direct investment in the United States, combined with the general decrease of American economic influence worldwide, mandates an examination

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51. *Id.*
52. *Id.* at 68.
53. *Id.*
54. *Id.*
55. *Id.* at 67. *See also* ANDERSSON *supra* note 13, at 9 (The influx of FDI into Thailand included a 325 percent increase in Japanese direct investment from 1979-89).
56. *See* ANDERSSON, *supra* note 13, at 17-18 (Of total Japanese direct investment in Europe from 1951-1989, over two-thirds occurred after 1985).
57. *See* JOHNSON, *supra* note 12, at 31.
58. *See* ANDERSSON, *supra* note 13, at 18-19.
59. *Id. See also* Julius *supra* note 1, at 11.

of the legal disincentives to foreign direct investment in the United States.

## III. ENVIRONMENTAL LAW

A threshold legal issue confronting the Japanese investor is the American environmental movement. The massive increase in environmental legislation, combined with current social and political views, has placed environmental concerns at the forefront of corporate America.[60] The cost of complying with complex, constantly changing laws and regulations is a heavy burden on businesses operating in the United States.[61] These costs, which are a major consideration to the potential Japanese investor, act as a legal and economic disincentive to foreign direct investment in the United States.[62] An initial compliance cost for the potential Japanese investor involves understanding the relevant laws and regulations applicable to the investor's business. Although a comprehensive description is beyond the scope of this Comment, a brief overview of the main federal environmental regulations and their applicability to the foreign investor is given below.[63]

### *A. The Clean Air Act*

The Clean Air Act regulates the discharge of stationary and moving sources of air pollution.[64] One of the first major pieces of environmental legislation passed in the United States, the Clean Air Act presents a complex set of regulations to the foreign investor.[65] The Japanese investor, whether investing in a new or existing business, should be

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60. John Smith, *Clean Up Costs,* BUS. NEWS, September 25, 1991, at 20 ("A CEO of a Fortune 50 company calls the environment 'the single most important business issue facing corporate America in the 1990's.'").

61. *Id.* A 1991 Price Waterhouse survey classifies compliance with environmental regulations as a "staggering" cost to corporate America. *Id.*

62. *See* Scott H. Peters, A *Guide for Foreign Investors to Environmental Laws in the United States,* 28 SAN DIEGO L. REV. 897 (1991). American environmental regulations are just one of the legal disincentives to foreign direct investment and the existence of numerous scholarly writings regarding American environmental regulations precludes an extensive discussion. *Id.*

63. *See id.* for a comprehensive discussion of the relevant environmental laws and regulations for the potential foreign investor.

64. 42 U.S.C.A. §§ 7401-7642 (West Supp. 1993).

65. *See* Peters, *supra* note 62, at 903 (citing Delaware Valley Citizens Council for Clean Air v. Davis, 932 F.2d 256, 260 (3rd Cir. 1991)) ("The arcane knowledge essential to resolve . . . disputes [over appropriate air pollution control measures under the Act] is foreign to non-experts, including judges.").

especially aware of certain "nonattainment areas"[66] which may impose abnormally strict controls on a business' emission standards.[67] In addition, the foreign investor must thoroughly investigate whether the potential investment involves hazardous air pollutants, which are strictly regulated under the Clean Air Act.[68] Although the applicability of the Clean Air Act to foreign investors depends largely on the type and location of the investment, Japanese investors must factor in compliance with the Clean Air Act when estimating his operating costs.[69]

### B. *Federal Water Pollution and Control Act*

The Federal Water Pollution and Control Act (Clean Water Act) regulates discharges of pollutants into the waters of the United States.[70] Enforcement of the Clean Water Act is ensured by the National Pollutant Discharge Elimination System (NPDES), from whom permits must be obtained.[71] The Japanese investor must determine whether the potential investment enterprise discharges toxic pollutants into American waters,[72] and should also investigate the location's "point sources."[73] In addition, the potential investor should investigate whether an existing target business is in total compliance with the Clean Water Act requirements.

### C. *The Resource Conservation and Recovery Act*

The Resource Conservation and Recovery Act (RCRA) regulates the generation, storage, transportation, treatment, and disposal of hazardous waste,[74] and requires the owner or operator of a facility engaging

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66. *Id.* Nonattainment areas are specific locations which do not meet the National Ambient Air Quality Standards (NAAQS) prescribed by the Clean Air Act. *Id.*

67. *Id.* at 903, n.56.

68. *Id.* at 903, n.58 (citing 42 U.S.C. § 7412 (West Supp. 1993) (listing of hazardous air pollutants)).

69. *Id.* at 904 (citing 42 U.S.C. § 7413 (West Supp. 1993) (authorizing monetary fines, imprisonment, or both on "any reponsible corporate officer" for failure to comply with the Clean Air Act)).

70. 33 U.S.C.A. §§ 1251-1387 (West Supp. 1993).

71. *See* Peters, *supra* note 62, at 905, n.73 (citing 40 C.F.R. §§ 121-125 (1991) (NPDES regulations)).

72. Peters, *supra* note 62, at 905, n.71 (citing 33 U.S.C. § 1317 (1988)). Discharges of toxic pollutants are regulated under stricter standards. *Id.*

73. Peters, *supra* note 62, at 904, n.69 (citing 33 U.S.C. § 1362(14) ("A 'point source' is any discernible, confined and discrete conveyance, including . . . any pipe, ditch, channel, tunnel, conduit . . . from which pollutants are or may be discharged.")).

74. *See* Peters, *supra* note 62, at 906 ("Hazardous waste is certain listed waste and other waste which is ignitable, corrosive, reactive, or toxic.").

in *any* of these activities to comply with statutory requirements.[75] The Japanese investor must initially determine whether the proposed investment involves hazardous waste, and then research the business' previous compliance with RCRA regulations. The RCRA transportation provisions pose a particular source of confusion to the investor because individual states impose different standards on the movement of hazardous waste, thus requiring manifests for passage through particular states.[76]

### *D. The Comprehensive Environmental Response, Compensation and Liability Act*

The Comprehensive Environmental Response, Compensation and Liability Act (CERCLA or "Superfund") addresses the cleanup of waste from previous activities.[77] CERCLA is especially important to foreign investors due to its broad scope of liability and the potential liability for cleanup costs.[78] In general, American courts have liberally assigned liability for CERCLA cleanup costs.[79]

CERCLA imposes strict liability,[80] and more importantly for the foreign investor, this liability may be applied retroactively.[81] There is no minimum standard for a hazardous release, and therefore any traceable amount of a hazardous substance is sufficient to support liability.[82] Courts have extended the already broad scope of liability

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75. 42 U.S.C.A. §§ 6901-6991i (West Supp. 1993).

76. Peters, *supra* note 62, at 906.

77. 42 U.S.C.A. §§ 9601-9675 (West Supp. 1993).

78. *See* Peters, *supra* note 62, at 907-08. "These cleanup costs may include costs of monitoring, investigation, laboratory fees, and fees of contractors and consultants." *Id.* at 908, n.103.

79. *See, e.g.*, Witco Corporation v. Beekhiius, 822 F.Supp. 1084 (D. Del. 1993); *see also* U.S. v. Reilly Tar & Chemical Corporation, 546 F.Supp. 1100, 1112 (D. Minn. 1982) ("CERCLA should be given a broad and liberal construction.").

80. 42 U.S.C.A. § 9601(32) (West Supp. 1993); *see* U.S. v. Alcan Aluminum Corp., 990 F.2d 711, 721 (2d Cir. 1993) ("What is not required is that the government show that a specific defendant's waste caused incurrence of clean-up costs."); *see also* U.S. v. Monsanto Co., 858 F.2d 160 (4th Cir. 1988) ("[A]pplying liability without regard to fault, knowledge, or intent.").

81. 42 U.S.C.A. § 9607(a) (West Supp. 1993); *see also* Peters, *supra* note 62, at 910. The statute classifies those statutorily responsible into three general categories: (1) current and post owners or operators of facilities from which a hazardous substance has been released; (2) those who arranged for disposal of hazardous substances at such facilities; (3) and those who transported the hazardous substances to such facilities. *Id.* at 910-11.

82. *See Alcan Aluminum*, 990 F.2d at 720; *see also* Peters, *supra* note 62, at 908, (citing Eagle-Pitcher Indus. v. EPA, 759 F.2d 922, 927-31 (D.C. Cir. 1985)).

under CERCLA to pierce the corporate veil and reach the shareholders.[83] This potentially extends liability to a foreign parent corporation for any environmental responsibilities of its American subsidiary. Liability under CERCLA is joint and several, and unless the defendant corporation can show a reasonable basis for apportionment, one "deep pocketed" corporation may be held liable for all cleanup costs.[84]

The crippling effects that Superfund liability imposes on a business has sparked a recent movement to remove retroactive and joint and several liability.[85] This movement focuses on channelling money towards the actual cleanup of toxic waste sites, rather than towards the legal and transactional costs inherent in retroactive and joint and several liability.[86] For American businesses, this represents a positive response to their consistent complaints that the Superfund program has weakened their ability to compete internationally. However, for the Japanese investor's estimation of the long-term business costs of operating in the United States, Superfund continues to threaten investments with potentially business-crippling liability.

### *E. Costs of Compliance to the Foreign Investor*

The complex set of American environmental laws and regulations is a significant factor for the Japanese investor in calculating the costs of doing business in the United States. Notwithstanding the cost of

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83. *See* Donahey v. Bogle, 987 F.2d 1250 (6th Cir. 1993); *see also* New York v. Shore Realty Corp., 759 F.2d 1032 (2d Cir. 1985) (holding that an owning stockholder who was managing the corporation was liable, and even suggested that active management may not be necessary to trigger CERCLA liability).

84. *See* Chesapeake and Potomac Telephone Co. of Virginia v. Peck Iron & Metal Co., 814 F.Supp. 1269, 1278 (E.D. Va. 1992), (citing *Monsanto*, 858 F.2d at 171 n.22) ("[E]quitable factors are not pertinent to the question of joint and several liability which focuses principally on the divisibility among responsible parties of the harm to the environment.").

85. *See* Environmental Protection Agency v. Sequa Corporation, 3 F.3d 889 (5th Cir. 1993) (holding that joint and several liability cannot be imposed if there is a reasonable way of apportioning damages); *see also A Clean Shot at Superfund*, BUS. INS., Oct. 18, 1993, at 8. The U.S. Treasury Department is calling for a radical overhaul of the Superfund liability scheme by eliminating retroactive and joint and several liability for cleanup costs. *Id. And see EPA Administrator calls for Sweeping Reform of Superfund Law*, PR Newswire, November 8, 1993 (calling for reform of Superfund law which needs "not just cosmetic changes, but a fundamental change.").

86. *Superfund Slammed in Study by I.I.I.*, NAT. UNDERWRITER, February 1, 1993 at 13.

actual liability,[87] the mere threat of litigation and cost of complying with the mass of constantly changing regulations serves as a strong disincentive to foreign investors.[88] In particular, the unique American "three-tier" legislative structure forces the potential investor to conduct a time-consuming investigation into the environmental laws of the federal government (EPA), the individual state, and the specific community or municipality of the potential investment.

The Japanese investor should first investigate all federal laws and regulations relevant to the proposed investment.[89] The potential investor must also research relevant state law, as many states impose more stringent regulations than does the EPA.[90] In addition, environmental laws and regulations differ between states, an issue particularly important to the transportation of "hazardous materials."[91] Finally, the Japanese investor must take notice of the laws and regulations, particularly zoning, of each community or municipality where he might locate his investment.[92]

The Japanese investor must make a complete environmental audit of the proposed site or location.[93] This audit should include inquiries to ensure current compliance with all existing laws and regulations.[94] The potential investor should investigate past owners of the property to ensure their compliance with environmental regulations in order to prevent retroactive liability.[95] Finally, the investor should investigate all adjoining sites to prevent liability for environmental violations caused by a neighboring site.[96]

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87. *See* Peters, *supra* note 62, at 902 (*citing* Sterling v. Velsicol Chem. Corp., 647 F.Supp. 303 (W.D. Tenn. 1986)). The court awarded $7.5 million in punitive damages for hazardous waste disposal. *Id.*

88. *Id.* at 930.

89. *See id.* at 930-32.

90. *See* Reed D. Rubinstein & Timothy M. Wittebort, *Environmental Law and Foreign Investment in the United States and in the EEC: A Practitioner's Guide*, 69 MICH. B.J. 642 (1990).

91. *See* Peters, supra note 62, at 906. For example, classification of material as "hazardous waste" in a particular state requires a manifest to transport through that state, regardless of whether the state where the shipment originated classified it as "hazardous waste." *Id.*

92. A vital factor in determining where to locate a business in the United States is whether the municipality and its local enforcement agencies hold a cooperative or an adversarial attitude between environmental and business concerns.

93. Janie L. Rosman, *Worried Buyers, Wary Lenders Hunting Out Ugly Environmental Surprises*, WESTCHESTER COUNTY BUS. J., January 18, 1993, at 11.

94. *See* Peters, *supra* note 62, at 932.

95. *See id.* at 930-32.

96. *Id.* at 931.

Once the investigation is complete, the potential investor must still factor in compliance with these regulations. Investment in an existing business may incur substantial costs to update technology in order to maintain a proactive stance towards environmental compliance. If the investment is made into a new business or a corporate relocation from another country, the Japanese investor faces massive training costs in order to emphasize absolute compliance with these complex environmental laws and regulations.

## IV. LABOR AND EMPLOYMENT LAW

A second threshold issue confronting the Japanese investor is the recent explosion of American employment discrimination law. Employers in the United States are subjected to a barrage of legislation regulating the employer/employee relationship, which promotes increased litigation over alleged employer discrimination. The resulting surge in litigation imposes increasing costs on employers, and acts as a significant disincentive to foreign direct investment in the United States.

The constantly changing employment laws and regulations warrant a brief description of the major pieces of legislation relevant to the foreign investor. Title VII of the Civil Rights Act of 1964 (Title VII) forbids employment decisions to be made on the basis of race, color, religion, sex, or national origin.[97] The Age Discrimination in Employment Act (ADEA) prohibits employers from making employment decisions on the basis of age.[98] The American Disabilities Act (ADA) protects persons with disabilities from employment discrimination.[99]

The Civil Rights Act of 1991 ('91 Act), which amended both Title VII and the ADEA in order to strengthen federal employment discrimination law, is especially relevant to the foreign investor.[100] By allowing compensatory *and* punitive damages for intentional discrimi-

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97. 42 U.S.C.A. §§ 2000e-2000e(17) (West Supp. 1993).

98. 29 U.S.C.A. §§ 623-634 (West Supp. 1993). The ADEA prohibits employers from refusing to hire, discharging, or otherwise discriminating against, individuals 40 years old or older with respect to compensation, terms, conditions or privileges of employment because of the individual's age. *Id.*

99. 42 U.S.C.A. §§ 12112-12117 (West Supp. 1993). The ADA prohibits private employers from discriminating against disabled job applicants and requires the employer to make a "reasonable accommodation." *Id.*

100. 42 U.S.C.A. §§ 2000e-2000-e-2 (West Supp. 1993); *see also* Jeffrey A. Blevins & Gregory J. Schroedter, *The Civil Rights Act of 1991: Congess Revamps Employment Discrimination Law and Policy,* 80 ILL. B.J. 336.

nation, the '91 Act exposes a Japanese corporation to increased liability at the discretion of an unpredictable jury.[101] The '91 Act also expressly provides for disparate impact claims of employment discrimination,[102] although courts appear reluctant to apply this disparate impact theory to foreign-owned corporations.[103]

### *A. Discrimination on Basis of Race or National Origin*

American employess have brought numerous claims against foreign-owned corporations for employment discrimination on the basis of race or national origin.[104] The bulk of this litigation revolves around the conflict between Title VII[105] and the particular Friendship, Commerce and Navigation Treaty (FCN) of the foreign corporation's home country.[106] Specifically, the employer choice provision in the U.S.—Japan

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101. *Cf.* 42 U.S.C.A. § 2000e-2(102)(b)(3) (West Supp. 1993). Recognizing the substantial increase in potential liability, the '91 Act imposes caps on recoverable damages based on the size of the employer's workforce: 15-100 employees capped at $50,000; 101-200 employees capped at $100,000; 201-500 employees capped at $200,000; 500 + employees capped at $300,000. *Id.*

102. 42 U.S.C.A. 2000e-2(k) (West Supp. 1993). The '91 Act expressly overturned Wards Cove Packing Co. v. Atonio 490 U.S. 642 (1989), which had severely limited an employee's ability to bring disparate impact claims. *Id.*

103. *See* Fortino v. Quasar Co., 950 F.2d 389 (7th Cir. 1991); *see also* MacNamara v. Korean Air Lines, 863 F.2d 1135 (3rd. Cir. 1989).

104. *See, e.g.*, Adames v. Mitsubishi Bank, Ltd., 751 F.Supp. 1548 (E.D.N.Y. 1990); *Fortino*, 950 F.2d at 393; *MacNamara*, 863 F.2d at 1140-41; Wickes v. Olympic Airways, 745 F.2d 363 (6th Cir. 1984); Sumitomo Shoji America Inc. v. Avagliano, 457 U.S. 176 (1982); Speiss v. C. Itoh & Company (America) Inc., 643 F.2d 353 (5th Cir. 1981).

105. 42 U.S.C. §§ 2000e-2000e(17) (1988) (Title VII forbids employment discrimination on the basis of race, color, religion, sex, or national origin. An exception is granted to the extent that the characteristics relied upon can be shown to be a "bona fide occupational qualification" (bfoq). *See also* Goyette v. DCA Advertising, 1993 WL 334712 (holding that a Japanese subsidiary failed to satisfy the bfoq requirements based on a failure to show that the position required: (1) Japanese linguistic or cultural skills, (2) knowledge of Japanese products, markets, customs and business practices; (3) familiarity with the parent enterprise in Japan; (4) acceptability to those with whom the company does business).

106. *See* Gerald B. Silver, *Friendship, Commerce and Navigation Treaties and United States Discrimination Law: The Right of Foreign Companies to Hire Executives of Their Choice*, 57 FORDHAM L. REV. 765 (1989). FCN: Treaties were passed shortly after World War II with the intent of encouraging foreign investment by ensuring fair and equal treatment of foreign corporations. *Id.* at 765.

FCN Treaty,[107] which gives Japanese corporations carte blanche in hiring "executives, managers, and any other specialist," conflicts with Title VII's prohibition of employment decisions based on race or national origin.

Courts have adopted conflicting views on the applicability of Title VII to foreign-owned corporations, largely based on the interpretation of the intent and weight of the existing FCN Treaty.[108] For instance, a literal reading and broad interpretation of the employer choice provision in the U.S.—Japan FCN Treaty gives a Japanese-owned business the ability to hire executive personnel based on whatever criteria they choose, with total immunity from Title VII.[109]

However, the trend is toward a more restrictive interpretation of the FCN treaty, which argues that the employer choice provision gives foreign corporations the authority to make employment decisions on the basis of *citizenship,* and is therefore distinguishable from Title VII's prohibition of employment discrimination based on *national origin.*[110] It is unclear under this limited interpretation exactly how much, if any, Title VII immunity an FCN treaty confers on a foreign corporation.[111]

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107. TREATY OF FRIENDSHIP, COMMERCE AND NAVIGATION, April 2, 1953, United States—Japan, art. VIII, 4 U.S.T. 2063, T.I.A.S. No. 2864 (hereinafter Treaty) ("Companies of either Party shall be permitted to engage, within the territories of the other Party, accountants and other technical experts, executive personnel, attorneys, agents and other specialists of their choice.").

108. *See* Silver, *supra* note 106, at 771-74.

109. *See* Speiss, 643 F.2d at 353 (basing its broad interpretation on argument that subjecting foreign corporations to Title VII liability would negatively affect foreign investment). *See also* Pauling C. Reich, *After Avagliano v. Sumitomo Shoji America, Inc.: What Standard of Title VII will Apply to Foreign-Owned U.S. Subsidiaries and Branches?*, 10 B.C. THIRD WORLD L.J. 259 (1990), (quoting the Japanese External Trade Organization's amicus brief in Avagliano) ("To limit the right [under Title VII] of Japanese investors to control and manage their enterprises in the United States . . . will tend to discourage such mutually beneficial investment.").

110. *See Fortino*, 950 F.2d at 392-93 ("[A contrary holding would have] Title VII taking back from the Japanese with one hand what the treaty had given them with the other."). *See also MacNamara* 863 F.2d at 1144. *And Wickes*, 745 F.2d at 366-67.

111. *See Fortinio*, 950 F.2d at 393 (holding expressly refused to articulate how much immunity from Title VII an FCN treaty confers on the foreign corporation); *cf. MacNamara* 863 F.2d at 1140-41 ("We agree . . . that Article VIII(1) goes beyond securing the right to be treated the same as domestic companies and that its purpose, in part, is to assure foreign corporations that they may have their business in the host country managed by their own nationals if they so desire. We also agree . . . that Article VIII(1) was not intended to provide foreign businesses with shelter from any law applicable to personnel decisions other than those that would logically or prag-

The confusion may be magnified for the Japanese investor because of the expansive language of the U.S.—Japan FCN treaty: "Companies of either Party shall be permitted to engage, within the territories of the other Party, accountants and other technical experts, executive personnel, attorneys, agents and *other specialists of their choice.*"[112] The phrase "other specialists of their choice" varies significantly depending on the interpretation and is a fertile ground for litigation.[113]

The distinction between citizenship and national origin presents difficulties when dealing with a homogeneous population such as Japan's, where citizenship and race are essentially synonymous.[114] For instance, a Japanese company operating under the U.S.—Japan FCN could arguably hire managers and executives of only Japanese citizenship. Due to the homogeneous population, this will invariably appear statistically as disproportionate effects on a hiring practice based on national origin. Thus, the U.S.—Japan employer choice provision, which gives the right to hire executives "of their choice" will almost always show disproportionate effects on their management hirings.[115] Courts have therefore held that FCN treaties and disparate impact claims are irreconcilable, and foreign corporations are largely exempt from disparate impact claims under Title VII.[116]

The Japanese investor should be aware, however, that the Civil Rights Act of 1991 expressly recognizes disparate impact claims.[117]

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matically conflict with the right to select one's own nationals as managers *because of their citizenship.*") (emphasis added).

112. *See* TREATY, *supra* note 107 (emphasis added).

113. *See, e.g., Adames*, 751 F.Supp. 1548; *Fortino*, 950 F.2d 389; *MacNamara*, 863 F.2d 1135; *Wickes*, 745 F.2d 363; *Sumitomo*, 457 U.S. 176; *Speiss*, 643 F.2d 353.

114. *See* Angelo A. Paparelli et al, *The Quasar Case: Hidden Problems of Employment, Immigration, and Tax Law*, 26 INT'L LAW. 1037 (1991). *See also,* LAURIE *supra* note 28, at 252-53.

115. *See MacNamara* 863 F.2d at 1140 ("In establishing this kind of disparate impact liability, parties generally rely exclusively on statistical evidence of disproportionate effect."); *see also Adames*, 751 F.Supp. 1548.

116. *See MacNamara*, 863 F.2d at 1148; *cf.* Steven Mark Tapper, *Building on MacNamara v. Korean Air Lines: Extending Title Disparate Impact Liability to Foreign Employers Operating Under Treaties of Friendship, Commerce and Navigation*, 24 VAND. J. TRANSNAT'L L. 757 (1991).

117. *See, e.g.*, 42 U.S.C.A. § 2000e-2000e-2 (West Supp. 1993). Disparate impact theory, which originated in Griggs v. Duke Power Co., 401 U.S. 424 (1971), is expressly revived under the Civil Rights Act of 1991. This means that a challenged employment criteria or condition, which adversely affects members of a protected class disproportionately, can impose Title VII liability on an employer even though the employer acted without discriminatory intent. *Id.*

Because of their homogeneous population and familial style of management,[118] application of disparate impact to Japanese corporations operating in the United States would almost certainly result in massive claims for alleged discrimination on the basis of national origin. Although the decisions excluding Japanese corporations from disparate impact claims still stand, the future is not as definite after the passage of the '91 Act.

Another source of potential litigation and cost to the foreign investor involves the distinction courts have made regarding American subsidiaries of foreign corporations.[119] The general rule is that the employer choice provision and its rights of protection from Title VII liability do not extend to wholly-owned subsidiaries incorporated in the United States.[120]

In *Fortino v. Quasar,* the 7th Circuit carved out an exception, holding that an American subsidiary, although not technically a foreign corporation, was exempt from Title VII liability based on a showing that its discriminatory conduct was dictated by the parent corporation.[121] This opinion has been criticized for giving too much latitude to Japanese-owned corporations operating in the United States, and extending the unequal "playing field" between Japanese and American businesses.[122] To avoid Title VII liability under this reasoning, in cases where FCN treaties exist, an unincorporated subsidiary must only show that its foreign parent directed the alleged discrimination in favor of its own citizens.[123]

However, the trend appears to be toward expanded application of Title VII to foreign corporations.[124] In addition, the Japanese investor

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118. *See, e.g.,* MARK ZIMMERMAN, HOW TO DO BUSINESS WITH THE JAPANESE, 64-75 (1985).

119. *See Avagliano*, 457 U.S. at 176. *See also Quasar*, 950 F.2d 389.

120. *See Avagliano*, 457 U.S. at 176 (holding Title VII employment discrimination laws applicable to Sumitomo, an American subsidiary, by focusing on fact that Sumitomo was incorporated under the laws of New York, and therfore was not covered under the plain meaning of the U.S.—Japan FCN Treaty).

121. 950 F.2d at 393 ("A judgment that forbids Quasar to give preferential treatment to the expatriate executives that its parent sends would have the same effect on the parent as it would have if it ran directly against the parent: it would prevent Matsushita from sending its own executives to manage Quasar in preference to employing American citizens.").

122. *See* Andrea Crowley, *American Subsidiaries of Foreign Corporations Immune from Title VII: Fortino v. Quasar Co.,* 34 B.C. L. REV. 422 (1993).

123. *Id.* at 429.

124. *See* Jackson, *supra* note 30, at 403 ("Exemption for Japanese companies

should be aware of the perception that Japanese corporations have been given preferential treatment in the past, and the corresponding trend to hold them to stricter legal standards. This awareness is directly related to the Japanese investor's understanding of the more broadly based and long-term business costs of successfully entering the United States market.

### *B. Discrimination on the Basis of Sex*

Liability for employment discrimination on the basis of sex represents a major source of potential liability for the Japanese investor.[125] Currently in Japan, women are subject to employment discrimination at every level.[126] Any significant Japanese investment in the United States will expose the Japanese company to an aspect of business which it has rarely confronted: women in management.[127]

Strong arguments exist for the applicability of Title VII's prohibition against gender discrimination to foreign companies operating in the United States.[128] The employer choice provision argument for Title VII immunity,[129] if applicable at all, stands on shaky ground.[130] In addition, a Japanese company's refusal to hire women for managerial positions cannot be justified under the bona fide occupational quali-

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from Title VII's racial and national origin anti-discrimination provisions makes no sense for Japan of the U.S."); *see also* Dana Marie Crom, *Clash of the Cultures: U.S.—Japan Treaty of Friendship, Title VII, and Women in Management*, 3 TRANSNAT'L L. 337 (1990).

125. *See, e.g.*, Ellen M. Marin, Gerald D. Skonig & Patricia K. Gillette, *Recent Developments in Sexual Discimination*, 441 PLI/Lit 647 (1992). *See also* LAURIE, *supra* note 28, at 269-70.

126. *See* William H. Lash III, *Unwelcome Imports: Racism, Sexism, and Foreign Investment*, 13 MICH. J. INT'L L. 1, 21 (1991). Japanese female college graduates are often limited to employment as "office ladies," whose duties are to greet visitors and tidy desks. *Id.* at 21. *See also* David L. Gregory, Book Review, 44 MD. L. REV. 926 (1985) (reviewing William B. Gould, JAPAN'S RESHAPING OF AMERICAN LABOR LAW (1984)).

127. *See* Crom, *supra* note 124, at 340. *See also* Lash, *supra* note 124, at 24 ("Given the level, nature and amount of discrimination present in Japan, it seems likely that Japanese firms would export sexist and racist attitudes when they invest in the United States.").

128. *See* Crom, *supra* note 124, at 341.

129. *See supra* part III.A. discussing Title VII conflict with the U.S.—Japan FCN treaty.

130. *See* David Cathcart & Mark Snyderman, *The Civil Rights Act of 1991*, C779 ALI-ABA 639, 679-80 (1992) ("Federal courts have interpreted these [employer choice] provisions to give foreign companies the right to discriminate in favor of their own nationals. The treaties do not confer the right to discriminate on any other basis.").

fication exception (BFOQ), which would require a showing that sex discrimination is essential for their business and that as a class, women are unable to perform the job efficiently.[131] Most importantly for the market-hungry Japanese investor, any overt sex discrimination would be contrary to American public policies against sex discrimination and in favor of a diversified workplace.[132] The Japanese investor faces an additional cost in retraining Japanese managers stationed in the United States that sexist attitudes and behavior are not culturally acceptable, and may be grounds for a sex discrimination lawsuit against the individual manager and the employer.

### C. *Discrimination on the Basis of Age*

The Age Discrimination in Employment Act (ADEA) prohibits employers of over twenty individuals from basing on age employment decisions concerning individuals forty years old or older.[133] The express purpose of the ADEA was to "promote employment of older persons based on their ability rather than age."[134]

In order to prove a prima facie case of age discrimination, the complainant must establish:

1. membership in the protected class;
2. qualification for the position;
3. applicant was rejected or otherwise discriminated against;
4. the position was filled by younger person.[135]

The burden then shifts to the employer, who must present a legitimate non-discriminatory reason for the employment decision, and then back to the plaintiff to show that defendant's reason(s) are a mere pretext for age discrimination.[136]

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131. *See* Crom, *supra* note 124, at 350.

132. *Id.*

133. 29 U.S.C.A. § 621 (West Supp. 1993) ("It is therefore the purpose of this chapter to promote employment of older persons based on their ability rather than age; to prohibit arbitrary age discrimination in employment; to help employers and workers find ways of meeting problems arising from the impact of age on employment.").

134. *See* Ira A. Turret, *Age Discrimination in Employment: Recent Trends and Developments*, 820 PLI/CORP. 349 (1993) (citing 29 U.S.C. § 621(a)(1) and (b)). *See also* EEOC v. Wyoming, 460 U.S. 226 (1983) (U.S. Supreme Court noting that the ADEA was prompted by Congressional concern that older workers were discriminated in employment based on inaccurate or stigmatizing stereotypes).

135. *See* Michael J. Crisafulli, *Age Discrimination in Employment*, 623 PLI/COMM 349 (1992).

136. *Id.* at 354. Although a showing of disparate impact is sufficient to make a prima facie case of age discrimination, it is rarely used because most statistical disparities of age can usually be explained by factors other than age discrimination. *Id.*

Japanese investors must be aware of the recent trends in American business and law which have made age discrimination a frequent source of litigation.[137] For example, with the exception of a narrow bona fide occupational qualification defense, the ADEA prohibits almost all mandatory retirement practices.[138] The foreign investor should also be aware that the broad ADEA definition of employment practices includes hiring, promotions, discharges, layoffs, demotions, transfers, and failure to rehire.[139] The ADEA also prohibits age discrimination with regard to sick leave, vacation benefits, insurance benefits, pension and other retirement benefits, severance pay, and access to training programs.[140]

### *D. Discrimination on the Basis of Disability*

The American with Disabilities Act (ADA), which became effective in 1992, prohibits private employers from discriminating against job applicants and employees who are disabled with respect to any term, condition, or privilege of their employment.[141] The ADA represents the broadest expansion of civil rights since the enactment of the Civil Rights Act of 1964, and marks a strong American trend to eliminate the stigmatizing of individuals with disabilities.[142] This codification of the broader societal trend represents another disincentive to the Japanese investor.

What sets the ADA regulations apart from other employment anti-discrimination legislation is its requirement that employers make "reasonable accommodations" for the applicant's or employee's disability,

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137. *See* Turrett, *supra* note 134, at 349.

138. *See* Crisafulli, *supra* note 135, at 351.

139. *Id.*

140. *Id.* at 354. Reasonable factors upheld in employment decisions involving age include business cutbacks, lack of qualifications, and poor health. Contrast with factors rejected as a defense: corporate image and the greater cost of employing older workers. *Id.*

141. Francis X. Dee, *Employment Litigation in the 90's: The Impact of the 1990 American Disabilities Act and the Civil Rights Act of 1991,* 455 PLI/LIT. 725 (1993) ("An employer may not discriminate against any 'qualified individual with a disability' because of such individual's disability with respect to job application procedures, the hiring or discharge of employees, employee compensation, advancement, job training and other terms, conditions, and privileges of employment.").

142. *See* Frank C. Morris, Jr., *Americans With Disabilities Act: Overview of the Employment Provisions,* C780 ALI-ABA 185 (1993) ("Every man, woman, and child with a disability can now pass through once-closed doors into a bright new era of equality, independence, and freedom.") (quoting President Bush).

as long as it would not result in "undue hardship" on the business.[143] This requirement to account for the person's disability by making reasonable accommodations places an extremely heavy burden on the employer.[144] Unlike discrimination on the basis of citizenship, which is arguably shielded by the FCN treaty,[145] there is no apparent protection for a Japanese employer from potential liability under the ADA. Similar to American corporations, Japanese investors are faced with three major sources of confusion and cost under the ADA.[146]

First, the employer must determine what constitutes a disability.[147] The broad definition of disability includes a physical or mental impairment[148] that substantially limits one or more of the major life activities, a record of such impairment, or being regarded as having such an impairment. Whether an impairment is substantially limiting is evaluated on a case-by-case analysis involving the following factors: (1) the nature and severity of the impairment; (2) the duration or expected duration of the impairment; and (3) the permanent long-term impact, or the expected long-term impact of the impairment.[149]

The broad definition of disability may surprise and discourage many Japanese investors. For example, the ADA classifies a recovering drug addict or alcoholic, who has completed some form of rehabilitation, as disabled and therefore entitled to the benefits of this Act.[150] In addition, the ADA expressly extends coverage to persons with AIDS, the AIDS virus, and even those perceived as having AIDS.[151]

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143. *See* Dee, *supra* note 141, at 725-26. *See also* Lisa Lavelle, *The Duty to Accommodate: Will Title I of the American with Disabilities Act Emancipate Individuals with Disabilities only to Disable Small Businesses?*, 66 NOTRE DAME L. REV. 1135 (1991).

144. *See* Thomas H. Barnard, *The American with Disabilities Act: Nightmare for Employers and Dream for Lawyers?*, 64 ST. JOHN'S L. REV. 229 (1990). *See also* Morris, *supra* note 142, at 213. During the period July 26, 1992 through March 31, 1993, 7,129 charges under the ADA were filed with the EEOC; approximately 2,235 were filed in February 1993 alone. *Id.*

145. *See supra* part III.A. discussing Title VII conflict with the U.S.—Japan FCN treaty.

146. *See, e.g.*, Barnard, *supra* note 144, at 232-35.

147. *See* Dee, *supra* note 141, at 728-30; *see also* James M. Zappa, *The Americans with Disabilities Act of 1990: Improving Judicial Determinations of Whether an Individual is "Substantially Limited,"* 75 MINN. L. REV. 1303 (1991) (giving comprehensive discussion of legislative history of disability definition under the ADA).

148. *See* Dee, *supra* note 141, at 728. Major life activities are defined as caring for one's self, performing manual tasks, walking, seeing, hearing, speaking, breathing, learning, and working. *Id.* at 730.

149. *See* Lavelle, *supra* note 143, at 1143-44 (citing 29 C.F.R. § 1630.2(j)(1)).

150. 42 U.S.C.A. § 12114(b) (West Supp. 1993).

151. *See* Morris, *supra* note 142, at 191.

The second issue, and major cost imposed by the ADA, is the requirement that the employer make reasonable accommodations for the employee's disability.[152] If the individual can perform the essential functions of the job[153] *with or without* reasonable accommodations, then the employer cannot deny employment because of the disability or the need for such accommodation.[154] This requirement places the burden on the employer to alter normal operating procedures in order to reasonably accommodate individuals with disabilities.[155] In essence, the reasonable accommodations requirement mandates that employers grant preferential treatment to individuals with disabilities.[156]

The third issue confronting the potential Japanese investor involves the defense of undue hardship.[157] The ADA provides that the employer is not required to offer an accommodation to a disabled employee if it would impose an "undue hardship" on the operations of the em-

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152. Barnard, *supra* note 144, at 245 ("That is, *favored* rather than simply that *equal* treatment is required.").

153. 29 C.F.R. § 1630.2(n)(1). Essential functions are tasks fundamental, not marginal, to the job. Essential functions exist if it is the reason that the job exists; because there are only a few employees available who can do it; or because a highly skilled individual is hired to perform the function. Consideration is given to the employer's judgment, although it is not dispositive. *Id.*

154. *See* Lavelle, *supra* note 143, at 1153. *See also* Barnard, *supra* note 144, at 246. The ADA defines discrimination to include: "(A) not making *reasonable accommodations* to the known physical or mental limitations of an otherwise qualified individual with a disability who is an applicant or employee, unless such covered entity can demonstrate that the accommodation would impose an undue hardship on the operation of the business of such covered entity; (B) denying employment opportunities to a job applicant or employee who is an otherwise qualified individual with a disability, if such a denial is based on the need of such covered entity to make *reasonable accommodation* to the physical or mental impairments of the employee or applicant." Lavelle, *supra* note 143, at 1153.

155. *See* Rosalie K. Murphy, *Reasonable Accommodation and Employment Discrimination Under Title I of the Americans with Disabilities Act,* 64 SO. CAL. L. REV. 1607 (1991).

156. *See* Barnard, *supra* note 144, at 231; *see also* Murphy, *supra* note 156, at 1618 (citing 42 U.S.C.A. § 12111(9) (West Supp. 1991)). The ADA defines "reasonable accommodation" as: (A) making existing facilities used by employees readily accessible to and usable by individuals with disabilities; and (B) job restructuring, part-time or modified work schedules, reassignment to a vacant position, acquisition or modification of equipment or devices, appropriate adjustment or modifications of examinations, training materials or policies, the provision of qualified readers or interpreters, and other similar accommodations for individuals with disabilities. 42 U.S.C.A. § 12111(9) (West Supp. 1993).

157. 42 U.S.C.A. § 12111(10)(A) ("The term undue hardship means an action requiring significant difficulty or expense, when considered in light of the factors set forth in subparagraph (B).").

ployer.[158] The defense of undue hardship is to be considered in light of the general cost of the reasonable accommodations versus the financial resources of the covered entity.[159]

The Japanese investor must be aware that the defense of undue hardship is to be narrowly construed by the courts.[160] The ADA, in anticipating potential costs to employers, suggests a cost-benefit analysis regarding the costs to the specific employer versus the societal cost of continuing discrimination against disabled persons.[161] This rather cryptic defense of the potential for expansive liability under the ADA seems to ignore the realistic costs of operating a business.

The potential costs imposed by the ADA represent a major concern for the Japanese investor. If the proposed investment is a new operation, the investor must build or acquire workplaces with facilities that are readily accessible to individuals with disabilities.[162] This may incur additional design and construction costs. In addition, the investor should try to anticipate potential costs involving disabled individuals, including the provision of qualified readers, training materials, interpreters, and other similar accommodations.[163] Finally, the Japanese investor will have to structure the proposed organization with enough flexibility to allow modified work schedules and job restructuring in order to reasonably accommodate workers with disabilities.[164]

If the proposed investment is an existing business, the Japanese investor may be faced with massive construction costs if all facilities

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158. *Id.* The ADA defines "undue hardship" as one that requires "significant difficulty or expense." *See also Murphy, supra* note 156, at 1619-20. The ADA also permits employment discrimination against disabled individuals who pose a significant threat to the health and safety of other workers. *See* 42 U.S.C.A. § 12113(a)-(b).

159. 42 U.S.C.A. § 12111(10)(B) ("In determining whether an accommodation would impose an undue hardship on a covered entity, factors to be considered include: (i) the nature and cost of the accommodation; (ii) the overall financial resources of the facility involved in the provision of the reasonable accommodation; the number of persons employed at such a facility; the net effect on expenses and resources, or the impact otherwise of such accommodation upon the operation of the facility; (iii) the overall financial resources of the covered entity; the overall size of the business of a covered entity with respect to the number of its employees; the number, type and location of its facilities; and (iv) the type of operation or operations of the covered entity, including the composition, structure and functions of the workforce of such entity; the geographic separateness, administrative, or fiscal relationship of the facility in question to the covered entity.").

160. *See* Morris, *supra* note 142, at 190-91.

161. *See* Murphy, *supra* note 156, at 1634.

162. *See* 42 U.S.C.A. § 12111(9)(A).

163. *See* 42 U.S.C.A. § 12111(9)(B).

164. *Id.*

within the workplace are not readily accessible to individuals with disabilities.[165] In addition, the investor should determine acquisition and modification costs of any existing equipment.[166] Finally, the Japanese investor should also investigate the flexibility of the management structure of the corporation, and determine whether the company could reasonably accommodate employees with disabilities through job restructuring, modified work schedules, or similar accommodations.[167]

Although the reasonable accommodation requirement is based on sound moral principles,[168] the requirement of reasonable accommodations for individuals with disabilities and the narrow construction of "undue hardship" makes the ADA a potential disincentive for the Japanese investor.

### *E. Costs to the Foreign Investor*

From the standpoint of a potential Japanese investor, the law regarding Title VII liability of foreign corporations is in a state of confusion.[169] For the Japanese company to be successful, it must assume a proactive approach and long-term attitude towards American employment law. This will entail substantial short-term legal and operating costs.

The Japanese investor must be especially wary of American sexual discrimination and harassment law.[170] In addition, the broad, inclusive definitions of "disability" and the corresponding responsibilities placed on employers demand extensive research into the current state of the ADA and how it affects the employer.

Further burdening the Japanese investor is his need to stay abreast of trends and societal changes, and anticipate their effect on current and future employment regulations. For instance, the '91 Act and its opening up of disparate impact liability, although currently precluded

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165. *Id.*

166. *Id.*

167. *Id.*

168. *See* Murphy, *supra* note 156, at 1609 ("Buildings, office equipment, and job tasks have long been designed around the unstated norm of an able-bodied worker: a person who can, for example, see, hear or climb stairs . . ."). Recognizing that equal treatment itself may be discriminatory is a necessary step toward ending discrimination based on disability. *Id.*

169. *See* Paparelli, *supra* note 114, at 1037.

170. *See* LAURIE, *supra* note 28, at 270 ("Japanese management style has been built around a system of male dominance that is a reflection of the larger culture. The corporation is a male sanctuary.").

from foreign corporations,[171] is of particular concern to Japanese investors. In addition, the indefiniteness surrounding the ADA and the uncertain scope of what constitutes "reasonable accommodations" for the employee versus "undue hardship" on the employer represents an area that the Japanese investor must consider when calculating his costs. The recurring issue of anti-Japanese bias and how it will affect future generations of American employees is especially relevant to the Japanese investor. If the Japanese investor perceives future American legal and social prejudices in the form of harassing, meritless discrimination claims, the disincentive to future investment already exists for the next twenty-five to fifty years.

Similar to the stringent environmental regulations, America's priority of eliminating employment discrimination cannot be faulted on a moral and ethical basis. However, unless attempts are made to reduce the amount of discrimination claims whenever an employee is not hired or terminated, the potential for employment based litigation and liability will continue to increase. This has a direct effect of needlessly increasing a business' operating costs and consequently acts as another disincentive to foreign direct investment.

## V. CONCLUSION: A LOOK TO THE FUTURE

Recent attempts by the United States to attract foreign direct investment have met with little success. Individually, the failure of these programs may represent poor planning or insufficient preparation. However, this low success rate also illustrates the overall decreasing sphere of American economic influence over foreign economies.

For example, the Immigration Act of 1990 (IA 1990) was intended to promote foreign direct investment through the loosening of immigration restrictions.[172] The IA 1990 specifically targeted the region of Hong Kong, whose 1997 return to Chinese control is causing a flood of capital from Hong Kong to be invested abroad, mainly in Canada and Australia.[173] The IA 1990 provides an automatic two year visa to any foreigner who invests one million dollars in a commercial enterprise

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171. *See supra* note 116 and accompanying text.

172. *See* Gary Endelman & Jeffrey Hardy, *Uncle Sam Wants You: Foreign Investment and the Immigration Act of 1990*, 28 SAN DIEGO L. REV. 671 ("Stimulus for the investor provision was twofold: (1) a recognition that foreign investment is both beneficial and necessary to the U.S. economy; and (2) an awareness that American must resist stiff competition from other countries for the foreign investor dollar.").

173. *Id.* at 671.

which creates at least ten jobs in the United States.[174] Although this program was denounced by some due to its shift to employment based immigration,[175] many business executives and attorneys expected a massive surge of foreign direct investment in the United States and for the demand to quickly consume the allotted 10,000 visas.[176] However, the investor visa provision has fallen flat on its face, with only 750 applications having been filed during the first two years.[177]

One of the primary reasons for its failure is the one million dollar investment requirement. Even a lowering of the requirement to $500,000 did not spark interest in the investor visa provision. This is in stark contrast to Canada's visa program, which requires only $250,000 for an initial investment and which attracted nearly 7000 investors in 1991. Judging from the poor response to the investor visa provision, the attraction of the United States to potential investors from Hong Kong was drastically overrated.[178] The United States no longer possesses the only market for foreign investment, and now must compete with other markets for the limited supply of foreign investment dollars.

The second method of attracting foreign direct investment is conducted through the individual states.[179] States often attempt to lure foreign investors through economic incentives including direct and indirect financial assistance and tax breaks.[180] Contrary to popular perception, however, these state incentives to foreign investors appear to have little effect on the final decision of the potential investor.[181] Instead, Japanese firms favor long-term macro-economic conditions, such as proximity to the relevant market, availability of international transportation, and environmental and infrastructural factors.[182]

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174. *Id.*

175. *Id.* at 676. Criticisms centered primarily on the perceived "cheapening" of American citizenship, and that this investor visa provision put a price tag on American citizenship. *Id.*

176. Sam Fulwood III, *Would-Be Advisers Bank on Visas for Foreign Millionaries,* L.A. TIMES, May 7, 1991, at A5.

177. Michael S. Arnold, *Special visas abundant as rich foreigners fail to apply,* WASH. POST, July 26, 1993, at A1.

178. *Id.* (quoting John Basel, management consultant) ("I think when the law was passed it looked like foreign investors would be willing to pay a premium to come to the United States. . . . I think we were a little arrogant in our position.").

179. *See* Kuo-Tsa Liou, *Foreign Direct Investment in the United States: Trends Motives, and the State Experience,* 23 AMERICAN REVIEW OF PUBLIC ADMINISTRATION 1. According to a 1990 study, forty-one states have set up offices in foreign countries in Asia for the sole purpose of recruiting foreign investment. *Id.* at 7.

180. *Id.* at 6.

181. *Id.* at 12.

182. *See* Anne Veigle, *Seat of Power, Lap of Luxury; Foreign Firms find D.C. area*

This long-term focus of foreign investors is clearly illustrated in the success of North and South Carolina and surrounding areas in recruiting foreign investment.[183] The Carolinas have succeeded in attracting foreign investment because they have gone beyond their cheap labor and low taxes; the foreign investors are lured by the area's commitment to the creation and maintenance of long-term infrastructure[184] and a cooperative approach to foreign industry.[185] In particular, foreign companies are attracted by the area's progressive educational programs and the promotion of cooperative research with the area universities.[186] With the increasing competition for Japanese direct investment, the United States, as a nation, must demonstrate a similar long-term cooperative commitment to potential investors in order to compete with the booming Southeast Asian region.

The future for Japanese direct investment in the United States does not look bright. The same laws which prevent American businesses from competing internationally also act as significant disincentives to foreign investment. These disincentives are becoming increasingly important due to the emergence of the Southeast Asian regional economy and Japan's growing influence in that economy. America's continuing perceived prejudice against Japanese business further deters foreign investment. These factors combine to produce an unattractive United States market for many Japanese investments, thus further weakening American economic influence abroad.

*P. James Schumacher, Jr.* *

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*Best for Business,* WASH. TIMES, Jan. 5, 1992, at A12 (quoting from a KPMG Peat Marwick survey) ("'[S]tate and local tax incentives are heavily outweighed by economic, environmental and infrastructural issues in attracting foreign investment.'").

183. *See* Dean Foust & Maria Mallory, *The Boom Belt: There No Speed Limit on Growth Along the South's I-85*, BUS. WK., Sept. 27, 1993, at 98. Between 1990 and 1992, North Carolina lured 93 new foreign owned plants. South Carolina attracted 45—as many as New England and the mid-Atlantic region combined. *Id.*

184. *Id.* at 101. These infrastructure attractions include Atlanta's Hartsfield International Airport, and Tennessee's state of the art phone system. *Id.*

185. *Id.* ("To land the BMW plant, South Carolina agreed to screen all job applicants and then train BMW's entire work force through the state's technical schools.").

186. *Id.* at 100 ("The prime draw [for foreign investment]: Research Triangle Park, a state-conceived development designed to lure companies to the research conducted at nearby schools such as Duke University and the University of North Carolina.").

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# The Grapes of Wrath: The Discretionary Function Exception of the Federal Tort Claims Act §2680(a), as Applied to the Chilean Grape Crisis of 1989

> Where discretion is absolute, man has always suffered. . . . It is more destructive of freedom than any of man's other inventions. . . . It makes a tyrant out of every contracting officer. He is granted the power of a tyrant though he is stubborn, perverse, or captious. . . . He is allowed the power of a tyrant though he is incompetent or negligent. He has the power of life and death over a private business even though his decision is grossly erroneous.[1]

## I. Introduction

The federal Food & Drug Administration (FDA) has been responsible for protecting the American public health since 1906. Its responsibilities have grown over the years, as it regulates the introduction of new drugs, cosmetics, foods, and a host of other products,[2] including imported food products.[3] Consequently, the FDA has the authority to refuse the admission of any food products that appear adulterated or otherwise into the United States.[4] The objective of this authority has consistently retained the same character: protection of the public health. Yet what happens when FDA investigators purportedly conduct inappropriate scientific testing or use poor judgment in their technical analysis of food imports, which results in a nationwide embargo causing the loss of thousands of jobs, hundreds of millions of dollars, and potential economic chaos in developing nations? In March, 1989, the FDA imposed such an embargo on all Chilean fruit, after investigators allegedly discovered small traces of cyanide in two grapes. This embargo led to severe hardship in Chile and was deemed to be

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1. United States v. Wunderlich, 342 U.S. 98, 101 (1951) (Douglas, J., dissenting).

2. *See generally* Congressional Quarterly's Federal Regulatory Directory, 289-321 (6th ed. 1990).

3. 21 U.S.C.A. § 331(a) (West Supp. 1993) (prohibiting the introduction of imported food products that appear to be adulterated into interstate commerce).

4. 21 U.S.C.A. § 381 (West Supp. 1993).

the result of negligent scientific testing by FDA officials. This event is now commonly referred to as the Chilean Grape Crisis.

Following the Chilean Grape Crisis, the Chilean Exporters Association brought a tort action against the United States on the grounds that the FDA did not have the discretion to impose an embargo as a result of the negligent violations of FDA laboratory procedures.[5] However, the court dismissed the action on the grounds that the suit fell within the "discretionary function" exception of 28 U.S.C.A. § 2680(a)[6] of the Federal Tort Claims Act (FTCA). This Note will examine the discretionary function exception of the FTCA as it applies to *Balmaceda v. United States*. Specifically, it will present the events surrounding the Chilean Grape Crisis, a brief history of the development of the Supreme Court's interpretations of the discretionary function exception, and the application of the two-step analysis developed by the Supreme Court. Additionally, this Note will demonstrate the application of the two-step analysis to conduct that is grounded in mathematical, scientific, and quantitative policy; describe why this conduct is an insufficient basis to shield a government agency from judicial scrutiny; and conclude with an analysis of the ramifications of such conduct on United States foreign policy and trade relations between the United States and developing nations.

## II. THE BALMACEDA DECISION

### A. *The Crisis*

On March 12, 1989, the FDA imposed a nationwide embargo on all seedless grapes imported from Chile after scientific testing allegedly revealed traces of cyanide in two grapes.[7] The Chilean Grape Crisis began when an anonymous telephone caller informed officials at the United States Embassy in Chile that Chilean fruit en route to the United States had allegedly been poisoned with cyanide.[8] The FDA detained and examined the Chilean fruit shipments, but subsequently determined that the calls had been part of a hoax and lifted the

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5. Balmaceda v. United States, 815 F. Supp. 823, 825 (E.D. Pa. 1992), *appeal docketed,* No. 93-1205 (3rd Cir. March 5, 1993).

6. 28 U.S.C.A. § 2680(a) (West 1965).

7. *Balmaceda*, 815 F. Supp. at 824.

8. Philip Shenon, *Chilean Fruit Pulled From Shelve As U.S Widens Inquiry on Poison*, N.Y. TIMES, March 15, 1989, at A1, A22.

temporary hold on the fruit.[9] A second anonymous telephone caller then informed the United States Embassy that the threats were not part of a hoax, as was indicated in the Chilean newspapers.[10] The FDA continued to inspect samples of all fruit imported from Chile and began to test imported fruit samples for cyanide contamination.[11]

During the investigation, FDA inspectors found three seedless grapes that were "suspicious-looking"[12] from a batch of approximately 2,000 grape-bunches sampled[13] aboard the *Almeria Star.*[14] Laboratory analysis purportedly confirmed that two of the three grapes were contaminated with cyanide.[15] Consequently, the FDA decided to impound all fruit imports from Chile and to impose a nationwide embargo on Chilean fruit imports.[16] Although disagreeing with the FDA embargo, the Chilean Government cooperated with the United States by immediately reinforcing security throughout the fruit production process and by conducting chemical tests in order to determine if other fruits had been contaminated.[17] The FDA asked American consumers to avoid eating seedless grapes and other fruit originating from Chile and warned them to throw away any fruit that might have come from Chile.[18] Subsequently, the FDA mandated that American distributors destroy all Chilean grapes in their possession and ordered the destruction of all Chilean fruit leaving the ports for distribution.[19]

The FDA's decision initiated a wave of panic among American distributors, grocers, wholesalers, and consumers, who hastened to

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9. *Id.*

10. *Id.*

11. David Lauter, *Cyanide Traces Lead U.S. to Seize All Chilean Fruit*, L.A. TIMES, March 14, 1989, at A1, A18.

12. Herbert Burkholz, *Killer Grapes: an FDA horror story*, NEW REPUBLIC, November 30, 1992, at 13. The FDA tightened security and inspectors then found two red grapes that were discolored and had a ring of crystalline dust around the puncture holes. Shenon, *supra* note 8, at A1.

13. Amy Callahan, *Stores remove Chilean fruit; Tons piled up as U.S. probes cyanide threat*, BOSTON GLOBE, March 15, 1989, *available in* LEXIS, NEWS Library, MAJPAP File.

14. The *Almeria Star* is the vessel that carried the grapes in question. The ship left Chile on February 27, 1989, and arrived in Philadelphia on March 11. Marlene Cimons, *U.S., Chile Seek Fruit Safety Plan*, L.A. TIMES, March 16, 1989, at A1, A26.

15. Shenon, *supra* note 8, at A1.

16. Lauter, *supra* note 11.

17. *Id.* at A18.

18. Warren E. Leary, *U.S. Urges Consumers Not to Eat Fruit from Chile*, N.Y. TIMES, March 14, 1989, at A15.

19. Marie Cocco, *Chilean Grapes to Make Comeback*, NEWSDAY, March 18, 1989, *available in* WESTLAW, PAPERSMJ Database.

destroy potentially contaminated Chilean fruit. Although the FDA commissioner initially sought to avoid panic, panic erupted as store owners frantically removed tens of thousands of pounds of grapes off of their shelves,[20] distributors and wholesalers hurriedly destroyed all grapes in their possession, and a mother even chased down a schoolbus for fear that she had packed contaminated grapes in her child's lunch.[21] Further, store-owners complained that consumers were refusing to purchase any and all fruit, in fear that everything had originated from Chile.[22] Additionally, the American Produce Association recommended that its participating members recall all Chilean fruit.[23]

The effects of the FDA's announcement were also manifested on the international front. On March 12, 1989, the Canadian Government banned all Chilean fruit imports and ordered retailers to remove existing fruit from store shelves. The Canadian ban on Chilean fruit was expected to last one week with an estimated loss of over ten million Canadian dollars in retail sales throughout the country.[24] Following the United States' and Canada's lead, West Germany, Hong Kong, and Denmark also stopped importing and selling Chilean fruit.[25] Authorities in Rio and Sao Paulo, Brazil also banned sales of Chilean grape imports.[26] Likewise, after receiving an anonymous telephone call at the Japanese Embassy in Chile threatening contamination, the Japanese halted shipments of Chilean fruit.[27] Additionally, several British supermarket chains removed all Chilean grapes from their shelves.[28]

The effects of the embargo were felt most harshly in Chile. As a result of the grape ban, approximately 25,000 Chilean workers were laid off and over $300 million in total grape sales were lost.[29] Even

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20. Craig Wolff, *Shoppers Confront a New Food Peril*, N.Y. TIMES, March 15, 1989, at A22.

21. Margaret Carlson, *Do You Dare To Eat A Peach?*, TIME, March 27, 1989, at 24, 26.

22. *Id.*

23. Leary, *supra* note 18.

24. *Chile Should Not Compensate Canada for Contaminated Fruit, says Ambassador*, XINHUA GENERAL OVERSEAS NEWS SERVICE, March 16, 1989, *available in* LEXIS, NEWS Library, XINHUA File.

25. Callahan, *supra* note 13.

26. *Brazil Bans Imports of African, Asian and Pacific Fruit*, REUTER LIBRARY REPORT, March 22, 1989, *available in* LEXIS, Nexis Library, LBYRPT File.

27. Callahan, *supra* note 13.

28. Ian Brodie & Imogen Mark, *Chile fails to shift US ban on fruit in Poison Grape Scare*, THE DAILY TELEGRAPH (London), March 17, 1989, *available in* LEXIS, NEWS Library, TELEGR File.

29. George de Lama, *U.S. - Chile grape crisis withering on vine*, CHI. TRIB., September 24, 1989, at 4.

after the ban was lifted, Chilean exporters could not sell the fruit that had been withheld at port, due to the lingering fear among buyers. Chilean officials were angered by the embargo, which was described by one of Chile's financial leaders as "almost an act of war . . . an aggression against Chile" and an "incident [that] could 'frustrate or harm' Chile's transition to democracy, scheduled for an important step in December [1989] with the first presidential election in 19 years."[30] Moreover, United States Ambassador Charles Gillespie stated: "This is scary, . . . [t]here are a lot of little countries in the world dependent on exports."[31] "People will be scared for quite a while," said agricultural economist Richard Brown; "[i]t's a blow to the whole table grape industry."[32]

After lifting the embargo on March 17, despite receiving a third anonymous phone call threatening contamination, FDA officials were questioned extensively by Chilean authorities regarding their decision to impose the embargo.[33] Surprisingly, the level of cyanide allegedly found in the grapes by the FDA investigators was considered "far below a lethal dose and below the amount that would even sicken a small child."[34] FDA commissioner Frank Young defensively stated that "[i]t's better to be safe than sorry."[35] He added: "We've got to call this to the attention of the American people. I couldn't let it be on my conscience."[36] However, after lifting the ban, Young, contrary to his initial concerns, stated: "It is impossible to assure 100% safety," even though the United States Embassy in Chile received a third similar anonymous threat the same day that the ban was lifted.[37]

On December 29, 1992, the United States District Court in the Eastern District of Pennsylvania dismissed a tort action brought by Chilean grape exporters against the United States government, which alleged that "the FDA did not have the discretion to act given alleged

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30. Eugene Robinson, *Chile's Grape Growers Rage Against U.S. Ban*, Wash. Post, March 16, 1989, at A1.

31. Tom Harvey, *U.S. Fruit ban an earthquake for Chile*, UPI, March 24, 1989, *available in* LEXIS, NEWS Library, UPI File.

32. David C. Rudd, *Chilean Fruit Pulled in Cyanide Alert*, CHIC. TRIB., March 15, 1989, *available in* LEXIS, NEWS Library, MAJPAP File.

33. *USA/Canada: Canada and U.S. Lift Import bans on Chilean Fruit*, REUTER TEXTLINE FINANCIAL POST, March 20, 1989, *available in* LEXIS, World Library, TXTLNE File.

34. Leary, *supra* note 18.

35. Callahan, *supra* note 13.

36. Shenon, *supra* note 8.

37. Cocco, *supra* note 19.

negligent violations of a procedures manual which provides instructions on testing procedures within the FDA laboratory."[38] The issue before the court was whether the discretionary function exception to the FTCA bars suit against the United States for tort actions.[39] In applying §2680(a), the court held that the

> FDA had the discretion to act during the Chilean grape crisis . . . [i]t had the discretion to test the fruit and determine whether the fruit was adulterated. . . . It also had the discretion to refuse entry into the United States. The actions taken were not violative of any regulatory or statutory provisions . . . [a]ccordingly, the FDA is protected by the discretionary function exception.[40]

In essence, the court determined that, in light of the FDA's responsibility to protect the public health, its actions in imposing a nationwide embargo on Chilean grapes involved judgment and choice that are grounded in policy,[41] regardless of the amount of negligence or abuse of discretion.[42] Consequently, the court refused to consider alleged violations of the FDA laboratory procedures manual, on the grounds that "[t]he proper focus under the discretionary function exception is on the discretion provided by the regulations, statutes and policies of the FDA."[43] Therefore, the court dismissed the case stating that "*all the acts* involved judgment and choice and were grounded in policy."[44] The plaintiffs in the case appealed the decision and oral arguments were heard by the Court of Appeals for the Third Circuit on September 24, 1993. Until the Third Circuit rules, the question remains whether the discretionary function exception of the FTCA precludes a suit on the grounds that the FDA negligently violated its laboratory procedures manuals and based its decision to impose a nationwide embargo on Chilean grapes on allegedly invalid and erroneous scientific analysis.

### B. *The Allegations*

Four days after the initial embargo, further analysis of the same two grapes revealed that there was actually no cyanide contamination

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38. *Balmaceda*, 815 F. Supp. at 825.
39. *Id.* at 824.
40. *Id.* at 827.
41. *Id.*
42. *Id.* at 826.
43. *Id.* (citing United States v. Gaubert, 111 S.Ct. 1267, 1274 (1991)).
44. *Id.* at 827 (emphasis added).

in the grapes at all.[45] Critics alleged that the FDA panicked as a result of questionable test data which seemed to indicate low levels of cyanide in two grapes.[46] However, it was claimed that cyanide injected into grapes or other fruit in Chile could not still be present in the fruit after a thirteen day trip to the United States, implying that the grapes were actually contaminated in the United States and not in Chile.[47] The Chilean Exporters Association alleged that the FDA "(1) used inappropriate tests to determine the presence of cyanide in the grapes, (2) inappropriately modified a test, thereby invalidating the test's results, (3) did not promptly record test results, and (4) did not exercise adequate control to protect fruit samples against contamination."[48]

A study commissioned by the Chilean Exporters Association, conducted at the University of California at Davis, revealed that it would have been impossible for the grapes to have been contaminated in Chile, because of the chemical effects that cyanide has on acidic fruits.[49] The FDA initially contended that, even though the grapes contained barely enough cyanide to make an infant ill, acidic fruits break down the chemical properties of cyanide, and therefore the grapes could have had much higher amounts of cyanide prior to discovery.[50] An investigation by the General Accounting Office (GAO) also reported that, although it is possible that all of the cyanide would probably have dissipated during the voyage from Chile, the effects of refrigeration would have reduced the dissipation of cyanide.[51] However, researchers at the University of California-Davis contended that the GAO's report was "deficient, replete with factual errors and omissions, and without a scientific basis for the conclusions reached."[52] The California study further indicated that the chemical reactions between acidic fruits and cyanide would have caused the grapes to shrivel and that, if there had been higher amounts of cyanide present, the contamination would have

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45. Matthew L. Wald, *This Autumn in New York, Fear of Asbestos Is in the Air,* N.Y. TIMES, September 26, 1993, at D5.

46. Burkholz, *supra* note 12.

47. *Food Tampering: FDA's Actions on Chilean Fruit Based on Sound Evidence*, UNITED STATES GENERAL ACCOUNTING OFFICE REPORT TO THE RANKING MINORITY MEMBER (hereinafter GAO), COMMITTEE ON FOREIGN RELATIONS, U.S. SENATE, September 1990, GAO/HRD-90-164, at 12.

48. *Id.*

49. *Id.* at 17.

50. Lauter, *supra* note 11, at A18.

51. GAO, *supra* note 47, at 17, 37.

52. Malcom Gladwell, *GAO Report Backs FDA in Cyanide Grape Debate*, WASH. POST, October 3, 1990, at A21.

migrated to the entire shipment of grapes and would not have remained confined in two grapes.[53] The California study concluded that "[t]he clinical evidence rejects virtually any possibility of contamination of the grapes in Chile or on the ship or at the port of Philadelphia . . . On the contrary, the laboratory results only support the hypothesis that the grapes were accidentally or intentionally contaminated inside the FDA laboratory in Philadelphia."[54]

The first issue in the Chilean Grape Crisis concerns the discretionary conduct manifested by the FDA investigators in their laboratory procedures for detecting the cyanide in the grapes. If the Chilean Exporters Association's allegations are true, then the FDA based its decision to impose an embargo on data that is both erroneous and misleading. Recognizing that the role of the FDA is to protect the public health, to what degree do we accept rash decision-making without a rational, scientific basis for the decision? Did slits in two grapes, out of two thousand bunches, justify the assumption that the grapes were contaminated and thus hazardous to public health which, in turn, led to the destruction of Chilean grape imports and a virtual public panic? The FDA's culpability lies in its negligent testing of the grapes and in its poor scientific judgment. The FDA was aware ten days prior to the discovery of the grapes in question that cyanide was the contaminant in question. Basic cyanide experimentation would have led a scientist to observe that grapes shrivel and turn black when contaminated and that the contamination would have migrated to other grapes in the batch if they had actually been poisoned in Chile.[55] The U.C.-Davis study concluded that two suspect grapes were contaminated within four hours of the FDA analysis, because of their physical appearance as portrayed by the FDA pictures.[56] If the FDA's testing had been conducted according to its procedural guidelines, the analysis may have revealed that the grapes were not contaminated with cyanide and the embargo could have been avoided. Thus, the question remains whether the United States can be held liable for its negligence in imposing an embargo based on erroneous scientific data.

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53. GAO, *supra* note 47, at 17, 37.

54. Gladwell, *supra* note 52.

55. Shirley Christian, *Chile May Sue U.S. over Grape Ban,* N.Y. TIMES, September 12, 1990, at A13.

56. *Id.* The cyanide testing conducted by the FDA required an injection of a known quantity of cyanide into the grapes commonly referred to as "spiking." If the agent accidentally injected quantities higher than expected, the testing would have resulted in a false positive, indicating cyanide contamination when there actually is no cyanide present. GAO, *supra* note 47, at 35.

The second issue concerns the international ramifications of the FDA's decision to place the nationwide embargo on Chilean fruit. Although the alleged contamination was isolated to two grapes in the laboratory, the mass destruction of Chilean grapes far exceeded the representative sampling of these two grapes. All Chilean grapes that were not inspected by the FDA were destroyed, including those that did not come from the ship that produced the two grapes in question, even though no other Chilean fruit was found to be contaminated.[57] It was later alleged that the grapes could not have been contaminated in Chile, due to the chemical properties of cyanide.[58] The question then becomes whether the FDA, in adopting their "better safe than sorry" approach to imported foods, is appropriately considering the consequences of its actions.[59] Can we allow the FDA to base its decisions on "suspicious-looking" fruit, and if so, will this form of discretion be favored in the face of foreign policy?

## III. THE DISCRETIONARY FUNCTION EXCEPTION

In an effort to satisfy the growing number of claims against the United States Government, the U.S. Congress adopted the Federal Tort Claims Act in 1946,[60] which authorizes suits against the United States for damages "for . . . loss of property . . . caused by the negligent or wrongful act or omission of any employee of the Government while acting within the scope of his office or employment."[61] Although one of the broadest waivers of sovereign immunity ever enacted by Congress,[62] the FTCA is subject to thirteen exceptions.[63] The discretionary function exception specifically states that the FTCA will not apply to:

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57. GAO, *supra* note 47, at 34.

58. Christian, *supra* note 55.

59. Allegations of discrimination center around the California grape industry. Because the California grape season begins in April, a sharp decline in Chilean grape supply during the apex of its season would spur the California season with huge demand and high prices. Lauter, *supra* note 11.

60. Barry R. Goldman, *Can the King Do No Wrong? A New Look at the Discretionary Function Exception to the Federal Tort Claims Act*, 26 GA. L. REV. 837, 838 (1992). This note examines the discretionary function exception, its history, and the policies and argument against its expansion.

61. 28 U.S.C.A. § 1346(b) (West 1993)(prescribing a basis of jurisdiction for civil actions against the United States government).

62. Captain Bruce Clark, USAF, *Discretionary Function and Official Immunity; Judicial Forays into Sanctuaries from Tort Liability*, A.F. L. REV., Spring 1974, at 33, 35.

63. 28 U.S.C.A. § 2680(a)-(n) (West 1965 & Supp. 1993).

> [A]ny claim based upon an act or omission of an employee of the Government, exercising due care, in the execution of a statute or regulation, whether or not such statute or regulation be valid, or based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of a federal agency or an employee of the Government, whether or not the discretion involved be abused.[64]

### A. *A Brief History*

To support its finding that the statutory language of the discretionary function exception of the FTCA precludes liability regardless of negligence, the court in *Balmaceda* suggested that the legislative history of the FTCA indicates that it was not designed to impose liability for acts performed by government employees or officers when acting in a discretionary manner.[65] However, over the past forty years, the courts have had great difficulty in determining what constitutes discretionary conduct. In 1988, the U.S. Supreme Court adopted a two-step analysis to determine whether the FTCA discretionary function exception applies to certain conduct.[66] First, the Court considers "whether the challenged action is a matter of choice for the acting employee: '[T]he discretionary function exception will not apply when a federal statute, regulation, or policy specifically prescribes a course of action for an employee to follow'" and the employee fails to follow that course of action.[67] Second,

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64. 28 U.S.C.A. § 2680(a) (West 1965). For a comprehensive analysis of the discretionary function exception, see Goldman, *supra* note 60.

65. *Balmaceda,* 815 F. Supp. at 825. The court stated:

> [I]n enacting the FTCA, Congress stated that this 'highly important exception' was designed to preclude application of the bill to a claim against a regulatory agency . . . based upon an alleged abuse of discretionary authority by an officer or employee, whether or not negligence is alleged to have been involved . . . The bill is not intended to authorize a suit for damages to test the validity of, or provide a remedy on account of, such discretionary acts, even though negligently performed and involving an abuse of discretion.

*Id.* (quoting H.R.REP. No. 1287, 79th Cong., 1st Sess. 5-6 (1945)).

66. Prescott v. United States, 973 F.2d 696, 703 (9th Cir. 1992)(citing Summers v. United States, 905 F.2d 1212, 1214 (9th Cir. 1990)(citing *Berkovitz*, 486 U.S. 531 (1988))).

67. *Id.* (citing Summers v. United States, 905 F.2d 1212, 1214 (9th Cir. 1990)(quoting *Berkovitz*, 486 U.S. 531, 536 (1988))).

"[i]f the challenged conduct does involve an element of judgment, the [court must] determine whether that judgment 'is of a kind that the discretionary function was designed to shield.'"[68] "To be shielded the judgment must be grounded in social, economic, or political policy."[69] Under this analysis, "the United States must prove that each and every one of the alleged acts of negligence (1) involved an element of judgment and (2) the judgment was grounded in social, economic, or political policy."[70] The following Supreme Court decisions illustrate the development of this analysis.

1. *Operational/Planning Distinction*

The U.S. Supreme Court first interpreted the FTCA in *Dalehite v. United States* in 1953, when the United States was sued for damages as a result of a fatal and disastrous explosion of ammonium nitrate fertilizer, which had been produced and distributed under the direction of the United States for export to devastated areas occupied by the Allied Armed Forces after World War II.[71] The Court broadly interpreted the discretionary function exception, suggesting that, although Congress desired to waive the Government's immunity from liability for tortious injuries as a result of a government agent's conduct, it did not intend that the government be liable for all damages that arise from acts of a governmental nature or function.[72] The Court held that the government would not be liable for initiating the fertilizer program

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68. *Id.*

69. *Id.*

70. *Id.*

71. 346 U.S. 15 (1953). Claims of negligence arose out of a catastrophic explosion of fertilizer containing ammonium nitrate in Texas City, Texas. The fertilizer was manufactured by the United States as part of its post-war effort to increase the food supply in areas under military occupation. The court held that all plaintiffs' claims fell within the discretionary function exception, such that "'the discretionary function or duty' that cannot form a basis for suit under the [FTCA] includes more than the initiation of programs and activities. It also includes determinations made by executives or administrators in establishing plans, specifications or schedules of operations. Where there is room for policy judgment and decision there is discretion." *Id.* at 35-36.

72. *Id.* at 27-28. "The Federal Tort Claims Act was passed by the seventy-ninth Congress in 1946 . . . after nearly thirty years of congressional consideration. It was the offspring of a feeling that the Government should assume the obligation to pay damages for the misfeasance of employees in carrying out its work. And the private bill device was notoriously clumsy. Some simplified recovery procedure for the mass of claims was imperative." *Id.* at 24-25.

because it involved an element of policy judgment.[73] The Court determined that the discretionary function includes the establishment of plans, specifications, or schedules of operations, stating "[w]here there is room for policy judgment and decision there is discretion."[74] As a result, the Court limited liability to tortious conduct arising from "operational" activities, but continued to shield the government from liability whenever tortious conduct arose from actions grounded in policy or planning activities.[75]

Following the *Dalehite* decision, the Supreme Court in *Indian Towing Co. v. United States*[76] attempted to limit *Dalehite's* interpretation of the discretionary function exception. In *Indian Towing*, the plaintiff sued the government for failing to maintain a lighthouse in good working order. The Court determined that the initial decision to undertake and to maintain lighthouse service was a discretionary judgment.[77] The Court held, however, that the failure to maintain the lighthouse in good condition subjected the government to suit under the FTCA.[78] The Court's decision focused on the broad scope of liability under the FTCA and suggested that once a government agent decides to act, that individual must act with a standard of due care because he or she is no longer shielded under the discretionary function exception.[79] The Court further focused on the dichotomy between discretionary functions and operational activities, holding that the government was liable because its actions were operational in nature.[80] Over the next thirty years, courts struggled to ascertain which acts were uniquely planning in nature versus those that were simply operational in nature and inconsistently applied the operational/planning test in determining the liability of the United States Government under the FTCA.

2. *Nature of Conduct*

In 1984, the Supreme Court in *United States v. Varig Airlines*[81] again addressed the discretionary function exception, in an effort to clarify the operational/planning test and to harmonize the lower courts' in-

73. *Id.* at 35.
74. *Id.* at 36.
75. *Id.* at 42.
76. 350 U.S. 61 (1955).
77. *Id.* at 69.
78. *Id.*
79. *Id.* at 68-69.
80. *Id.* at 67-68.
81. 467 U.S. 797 (1984).

consistent definitions of a discretionary act.[82] In *Varig,* the survivors of two separate airplane accidents brought a tort action alleging that the Federal Aviation Administration (FAA) had acted negligently in certifying certain airplanes for operation. The Court found that the FAA's decision to certify planes according to a spot-check procedure without first inspecting them was a discretionary act for which the government was immune from liability.[83] The Court held that FAA spot-checking procedures were within the discretionary exception because the FAA balanced the burden of regulating with that of safety through these procedural mechanisms.[84] In an effort to limit the tort liability of the government, the Court held that it was "the nature of the conduct, rather than the status of the actor, that governs whether the discretionary function exception applies in a given case."[85] The Court was concerned that tort liability had been extended to certain governmental activities that were intended to be protected from suit by private individuals.[86] It stated that the discretionary function exception was designed by Congress to reflect its "wish[ ] to prevent judicial 'second guessing' of legislative and administrative decisions grounded in social, economic, and political policy through the medium of an action in tort."[87] The Court was attempting to clarify *Dalehite* by suggesting that, although administrative actions may involve discretionary judgment, the actions must be grounded in economic, political, or social policy before the exception will shield the government from liability.[88]

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82. Donald N. Zillman, *Regulatory Discretion: The Supreme Court Reexamines the Discretionary Function Exception to the Federal Tort Claims Act*, 110 MIL. L. REV. 115, 117 (1985).

83. *Varig,* 467 U.S. at 820. Varig Airlines involved two lawsuits challenging the FAA's certification for commercial use of two airplanes which later caught fire in flight. The Court held that the discretionary function exception applied to both the initial FAA decision to adopt a spot-check system of compliance review and the application of that system to the particular planes involved in the two crashes, because the two challenged FAA actions were taken within a statutory and regulatory element, leaving both the FAA and its spot-check inspectors room to make policy decisions. *Id.* at 819-20.

84. *Id.* at 820.

85. *Id.* at 813.

86. *Id.* at 808.

87. *Id.* at 814.

88. *Id.* "[T]he exception covers '[n]ot only agencies of government . . . but all employees exercising discretion.' Thus the basic inquiry . . . is whether the challenged acts of a Government employee—whatever his or her rank—are of the nature and quality that Congress intended to shield from tort liability." *Id.* at 813 (citations omitted).

3. *The Two-Step Analysis*

In 1988, the Supreme Court in *Berkovitz v. United States*[89] specified that the discretionary function exception of the FTCA does not preclude liability for any and all acts arising out of the regulatory programs of federal agencies; rather, the Court determined that the degree of discretion specifically prescribed by statute, regulation, or policy is determinative.[90] In *Berkovitz*, a child contracted severe polio and became paralyzed after ingesting a dose of Orimune, a polio vaccine which had been licensed and approved by the National Institute of Health's Division of Biologic Standards (DBS). The plaintiff challenged both the initial licensing of the vaccine and the approval of a particular lot for release to the public. The Court held that neither claim fell within the discretionary function exception, stating that if DBS incorrectly determined that the vaccine complied with regulatory safety standards, the crucial issue would be whether that determination "involve[d] the application of objective scientific standards . . . [or] 'policy judgment.'"[91]

As a result, the Court developed a two-step analysis. The Court first considered whether the action is a matter of choice for the acting employee.[92] If there is a federal statute, regulation, or policy specifically prescribing a course of action for the employee to follow, then the discretionary function exception will not apply.[93] If no regulation is involved, then the second step in the test is to "determine whether that judgment is of the kind that the discretionary function exception was designed to shield."[94] To be shielded from liability, the judgment must be "grounded in social, economic, and political policy."[95] The Court in *Berkovitz* determined that some of the claims fell outside the exception, because the agency employees had neglected to follow the specific directions contained in the applicable regulations; in those instances, there was no room for choice or judgment.[96] In other words, the employee had no rightful option but to adhere to the directive since his conduct cannot be the product of judgment or choice; "there is no discretion in the conduct for the discretionary function exception to protect."[97]

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89. 486 U.S. 531 (1988).
90. *Id.* at 538.
91. *Id.* at 544-45.
92. *Id.* at 536.
93. *Id.*
94. *Id.*
95. *Id.* at 536-37 (quoting *Varig,* 467 U.S. at 814).
96. *Id.* at 544.
97. *Id.* at 536. The Court held that the exception did not apply in Berkovitz

In 1991, the Supreme Court in *United States v. Gaubert*[98] abandoned the operational/planning distinction from *Dalehite* on the basis that all acts involve some form of discretion and that the central question is whether the act is grounded in policy. *Gaubert* involves the alleged negligent behavior on the part of federal bank regulators in their supervisory capacities over a failed savings and loan. Although the plaintiff contended that the actions fell outside the exception because the supervisory acts involved "the mere application of technical skills and business expertise," the Court held that "[i]t may be that certain decisions resting on mathematical calculations, for example, involve no choice or judgment in carrying out the calculations, but the regulatory acts alleged here are not of that genre."[99] The Court further held that "it is [obvious] that each of the challenged actions involved the exercise of choice and judgment."[100] The Court concluded that "if the routine or frequent nature of a decision were sufficient to remove an otherwise discretionary act from the scope of the exception, then countless policy-based decisions by regulators exercising day-to-day supervisory authority would be actionable."[101]

Although the Court in *Gaubert* rejected the operational/planning distinction that was set forth in *Dalehite*, it reaffirmed that the exception only protects those actions and decisions grounded in public policy and covers only acts that involve an element of judgment.[102] The Court

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at least insofar as it does not apply if the "Bureau's policy leaves no room for an official to exercise policy judgment in performing a given act, or if the act simply does not involve the exercise of such judgment, the discretionary function exception does not bar a claim that the act was negligent or wrongful." *Id.* at 546-47.

98. 111 S.Ct. 1267 (1991).

99. *Id.* at 1278.

100. *Id.*

101. *Id.* at 1279.

102. *Id.* at 1278-79. *Compare* Olsen v. Government of Mexico, 729 F.2d 641, 647 (9th Cir. 1984), *cert. denied,* 469 U.S. 917 (1984) (where a wrongful death suit was filed by the children of the deceased, who was killed in an airplane crash while being transported from Mexico to the United States. The court held that Mexico's alleged acts or omissions of negligently piloting a plane which contributed to the accident were not discretionary).

> [F]irst, while Mexico's decision to enter into the Prisoner Exchange Treaty with the United States or to transfer these particular prisoners to United States custody might well be deemed discretionary, those decisions were not implicated in the [alleged negligence of maintaining, directing, and piloting of the aircraft]. Such conduct represents measures taken to implement the broader policy or plan to exchange prisoners. The acts or omissions in question involved the transportation of prisoners, an act remote

also reaffirmed its holding in *Berkovitz* that the nature of conduct will not shield the government from liability "if a federal statute, regulation, or policy specifically prescribes a course of action for an employee to follow because the employee has no rightful option but to adhere to the directive."[103] Secondly, the Court reaffirmed its position in *Varig* that, "'assuming the challenged conduct involves an element of judgment,' it remains to be decided 'whether that judgment is of the kind that the discretionary function exception was designed to shield.'"[104] The Court concluded that, "the exception 'protects only governmental actions and decisions based on considerations of public policy'."[105] Therefore, to overcome a motion to dismiss under the discretionary function exception, the complaint "must allege facts which would support a finding that the challenged actions are not the kind of conduct that can be said to be grounded in the policy of the regulatory regime."[106] Further, "[t]he focus of the inquiry is not on the agent's

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from the policy decision to transfer them. While the pilot and air controllers had considerable discretion in carrying out their assigned tasks, it is clear they acted on the operational level, far from the centers of policy judgment.

*Id.* (citations omitted).

103. *Gaubert*, 111 S.Ct. at 1273 (citing *Berkovitz,* 486 U.S. at 536).

104. *Id.* (citing *Varig,* 467 U.S. at 813). The Court gave an analogy when discretionary acts will not be shielded. The Court stated:

> [T]here are obviously discretionary acts performed by a Government agent that are within the scope of his employment but not within the discretionary function exception because these acts cannot be said to be based on the purposes that the regulatory regime seeks to accomplish. If one of the officials involved in this case drove an automobile on a mission connected with his official duties and negligently collided with another car, the exception would not apply. Although driving requires the constant exercise of discretion, the official's decisions in exercising that discretion can hardly be said to be grounded in regulatory policy.

*Id.* at 1275, n.7.

105. *Id.* at 1273-74 (citing *Berkovitz*, 486 U.S. at 537).

106. *Id.* at 1274-75.

> [U]nder the applicable precedents, therefore, if a regulation mandates particular conduct, and the employee obeys the direction, the Government will be protected because the action will be deemed in furtherance of the policies which led to the promulgation of the regulation. If the employee violates the mandatory regulation, there will be no shelter from liability because there is no room for choice and the action will be contrary to policy. On the other hand, if a regulation allows the employee discretion, the very existence of the regulation creates a strong presumption that a discretionary act authorized by the regulation involves consideration of the same polices which led to the promulgation of the regulations.

*Id.* at 1274 (citations omitted).

subjective intent in exercising the discretion conferred by statute or regulation, but on the nature of the actions taken and on whether they are susceptible to policy analysis."[107] However, the Court recognized that "not all agencies issue comprehensive regulations . . . [rather,] . . . [s]ome establish policy on a case-by-case basis . . . or . . . rely on internal guidelines rather than on published regulations."[108] The Court stated that, "[i]n any event, it will most often be true that the general aims and policies of the controlling statute will be evident from its text."[109] Thus, in determining whether the discretionary function exception of the FTCA shields the government from liability, a two-step analysis must be conducted; the government must prove that the acts of negligence (1) involved an element of judgment and (2) that the judgment was grounded in social, economic, or political policy.

### B. *The Application of the Two-Step Analysis*

In granting a motion to dismiss, the U.S. District Court in *Balmaceda* determined that no inquiry into the alleged violations of the FDA laboratory procedure manual was necessary, on the grounds that negligence is not a consideration because the government is immune from liability under the discretionary function exception to the FTCA.[110] However, prior to dismissing an action on the basis of the discretionary function exception, the "United States bears the burden of proving the applicability of the [discretionary function exception] to the FTCA's general waiver of immunity."[111] At a minimum, the government must establish that the agent's discretionary act involved a balancing of policy.[112] The following section illustrates the application of the two-step analysis to *Balmaceda*.

#### 1. *Did the FDA decision to impose an embargo involve an element of judgment?*

The first issue concerns whether the allegedly negligent acts of the FDA investigators were discretionary and thus involved an element of

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107. *Id.* at 1274-75.
108. *Id.* at 1274.
109. *Id.*
110. *Balmaceda*, 815 F. Supp. at 826.
111. *Prescott*, 973 F.2d at 702.
112. *Id.* at 703.

judgment. While the operational/planning test has been rejected, courts have not abandoned the central theme that there is no discretion in an act which violates a regulation and, therefore, the exception will not reinstate sovereign immunity. In conducting a scientific analysis of the impounded grapes, the FDA investigators decided to modify the testing procedures in violation of both the Code of Federal Regulations and the FDA Regulatory Procedures Manual.[113] The facts indicate that the cyanide was discovered in the Philadelphia laboratory and then sent to a specialist in cyanide contamination for additional testing.[114] Because of the migratory characteristics of cyanide, the surrounding grapes in the sample should have revealed traces of contamination; however, no traces were found.[115] In an effort to explain the discrepancy, the investigators were to retest the sample. However, as a result of their testing methods,[116] the sample had been destroyed in violation of FDA laboratory procedures, which require the retention of any original sample in case reexamination becomes necessary.[117] Although the GAO determined that the violation of FDA procedures was acceptable, the discrepancy in testing procedures rendered the grape sample useless for further testing.[118] Therefore, in violating FDA regulations on laboratory procedures, the agents did not engage in discretionary conduct involving an element of judgment. However, if the court finds that the scientific testing did involve an element of judgment, the second part of the two-step analysis requires an examination of whether the conduct was grounded in social, economic, or political policy.

2. *Was the FDA's judgment grounded in social, economic, or political policy?*

At the outset, the two types of conduct manifested by the FDA in the Chilean Grape Crisis must be distinguished. The court in *Balmaceda* focused on the FDA's decision to impose an embargo on Chilean fruit as the discretionary act in question. However, the Chilean Exporters Association sued for negligence on the grounds that the FDA did not have the discretion to impose the embargo, based on alleged

113. Burkholz, *supra* note 12, at 14. *But see* GAO, *supra* note 47, at 13-14, 29-38.

114. Burkholz, *supra* note 12, at 14.

115. *Id. See also* GAO, *supra* note 47, at 39.

116. GAO, *supra* note 47, at 34.

117. Burkholz, *supra* note 12, at 14.

118. *Id.*

negligent violations of a procedures manual which delineates mandatory testing procedures within the FDA laboratory. Further, the findings of the GAO indicate that the violations of the FDA's laboratory testing and sampling procedures were the proximate cause of the FDA's actions in imposing the embargo on Chilean fruit imports.[119] Therefore, it must be determined whether both the decision to impose an embargo on Chilean fruit and the decision to modify FDA laboratory procedures were judgments grounded in social, economic, or political policy which are immune from liability under the discretionary function exception.

a. *The FDA's Decision to Impose the Embargo*

Recognizing the FDA's role as the protector of the public health, there is little question that it has the authority to refuse the admission of adulterated fruit into the United States.[120] The FDA's judgment to impose an embargo on Chilean fruit was grounded in policy designed to protect the public health. The question, however, is whether the actions which led to that judgment are shielded under the discretionary function exception. In *Kennewick Irrigation District v. United States,*[121] the court determined that the government's design of a canal was a discretionary act which was grounded in economic policy.[122] In *Kennewick*, the United States Bureau of Reclamation designed and constructed the canal in question in the 1950s. Once the canal was completed, the district of Kennewick assumed responsibility for its operation and maintenance. As a result of "piping" due to rodent holes, several breaks erupted in the main canal during its operation. The eruption caused a railroad right-of-way and track bed to be washed away and led to the derailment of a passenger train, which resulted in a number of personal injuries. The magistrate found that the negligence of the United States in both the design and the construction of the canal was the proximate cause of the breaks in the canal which led to the damage.[123] In applying the two-step analysis to determine whether the government's actions were discretionary and whether its judgment was grounded in

119. GAO, *supra* note 47, at 6.

120. 21 U.S.C.A. § 381 (West Supp. 1993). "The FDA may refuse admission of food into the United States '[i]f it appears from the examination of such samples or otherwise that . . . such article is adulterated.' . . ." *Balmaceda,* 815 F. Supp. at 826 (quoting 21 U.S.C.A. § 381(a)(West Supp. 1993)).

121. 880 F.2d 1018 (9th Cir. 1989).

122. *Id.* at 1031-32.

123. *Id.* at 1030.

social, economic, and political policy,[124] the court determined that the design of the canal was grounded in policy; however, the government official's discretion in the construction of the canal was based not on policy judgments, but on technical, scientific, and engineering considerations.[125] Thus, the court held that the discretionary function exception did not bar a claim of negligence arising from the exercise of scientific judgment.[126] Similarly, the FDA's decision to impose an embargo on Chilean fruit was grounded in social policy designed to protect the public health. However, the proximate cause of the embargo was the scientific analysis conducted by the FDA investigators, which erroneously led to a finding that the grapes were contaminated with cyanide. Therefore, it must be determined whether these scientific judgments[127] were grounded in technical and scientific considerations such that they are not shielded by the discretionary function exception.

b. *The FDA's Scientific Testing*

Assuming that the FDA investigators were acting with discretion, the second issue concerns whether the decision to modify FDA laboratory procedures involved the weighing of social, economic, and political policy considerations.[128] While the predominant goal of FDA policy is the protection of the public health, the exercise of sound scientific laboratory practices is essential in determining when protection is necessary. The Supreme Court in *Berkovitz* stated that "the discretionary function exception will not apply when a federal statute, regulation, or policy specifically prescribes a course of action for an employee to follow."[129] The Court determined that, if the conduct is "not a product of judgment or choice," then there cannot be any discretion for the exception to protect.[130] In *Berkovitz*, a child contracted a severe case of polio after orally ingesting a polio vaccination that was licensed and approved by the FDA. The child's parents alleged that the FDA acted wrongfully in approving the release of a particular lot of vaccine to

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124. *Id.* at 1025.

125. *Id.* at 1031.

126. *Id. See also* Routh v. United States, 941 F.2d 853 (9th Cir. 1991). Following Kennewick's two-step analysis, the court determined that a "contracting officer's on-site decision were not of the nature and quality that Congress intended to shield from tort liability." *Id.* at 857.

127. GAO, *supra* note 47, at 6.

128. *Berkovitz,* 486 U.S. at 536-37.

129. *Id.* at 536.

130. *Id.*

the public in violation of federal law and policy.[131] The Court found that the discretionary function exception did not bar suit when a specific regulation requires the employee to gather certain test data before making a determination as to whether the polio vaccine lot complies with regulatory standards.[132]

Conversely, in *Ayala v. United States,*[133] a suit was brought against the United States for alleged negligent technical advice and inspection of mining equipment by a coal mine electrical inspector employed by the Mine Safety and Health Administration (MSHA) in violation of MSHA standards. The main dispute revolved around the discretion used in giving technical advice. The district court focused on "the fact that inspectors had discretion in deciding whether or not to offer technical advice."[134] However, the Court of Appeals for the Tenth Circuit stated that, "[t]he specific technical assistance (i.e. to connect the wires to the wrong terminal in violation of mandatory safety standards) is what is at issue."[135] The court held that this particular decision was not grounded in any consideration of social, economic, or political policy; rather, the discretion exercised was based solely on technical considerations governed by "objective principles of electrical engineering."[136] Thus, the court in *Ayala* reversed the decision that the technical assistance claim "was barred by the discretionary function exception" and concluded that scientific practices are not immune from judicial scrutiny.[137] Likewise, in *In re Sabin Oral Polio Vaccine Products Liability Litigation,*[138] the court held that scientific analysis does not immunize the government from judicial review.[139] The court determined that neurovirulence testing of polio vaccines "requires the exercise of sound scientific judgment" when a regulation guiding action "calls for a 'comparative evaluation,' not simply a comparison of numerical test scores."[140] Similarly, the FDA agents' discretion in deciding to modify the scientific procedures during the testing and inspection of the grapes

131. *Id.* at 542-43.
132. *Id.*
133. 980 F.2d 1342 (10th Cir. 1992).
134. *Id.* at 1349.
135. *Id.*
136. *Id.* at 1349-50.
137. *Id.* at 1354.
138. 763 F.Supp. 811 (D. Md. 1991), *aff'd,* 984 F.2d 124 (4th Cir. 1993).
139. *Id.* at 821-22.
140. *Id.*

for cyanide was based on technical and scientific considerations.[141] In this case, no traces of cyanide could be detected after the original tests had been conducted because the remainder of the original samples was too scarce to allow retesting and a confirmation of the findings because of the alteration of testing procedures.[142] The policy of following the FDA laboratory procedures in retaining part of the original sample is to confirm cases of contamination when there are disparities in the findings.[143] Therefore, the violations of these FDA laboratory procedures are not based on social, economic, or political policy, but rather on technical and scientific considerations. Consequently, the scientific testing procedures are not immune from judicial scrutiny under the discretionary function exception to the FTCA.

### C. *Summary*

While recognizing that the FDA has discretion in its actions to protect the public health, it must also be recognized that the FDA does not have absolute discretion. The FDA is responsible for regulating and inspecting food shipments entering the United States. Shipments can be rejected after the FDA follows certain procedural guidelines. However, if those guidelines are negligently administered, then the exception should not protect the government from liability. If arbitrary guidelines are employed, then the FDA could reject any shipment of grapes for any reason. For example, the grapes may look too big, too small, slightly unripe, or just not to the inspector's liking. However, this is not an appropriate procedure to be used in refusing admission of food imports. In today's age of sophisticated scientific analysis, we expect regulators to employ sound and accurate procedures. If the testing is performed negligently, and is the proximate cause of injury, then the discretionary function exception to the FTCA should not bar suit. If the grapes had actually been contaminated and were allowed to enter the stream of commerce in the United States because the negligent testing by the FDA failed to reveal the contamination, then we would not want to deny recovery if American lives had been lost. The scrutiny must be placed upon the actors that performed the negligent analysis. If the *Balmaceda* decision is allowed to stand, then a

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141. GAO, *supra* note 47, at 6. The GAO's report stated that the modifications made in the inspecting and testing procedures were based on *scientific practices* rather than on economic considerations. *Id.*

142. *Id.* at 34.

143. Burkholz, *supra* note 12, at 14.

loophole is created for all administrative agencies to make their decisions on "other factors," essentially shielding decisions based on policy, as well as the negligent conduct that led to that decision. The general policy of protecting the public health and of granting FDA agents discretion to achieve those ends is far too broad and indefinite to insulate FDA investigators' conduct from suit.

## IV. FOREIGN POLICY CONCERNS

"International trade in FDA-regulated products has become increasingly important to the United States economy."[144] Our dependence on imported foods during off-seasons has become commonplace in the fruit industry. Prior to the Chilean Grape Crisis, most Americans were unaware that certain foods would be unavailable if it were not for the antithetical seasons of the southern hemisphere providing grapes, kiwis, melons, and other non-citrus fruits that would normally be unavailable during the winter months.[145] Chile has also benefited from the increase in market demand for fruit and has become a "star among the new exporters,"[146] being "virtually the sole supplier of soft tree fruits such as peaches and plums."[147] Likewise, the United States and Japan are Chile's largest trading partners, together accounting for over 32 percent of all exports.[148] Because of Chile's increasing fruit exports[149] and because the Chilean agricultural industry is a major employer accounting for

144. Paul M. Hyman, *Legal Overview of FDA Authority Over Imports and Exports*, 42 FOOD DRUG COSM. L.J. 203 (1987).

145. Leary, *supra* note 18. Because Chile is located in the Southern Hemisphere, its fruit season is opposite to that of the United States. As a result, most fruit that Americans buy during the winter and spring months come from Chile. This symbiotic relationship helps maintain a continual flow of fruit in both countries when the supply is low due to their diametrically opposing seasons.

146. Clemons P. Work & Robert E. Norton, *The Great Global Food Fright: Whether it's Grapes, Apples, or other Produce, World Food Exports are Growing. So, too, are Safety Concerns*, U.S. NEWS & WORLD REPORT, March 27, 1989, at 56, 57.

147. Lauter, *supra* note 11, at A1.

148. *Foreign Trade and External Payments and Debt, Chile Country Profile*, BUS. INT'L., May 1, 1993, *available in* LEXIS, NEWS Library, BUSINT File. While fruit exports do not constitute a large portion of Chile's gross domestic product, they averaged around 11 percent in 1991 of Chile's total exports. *Id.*

149. Chile's fruit exports earned a total of $949 million in 1991, and $704 million in 1990, with grapes accounting for 43.8 percent of total fruit exports in 1991-92. *Agriculture, Forestry, Fishing and Crops, Chile Country Profile*, BUS. INT'L., May 1, 1993, *available in* LEXIS, NEWS Library, BUSINT File.

over 17.5 percent of the Chilean workforce,[150] threats of a potential disruption in fruit shipments can have devastating effects on the Chilean economy.[151] Thus, when a United States agency such as the FDA takes action, its action affects not only domestic consumers and suppliers, but also the people of the nations with whom we trade.

This trend towards economic interdependence has encouraged the development of multilateral and bilateral free trade agreements throughout the world. With the European Community as a model of successful cooperation between nations, pockets of "communities" are discussing the possibilities of multilateral free trade agreements, including countries within the Pacific Basin, the continent of South America,[152] and the United States.[153] As the United States engages in free trade agreements, it must recognize the problems that are inherently associated with them, specifically the effects of absolute discretion and the perception of participating countries who, despite their dependency on American consumption, are suddenly barred from entering the American market because of the lack of due care exercised by American administrative agents. The policies of administrative agencies must also be adjusted by balancing the interests of the American public with the commercial interests of our trading partners.[154]

The Chilean Grape Crisis prompted Chile to ask the Council on General Agreement on Tariffs and Trade (GATT) to consider adopting directives that would require nations to balance "both the rights of contracting parties to defend the health of their populations . . . [with the interests of] . . . insur[ing] a stable climate for trade and exports."[155]

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150. *Chile Country Reports,* WALDEN COUNTRY REPORTS., December 18, 1992, *available in* LEXIS, World Library, COUREP File.

151. Shenon, *supra* note 8, at A22.

152. Don Podesta, *South Americans Give More Than Lip Service to Economic Integration,* WASH. POST, January 18, 1994, at A15.

153. On January 1, 1994, the North American Free Trade Agreement (hereinafter NAFTA) between Canada, Mexico, and the United States went into effect, making it the largest economic trading bloc in the world. *Nafta signed in 'defining moment',* USA TODAY (Int'l Ed.), December 9, 1993, *available in* WESTLAW, PAPERSMJ Database.

154. *See, e.g.,* Robinson, *supra* note 30. In spite of the United States embargo, the European Community had opted to inspect the incoming Chilean fruit rather than banning it. *Id. But cf.* William Pendergast, *Does, or Can, FDA Discriminate Against Foreign Origin Goods to the Advantage of Domestic Products?,* 42 Food Drug Cosm. L.J. 527 (1987). This article suggests that the current FDA policies and procedures governing foreign origin goods tend to illustrate a pattern of discrimination against such imports and recommends that the FDA policy on the regulation of international trade should reflect fair and equal treatment.

155. Chakravarthi Raghavan, *Trade: U.S. Blocks Panel Ruling on Section 337 Pro-*

As a result of Chile's request, the GATT Council provided guidelines to ensure that any measures taken by nations toward a third nation must bear a reasonable relationship to the conservation or public health objective.[156] The guidelines specifically state that "[a] measure taken by an importing contracting party should not be any more severe, and should not remain in force any longer than necessary to protect human, animal, or plant life or health involved, as provided in Article XX(b)."[157] The objective of this measure is to deal with the potential threats of "economic terrorism" and to avoid prejudicing the commercial interests of smaller nations when the threat is small compared to the action taken against that threat.[158] Therefore, under these guidelines, the FDA would have to weigh its decision to impose an embargo, after finding two grapes with scant traces of cyanide barely enough to make a small child sick, with the severe hardship inflicted upon the people, the industry, and the economy of another nation.

With the recent passage of NAFTA, administrators are seriously considering Chile as the next prospective nation to join the North American trading bloc, due to its consistent growth rate and political stability.[159] In May, 1992, the United States and Chile entered into free trade negotiations to enable Chile to export mineral and agricultural products to the United States and to allow the United States to export American mining, machinery, and telecommunications equipment into Chile.[160] The long-term goal of such an agreement is to eventually create a free-trade zone between the two countries.[161] The benefits for Chile are enormous, as the agreement reduces tariffs and protectionist measures after years of scrutiny by our government for violations of

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*ceedings*, INTER PRESS SERVICE, Geneva, April 12, 1989, *available in* LEXIS, NEWS Library, INPRES File.

156. Janet McDonald, *Greening the GATT: Harmonizing Free Trade and Environmental Protection in the New World Order*, 23 ENVTL. L. 397, 436 (1993) (citing GATT, GATT ACTIVITIES 1989, 100 (1990)).

157. *Id.* "[T]he guidelines do not provide any real guidance on the meaning of Article XX(b) but at least indicate that the measure taken must intrude as little as possible on trade policies and must bear a proportionate relationship to the policy objective being pursued." *Id.*

158. Raghavan, *supra* note 155.

159. Don Podesta, *South Americans Bank on NAFTA Trade Pact's Passage Viewed as Crucial for U.S. Ties in Region*, WASH. POST, November 13, 1993, at A20. *See also* Stan Hinden, *Some Favored Foreign Funds Could Be Winners in 1994*, WASH. POST, December 22, 1993, at D3.

160. Vicki Mayer, *The fever for free trade*, AMERICAS, July-August, 1992, at 2, 2-3.

161. *Id.*

human rights by the former military government.[162] For the United States, the tangible economic benefits are slim, as the United States only imports about $1.3 billion in goods from Chile; however, the treaty is a symbol of the United States' support of the reinstitutionalization of democracy in Chile.[163] The passage of a free trade agreement will signal an era of increasing trade between the United States and Chile and will require cooperation among both nations so that free trade can prosper. Thus, the United States should analyze how its foreign policy will affect free trade agreements. It should also consider how a single act of negligence by one or two individuals in a United States regulatory agency will impact another nation, particularly a developing nation that is vulnerable to, and dependent upon, more advanced nations such as the United States. The United States must accommodate this vulnerability if it is willing to engage in free trade agreements with developing nations.

## V. CONCLUSION

The discretionary function exception to the FTCA remains as controversial today as it was forty years ago, with the central issue being when, if ever, the government will become liable for acts arising out of a government agent's actions. The holding in *Balmaceda v. United States* suggests gross inequity, because it implies that administrative agency decisions will be shielded regardless of the negligence of government employees in exercising their power to regulate the importation of food products. The U.S. Supreme Court and lower court decisions suggest that acts prescribed by statute, regulation, or procedure, or acts that are not grounded in economic, social, or political policy, will not be shielded by the discretionary function exception, and will thus be subject to tort liability. Scientific analysis is a means to an end and merely provides the basis upon which a decision can be made. To suggest that any action towards imposing an embargo is protected, irrespective of how that decision is grounded, is to imply that both the means and the end are protected from tort action. While the final decision to impose an embargo may be protected, scientific analysis cannot be afforded that same protection.

Likewise, building a global market is important to the United States economy, as demonstrated by efforts to promote free trade and market economies throughout the world. However, with one negligent

162. *Id.* at 2, 3.
163. *Id.*

act, the FDA has the power to destroy consumer confidence in another nation's food products and thereby to inhibit trade with that nation and economic growth within that nation. The government should be wary of the implications of providing the FDA with such broad discretionary power. Through the imposition of an embargo on Chilean grape exports, the FDA crippled a developing economy, leading to enormous capital losses, further unemployment, and overall social, political, and economic hardship. Although the protection of the public health is an important and valid concern for the United States, perceived threats to the public health which are illusory and unfounded do not justify the closing of the United States market and the destruction of consumer confidence in another nation's goods. As a world trader, the United States must restrict the scope of protection afforded to the FDA in an effort to promote free and fair trade. Therefore, the United States must adopt policies which adequately balance the interests of protecting its citizens with the interests of engaging in prosperous relationships with other people and nations of the world.

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# Antidumping, A Choice Between Unilateral Duties or Negotiation of a Suspension Agreement: The Aftermath of *Techsnabexport, Ltd. v. United States*

## I. INTRODUCTION

More than a century has passed since the Sherman Antitrust Act of 1890,[1] the first major body of law regulating foreign trade in the United States, was enacted. A line of statutes has developed to address the problem of foreign merchandise being sold at discriminatory prices, or "dumped," in the United States.[2] The purpose of these laws is to protect domestic industries from unfair competition.[3] One of the most powerful regulations[4] in international trade is the Antidumping Act of 1921,[5] which is administered by the International Trade Commission (Commission) and the International Trade Administration (ITA), under the authority of the Department of Commerce (Commerce). This statute provides only an administrative remedy and consequently does not afford direct damages to an injured domestic industry.[6] The incentive for initiating an antidumping investigation results from perceptions that another country's industry is attempting to gain a competitive advantage

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1. Sherman Antitrust Act, Ch. 349, 28 Stat. 509 (current version at 15 U.S.C. §§ 1-7 (1988)).

2. Michael Huecker, Nichimen America, Inc. v. United States: *The Federal Circuit Untangles the Statutory Framework for Review of Antidumping Proceedings*, 17 N.C. J. INT'L L. & COM. REG. 531 (1992) (tracing the development of legislation attempting to prevent price discrimination; including the 1890 Sherman Antitrust Act, the Wilson Tariff Act, the 1916 Revenue Act, the Antidumping Act of 1921, the Tariff Act of 1930, and finally the 1979 Trade Agreements Act containing modern day antidumping law).

3. Peter Ehrenhaft, *Remedies Against "Unfair" International Trade Practices*, 12 A.L.I.-A.B.A. COURSE MATERIALS JOURNAL 93, 95 (1987).

4. *See* Charlene Barshefsky & Nancy B. Zucker, *Amendments to the Antidumping and Countervailing Duty Laws Under The Omnibus Trade and Competitiveness Act of 1988*, 13 N.C. J. INT'L L. & COM. REG. 251 (1988) [hereinafter Barshefsky & Zucker].

5. Antidumping Act of 1921, Ch. 14, 42 Stat. 9 (codified in 19 U.S.C. § 1303), *repealed by* Trade Agreements Act of 1979, Pub. L. No. 96-39, 93 Stat. 144 (codified as amended in Chapter 4 of the Tariff Act, Title IV, 19 U.S.C. § 1673-1677 (1988)).

6. Ehrenhaft, *supra* note 3, at 96. *Compare* Trade Agreements Act of 1916, 15 U.S.C. § 72 (1988), which created a private cause of action similar to antitrust statutes, but is rarely used because the claimant must prove predatory intent.

in a particular market by cutting prices, or to completely eliminate domestic producers.[7] Dumping could lead to a foreign producer gaining a monopoly, and potentially controlling United States prices.[8] Ideally, the purpose of antidumping legislation is to ensure a "level playing field" in international trade, not to compensate an injured industry by awarding monetary damages.[9]

A recent antidumping investigation against producers in the former Soviet Union raised two issues rarely or never before addressed. In *Techsnabexport (Tenex), Ltd. v. United States*,[10] uranium importers unsuccessfully challenged the legality of an antidumping investigation against twelve former Soviet republics. In a case of first impression, the Court of International Trade addressed the question of whether an investigation may continue after the country against which it was initiated has dissolved. The Commission's decision to continue the investigation against six republics[11] was upheld twice within four months by the court. *Tenex* involves a unique fact pattern, and the dissolution of an established nation rarely occurs. However, the case is important because the holdings indicate precedent for other importers or nations who might attempt to prematurely terminate an antidumping proceeding because of a change in government. The modern international trade arena includes an increasing number of new nations or restructured governments eager to create healthy trade relations with economically stable countries such as the United States. *Tenex* not only demonstrates how the court will apply American antidumping law, but reveals how the negotiation of a suspension agreement can promote a sound trade relationship.

As a background to the *Tenex* case, the relevant sections of the Antidumping Act will first be discussed. In Part II, the issues raised and the cases relied upon in the Court of International Trade's review of the *Tenex* investigation and its subsequent holdings will be examined. The significance and consequences of this case will be discussed in Part

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7. Huecker, *supra* note 2, at 531 (citing Charlene Barshefsky & Richard O. Cunningham, *The Prosecution of Antidumping Actions Under the Trade Agreements Act of 1979*, 6 N.C. J. INT'L L. & COM. REG. 307, 308 (1981)).

8. Barshefsky & Zucker, *supra* note 4, at 254.

9. Michael Sandler, *Primer on United States Trade Remedies*, 19 INT'L LAW 761, 763 (1985).

10. Techsnabexport, Ltd. v. United States, 795 F. Supp. 428 (Ct. Int'l Trade 1992)[hereinafter *Tenex*]. *See also* later proceeding 802 F.Supp. 469 (Ct. Int'l Trade 1992)[hereinafter *Tenex II*].

11. The six republics which Commerce initiated final investigation proceedings against are: Kazakhstan, Kyrgyzstan, Russia, Tajikistan, Ukraine, and Uzbekistan.

III, including the suspension agreements negotiated to prevent imposition of antidumping duties. Part IV concludes that the decision to continue an antidumping proceeding, regardless of whether a country's political boundaries have changed, was correct. However, it will be proposed that the time and cost spent during the investigation process would have been significantly reduced if the United States and Commerce more strongly encouraged negotiation of suspension agreements as an initial step in antidumping proceedings.

### *A. Antidumping Procedure*

Although the Antidumping Act does not define dumping in detail, it generally proscribes three types: (1) price discrimination, (2) below-cost sales, and (3) "constructed" below-cost sales.[12] Price discrimination is selling merchandise in a certain market at prices lower than similar merchandise is sold in the home or other foreign markets, without corresponding differences in production or transportation costs.[13] Below-cost selling occurs when merchandise is sold in the United States at prices lower than in the home market, and possibly lower than the cost of production.[14] Similarly, when merchandise is sold in the United States at prices lower than it is sold in third countries, the method of dumping is labeled constructed below-cost sales.[15]

An antidumping duty investigation may be initiated either by petition from an "interested party"[16] on behalf of a domestic industry

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12. Steven F. Benz, Note, *Below-Cost Sales and the Buying of Market Share*, 42 STAN. L. REV. 695, 710 (1990). Benz indicates three categories of dumping defined by economists as: (1) sporadic discounts to reduce surplus, (2) permanent policy of low cost sales to cover marginal costs, and (3) predatory or intentional dumping to destroy a domestic industry. Of these, (2) and (3) are considered unfair long-term trade practices and are subject to antidumping laws. *Id.*

13. *Id.* at 714-15.

14. *Id.* at 728.

15. *Id. See also* Sandler, *supra* note 9, at 765.

16. 19 U.S.C. § 1677(9). An interested party may be:

(A) a foreign manufacturer, producer, or exporter, or the United States importer, of merchandise which is the subject of an investigation under this subtitle or a trade or business association a majority of the members of which are importers of such merchandise,

(B) the government of a country in which such merchandise is produced or manufactured,

(C) a manufacturer, producer, or wholesaler in the United States of a like product,

(D) a certified union or recognized union or group of workers which is

or by Commerce *sua sponte*.[17] Next, the Commission and the ITA together make a series of determinations in a lengthy and complicated process.

The Commission first makes a preliminary determination of injury or threat of injury to the domestic industry.[18] At the same time, the ITA makes a preliminary decision of whether there is a reasonable indication that merchandise is "being sold, or is likely to be sold, at less than fair value."[19] Within seventy-five days of its preliminary determination, the ITA must make a final determination regarding sales at less than fair value (LTFV).[20] If the ITA makes an affirmative final LTFV determination, the Commission must make a final injury determination within seventy-five days.[21]

If both the Commission and ITA make an affirmative final determination, the ITA issues an antidumping duty order.[22] Customs then assesses a duty "equal to the amount by which the foreign market value of the merchandise exceeds the United States price."[23]

### B. *Review of Antidumping Duty Order*

The majority of administrative and judicial reviews take place after a final dumping determination is reached. The Antidumping Act provides for administrative review of antidumping duty orders or suspension

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representative of an industry engaged in the manufacture, production or wholesale in the United States of a like product,
(E) a trade or business association a majority of whose members manufacture, produce, or wholesale a like product in the United States,
(F) an association, a majority of whose members is composed of interested parties described in subparagraph (C), (D), or (E) with respect to a like product . . . .

*Id.*

17. 19 U.S.C. § 1673a(a).

18. *Id.* § 1673b(a).

19. *Id.* § 1673b(b).

20. *Id.* § 1673d(a). This final determination shall be made even if the preliminary less than fair value (LTFV) determination was negative. As long as the preliminary determination of injury is affirmative, the investigation will continue to its final stages. *Id.*

21. *Id.* § 1673d(b)(3). An antidumping investigation, without extensions for extremely complicated cases, can take up to 310 days (or more than 10 months).

22. *Id.* § 1673d(c).

23. *Id.* § 1673e. The basis for antidumping duty comes from the ITA's calculation of foreign market value during the investigation. *Id. See also* § 1673f, directing how to treat the difference between the estimated duty deposit and the actual duty assessment.

agreements at the request of an interested party,[24] but only where sufficiently changed circumstances are shown.[25] In addition, the Tariff Act of 1930 supplies rules for protest and judicial review immediately after any determination by the Commission or the ITA.[26] Within thirty

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24. *Id.* § 1675(a)(1). To prevent unnecessary costs, the 1984 amendments to the Trade and Tariff Act added the stipulation that administrative review will not occur without a formal request from an interested party. *Id.* (Pub. L. No. 98-573, § 611, 98 Stat. 2948, 3031).

25. *Id.* § 1675(b)(1). Absent good cause, review of preliminary determinations under § 1673b and suspension agreements under § 1673c cannot be reviewed "less than 24 months after the date of publication of notice of that determination or suspension." *Id.* § 1675(b)(2). All other determinations may be reviewed at least twelve months after their publication. *Id.* § 1675(a).

26. Tariff Act of 1930, 19 U.S.C. § 1516a (1988). The statute allows judicial review in antidumping duty proceedings under the following circumstances:

> (B) Reviewable determinations
>
> The determinations which may be contested under subparagraph A are as follows:
>
> (i) Final affirmative determinations by the administering authority [ITA] and by the Commission under section 1671d or 1673d of this title, including any negative part of such a determination (other than a part referred to in clause (ii)).
>
> (ii) A final negative determination by the administering authority or the Commission under 1671d or 1673d of this title, including, at the option of the appellant, any part of a final affirmative determination which specifically excludes any company or product.
>
> (iii) A final determination, other than a determination reviewable under paragraph (1), by the administering authority or the Commission under section 1675 or this title.
>
> (iv) A determination by the administering authority, under section 1671c or 1673c of this title, to suspend an antidumping duty or countervailing duty investigation, including any final determination resulting from a continued investigation which changes the size of the dumping margin or net subsidy calculated, or the reasoning underlying such calculations, at the time the suspension agreement was concluded.
>
> (v) An injurious effect determination by the Commission under section 1671c(h) or 1673c(h) of this title.
>
> (vi) A determination by the administering authority as to whether a particular type of merchandise is within the class or kind of merchandise described in an existing finding of dumping or antidumping or countervailing duty order.
>
> (3) Exception—Notwithstanding the limitation imposed by paragraph (2)(A)(i)(II) of this subsection, a final affirmative determination by the administering authority under section 1671d or 1673d of this title may be contested by commencing an action, in accordance with the provisions of paragraph (2)(A), within thirty days after the date of publication in the

days of publication of certain determinations, any party to the proceeding may request judicial review by the Court of International Trade.[27] The court "shall hold unlawful any [administrative] determination . . . found . . . to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law, or . . . unsupported by substantial evidence on the record . . . ."[28] The circumstances giving cause for review are final affirmative determinations, final negative determinations, determinations upon administrative review, determinations to terminate or to suspend an investigation, an injurious effect determination, or a determination of whether particular merchandise is within the class to be investigated.[29]

Because the Antidumping Act only allows judicial review under the above enumerated circumstances, Congress found it necessary to add a general grant of jurisdiction to provide for review of unique situations. Through the Customs Court Act of 1980, Congress conferred exclusive jurisdiction to the Court of International Trade for antidumping actions.[30] In addition to the enumerated circumstances of the Antidumping Act, residual jurisdiction was granted for controversies concerning "tariffs, duties, fees, or other taxes on the importation of merchandise" where jurisdiction under another subsection of the Customs Court Act is unavailable.[31] The threshold issue in *Tenex* was whether the legality of an antidumping proceeding can be reviewed, prior to any final agency determination, pursuant to the residual jurisdiction provision of the Customs Court Act.

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Federal Register of a final negative determination by the Commission under section 1671d or 1673d of this title.

*Id.* at § 1516a(a)(2)(B).

27. *Id.* § 1516a(a)(1).

28. *Id.* § 1516a(b)(1).

29. *Id.* § 1516a(a)(2)(B).

30. Customs Court Act of 1980, Pub. L. No. 96-417, 94 Stat. 1747 (codified as amended in scattered sections of 28 U.S.C.). The Customs Court was renamed the Court of International Trade to reflect "more accurately . . . the court's clarified and expanded jurisdiction and its new judicial functions relating to international trade." H.R. REP. No. 1235, 96th Cong., 2d Sess. 18 (1980), *reprinted in* 1980 U.S.C.C.A.N. 3729.

31. 28 U.S.C. § 1581(i)(2) (1988). Subsection (c) grants exclusive jurisdiction to the Court of International Trade to hear "any civil action commenced under section 516A of the Tariff Act of 1930 [19 U.S.C. § 1516a]." Subsection (i)(4) also provides an equitable remedy of residual jurisdiction, but states that it "shall not confer jurisdiction over an antidumping . . . duty determination which is reviewable . . . under section 516A(a) of the Tariff Act of 1930 [19 U.S.C. § 1516a(a)]." *Id.*

### C. *Provision for Suspension of Investigation*

The Antidumping Act provides three alternative methods to suspend antidumping proceedings. An investigation may be terminated by (1) withdrawal of petition, (2) an agreement to completely eliminate either exports or sales at less than fair value, or (3) an agreement to eliminate the injurious effect.[32] Commerce must be satisfied that ending the proceeding is in the public interest and can be practically monitored before accepting an agreement.[33] The *Tenex* case was eventually concluded by a suspension agreement negotiated between Russia and the United States. The agreement was signed on the eve of the scheduled date for imposition of duties on incoming uranium.

If Commerce receives a request from an interested party to continue the investigation within twenty days after notice of suspension, it can only do so under certain circumstances.[34] The investigation will be resumed if the agreement no longer meets the statutory requirements[35] or the exporters violate the agreement.[36] The Antidumping Act also provides for review of the suspension agreement by petition from an interested party within twenty days after the suspension notice.[37]

## II. STATEMENT OF THE CASE: TECHSNABEXPORT, LTD. v. UNITED STATES

### A. *Factual Background*

On November 8, 1991, pursuant to American antidumping laws, the Ad Hoc Committee of Domestic Uranium Producers and the Oil,

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32. 19 U.S.C. § 1673c.

33. *Id.* § 1673c(a), (b), and (c).

34. *Id.* § 1673c(f) and (g). The relevant portions state:

(3) where investigation is continued. If, pursuant to subsection (g) of this section, the administering authority and the Commission continue an investigation in which an agreement has been accepted under subsection (b) or (c) of this section, then . . .

(B) if the final determinations by the administering authority and the Commission under such section are affirmative, the agreement shall remain in force, but the administering authority shall not issue an antidumping duty order in the case so long as . . .

(ii) the agreement continues to meet the requirements of subsections (b) and (d), or (c) and (d) of this section, and

(iii) the parties to the agreement carry out their obligations under the agreement in accordance with its terms.

*Id.*

35. *See id.* § 1673c(b), (c), and (d).

36. *Id.* § 1673c(i).

37. *Id.* § 1673c(h).

Chemical and Atomic Workers International Union filed a petition requesting initiation of an investigation against uranium exporters from the Union of Soviet Socialist Republics (U.S.S.R.).[38] The domestic industry (industry) alleged that imports during 1989-91 of natural and enriched uranium "present a real threat of material injury to the United States uranium industry" and that "actual injury is imminent."[39] According to the industry, foreign uranium imports adversely affect domestic prices both directly by price-cutting, and indirectly by increasing the volume of foreign uranium in the marketplace.[40] The imported products to be investigated include uranium ores and concentrates; natural and enriched uranium metal and uranium compounds; and alloys, dispersions, or ceramic products and mixtures containing natural or enriched uranium.[41] In light of the U.S.S.R.'s political turmoil at the time,[42] the industry specifically named each individual republic to ensure relief in case any of them withdrew.[43] The Commission made its preliminary affirmative injury determination on December 23, 1991.[44]

After months of Parliamentary debate in Moscow, dissolution of the Soviet nation was formally announced on December 25, 1991.[45] On January 10, 1992, Tenex, the largest uranium exporter from the U.S.S.R., and Nuexco Trading Corporation, the sole American im-

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38. Uranium from the Union of Soviet Socialist Republics, 56 Fed. Reg. 63,711 (Dep't Comm. 1991) (initiation of antidumping duty investigation) [hereinafter Initiation]. The Antidumping Act allows imposition of antidumping duties if a "class or kind of foreign merchandise is being, or is likely to be, sold . . . at less than its fair value, and . . . an industry in the United States is materially injured, or is threatened with material injury." 19 U.S.C. § 1673.

39. Michael Knapik and Wilson Dizard III, *Producers, Union File Antidumping Case Against Imports of Soviet Uranium*, 16 NUCLEARFUEL No. 24, at 1 (November 25, 1991).

40. *Id.*

41. *Initiation, supra* note 38.

42. *See* Andranik Migranyan, *Can Yeltsin's Russia Survive?*, 12 MOSCOW NEWS WEEKLY No. 40 (October 2, 1991). The author states: "The instant collapse of the U.S.S.R. has suprised not only the advocates of a renovated empire, but also its most ruthless destroyers. It was an explosion rather than a new bout of centrifugal tendencies." *Id. See also* L.T., *Last Days of the U.S.S.R. Supreme Soviet*, 15 MOSCOW NEWS WEEKLY No. 51 (December 18, 1991).

43. *Tenex*, 795 F. Supp. 431 n.4.

44. *Uranium from the U.S.S.R.*, 57 Fed. Reg. 68 (Dep't Comm. 1992) (affirmative preliminary injury determination).

45. *See The Soviet Parliament Adopts a Resolution on the End of the U.S.S.R.*, Agence Europe, December 25, 1991, *available in* LEXIS, Newspaper Library, International File.

porter, requested Commerce to terminate the investigation since the country named in the petition had ceased to exist.[46] Commerce announced on March 24, 1992, that it intended to continue the investigation and had issued questionnaires to the twelve newly independent republics.[47]

The deadline for a preliminary dumping determination was extended until May 18, as it was an "extraordinarily complicated" investigation.[48] Commerce stated that although Tenex was attempting to cooperate, Commerce found it difficult to communicate with the new republics.[49] The "situation where the country identified in the petition has dissolved" was also cited as an issue novel enough to warrant extension of the investigation.[50]

Two republics, Ukraine and Tajikistan, filed suit on April 9, 1992, requesting that the Court of International Trade order the Commission to cease its antidumping investigation.[51] Tenex subsequently made the same request for injunctive relief and the actions were consolidated. The republics and Tenex (collectively referred to as Tenex) named three forms of irreparable injury that would result if the investigation was continued, including denial of right to due process of law, interference with credibility as sovereign nations, and interference with ability to function effectively in the international trading community.[52]

### *B. In the Court of International Trade: May 21, 1992*

The first proceeding in the Court of International Trade resolved two issues. The first issue addressed was whether the court had jurisdiction to hear a challenge to the legality of an antidumping investigation before any final determinations were made by the Commission.[53] The

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46. *Tenex*, 795 F. Supp. at 431.

47. *Id.*

48. *Uranium from the Former Union of Soviet Socialist Republics (USSR)*, 57 Fed. Reg. 11,064-02 (Dep't Comm. 1992) (postponement of preliminary antidumping duty determination)[hereinafter *Postponement*].

49. *Id.* Under subsection (c) of 19 U.S.C. § 1673b, the investigation may be extended in "extraordinarily complicated cases" including (1) large number and complexity of transactions, (2) novelty of issues, or (3) number of firms to be investigated. The notice of postponement and specific reasons must be published in the Federal Register. 19 U.S.C. § 1673b(c).

50. *Id.*

51. *Tenex II*, 802 F. Supp. at 470.

52. Michael Knapik, *Two CIS Countries File Suit to Block Antidumping Uranium Case*, 17 NUCLEARFUEL No. 8, at Extra (April 13, 1992).

53. *Tenex*, 795 F. Supp. at 432-33.

second issue was whether a decision by the Commission to continue an antidumping investigation after the country named in the petition has ceased to exist violates due process and warrants injunctive relief.[54]

*1. Residual Jurisdiction*

Tenex asserted that the court had residual jurisdiction under section 1581(i) of the Customs Court Act. The defendant United States (government) asserted that Tenex would have an adequate remedy by protesting the continued investigation after a final affirmative duty determination was issued, granted in section 1581(c).[55] Tenex argued that such a remedy would be manifestly inadequate because "mere continuation of the investigation will cause irreparable harm . . . ."[56]

Section 1581 of the Customs Court Act grants exclusive subject matter jurisdiction to the Court of International Trade to review proceedings arising under the Tariff Act of 1930.[57] Subsections (a) through (h) narrowly define areas in which the court has jurisdiction.[58] In addition, Congress provided residual jurisdiction in subsection (i) for controversies that do not fit under subsections (a)-(h).[59] Both the Court of International Trade and the federal circuit have read the additional provision narrowly, only allowing its use in exceptional circumstances.[60]

The court in *Tenex* held that residual jurisdiction may be invoked where "another subsection of [section] 1581 is unavailable or the remedy provided by the other subsection is 'manifestly inadequate'."[61] The court relied on several cases that applied residual jurisdiction in antidumping or countervailing duty cases, including *Asociacion Colombiana de Exportadores de Flores (Asocoflores) v. United States*[62] and *Carnation En-*

54. *Id.* at 430-31.
55. *Id.* at 432-33.
56. *Id.* at 433.
57. 28 U.S.C. § 1581.
58. *Id.* § 1581(a)-(h).
59. *Id.* § 1581(i).
60. Honorable Gregory W. Carman, *The Jurisdiction of the United States Court of International Trade: A Dilemma for Potential Litigants*, 22 STETSON L. REV. 157, 162 (1992). Without § 1581(i) residual jurisdiction, litigants would have to "slide exactly into a glove of eight jurisdictional fingers, listed at 28 U.S.C. § 1581(a)-(h)." *Id.*
61. *Tenex*, 795 F. Supp. at 433 (citing National Corn Growers Ass'n v. Baker, 840 F.2d 1547, 1557 (Fed. Cir. 1988); Miller & Co. v. United States, 824 F.2d 961,963 (Fed. Cir. 1987), *cert. denied*, 484 U.S. 1041 (1988) (holding that plaintiff who failed to participate in administrative proceedings lacked standing to bring 1581(i) action and remedy under 1581(c) was not manifestly inadequate)).
62. Asociacion Colombiana Exportadores Flores (Asocoflores) v. United States, 717 F. Supp. 847 (Ct. Int'l Trade 1989), *aff'd*, 903 F.2d 1555 (Fed. Cir. 1990).

*terprises v. United States Dep't of Commerce.*[63] The government argued that *Tenex* was similar to *Macmillan Bloedel Ltd. v. United States,*[64] which was a challenge for failure to exclude a party. The court disagreed and distinguished the case from *Tenex*, stating that *Macmillan Bloedel* was not as unique and therefore did not compel interim review.[65] The controversy and confusion among parties and the courts regarding jurisdiction in actions under the Tariff Act[66] warrants close examination of the cases cited in *Tenex*.

In *Asocoflores*, plaintiffs petitioned for an injunction to prevent the defendant (ITA) from conducting a review of certain producers or exporters of fresh cut flowers, because the Floral Trade Council failed to state specific reasons for the review when requesting it. The ITA argued that residual jurisdiction "should not be utilized to circumvent the exclusive methods of judicial review . . . set forth in 19 U.S.C. [section] 1516a."[67] The ITA also relied upon legislative history, in which Congress explicitly stated that section 1581(i) "was not intended to create new causes of action."[68] The court agreed with these assertions, but found it necessary to examine "whether [section 1581(c)] provides an adequate avenue for relief . . . ."[69] Because the action was not protesting a preliminary decision or procedural matters by the ITA, the court reasoned that judicial review after a final countervailing duty determination would be unavailable.[70] Instead, the legality of a "massive review of an entire industry" was being challenged, and the court found such an issue to fit the "extraordinary situation" criterion under section 1581(i).[71] The court held that it could exercise jurisdiction because "[i]n the absence of specific legislative guidance to the contrary, the court relies on the general presumption in favor of reviewability."[72]

*Carnation* involved Indian exporters of iron construction castings who, before any final determination, attempted to challenge the right

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63. Carnation Enter. Pvt. Ltd. v. United States Dep't Commerce, 719 F. Supp. 1084 (Ct. Int'l Trade 1989).

64. Macmillan Bloedel, Ltd. v. United States, 1992 WL 107336 (Ct. Int'l Trade 1992).

65. *Tenex*, 795 F. Supp. at 433-34.

66. *Carman, supra* note 60, at 160.

67. *Asocoflores*, 717 F. Supp. at 849. *See supra* note 26 and accompanying text for enumerated methods of judicial review.

68. *Id.* (quoting H.R. REP. No. 1235, *supra* note 30).

69. *Id.* at 850.

70. *Id.*

71. *Id.* at n.4.

72. *Id.* at 851.

of Commerce to conduct administrative reviews of a dumping order. Commerce argued that adequate judicial review was provided by section 1516a of the Antidumping Act,[73] and the exporters were merely "attempting to circumvent the statutory scheme for judicial review after completion of an administrative review."[74] Further, Commerce argued that the exporters lacked standing as "adversely affected" parties and could not file a claim until the agency action is final.[75] The court noted that the party propounding section 1581(i) jurisdiction "has the burden to show how [another] remedy would be manifestly inadequate."[76]

One case cited by Commerce as controlling, *Koyo Seiko v. United States*,[77] was distinguished by the *Carnation* court as involving procedural issues in the administrative process. In contrast, *Carnation* involved the legality of administrative proceedings. The court agreed that the remedy under 1581(c) would be manifestly inadequate for two reasons. First, if the exporters decline to participate in what they feel are illegal administrative reviews, but a court finds the reviews valid, the exporters then lack standing as participants and would not be able to compel judicial review.[78] Second, if dumping margins are not found from the review, the exporters will not be "aggrieved parties" and again cannot compel judicial review under 1581(c) jurisdiction.[79]

Secondary support for invoking section 1581(i) jurisdiction in *Carnation* was found in legislative history. The House Judiciary Committee report stated: "subsection (i) . . . makes it clear that the court is not prohibited from entertaining a civil action relating to an antidumping . . . proceeding," as long as the issue does not relate to reviewable procedures specified in section 1516a.[80] In consideration of the statutory language, case precedent, legislative history, and the "general presumption in favor of judicial review,"[81] *Carnation* held that residual jurisdiction under section 1581(i) was proper.[82]

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73. 19 U.S.C. § 1516a.

74. *Carnation*, 719 F. Supp. at 1087.

75. *Id.* at 1088.

76. *Id.* at 1089 (citing *Miller & Co.*, 824 F.2d at 963, and American Air Parcel Forwarding v. United States, 718 F.2d 1546, 1550-51 (Fed. Civ. 1983), *cert. denied*, 466 U.S. 937 (1984)). The court distinguishes the plaintiff in *Miller & Co.*, who did not participate in Commerce proceedings (thus deciding the issue on standing), from the plaintiff in *Carnation* who did participate. *Id.*

77. Koyo Seiko Co. v. United States, 715 F. Supp. 1097 (Ct. Int'l Trade 1989).

78. *Carnation*, 719 F. Supp. at 1090.

79. *Id.*

80. *Id.* (quoting H.R. REP. No. 1235, *supra* note 30).

81. *Id.* at 1091.

82. *Id.*

In contrast to the two previous cases, the court in *Macmillan Bloedel* held that it lacked jurisdiction to review a pending countervailing duty investigation because plaintiff (Macmillan) would have a "meaningful opportunity after the final determination to challenge" the denial of exclusion.[83] Macmillan sought a writ of mandamus ordering Commerce to investigate whether Macmillan should be excluded from a countervailing duty order on softwood lumber products from Canada. The court recognized certain circumstances in which residual jurisdiction under 1581(i) has been appropriate, such as *Nissan Motor Corp. v. United States*.[84]

In *Nissan*, Japanese plaintiffs (exporters) who manufactured tapered roller bearings and components sought to prevent the ITA from conducting administrative reviews after Commerce had tentatively decided to revoke their antidumping finding on products exported by plaintiffs. The exporters argued that the ITA had "failed to abide by its own regulations and time limits."[85] The court held that the exporters' action fell within 1581(i) jurisdiction because it was one "which cannot be contested via [section] 1516a."[86]

The *Macmillan Bloedel* court noted that the cases allowing residual jurisdiction all "would have been denied relief if required to wait for the final determinations."[87] *Nissan* and similarly cited cases[88] were distinguished from *Macmillan Bloedel* on the basis that Macmillan would have a "meaningful opportunity" to seek judicial review after the Commission's final determination.[89] The reason stated for drawing such a narrow distinction was that, although Congress did not intend to completely preclude interim judicial review in antidumping and countervailing duty cases, the jurisdiction granted under 1581(i) "is not broad."[90]

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82. *Id.*

83. *Macmillan Bloedel*, 1992 WL 107336 at *2. *Accord* Associacao Industriais Cordoaria Redes v. United States, 828 F. Supp. 978 (Ct. Int'l Trade 1993).

84. Nissan Motor Corp. v. United States, 651 F. Supp. 1450 (Ct. Int'l Trade 1986).

85. *Id.* at 1453.

86. *Id.*

87. *Macmillan Bloedel*, 1992 WL 107336 at *1.

88. The court also cited Nakajima All Co. v. United States, 691 F. Supp. 358 (Ct. Int'l Trade 1988); *Carnation*, 719 F. Supp. 1084; and *Asocoflores*, 717 F. Supp. 847.

89. *Macmillan Bloedel*, 1992 WL 107336 at *2.

90. *Id.*

Of the above discussed cases, no factual situation or challenge involved is completely on point with the facts or challenge of *Tenex*. However, the Court of International Trade seems to be more willing to invoke residual jurisdiction when the legality, instead of a procedural aspect, of the administrative proceeding is questioned. Therefore, *Tenex* found the challenge to the validity of continuing an antidumping investigation after the Soviet Union has ceased to exist sufficient to invoke residual jurisdiction. In addition, the court concluded that "there is no guarantee that an adverse appealable decision will result" from the antidumping investigation.[91] Based on these two factors, the court held that review under section 1581(c) would be manifestly inadequate and thus exercised jurisdiction under 1581(i).[92]

*2. Legality of Antidumping Proceedings*

The substantive issue of whether preliminary relief can be granted to prevent the continuation of an allegedly invalid antidumping investigation was next discussed by the court. A balancing test of four factors was deemed necessary, including (1) the likelihood of success on the merits, (2) the threat of immediate irreparable harm if relief is denied, (3) the balance of hardships, and (4) the public interest.[93]

The first factor of success on the merits was not discussed in detail. In fact, the court stated that it is "inappropriate to resolve [the issues] . . . according to a likelihood of success on the merits standard."[94] The fourth factor of public interest also did not receive a detailed examination, except the controversy was found "extremely complicated and of great importance to all of the parties."[95] The court hinted that the public interest would favor completing the investigation before deciding upon its validity.[96] But what the court did not discuss was how an issue important to the parties would also be important to the public. The brevity of the discussion concerning factors one and four left the

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91. *Tenex*, 795 F. Supp. at 434.

92. *Id.*

93. *Id.* at 435.

94. *Id.* at 437. Because the antidumping investigation was not complete at the time, and therefore not all the necessary information had been gathered, the court seemed unwilling to predict whether the exporters would succeed at a review after final administrative determinations were published.

95. *Id.*

96. The court stated that "it is inappropriate to resolve them (the issues of statutory interpretation) in a hurried manner." *Id.*

remaining factors to weigh heaviest in the court's determination of relief.

Factor two, threat of immediate irreparable harm, was given the most in-depth discussion by the court. Tenex argued that their procedural due process rights were violated, which has been considered sufficient irreparable harm in prior cases to command immediate relief.[97] A two-part test was applied: 1) did a protected interest exist, and 2) what is necessary to protect the interest if it exists?[98]

For a foreign entity to have a protected interest under the U. S. Constitution, the interest must be one worthy of protection, such as a property interest, but more than a "unilateral expectation."[99] Tenex claimed its property interest is in "avoiding damaged business relationships, lost sales, and arbitrary antidumping duties."[100] The republics claimed that as interested parties, their interest is found in sections 1677(9)(A) and (B) of the Antidumping Act as "access to the United States market."[101] The court referred to *Perry v. Sinderman*,[102] which held that "mere subjective expectation of a future business transaction does not rise to the level of an interest worthy of constitutional protection."[103] Consequently, potentially damaged business interest and lost sales were not found to be interests worthy of due process protection in *Tenex*. Although some courts have held that due process rights stem from import statutes,[104] this court rejected the argument that the republics have an interest in access to the United States market under

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97. *Id.* (citing Bowman v. Township of Pennsauken, 709 F. Supp. 1329 (D.N.J. 1989) (equal protection and due process violations establish irreparable harm), and Cate v. Oldham, 707 F.2d 1176 (11th Cir. 1983) (violation of First Amendment rights constitutes irreparable injury)).

98. *Id.* at 435.

99. *Id.* (citing American Ass'n of Exporters and Importers-Textile and Apparel Group v. United States, 751 F.2d 1239, 1250 (Fed. Cir. 1985)[hereinafter *American Ass'n*] (trade association representing domestic importers had no right to challenge on due process grounds because no legitimate claim of entitlement was made and no international agreement gave a proprietary interest)). *See also* Board of Regents v. Roth, 408 U.S. 564, 571 (1972).

100. *Id.* (quoting company plaintiff's brief at 51-52).

101. *Id.* (citing sovereign plaintiffs' brief at 48).

102. Perry v. Sinderman, 408 U.S. 593, 603 (1972).

103. *Id.*

104. *See Koyo Seiko*, 796 F. Supp. at 523-24 (Commerce's excessive delay in completing final determination implicitly violated due process rights) *and* Lois Jeans & Jackets v. United States, 566 F. Supp. 1523, 1527-28 (Ct. Int'l Trade 1983) (lack of notice and opportunity to comment prejudicial enough to violate due process).

the "interested party" provision of the Antidumping Act.[105] The court did not expressly distinguish the cases finding due process rights from *Tenex*, but implied that because those cases gave no detailed explanation of the property interest involved; they do not compel a finding of due process violation in all situations.[106]

Tenex also failed to prove the existence of harm from an alleged due process violation.[107] Due process includes the elements of notice and the opportunity to be heard.[108] Both constructive and actual notice of the antidumping investigation was given to all parties under investigation.[109] Also, because Commerce has delayed the deadline for preliminary determinations to give the republics more time to respond to questionnaires, ample opportunity was given to be heard and participate in the antidumping proceedings.[110] The court found both elements were offered to Tenex and concluded that the necessary constitutional standards were met.[111] Because no worthy property interest existed and adequate process was provided, the court found insufficient proof of immediate irreparable injury.[112]

The third factor in determining whether preliminary relief should be granted is a balance of hardships on the parties involved. The court stated that it was "impossible to determine . . . which is suffering the greater harm" at this point in the antidumping proceedings.[113] Because Tenex had the burden to prove hardship and insufficient evidence was presented, the court presumed the hardships to balance.[114]

After a four-factor balancing test was announced, the court in reality only weighed two out of the four factors. Although it is not clear from the opinion, the reason might have been that the parties had insufficient information to support their arguments because the antidumping proceeding was not complete. The court was perhaps unwilling to make an uninformed ruling at this stage. Preliminary relief was denied because both imminent irreparable harm and demonstrable

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105. *Tenex*, 795 F. Supp. at 436.
106. *Id.*
107. *Id.*
108. *Id.* (citing Barnhart v. United States Treasury Dep't, 588 F. Supp. 1432, 1438 (Ct. Int'l Trade 1984)).
109. *Id.* at 436 n.13.
110. *Id.* at 437.
111. *Id.* at 436.
112. *Id.* at 437.
113. *Id.*
114. *Id.*

hardship was lacking, therefore the "four-factor" balance fell in the government's favor.

### *C. Later Proceedings In the Court of International Trade: September 25, 1992*

Four months later, four of the six investigated republics again challenged Commerce's decision to continue the uranium antidumping proceedings.[115] The republics included Kyrgyzstan, Russia, Tajikistan, and the Ukraine. Tenex, the export company, also joined the challenge in the Court of International Trade. In the time between the two actions, the Commission issued a preliminary determination[116] finding sales at less than fair value in six of the twelve original republics.[117] The Commission issued notice of the initiation of final antidumping investigation against the six republics on June 17, 1992.[118] Despite the action filed in the Court of International Trade, the Commission announced its intention to continue the investigation on September 10, 1992.[119]

The court first briefly discussed the question of residual jurisdiction. Although jurisdiction may be raised at any point in the proceedings, and Commerce presented new arguments, the court found those arguments not new enough to "compel the court to reexamine its previous analysis."[120] The sole issue addressed in the second proceeding was whether an antidumping duty investigation may be continued against newly-independent republics after the country named in the original proceeding has dissolved.[121]

The language of the Antidumping Act does not expressly provide an answer to the issue involved in this action. Both Tenex and Commerce based their arguments on the overall structure of the Antidumping Act and "tangentially related provisions of the statute."[122] Tenex fo-

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115. *Tenex II*, 802 F. Supp. 469.

116. *Uranium from Kazakhstan, Kyrgyzstan, Russia, Tajikistan, Ukraine, and Uzbekistan*, 57 Fed. Reg. 23,380 (Dep't Comm. 1992) (preliminary determinations of sales at less than fair value).

117. The countries excluded from the preliminary affirmative less than fair value determination were Armenia, Azerbaijan, Byelarus, Georgia, Moldova, and Turkmenistan. *Id.*

118. *Uranium from Kazakhstan, Kyrgyzstan, Russia, Tajikistan, Ukraine, and Uzbekistan*, 57 Fed. Reg. 27,065 (Dep't Comm. 1992) (institution of final antidumping investigations).

119. *Tenex II*, 802 F. Supp. at 471.

120. *Id.*

121. *Id.*

122. *Id.*

cused its argument on the use of the word "country" in the statute.[123] Its rationale was that investigations and duty orders relate to exports from a particular country, so when an investigated country ceases to exist, a new antidumping proceeding must be initiated against each republic evolving from the dissolution.[124]

In essence, Tenex asserted that Commerce's failure to give notice of a new proceeding violated the statute. A secondary argument was that antidumping duties are calculated based on future conduct.[125] Because the new republics are now market economies instead of state-controlled economies, past behavior cannot be used to predict future trade practices.[126]

Commerce argued that the statutory focus is on "merchandise", not countries.[127] Although political boundaries had changed, the merchandise, uranium, was being produced by the same companies in the same locations.[128] Also, if the antidumping investigation were discontinued, an "impermissible gap" in statutory coverage would be created between the ongoing and new proceedings.[129] An antidumping investigation can take up to ten months or more before a final negative determination is made and duties are assessed.[130] Therefore, the republics could potentially continue to dump uranium at less than fair value without statutory repercussions during the gap between the two investigations.

When reviewing an agency determination, the court is compelled to give great deference to administrative decisions, because the agency is presumed to have greater expertise concerning matters that it regulates.[131] The general statutory construction rule in administrative proceedings was stated in *Chevron U.S.A. v. Natural Resources Defense Council, Inc.*[132] In order to invalidate an agency determination, the court must find the statutory interpretation by the agency contrary to express Congressional intent.[133] Absent Congressional intent, the construction

123. *Id.* at 472.
124. *Id.*
125. *Id.*
126. *Id.*
127. *Id.* at 471.
128. *Id.*
129. *Id.*
130. *See supra*, note 21 and accompanying text.
131. Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 844 (1984).
132. *Id.*
133. *Id.* at 843.

will be rejected only when it is unreasonable.[134] The *Chevron* court also noted that even though two or more interpretations may be reasonable, the court cannot impose its own construction over the agency's reasonable construction.[135]

In *Tenex*, the court found the statutory intent to lie "somewhere between the arguments of the opposing litigants."[136] Section 1673 of the Antidumping Act allows antidumping duties if a "class or kind of foreign merchandise is being, or is likely to be, sold in the United States at less than its fair value."[137] Even though this statutory language supports the government's argument, the statute also indicates that investigations as well as duty orders should focus on merchandise from a particular country, which assists Tenex's argument. What the statute does not expressly require is that the same country exist at the beginning and end of an antidumping investigation.[138] The court stated that it should not "concern itself with the new economic policies of respondent countries" when reviewing the legality of an ongoing proceeding because such an issue can be properly addressed at the first annual administrative review.[139] The court stated that "the merchandise did not evaporate upon dissolution of the Soviet Union."[140] Because dissolution of a country rarely happens, Congress was reluctant to expressly provide for such situations in the Antidumping Act.[141] In its antidumping duty determination, Commerce inferred from the overall purpose of the Act that successor countries must bear the antidumping duties calculated from import prices of their predecessor.[142] Pursuant to the *Chevron* rule, the court upheld Commerce's statutory construction as reasonable.[143]

In support of the its conclusion that dissolution of a country does not compel termination of an antidumping investigation, the court relied on the Commission's preliminary determination to continue in a recent case involving similar issues.[144] In *Ferrosilicon from Argentina*, the Com-

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134. *Id.* at 844.
135. *Id.*
136. *Tenex II*, 802 F. Supp. at 472.
137. *See* 19 U.S.C. § 1673.
138. *Tenex II*, 802 F. Supp. at 473.
139. *Id.* at 472.
140. *Id.*
141. *See Tenex*, 795 F. Supp. at 433.
142. *Tenex II*, 802 F. Supp. at 473.
143. *Id.* at 472.
144. *Ferrosilicon from Argentina, Kazakhastan, the People's Republic of China, Russia, Ukraine and Venezuela*, USITC Pub. 2535, Inv. Nos. TA-23, 731-TA-565-570 (Dep't Comm. 1992).

mission reasoned that to discontinue an investigation merely because the country has dissolved would prevent a domestic industry from being protected under the Antidumping Act, because unfairly priced products could continue to be imported.[145] The Commission likened the change of political status to a change in ownership of a foreign factory, which has never prevented the Commission from continuing an investigation.[146] Consequently, the decision by Commerce in *Tenex* to continue an antidumping duty investigation against six new republics was found legal and upheld for a second time by the Court of International Trade.

## III. THE AFTERMATH: SIGINFICANCE AND CONSEQUENCES OF *TENEX*

### *A. Judicial Review of Administrative Proceedings Before Final Antidumping Determination*

The first Tenex proceeding in the Court of International Trade created a two-part test to determine whether interim judicial review could be exercised in an antidumping investigation. First, section 1581(i) residual jurisdiction may be invoked only if the legal, not the procedural aspects, of an investigation are being challenged. Second, the possibility that no adverse appealable determination will result from the investigation will compel the court to review Commerce's decision to continue before any final determinations are announced.[147]

Residual jurisdiction under section 1581(i) was granted by Congress in 1980, when the jurisdiction of the Court of International Trade was substantially revised. The legislative history to the proposed Senate bill called it a "broad jurisdictional grant" and stated that the provision "will ensure that in the future these suits are heard on their merits."[148] However, the House of Representatives proposal narrowed residual jurisdiction to apply only when section 1516a of the Tariff Act does not provide judicial review.[149] The House version was enacted, and consequently the courts have been willing to invoke residual jurisdiction

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145. *Id.*

146. *Tenex II*, 802 F. Supp. 473 n.8.

147. *See generally supra* notes 55-91 and accompanying text.

148. Andrew P. Vance, *The Unrealized Jurisdiction of 28 U.S.C. § 1581(i): A View from the Plaintiff's Bar*, 58 ST. JOHN'S L. REV. 793, 798 (1984) (quoting S. REP. No. 466, 96th Cong., 1st Sess. 3 (1979)).

149. *Id.* at 801-02 (citing *Customs Courts Act of 1980: Hearings on H.R. 6394 Before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary*, 96th Cong., 1st Sess. 1 (1980)).

sparingly.[150] The argument has been made that courts should utilize residual jurisdiction more often because they are "looked to as the bulwark of the citizen's defense against unchecked and unbridled government action."[151] The decision by the court in *Tenex* to exercise residual jurisdiction would seem to be a step toward controlling arbitrary government action through a more broad interpretation of section 1581(i).

### *B. Continuation of Antidumping Proceedings After Dissolution of Country Originally Named in Investigation*

In determining that the Antidumping Act does not compel discontinuation of an antidumping proceeding when the country named in the petition subsequently dissolves, the court came to a logical conclusion. The Commission was confronted with a unique and complicated situation when the U.S.S.R. dissolved mid-investigation. However, the decision to continue was reasonable and fair to all parties involved, because it ensured that more information would be gathered before antidumping duties were imposed, and at the same time continued to protect the domestic uranium industry from unfair competition. Deference by the court to an agency administering a body of law is a well-established rule and the court was correct in relying on it.[152] Further, because of the number of interested parties, the amount of uranium being imported, and the potential consequences of a negative dumping determination on the domestic uranium industry, neither Commerce nor the courts should be forced to prematurely end an investigation.[153]

The purpose of antidumping laws is to protect domestic industries from unfair competition, but the law only goes as far as restoring prices of imported products to the same level as the domestic prices. Although it does not afford monetary damages to the injured domestic producer, this remedy ensures that a foreign entity will not inflate prices after the domestic industry has been eliminated by unfair competition. Pur-

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150. *See* United States v. Uniroyal, Inc., 687 F.2d 467 (C.C.P.A. 1982) (holding that jurisdiction under § 1581(i) is in addition to §§ 1581(a)-(h) and should not be used to bypass administrative review) *and* Lowa, Ltd. v. United States, 561 F. Supp. 441 (Ct. Int'l Trade 1983) (holding that invocation of § 1581(i) was invalid because even if the issue was one of legality, the decision should be by the administrative agency).

151. Vance, *supra* note 148, at 813.

152. *See generally supra* notes 129-41 and accompanying text.

153. *See supra* note 94 and accompanying text.

suant to current American trade policy reflected in the Antidumping Act, the court was correct in allowing Commerce to continue its antidumping investigation against the six former Soviet republics.

### *C. Negotiation of Suspension Agreement as Alternative to Antidumping Duties*

The Tenex case continued to create unique controversies even after the two court decisions. In August, 1992, prior to the second court determination, the United States and Russia began discussing an agreement which would suspend imposition of antidumping duties.[154] If Russia successfully settled with the United States, the other investigated republics (Republics) would join the agreement.[155] The Antidumping Act provides for suspension agreements in section 1673c as a substitute to assessment of antidumping duties.[156] An antidumping investigation will be suspended only if the agreement is found to be in the public interest and it can be monitored effectively.[157] Three factors which may be considered in determining public interest include (1) adverse impact on consumers, (2) "international economic interests of the United States," and (3) "relative impact on the competitiveness of the domestic industry."[158]

Divergent interests of the two governments almost prevented Russia from signing the agreement, but the executive branch of the United States strongly desired a settlement for political reasons.[159] Commerce

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154. Wilson Dizard III and Michael Knapik, *U.S., Russian Representatives Discuss Ways of Settling Uranium Antidumping Case*, 17 NUCLEARFUEL No. 18, at 1 (August 31, 1992).

155. *Id.*

156. 19 U.S.C. § 1673c.

157. *Id.* The relevant portion of the section provides:

> [T]he administering authority [ITA] may not terminate an investigation . . . by accepting an understanding or other kind of agreement to limit the volume of imports into the United States of the merchandise that is subject to the investigation unless the administering authority is satisfied that termination on the basis of that agreement is in the public interest.

*Id.* § 1673d(a)(2)(A).

158. 19 U.S.C. § 1673c(a)(2)(B). Although the statute states that these factors apply to termination by petition under subsection (a), public interest is undefined for suspension agreements in subsections (b) and (c). The Commission is not compelled to consider these factors in deciding to approve suspension agreements, but they serve as helpful guidelines.

159. Michael Knapik and Wilson Dizard III, *Differences Between Russia, U.S. May Imperil Final Agreement in Uranium Dumping Case*, 17 NUCLEARFUEL No. 20, at 1 (September 28, 1992).

wanted an import quota based on prices; if uranium prices from the former Soviet republics rose above $13 per pound, it would be allowed to export certain amounts of uranium.[160] A quota table[161] would allow for increased volume as the price per pound increased, and any price above $21 per pound would allow unlimited amounts for all republics but Russia. Russia argued that a quota based on a percentage of domestic nuclear reactor requirements would be fairer.[162]

Frank Fahrenkopf, attorney for Tenex and Nuexco, argued that an antidumping order would fail to protect the domestic industry and "sour relations with the newly independent countries that the U[nited] S[tates] government has said it wants to help."[163] Other speculations followed regarding the effects of suspension agreements. For example, restrictions on foreign uranium sales in the United States were predicted to lead to the loss of American uranium sales in other countries because the Republics would presumably sell to the foreign countries.[164] Also, it was claimed that price restrictions on the Republics will encourage other low-cost, unrestricted producers to undercut American prices. In effect, the dumping problem would merely shift from one country to another.[165]

Commerce's antidumping investigation was eventually suspended on October 26, 1993, following the signing of quantitative restraint agreements between the United States and all six republics.[166] The agreements were found to satisfactorily prevent "suppression or undercutting of price levels" by foreign imports, but would be subject to periodic administrative review by Commerce.[167] Agreements which

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160. *Id.*

161. *Id.* at 6-7. The editor of NUCLEARFUEL noted that the "specific price-quota levels appearing in the Agreement" were not available, but gave an example of what the table may look like. *Id.*

162. *Id.* at 1.

163. *Id.* at 3.

164. *Id.* at 4.

165. Michael Knapik, *Miners Will Oppose Uranium Agreements Unless all Five CIS Republics Sign*, 17 NUCLEARFUEL No. 21 at 20 (October 21, 1992).

166. *Uranium From Kazakhstan, Kyrgyzstan, Russia, Tajikistan, Ukraine, and Uzbekistan*, 57 Fed. Reg. 48,527 (Dep't Comm. 1992) (suspension of investigations). *See also Commerce Enters Suspension Agreements with Former U.S.S.R. Republics on Uranium*, INTERNATIONAL TRADE REPORTER (October 21, 1992).

167. *Antidumping, Uranium from Kazakhstan, Kyrgyzstan, Russia, Tajikistan, Ukraine, and Uzbekistan*, 57 Fed. Reg. 49,220 (Dep't Comm. 1992) (detailed notice of suspension and amendment of preliminary determination). The Antidumping Act requires that an agreement which revises prices is acceptable only if it serves to "eliminate completely the injurious effect of exports to the United States of that merchandise" and the suppression or undercutting of domestic prices will be prevented. 19 U.S.C. § 1673c(c).

control prices are encouraged under the Antidumping Act, especially when "extraordinary circumstances" exist. Extraordinary circumstances, according to the Antidumping Act, exist when suspension would be more beneficial to the domestic industry and the investigation is complex.[168] The term "complex" is defined as a large number of transactions, novel issues, or large number of firms involved.[169] Congress probably did not provide for suspension agreements in the Antidumping Act merely to have that provision ignored.

Although Commerce never expressly stated how the suspension agreement would benefit the domestic industry, the circumstances in *Tenex* clearly were complex enough to be considered "extraordinary." In fact, the deadline for preliminary determinations was extended because the ITA considered the case extraordinarily complicated.[170] The dissolution of a country being investigated has never occurred in seventy years of antidumping investigation, thus presenting a novel issue to Commerce.[171] The parties in *Tenex* included six independent countries and their respective uranium-producing companies, an exporter, an importer, at least thirteen domestic companies, and a labor union.[172] The investigation covered imports of uranium from January 1990 to August 1991, which involved a large number of transactions.[173] Commerce probably found the case extraordinary enough to suspend an investigation for the same reasons it concluded the case to be complicated enough for postponement.

According to Michael Sandler, an authority on international trade, voluntary restraint agreements provide "diplomatic flexibility in serious trade disputes" and allow the United States to avoid "many of the political and international repercussions of unilaterally imposed remedies."[174] In the interest of preserving positive foreign relations with fledgling democratic countries, it may have benefitted the government to initiate negotiations for an agreement in January 1992, immediately following the dissolution of the U.S.S.R.

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168. *Id.* The circumstances require for allowing a suspension agreement are quite similar to § 1673b(c), which allows extension of the preliminary investigation period in cases which are "extraordinarily complicated." *Id.* § 1673b(c).

169. *Id.*

170. *See supra* notes 48-50 and accompanying text.

171. *Postponement, supra* note 48.

172. *Initiation, supra* note 39

173. *Id.*

174. Sandler, *supra* note 9, at 790.

## IV. CONCLUSION

The decision by Commerce to continue its antidumping duty investigation after the U.S.S.R. divided into twelve independent republics was correct under the circumstances. However, international trade has evolved significantly since the first Antidumping Act was enacted in 1921. An increasingly global market means that it is critical for the United States to maintain and improve trade relations with other countries. Indeed, President Clinton's current trade policy has been reported to have an "emphasis on competitiveness, reciprocity, [and] industrial policy," which reflects the need for "reform at home."[175] Opportunities to develop positive relationships increase as the number of independent countries increase. The difficult issues raised in *Tenex* should not serve to discourage newly independent countries from openly trading with United States companies. Instead, the aftermath of *Tenex* should serve to open the door to an increasing number of voluntary restraint agreements in lieu of antidumping duties.

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175. *See International Trade: Clinton Emphasis on Competitiveness May Sharpen Trade Dialogue, Dobbins Says*, DAILY REPORT FOR EXECUTIVES: REGULATION, ECONOMICS AND LAW (March 5, 1993), *available in* WESTLAW, BNA-ATR database, 1993 DER 42 d5.

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