A Practical Guide to Advising Clients About International Joint Ventures

Alison B. Brotman  Philip R. Marx

The recent explosive growth in international trade has generated unprecedented interest among U.S. companies in forming international joint ventures. Many medium-size and smaller companies, and their attorneys, have no experience in this area. This article provides a map of the entire process of preparing for and concluding an international joint venture, which refers to an American company doing business outside of the United States in conjunction with one or more foreign companies.

Preparation

Do not be surprised if your client simply does not know where to start—and expects you, as the attorney, to provide advice. The decision to do business in a particular country can be driven by several factors. Your client may be following customers, meeting a perceived demand for products or responding to an invitation from a private or public entity for bids in a privatization.

As a first step, a client should gather information to create a country "profile" which gives a sense of the opportunity, and the risk, involved in engaging in the type of business being contemplated. This profile will assist in deciding whether to do business and how to enter that country’s market. It should provide the tools for assessing whether a particular venture makes business sense. (Even though this may seem self-evident, many clients may overlook it.)

The profile should include tax, labor, economic, political, industry-specific and legal information. To some extent the type of detailed information relevant to your client will depend upon the joint venture activity being contemplated. It is fairly certain that your client will need to know about taxes on income, dividends, interest, loans and on management or technical services agreements.

Your client will also want to know if any tax holidays or other type of tax relief is available (and the strings attached to it). Check for favorable tax treaties; it may be advantageous for your client to own interest in the venture through a non-U.S. entity.

With respect to labor concerns, it may be relevant for your client to know the rules regarding unionization and the use of expatriates. It may also be important to understand the general labor climate and obtain favorable tax treaties; it may be advantageous for your client to own interest in the venture through a non-U.S. entity.

Symposium: International Law

The rapidly changing world order is creating new opportunities and challenges for lawyers in the area of international law. The prospect of free trade in North America may greatly affect how business in the United States is conducted.

This special symposium issue represents the work of the ABA/YLD International Law Committee, and is designed to acquaint the reader with some of the practical aspects and considerations in representing clients in international transactions.

Alison B. Brotman and Philip R. Marx provide a useful outline for representing clients in international joint ventures. David Silberstein looks at representing principals in international transactions, and provides insight into factors which clients must consider before involving themselves in international transactions.

Timothy K. Barnes provides a guide on practice under the Uniform Foreign Money Judgments Recognition Act.

Myron Brilliant discusses the increasing importance of environmental considerations in international transactions, particularly with respect to the proposed North American Free Trade Agreement.

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—Richard L. Alvidrez
Editor-in-Chief
Law Practice Notes
information about health and welfare policies, at-will employment, and applicable labor laws.

Important economic information would include the rate of inflation; the risk of devaluation; limitations on repatriation of earnings, profits, dividends and capital; restrictions on foreign investment, and controls on currency exchange.

In addition, your client may need to know whether there are restrictions on exports or imports, whether licenses may be required, or duties imposed. The proposed joint venture may not be financially feasible if the necessary equipment is not manufactured in the country and the import duties make the cost prohibitive.

**Political Situation**

The importance of the political situation should not be underestimated. Factors to consider are receptivity to foreign ownership in general (and American ownership in particular), the need for a local partner, the influence of government officials or departments, the stability of the political system, whether there is a history of expropriation, and any special influences on governmental decisions which would affect the venture.

One of your first legal considerations should be whether the joint venture would fall within the scope of any antitrust or competition law, U.S. or foreign. If it does, the proposed venture may need to be significantly modified to be legally viable.

Although specific tests of the applicable law must be applied to the situation, a first-run analysis would look for the creation of any barriers to entry, misuse of dominant market power, market division, or price-fixing. If the joint venture involves an equity investment, merger laws may apply.

Other pertinent information includes whether the legal system is based upon civil or common law, the system's reputation for quality and impartiality in general (and in handling foreigners in particular), applicable corporate or partnership law, whether relevant consulates, the World Bank, the IMF, the European Commission, the American Chamber of Commerce in the foreign country, consultants, large accounting firms and their publications (for example, Price Waterhouse's Doing Business guides), local counsel and potential local partners.

**Strategic Approach**

Concurrent with developing the country profile, your client should develop a strategic approach which includes goals, limits, and alternatives. One of your most important contributions to the transaction will be to continuously and consistently help your client focus on the business decisions to be made, and advise about the available alternatives.

Questions to consider include: What will happen if the transaction falls through? What alternatives are available? How much is your client willing to risk to make it work? How much capital and how many employees is the client willing to devote to the project?

Your client should:
- Have a clear sense of limits before developing the transaction and expending a significant amount of money and resources in the course of it.
- Form a clear idea of business goals and fallback positions, before approaching potential joint venture partners.
- Develop a sense of the amount of equity and the degree of operating control desired.
- Decide how long to stay in the venture and how long partners should stay in.

This strategic approach will evolve as your client gains more information, and will provide the sense of direction necessary to complete the transaction.

**Local Counsel**

It is also imperative that you engage a smart, reliable, responsive, experienced, English-speaking local counsel. If possible, engage one who is experienced in the particular type of joint venture in which your client would like to engage. The local counsel should already be familiar with all applicable laws and regulations.

Ideally local counsel will have handled transactions involving U.S. participants, and would be familiar with both U.S. legal documents and local partner and governmental reaction to them.

Look for a personal recommendation. A partner in your firm, a corporate counsel engaged in international business, the YLD International Law Committee, or the ABA International Law and Practice Section, among other sources, may have suggestions. Martindale Hubbell is also a helpful resource.

In engaging local counsel you may want to send a preliminary memorandum explaining the type of legal expertise required, requesting a conflict-of-interest check and billing rates, and requiring that itemized bills be sent regularly at reasonable intervals. Your client may wish to require bills in U.S. currency.

You should decide at
the outset what role you want local counsel to play. Your client, and you, may feel most comfortable having you controlling and drafting documents, with local counsel reviewing documents and assisting in negotiations. In situations involving extreme distrust of foreigners and foreign-looking documents, you may still take a lead role, but a less visible one, working through local counsel.

Alternatively, you can entirely delegate the matter to local counsel. However, you should realize that this can be problematic because of geographic and cultural distances and differences. Expect communication to be a problem. Stay in close contact with local counsel to assure that he or she is doing what you want, how and when you want it.

Local counsel fees grow quickly. Bills should be scrutinized carefully and may be negotiated, depending upon the circumstances.

**Joint Venture Partners**

Companies seek local joint venture partners for many reasons. They may want local capital, skills, political acumen, or technological or business expertise. A local partner may be required by law, for example, for a bid regarding a telecommunications license. In some cases, economic policy may simply dictate local ownership and/or control.

Partnering raises significant issues, which increase in number and complexity as the number of joint venture partners grows. Your client needs to be aware of this when engaging in preliminary discussions with potential partners. Carefully research and investigate all potential partners. It is important to determine their financial condition, the identity and percentage ownership of the actual shareholders or partners, background and the existence of any political scandals or bribery, experience in the proposed business and ability they claim to bring to the venture. The same sources of information used for the country profile may be able to contribute to this effort.

Generally, the most important issues among partners concern the scope, purpose, control, financing and expected financial return of the venture. Other common major issues are operation of the venture, contracts between parties, and transferability of interests. Resolution of these issues will often turn upon what each partner brings to the venture.

**Teaming Agreements**

Once your client enters serious discussions with certain potential partners, and particularly in a bid for public license, the parties may find a teaming agreement useful.

Bids are generally complex and on a tight time schedule. The combination often requires work to begin before the parties have reached agreement. Teaming agreements typically provide for confidentiality, sharing of expenses and exclusivity while the parties determine whether they can reach a definitive agreement regarding their business relationship.

By addressing these issues upfront they provide a temporary framework in which the parties can work without diverting attention from working through substantive issues.

Letters of Intent

In non-bid situations, potential joint venture partners often enter into a letter of intent with respect to the proposed transaction. The letter of intent may vary widely in its content. It may address the same issues as a teaming agreement, or may begin to outline ideas with respect to terms of the joint venture agreement.

Regardless of the level of detail, in almost all cases the letter of intent will not commit the parties to consummate a transaction, although it may commit them with respect to expense-sharing, confidentiality and (possibly) exclusivity during the negotiations.

**Exclusivity provisions** should be drafted with extreme consideration and care. The failure rate for these discussions is high, and your client will generally want the freedom to pursue this opportunity with other partners without significant time delays or other considerations.

**Joint Venture Issues**

Substantive issues regarding the form and substance of the joint venture must be addressed. A basic issue is choice of joint venture entity. The laws of foreign countries generally provide for entities which resemble U.S. corporations and partnerships, however, they may have other attributes as well. Local counsel should be consulted.

The overriding considerations are tax consequences and limitation of liability. You, or your U.S. tax counsel, should analyze your client's foreign tax credit situation. Tax treaties should also be reviewed with respect to withholding taxes on dividends and royalties. Advice from local tax counsel will be crucial to the successful structuring of the venture. Limitation of liability is another consideration, although it may be less important in light of tax consequences and appropriate corporate structuring.

Once the form of entity is selected, you or local counsel should keep on top of the mechanics involved in the procedures and time for creation, costs and fees, restrictions on foreign participation (as an investor, officer or
director) and capitalization requirements.

A major issue is the provision of capital. The amount, timing and type (cash, services, property) of initial capital contribution must be agreed upon and clearly set forth in the joint venture agreement. The agreement should include a mechanism for the provision of additional capital. And it should provide for a response to the failure to contribute capital, which might be particularly tricky if the foreign law limits the percentage of foreign ownership or enforcement of certain remedies.

Your client may also wish to set a debt to equity ratio and address the issue of third-party loans at the outset. Most decisions regarding contribution of capital should flow from the business plan, and it would be helpful for your client to provide you with updated versions as completed.

**Decision Making**

Control over joint venture decisionmaking is one of the most highly negotiated issues. Who controls which decisions? Who selects how many board members, and what rules govern or limit actions of the board? Which are board-level decisions? Which are management-level decisions? Who appoints, which officers? Which decisions are so important to all partners they should be subject to supermajority provisions or unanimous consent?

Important decisions usually include approval of budgets, significant capital expenditures, major loans or investments, hiring and compensation of key managers, declaration of dividends, issuance of additional stock or admission of additional partners, and other items not in the ordinary course of business.

If these positive powers are unobtainable, can your client negotiate for a veto power? Is deadlock possible and, if so, how can it be resolved?

These issues are usually tied to the economic risks and rewards of the parties (whether a party should pay less for a passive interest). In some situations it will be difficult to assign the most senior management role to a non-national. This can often be handled by creating a less senior position with the requisite powers.

The joint venture agreement should also address the transferability of interests. This issue involves the commitment of the partners: Are they in for the long haul or a quick profit? Generally, if partners are relying upon the particular skills or resources of their partners, they will want, at a minimum, to restrict transfer during the “start-up” period when those skills or resources are (presumably) crucial. A reasonable exception might be a transfer to wholly owned subsidiary with the necessary resources. These restrictions must be carefully drafted to avoid evasion through changes in control.

Foreign partners may also seek to evade such restrictions by combining their interests in a holding company which holds an interest in the joint venture company to which the restriction applies.

Termination of the joint venture raises similar concerns: How fragile do the partners want the joint venture to be? Can they dissolve it at any time with written notice? Will a mandatory buyout of one party by the other satisfy their needs? What is the effect of insolvency, withdrawal, or default of a party?

**Negotiating and Drafting the Agreement**

Foreign partners, particularly in Asia, may want to form a joint venture based upon a handshake or an extremely brief and vague agreement. It is a common negotiating tactic to assert local custom, practice and (sometimes) law, as a basis for omitting many provisions which are typically found in U.S.-style documents.

Local counsel should be able to help you sort out these issues. You and your client should negotiate a
clear, concise, and comprehensive agreement so the parties fully understand what they are doing and the consequences of their actions.

As a negotiating matter, you will want to consider whether the document should follow the form common in the foreign jurisdiction or in the U.S. based upon the experience, sophistication and flexibility of your client and the partners.

When negotiating with non-English speakers, you should seriously consider having local counsel, or at least a fluent speaker of the foreign language, present. Particularly in the beginning, you may not want the ultimate decision-maker present, so that you may take matters subject to their determination.

However, all of the ultimate decisionmakers should be present when you want to achieve sign-off.

You should also be aware of laws affecting the enforceability of the agreement. Certain provisions may be invalid, such as a choice of forum clause in certain countries.

Even if a choice of forum clause is enforceable, the resulting foreign judgment may not be. Furthermore, equitable relief, which may be the only effective remedy, may not be available, or available only in limited circumstances.

Arbitration may be, but is not always, less costly and time-consuming than litigation in foreign forums. Your client should be advised of the costs and time periods under the rules of arbitration available, such as those of the International Chamber of Commerce, or the American Arbitration Association, and, most important, whether the award would be considered binding.

Foreign courts will generally enforce U.S. arbitration awards if the foreign country is a party to the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards. However local counsel should be consulted since a foreign court may take it upon itself to reject the Convention even if its country is a member.

Closing the Transaction

The next step is to close the transaction. Generally, the principals must all meet and be prepared to stay until all outstanding issues are resolved. This usually involves staying up all night (at least once) in a foreign time zone.

My advice here is to make the best of it, close—and sleep. You will particularly need the sleep afterward, since closing the transaction is the birth of the joint venture, and chances are a large amount of more interesting legal work for you.

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Representing Principals in International Transactions

Escalating pressures to reduce business costs and the general movement to a global economy have dramatically increased the attractiveness of foreign investment. At the same time, investment laws throughout the world change daily, and more changes are foreseeable.

Cross-border transactions have long been a concern for businesses which daily conduct their business on an international basis. More and more, however, businesses are expanding into new markets, and new businesses are developing to fill a niche for industries in developing countries.

International transactions have increasingly taken the form of privatization and ventures into new markets. Privatization, the process by which companies and businesses traditionally owned by state government are transferred to private (often foreign) ownership, is the focus of many foreign investors. Existing businesses have increasingly ventured into new markets with their products.

In addition to the social and economic benefits to the country of investment, including increased competition, financial freedom, efficiency and effectiveness, plus development of capital markets, and diversification of decision-making, principals recognize opportunities to expand their existing product markets.

New opportunities, however, create new concerns for principals.

More advice is being sought on complex legal and business implications of new investments. Advisors include consultants, attorneys, accountants, financial planners, appraisers, and other service providers. Attorneys should be prepared to render competent legal advice where appropriate and to recognize their limitations with respect to that advice, seeking at times to involve a team of experts to conclude certain international transactions.

Investment Concerns

Experience has proven that the most crucial stage of any foreign investment is the consideration given to preliminary concerns. Potential investors should carefully identify and consider each of their short-
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Conversions of Currency

Any foreign investment may require that currency be converted into host country currency. The convertibility, valuation, and stability should be analyzed prior to concluding any international transaction.

If host country currency is not readily convertible, it might be convertible through barter transactions via one or more intermediary countries. If a barter transaction is to be relied upon, the laws of all countries involved should be reviewed and any such barter opportunities should be put into place prior to concluding any foreign investment.

Insuring Investments

Insurance is often available to minimize the risks involved in international transactions. Particular attention should be given to the type(s) of coverage, any waiting period for payment of claims, the length and cost of coverage. In addition, insurers often require significant amounts of information concerning the proposed investment and financial situation of the investor prior to issuing the coverage.

Insurance may be available for confiscation, expropriation, nationalization and deprivation, political violence, currency in convertibility, contract frustration, wrongful calling of bank guaranty coverage, and wrongful dishonor of letter of credit.

These coverages may be combined by various insurers or may be available through government-sponsored programs. In addition, host countries may guarantee investment (sometimes subject to request and negotiation) against that country’s nationalization or expropriation of the potential investment. Since the host country in this case would be guaranteeing that it would not appropriate the potential investment, counsel should carefully consider the value of any such guaranty.

International Tax Agents

As with any international investment, proper planning requires an analysis of tax laws presented by the host country, the country of the foreign investor, and any intermediary countries involved. Any applicable international tax treaty should also be considered.

Tax Exchange of Information Agreements, such as the ones recently entered into by the United States with Mexico and many Caribbean countries, are becoming more and more common and cannot be overlooked.

Counsel should be careful not to subject principals to taxation in other countries as a result of their advice unless such taxation would result in substantial reduction of overall tax costs, and careful consideration has been given to other intangible aspects, such as unwanted scrutiny by intermediary country tax authorities.

Personal Concerns

Principals must be careful that investments will not adversely impact their personal financial situations. Foreign principals are often concerned about maintaining their investments in confidence. Fear of reprisal by governmental authorities and others are very real concerns and should be cau-
Practice under the Uniform Foreign Money-Judgments Recognition Act

Merchandise exports in 1990 contributed about three-fourths of real growth in the US. In recognition of the importance of exports to GNP growth, the US. Commerce Department’s International Trade Administration and other Federal agencies have increased their efforts to assist US. companies of all sizes to pursue international markets. Consequently, this increase in participation of smaller, more geographically diverse companies in international commerce has afforded practitioners in smaller towns and cities opportunities to address issues which, perhaps, many previously thought were the exclusive domain of large law firms in large coastal cities.

Because the increase in international commerce and the concomitants of disputes and litigation have led to an increase in the need of foreign clients to enforce judgments in the United States, the likelihood that a practitioner will be retained to enforce or defend the enforcement of such judgments increases.

In this milieu, the Uniform Foreign Money-Judgments Recognition Act, approved by the National Conference of Commissioners on Uniform State Laws, and the American Bar Association in 1962, takes on new importance. The Act represents a codification of the law applied in the majority of states regarding the recognition of certain foreign-nation money-judgments. Familiarity with the Act will also be beneficial to practitioners in nonadopting states by providing an awareness of the basic issues involved in the enforcement of foreign-nation money-judgments.

Purpose and History

Foreign-nation judgments were enforceable in the US. long before the Act was drafted. The U.S. Supreme Court in Hilton v. Guyot, 159 U.S. 113 (1895), ruled that foreign-nation judgments must be given the same recognition as judgments of sister states, provided certain fundamental standards of fairness are met. Unlike the decision in Hilton v. Guyot, however, the Act is not based upon principles of comity.

As is succinctly expressed in its prefatory note, 13 U.L.A. 261 (1962), the purpose of the Act is to increase the likelihood that US. judgments will be recognized in other countries. Because many countries require reciprocity of recognition of judgments, the existence of a statute which clearly states that foreign-nation judgments are recognized makes it much easier to meet the reciprocity requirement.

Without such a statute a US. citizen seeking to enforce a judgment abroad would have to depend upon case law and the somewhat amorphous concept of comity in convincing the foreign tribunal that reciprocity does, in fact, exist in his or her state. Most foreign-nation tribunals, many of which are based upon the civil law system are, understandably, much more comfortable with statutes than statements of general principles of law buried in opinions.

Another, albeit secondary, purpose of the Act is to provide uniformity in the recognition of foreign-nation money-judgments. It is important to distinguish between recognition and enforcement of a foreign-nation judgment. Recognition gives that judgment res judicata and collateral estoppel effect in the US. forum. Enforcement is not dictated by the Act.

Enforcement is accomplished in the same man-

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"Foreign state" is defined in such a way as to exclude the judgments of sister states, although some jurisdictions have, at least by implication, applied the Act to sister-state judgments.

Support provisions of divorce decrees have been held to be matrimonial matters, not actions on debt and, thus, not subject to recognition under the Act. The word "penalty" is a codification of the conflicts of law principle that courts of one country do not execute the penal laws of another country. Although it has not always been clear as to what constituted a "penal law," the U.S. Supreme Court in *Huntington v. Attrill*, 146 U.S. 657 (1892), articulated a test that is widely applied today.

Writing for the court, Justice Gray stated: "The question whether a statute of one state, which in some aspects may be called penal, is a penal law in the international sense, so that it cannot be enforced in the courts of another state, depends upon the question whether its purpose is to punish an offense against the public justice of the state, or to afford a private remedy to a person injured by the wrongful act." (Id. at 673-74, 13 S.Ct. at 229-30.)

For the practitioner seeking to apply the Act to a judgment which is subsequently found to be outside the scope of the Act, all is not lost. Section 7 of the Act is the savings clause which provides that the "[a]ct does not prevent the recognition of a foreign judgment in situations not covered by the Act. Therefore, a judgment which is considered a matrimonial matter, for example, and not subject to the Act may still be recognized by a court as a matter of comity." (See *Wolff v. Wolff*, Md. App. —, 389 A.2d 413 (1978).)

Defenses to Recognition

Section 2 states that the "[a]ct applies to any foreign judgment that is final and conclusive and enforceable where rendered even though an appeal therefrom is pending or it is subject to appeal."

Mandatory Nonrecognition Grounds

Section 4 provides that certain defects or characteristics will render the judgment "not conclusive" and, therefore, not subject to recognition under the Act. These defects or characteristics can be:

- The procedures of the rendering tribunal are incompatible with the requirements of due process;
- The tribunal lacked personal jurisdiction over the defendant;
- The tribunal lacked subject matter jurisdiction.

As much as the nonrecognition grounds represent a codification of case law, the Act's non-recognition grounds may be clarified and fleshed out by this substantial body of conflicts law from which it is taken.

The nonrecognition ground of lack of due process, Section 4(a)(1), was addressed in the case of *Hilton v. Guyot*. The court in *Hilton* stated that when it appears that the foreign-nation court had subject matter jurisdiction "and its proceedings are according to the course of a civilized jurisprudence, and are stated in a clear and formal record, the judgment is prima facie evidence, at least, of the truth of the matter adjudged; and it should be held conclusive. . ."

*Hilton* has been widely followed by courts in this country with regard to the issue of the compatibility of the foreign procedures with due process. (See also Restatement (Second) of Conflict of Laws § 98, comment c (1986)).

The nonrecognition ground of lack of personal jurisdiction, § 4(a)(2), the most commonly litigated of the nonrecognition grounds, should be read in conjunction with section 5 of the Act which recognizes certain methods of obtaining personal jurisdiction, namely:
personal service in the foreign state; 
- defendant's voluntary general appearance; 
- agreement prior to commencement of proceedings to submit to jurisdiction with respect to subject matter involved; 
- domicile in foreign state, incorporated in foreign state (or otherwise gain corporation status in foreign state), or have corporate principal place of business in foreign state; 
- defendant has business office in foreign state and cause of action involved in proceedings arises from business done through that office; 
- cause of action arising out of the operation of a motor vehicle or airplane in the foreign state.

While on holiday in Vienna, the defendant purchased from the plaintiff, an antiques dealer, a porcelain figure. Believing its age and value had been misrepresented, the defendant refused to pay. Two years later the plaintiff sued in the Austrian court under a long-arm statute. The defendant was served with process in New York.

The New York court ruled that it was not the intention of the legislature to adopt as a basis for recognition of a foreign-nation judgment a ground for personal jurisdiction as liberal as "transacting any business" applicable under the New York long-arm statute. The New York court recognized that the holding could result in the adverse treatment of New York judgments abroad for lack of reciprocity; however, the court maintained that the defendant's contact in this case "was so casual and incidental to the foreign forum that it could not possibly serve as a jurisdictional predicate sufficient to grant conclusive effect to the default judgment sued upon...."

In another more recent New York case, however, the Fourth Department of the Appellate Division in Porsini v. Petricca, 90 A.D. 2d 949, 456 N.Y. S.2d 888 (A.D. 1982), ruled that recognition should be extended to any jurisdictional bases it recognizes in its internal law.

Tourist Traps

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Discretionary Grounds for Nonrecognition

In the event one of the three grounds for mandatory nonrecognition cannot be established, a person seeking to avoid recognition may still raise other grounds which the court may consider in the court's discretion grant or refuse recognition. These grounds are also in Section 4 of the Act and are briefly described as follows:

- insufficient notice—not timely;
- judgment obtained by fraud;
- judgment rendered upon a cause of action repugnant to public policy;
- judgment conflicts with another judgment;
- judgment is contrary to agreement that dispute would be settled by means other than proceedings in court; and
- in a case based only on personal service, foreign court was seriously inconvenient.

One of the most commonly litigated discretionary nonrecognition grounds is the repugnance to public policy ground. It is clear from the case law that just because a cause of action or basis for damages does not exist in a state as a matter of public policy, it does not, per se, render a judgment based upon such a cause of action or basis of damages repugnant to public policy.

Constitutionality

In at least one adopting jurisdiction, the Act has been found to be unconstitutional in that it did not meet due process requirements.

The Texas Court of Appeals in Plastics Engineering v. Diamond Plastics, 764 S.W.2d 924 (Tex. Ct. App. 1989), pointed out that although there are grounds for nonrecognition in the Act, there was no procedural mechanism for raising those grounds and, therefore, the Act fails to meet due process requirements. The practitioner should consider whether a similar procedural deficiency exists in his or her jurisdiction.

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The Importance of the Environment in International Trade:
Spotlight on NAFTA

Myron A. Brilliant

As environmental issues become more pervasive in the global arena, they grow more complex and assume a larger role in international trade affairs. Since the 1960s, the public has been paying more attention to the discharge of hazardous waste and other pollutants into the environment. More recently, the problems of ozone depletion, acid rain, and global warming have become highly sensitive global issues and so have concerns over the impact of international trade on the quality of the environment.

Consequently, an emerging trend in the 1990s is the increasing influence of environmental issues on a country’s international trade policy.

No one doubts that unrestricted economic growth can be harmful to the environment. Consider that from 1980 to 1990, total exports around the world nearly doubled from roughly $2 trillion to $3.4 trillion. Along with this dramatic collective economic expansion have come a dramatic rise in the world population, rapid industrialization, and an increase in the number of automobiles on the road. This, in turn, has increased the focus on the quality of the environment.

In recent years, environmental issues have been raised in connection with the global GATT trade negotiations and in regional trade negotiations. For example, in the negotiations for the U.S.-Canada Free Trade Agreement, an issue of great concern to both countries was the effect of acid rain on the environment.

It is clear that environmental issues are becoming an integral part of global and regional trade negotiations. As a consequence, it no longer appears politically feasible or possible to deal with international trade and environmental issues in isolation from each other. This is illustrated by the North American Free Trade Agreement (NAFTA) negotiations between the United States, Mexico, and Canada.

Impact on the Fast Track Debate

During the 1991 congressional consideration of whether to extend the “fast-track” authority for negotiating NAFTA, environmental issues were clearly front and center. Throughout the congressional debate, many prominent environmental groups loudly voiced their concerns about the negotiations. Many expressed fears that a NAFTA would exacerbate regional problems, such as acid rain in the Great Lakes region, and air and water pollution in the Tijuana-San Diego area.

Environmental issues receiving attention in the context of NAFTA are not new. The fact that these issues are an integral part of whether the NAFTA negotiations will be successful, however, is noteworthy, and underscores the growing political implications of the environment in international trade forums.

One of the difficult issues raised in the debate on fast-track negotiations was whether environmental issues should be encompassed in the four corners of a trade agreement, or whether they would be better addressed in separate bilateral agreements. Environmental organizations like Greenpeace USA, the National Wildlife Federation, and Friends of the Earth lobbied the administration and Congress to address environmental, public health, and worker safety issues.

These proponents of incorporating an environmental component within the North American trade talks offered three major justifications for doing so.

First, environmentalists argued that NAFTA would not "naturally" lead the region and, in particular, Mexico toward sustainable development. Critics argued that NAFTA would accelerate investment and production in Mexico beyond that country's ability to handle the stress on the environment caused by increased population, more automobiles, and greater industrialization. Mexico's ability to provide the land transportation services, sewer systems, wastewater treatment facilities, and hazardous waste treatment and disposal facilities necessary to sustain increased industrialization and a growing population was questioned.

A second concern was that NAFTA, because of the disparity in pollution control costs, would lead to the shutdown of "good" production in the U.S. and Canada and the acceleration and start-up of "bad" production in Mexico along the U.S.-Mexico border, with damaging implications for the quality of the environment in a re-
Building on Joint Initiative and Public Participation

The U.S. and Mexico have a long history of cooperating to protect the environment together.

In November 1990, Presidents Bush and Salinas signed the 1990 Border Environmental Agreement, which was expanded in 1992. This agreement, known as the 1990 Border Environment Plan, was intended to promote cooperation between the two countries to address environmental issues.

The 1990 Border Environment Plan included initiatives to improve water quality, reduce air pollution, and protect natural resources. The plan also encouraged public participation in environmental decision-making.

Given the complexity of environmental issues, both countries have continued to work together to address these challenges. The 1990 Border Environment Plan served as a foundation for future cooperation on environmental issues.

In 1991, the United States and Mexico signed the U.S.-Mexico Cooperation Agreement on Environmental Protection, which was designed to promote environmental cooperation and exchange of best practices.

The 1990 Border Environment Plan was a significant step in promoting environmental cooperation between the U.S. and Mexico. It demonstrated the commitment of both countries to address environmental issues and improve the quality of life for their citizens.
increasing efforts in the planning, training, and education area; and ensuring improved understanding of the border environment.

The plan has been used by the two governments to answer criticism in each country that environmental issues are not being adequately addressed in the NAFTA.

As of spring 1992, other developments which have taken place outside of the NAFTA negotiations have helped strengthen U.S.-Mexican commitment to a better environment. In early 1992, Mexico committed substantial funding, in the amount of $147 million, for border infrastructure projects and environmental enforcement. Also, the U.S. and Mexico have had substantive discussions on how to tackle polluters on both sides of the border through joint enforcement actions, and on proposals to address increasing pollution problems in Mexico City.

**Trade Issues in the NAFTA**

Environmental issues are being addressed in the NAFTA chapters on investment, standards, and dispute resolution, but they are clearly subservient to trade matters. For instance, environmental issues relating to pesticide or other environmental standards are being dealt with in the context of the free trade agreement only if they are perceived to have a direct bearing on trade.

There has been an ongoing effort in the negotiations to seek harmonization of regulations and standards to raise the level of environmental and health protection, but this has been a difficult issue in the negotiations. Negotiators do not want environmental laws and regulations to amount to trade barriers under the NAFTA. But the Bush administration has said that the final NAFTA package will include language that preserves U.S. environmental laws and this is clearly necessary to ensure broad support for the trade pact in Congress.

**Increasing Pressure on the White House**

Public and congressional pressure on the administration to secure environmental commitments as the price for passage of the NAFTA is increasing. Despite the significant bilateral efforts undertaken by the U.S. and Mexico outside of the trade negotiations, the potential conflict between promoting trade and protecting the environment has become and will continue to be a hot political issue as the NAFTA negotiations conclude.

Some members of Congress and some environmental groups insist that the NAFTA can be a substantial "win-win" proposition for promoting trade and protecting the environment only if an environmental component is incorporated into NAFTA and only if Mexico's commitment to spend hundreds of millions of dollars on environmental cleanup is secured before its passage.

Moreover, environmentalists argue that as long as environmental issues remain on a schedule of implementation outside of the NAFTA, the pressure to enhance health and safety standards and to improve environmental protection will be lost.

From the beginning of the negotiations, the administration has stated that environmental issues should not be an impediment to trade negotiations.

The president has stated that environmental issues should not impede trade negotiations.

Regardless of which position is correct, though NAFTA will certainly fall short of dealing with environmental issues in the manner proposed by most environmental groups, the Bush administration is being forced to focus more attention on environmental concerns in the NAFTA than it had desired.

With rising public expectations, the issues of trade and environment may end up on a collision course which could derail the entire agreement.

NAFTA is leading to significant changes in how trade negotiators approach a free trade agreement. Trade policymakers have struggled to address the concerns of the environmentalists without turning the NAFTA into a trade and environmental agreement.

Given the growing public concern about the effect of trade on the environment, this is not an easy task and has added to the complexities of negotiating a free trade agreement with countries that have vastly different capabilities in coping with environmental issues. Nevertheless, it is fairly clear that free trade and the protection of the environment are no longer mutually exclusive objectives.

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