ANNUAL SURVEY OF DEVELOPMENTS IN INTERNATIONAL TRADE LAW: 1986

As the volume of world trade burgeons, the demands on private international law associated with the trend toward a world economy escalate. In recognition of this private legal trend, The Georgia Journal of International and Comparative Law features a yearly survey of developments in international trade law. The following survey catalogues the changes and developments which occurred in international trade law during 1986, and will serve both academicians and practitioners. The survey highlights developments in a United States perspective, and focuses on areas such as the regulation, litigation, and multilateral or bilateral negotiation of trade issues.

—the 1987-88 Managing Board—
TRADE LAW SUPPLEMENT

Contents

I. TAXATION ................................................................. 463
   A. Legislation ......................................................... 463
      1. Tax Reform Act of 1986 .............................. 463
         a. Title XII—Foreign Tax Provisions ........ 463
         b. Miscellaneous Provisions .................... 469
      2. Omnibus Budget Reconciliation Act of 1986 .... 469
      3. Unitary Taxation ...................................... 470
   B. Income Tax Treaties and Protocols .................... 473
      1. Instruments of Ratification Exchanged ........... 473
      2. Tax Treaties Signed and Awaiting Approval .... 475
      3. Caribbean Basin Initiative Agreements .......... 477
      4. Treaties Under Negotiation ..................... 478
   C. Regulations ...................................................... 479
      1. Final Regulations ...................................... 479
      2. Temporary Regulations ............................... 479
      3. Proposed Regulations ................................ 480
   D. Revenue Rulings and Procedures ....................... 483
      1. Controlled Foreign Corporations ................ 483
      2. Domestic International Sales Corporations
         (DISC's) ................................................ 485
      3. Rulings Issued Pursuant to Income Tax
         Treaties ............................................... 485
      4. Miscellaneous Rulings ............................. 486
      5. Revenue Procedures .................................. 487
   E. Cases .............................................................. 487
      1. Cases Arising Under Treaties ..................... 487
      2. State Taxes Affecting International Business .. 491
      3. Excise Tax Imposed on Tax-Avoidance
         Transfers ............................................... 493
      4. Tax Shelters ............................................ 494
      5. Foreign Tax Credits .................................. 496

II. TRADE CONTROLS ..................................................... 501
   A. Export Controls .............................................. 501
      1. Drug Export Amendments of 1986 .................. 501
   B. Sanctions ....................................................... 503
1. Libyan Sanctions ........................................ 503
2. Syrian Sanctions ....................................... 504
3. South African Sanctions ............................... 505

III. CUSTOMS .............................................. 507
A. Customs User Fee ...................................... 507
B. Trademark Owner Entitled to Destroy Counterfeit Goods ........................................ 509

IV. EXPORT FINANCING .................................. 513
A. Eximbank Act Amendments ............................. 513
B. Eximbank Activities ................................... 516
C. Cases .................................................... 517
D. Mixed Credit Talks .................................... 519

V. TRADE ADMINISTRATION ............................... 523
A. Multi-Fiber Arrangement Extended ................... 523

VI. UNFAIR TRADE PRACTICES ......................... 527
A. Antitrust ............................................... 527
   1. Certificate of Antitrust ............................ 527
   2. Japanese Antitrust Litigation .................... 528
B. Countervailing Duties ................................. 530
   1. Reasonable Indication of Injury Standard Upheld ........................................ 530
   2. Cumulation of Like Products Required .......... 532
   3. Countervailing Duty Law Inapplicable to Non-Market Economics ......................... 534
C. Dumping ................................................. 536
   1. Price Differential May Establish Importer’s Knowledge of LTFV Sales .................. 536
   2. ITA Lacks Power to Alter Scope of Findings During § 751 Review ....................... 538
   3. Recalculation of LTFV Margins Necessary Where ITC Changes Scope of Case .......... 540
   4. Commerce Department’s DeMinimus Standard Invalid ...................................... 542
D. Trade Agreements ...................................... 543
   1. United States-Japan Semiconductor Agreement ........................................ 543
   2. United States-Canadian Softwood Lumber Settlement ..................................... 545
   3. United States-European Community Semifinished Steel Agreement ..................... 546
E. Section 301 Cases ........................................... 547
   1. United States-Korea § 301 Settlement .............. 547

VII. AGRICULTURE ........................................... 549
   A. Citrus-Pasta Dispute .................................. 549
   B. Canadian Countervailing Duty on United States Corn ........................................... 550
   C. United States-European Community Interim Agreement on Farm Trade ........................................... 551

VIII. INTELLECTUAL PROPERTY .................................. 553
   A. United States Implements Chapter II of the Patent Cooperation Treaty ........................................... 553
   B. Gray Market Goods Litigation ......................... 554
   C. Unauthorized Importation of Lawfully Produced Books Prohibited by § 602 of Copyright Act .............. 557
   D. Showing of Patent Infringement Sufficient for § 337 Complaint ........................................... 559

IX. JURISDICTION ............................................... 563
   A. California Supreme Court Finds Non-Resident Component Part Manufacturer Subject to Long-Arm Jurisdiction ........................................... 563
I. TAXATION

A. Legislation

1. Tax Reform Act of 1986

On October 22, 1986, President Reagan signed into law the Tax Reform Act of 1986. Upon signing the bill into law, the President proclaimed it "the most sweeping overhaul of our tax code in our nation's history." By virtue of the Act, Congress redesignated the Internal Revenue Code of 1954 as the Internal Revenue Code of 1986, to reflect the enormity of the changes made.

a. Title XII - Foreign Tax Provisions

Title XII - Foreign Tax Provisions, sets out most of the legislation affecting international transactions. The title encompasses foreign tax credits, source rules, taxation of income earned through foreign corporations, special tax provisions for United States persons, treatment of foreign taxpayers, foreign currency transactions, and tax treatment of possessions.

With respect to foreign tax credits, the Act generally retains the overall foreign tax credit limitation of prior law, although it adds separate limitations for five new categories: high-withholding tax interest, passive income, shipping income, financial services income, and other foreign income.

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3 Tax Act, § 2, 100 Stat. 2085, 2095.
4 Id. at Title XII, § 1201-77, 100 Stat. 2085, 2520-602.
5 Id. at Title XII, subtitle A, § 1201-05, 100 Stat. 2085, 2520-33.
6 Id. at Title XII, subtitle B, § 1211-16, 100 Stat. 2085, 2533-49.
7 Id. at Title XII, subtitle C, § 1221-27, 100 Stat. 2085, 2549-61.
8 Id. at Title XII, subtitle D, § 1231-36, 100 Stat. 2085, 2561-76.
9 Id. at Title XII, subtitle E, § 1241-49, 100 Stat. 2085, 2576-85.
10 Id. at Title XII, subtitle F, § 1261, 100 Stat. 2085, 2585-91.
11 Id. at Title XII, subtitle G, § 1271-77, 100 Stat. 2085, 2591-602.
12 Id. at § 1201, 100 Stat. 2085, 2520-21. High withholding tax interest is any interest subject to withholding tax in a foreign country or U.S. possession, the rate of which tax is at least five percent. Export finance interest is excluded. Id. See generally RESEARCH INSTITUTE OF AMERICA, RIA COMPLETE ANALYSIS OF THE '86 TAX REFORM ACT ¶ 1654 (1986) [hereinafter RIA ANALYSIS].
13 Tax Act, § 1201, 100 Stat. 2085, 2520-21. Passive income is any income which would be considered foreign personal holding company income under Code section 954(c), although it does not include export financing interest, high-taxed income, and foreign oil and gas extraction income. Id. See generally RIA ANALYSIS, supra note 12, at ¶ 1652.
and dividends from certain noncontrolled foreign corporations.\textsuperscript{14} The Act also modifies the look-through rule for controlled foreign corporations.\textsuperscript{15} The Act amends the deemed paid credits under Code sections 902 and 960\textsuperscript{16} and clarifies Code treatment of separate limitations losses.\textsuperscript{17} In addition, the Act codifies a regulation denying credits for tax subsidies received from foreign governments.\textsuperscript{18}

With respect to source rules, the Act generally designates the source of income for the sale of personal property as the seller's residence.\textsuperscript{19} Special rules apply to transportation income to a nonresident from United States sources, now subject to a four percent tax,\textsuperscript{20} and to 80-20 corporations.\textsuperscript{21} The Act also amends the rules for allocating interest to foreign source income.\textsuperscript{22} With regard to affiliated groups, interest

\textsuperscript{14} A noncontrolled section 902 corporation is a foreign corporation in which United States taxpayers own ten to fifty percent. Tax Act, § 1201, 100 Stat. 2085, 2520, 2522.

\textsuperscript{15} Tax Act, § 1201, 100 Stat. 2085, 2523-28. In certain circumstances, dividends, interest, rents, and royalties received from a controlled foreign corporation may be subject to the tax credit. \textit{Id.; see also} RIA ANALYSIS, \textit{supra} note 12, at ¶ 1658.


\textsuperscript{19} Tax Act, § 1211, 100 Stat. 2085, 2533-36. Under prior law, income was sourced where the title to property passed to the buyer. The new provision does not apply to inventory property, which still is governed by prior law, and depreciable personal property, gain from the sale of which may be sourced in both countries. Special rules apply where a nonresident maintains an office in the United States. \textit{Id.; see generally} RIA ANALYSIS, \textit{supra} note 12, at ¶ 1667.

\textsuperscript{20} Tax Act, § 1212, 100 Stat. 2536-39. In general, transportation income from transportation that either begins or ends in the United States is sourced one-half to the United States and one-half to the foreign source. \textit{Id.; H.R. CONF. REP. 841, reprinted in} 1986 U.S. CODE CONG. & ADMIN. NEWS 4075, 4681-84.

\textsuperscript{21} Tax Act, § 1214, 100 Stat. 2085, 2541-44. The Act repeals most of the special rules regarding dividend and interest income to a United States "80-20" corporation which derives more than eighty percent of its income from foreign sources. Under prior law, the income was sourced in the country of residence of the payer. H.R. CONF. REP. 841, \textit{reprinted in} 1986 U.S. CODE CONG. & ADMIN. NEWS 4075, 4685-89.

\textsuperscript{22} Tax Act, § 1215, 100 Stat. 2085, 2544-48.
and other expenses are allocated as if the group consisted of one taxpayer. Thus, consolidation applies to corporations permitted to file a consolidated return, as well as possessions corporations, although the rule applies separately to financial institutions.\(^{23}\)

The Act makes several changes in the tax treatment of income earned through foreign corporations. The most substantial change concerns income subject to current taxation. The Act redefines "foreign personal holding company income" to include dividends, interest, rents, royalties, certain property transactions, commodities transactions, foreign currency gains, and income equivalent to interest.\(^{24}\) The provisions of the subtitle also modify the rules relating to offshore insurance concerns\(^{25}\) and repeal certain limitations on the amount of foreign personal holding company income.\(^{26}\)

The sections of this subtitle also modify the treatment of controlled foreign corporations (CFC's). Under the 1986 Code, a controlled foreign corporation is any foreign corporation of which more than fifty percent of the total voting power of all classes of stock or of the total value of the stock is owned by or attributed to United States shareholders on any day of the taxable year.\(^{27}\) Possessions corporations no longer receive exemptions from the CFC provisions.\(^{28}\)

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\(^{23}\) H. R. Conf. Rep. 841, reprinted in 1986 U.S. Code Cong. & Admin. News 4075, 4689-92. Interest expense must be allocated on the basis of the asset method, rather than the gross income method. The asset method was modified to require a basis adjustment for any stock which is excluded in the affiliate group and in which a group member owns at least ten percent of the voting power. In addition, section 1215 directs the Treasury to prescribe regulations for the new provisions. RIA Analysis, supra note 12, at ¶ 1676.

\(^{24}\) Tax Act, § 1221, 100 Stat. 2085, 2549-56. Exceptions to the definition include rents and royalties derived in the active conduct of business from someone other than a related person, and certain export financing. The new provision also redefines insurance income and sets out special rules for captive insurance companies. Id.

\(^{25}\) Id.; see, e.g., H. R. Conf. Rep. 841, reprinted in 1986 U.S. Code Cong. & Admin. News 4075, 4701-06. These provisions impact tax treaties between the United States and both Barbados and Bermuda. See infra notes 80, 83-87, 96, 102-03 and accompanying text.

\(^{26}\) Tax Act, § 1221, 100 Stat. 2085, 2554-55. The Act provides in general that the foreign personal holding company income of any controlled foreign corporation shall not exceed the earnings and profits of the corporation in the same taxable year. Id.

\(^{27}\) Id. at § 1222, 100 Stat. 2085, 2556-57.

\(^{28}\) Id. at § 1224, 100 Stat. 2085, 2258. Under prior law, a corporation chartered in a United States possession was not treated as a controlled foreign corporation if at least eighty percent of its income was derived in the possessions and at least fifty percent of its gross income was from certain active businesses. A
Subtitle D encompasses changes in special tax provisions for United States persons. The Act substantially modifies the section 936 possessions tax credit. It extends the credit to investment income from funds generated in an active Puerto Rican business and reinvested in Caribbean Basin countries and to corporations doing business in the Virgin Islands. The Act increases the minimum amount of gross income which a United States corporation must derive from an active possessions business in order to qualify for the credit, from sixty-five percent to seventy-five percent. The Act also relaxes the rule barring credit for income received in the United States. Under the 1986 Code, United States citizens working in Panama are not exempt from federal income taxes. The foreign earned income exclusion ceiling is reduced from $80,000 to $70,000. The Act also specifies new information required of immigrants and persons applying for United States passports or renewals.

The Act makes significant changes with regard to passive foreign investment companies (PFIC's). Under the 1986 Code, United States shareholders in PFIC's pay United States income tax plus an interest charge based on the value of the tax deferral at the time the shareholder disposes of the stock or at the time he receives an "excess" distribution. Shareholders of qualified electing qualifying business thereby could defer United States income tax on its tax haven income. H.R. Conf. Rep. 841, reprinted in 1986 U.S. Code Cong. & Admin. News 4075, 4695.

Tax Act, § 1231, 100 Stat. 2085, 2561-63.
Tax Act, § 1231, 100 Stat. 2085, 2562.
Tax Act, § 1231, 100 Stat. 2085, 2561. Under prior law, income received within the United States by an electing corporation did not qualify for the credit, regardless of whether the income was derived from foreign sources. The Act, however, allows the credit for income received in the United States which is derived from the active conduct of a trade or business in a United States possession and is received from an "unrelated person." RIA Analysis, supra note 12, at ¶ 1708.

Tax Act, § 1233, 100 Stat. 2085, 2564.
Id. at § 1235, 100 Stat. 2085, 2566-76. Gain recognized on the sale of the stock or on receipt of an "excess" distribution is deemed to be earned pro rata over the shareholder's holding period. The tax due on such gain consists of the United States tax computed using the highest applicable rate, plus interest on the deferred tax, plus tax on the gain attributed to that taxable year and to years in which the corporation did not qualify as a PFIC. Id.; see H.R. Conf. Rep. 841, reprinted in 1986 U.S. Code Cong. & Admin. News 4075, 4726-28.
funds must include in gross income their proportionate share of the PFIC earnings and profits and must pay tax on the income for each taxable year. The Act also redefines a PFIC for purposes of these provisions.

The Act makes a variety of changes affecting foreign taxpayers. First, the Act creates a thirty percent branch profits tax on foreign corporations. The Act modifies withholding rules for nonresidents by imposing withholding obligations on partners whose partnership has any income, gain, or loss which is effectively connected with the conduct of a trade or business in the United States. Under the 1986 Code, income of foreign governments and international organizations derived from certain United States investments and interest on United States bank deposits are excluded from gross income. The Act also makes minor modifications in Code sections affecting dual residence corporations, determination of basis,

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38 Tax Act, § 1235, 100 Stat. 2085, 2570-71. The shareholder may elect to defer tax on amounts included in income for which he received no current distributions. Such deferral is subject to an interest charge. H.R. Conf. Rep. 841, reprinted in 1986 U.S. Code Cong. & Admin. News 4075, 4728.

39 Tax Act, § 1235, 100 Stat. 2085, 2572-73. A PFIC is a foreign corporation, for which at least seventy-five percent of its gross income is passive income or for which an average fifty percent of assets (by value) produce passive income. RIA Analysis, supra note 12, at ¶ 1714.

40 Tax Act, § 1241, 100 Stat. 2085, 2576-80. The tax imposed is equal to thirty percent of the dividend equivalent amount, or the corporation's "effectively connected" earnings and profits for the taxable year adjusted to reflect any increase or decrease in United States net equity for the year. The net equity is defined as U.S. assets less liabilities. The term "effectively connected" refers to earnings and profits attributable to income effectively connected with the conduct of a trade or business within the United States. A corporation may be exempted from the branch profits tax if it qualifies under appropriate treaty provisions. Id.

41 Id. at § 1246, 100 Stat. 2085, 2582-83. The tax imposed under this section is equal to twenty percent of any distribution made to a non-United States partner. If the effectively connected percentage is less than eighty percent, however, only the effectively connected percentage may be included in the computations. Id.

42 Id. at § 1247, 100 Stat. 2085, 2583-84.

43 Id. at § 1249, 100 Stat. 2085, 2584-85 (dual consolidated loss of one corporation does not reduce taxable income for affiliated corporations).

44 Id. at § 1248, 100 Stat. 2085, 2584 (limiting taxpayer's basis in property imported from related persons).
expatriation, and reporting by foreign-controlled corporations. Under the 1986 Code, all computations for determining gain and loss arising from fluctuations in the value of foreign currency are made in the taxpayer’s “functional currency.” They may then be translated into dollars. A taxpayer may elect to use the dollar as his functional currency, but only to a limited extent.

The 1986 Act modifies the tax treatment of United States possessions. With respect to Guam, American Samoa, and the Northern Mariana Islands, the 1986 Code grants their governments the authority to enact revenue laws regarding income derived solely from business within the possession or received or accrued by a resident of the possession. The Act also grants an exclusion for possession source income from the gross income of bona fide possession residents. A similar anti-abuse provision applies to possession corporations. In addition, Title XII coordinates United States and Virgin Islands income taxes and grants a possessions tax credit to Virgin Islands corporations.

b. Miscellaneous Provisions

The remaining titles of the Act modify several provisions affecting international transactions. For instance, Title VI changes

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45 *Id.* at § 1243, 100 Stat. 2085, 2580-81 (treatment under section 887 of gain on property received in tax-free exchanges).

46 *Id.* at § 1245, 100 Stat. 2085, 2581 (foreign controlled corporation’s obligation to report transactions with all related foreign persons).


48 Tax Act, § 1271, 100 Stat. 2085, 2591-93. The governments can only enact revenue laws so long as an implementing agreement is in effect between the possession and the United States with respect to the elimination of double taxation, the disallowance of tax avoidance, the exchange of information, and the resolution of other tax administration provisions. *Id.* Under prior law, the tax codes of Guam and the Northern Mariana Islands (CNMI) were mirror images of the United States Internal Revenue Code. American Samoa, however, had adopted its own income tax system, which was similar to the United States system. The 1986 Act places Guam and CNMI “on a par” with American Samoa. H.R. Conf. Rep. 841, reprinted in 1986 U.S. Code Cong. & Admin. News 4075, 4764-65.


50 Tax Act, § 1273, 100 Stat. 2085, 2595-96.

51 *Id.* at § 1274, 100 Stat. 2085, 2596-98. In general, a United States citizen owing United States taxes on income derived from sources within the Virgin Islands pays a percentage of this U.S. tax to the Virgin Islands. *Id.*

52 *Id.* at § 1275, 100 Stat. 2085, 2598-99.
the treatment of intangible drilling costs and oil, gas and mineral exploration and development costs incurred outside the United States. The taxpayer may elect to include such costs in his adjusted basis for determining the relevant deduction. The alternative minimum tax provisions, which underwent a substantial change, set out new rules for the alternative minimum tax foreign credit, which rules apply to both corporations and individuals. The Act also makes various technical corrections in Title XVIII which apply to international tax provisions.

2. Omnibus Budget Reconciliation Act of 1986

The Omnibus Budget Reconciliation Act of 1986 includes one provision affecting tax benefits with respect to activities in certain foreign countries. The provision denies foreign tax credits for any taxes paid or accrued to countries whose governments the United States does not recognize, countries with whom the United States has severed or does not conduct diplomatic relations, and countries designated by the United States Secretary of State as repeated supporters of international terrorism.

3. Unitary Taxation

During 1986, intervention by both the federal government and governments of several foreign countries prompted four states to

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53 Id. at § 411, 100 Stat. 2085, 2225-27.
54 Id. The taxpayer may elect to recover exploration expenditures either by adding the costs to the basis for cost depletion or by deducting the costs ratably over a ten-year period. Under prior law, the taxpayer could elect to deduct exploration expenditures rather than capitalize them, by a section 617 election. RIA Analysis, supra note 12, at ¶ 1212.
55 Tax Act, § 701, 100 Stat. 2085, 2320, 2336-39 (amending Code section 59). The alternative minimum foreign tax credit is computed in a similar fashion to the regular foreign tax credit. It cannot offset more than ninety percent of the tentative minimum tax, although it may be carried forward or backward. Id.; see generally RIA Analysis, supra note 12, at ¶ 224.
58 Id. at § 8041, 100 Stat. 1874, 1962-63 (1986).
59 Id.
repeal state laws imposing unitary taxation on multinational corporations. Unitary taxation, or the worldwide unitary apportionment method, is an accounting method by which states tax the percentage of a firm’s worldwide income earned in the state, based on the number of employees within the state, the extent of sales activity in the state, and the amount of property located within the state. By contrast, the water’s edge formula for taxation applies the unitary method only to income earned in the United States.

During 1986, the federal government actively encouraged states to repeal unitary taxation laws. Secretary of State George Schultz wrote letters to governments of six of the seven states employing unitary taxation - Alaska, California, Idaho, Montana, New Hampshire, and North Dakota - urging them to change their laws. The Justice Department filed motions for leave to file amicus curiae briefs in two cases challenging California’s law. In addition,
Congress had legislation pending before it to bar states' use of the controversial tax method.\textsuperscript{65} Foreign governments also joined the movement by pressuring the federal government to take appropriate action.\textsuperscript{66}

Utah was the first state to respond. In February of 1986, it passed a bill which replaced the worldwide unitary tax with a water's edge approach.\textsuperscript{67} The legislation followed the promulgation of an administrative regulation which had adopted the water's edge approach on a conditional basis.\textsuperscript{68}

California, the largest and most influential of the unitary tax states, also enacted a law providing for the water's edge approach in September 1986.\textsuperscript{69} The law permits a corporation to elect water's edge treatment for a ten-year period upon the payment of a fee.\textsuperscript{70}


\textsuperscript{67} Uniform Division of Income for Tax Purposes Act, ch. 2, 1986 Utah Laws ___ (codified at Utah Code Ann. § 59-7-301-321 (Supp. 1987)).

\textsuperscript{68} Montgomery, \textit{Worldwide Unitary Taxation: Federal and State Developments}, 20 THE INT'L LAW. 1049, 1051 n.19 (Summ. 1986). The regulation would adopt the approach only if the federal government would increase "administrative assistance and cooperation with the states to promote full taxpayer disclosure and accountability," one of the three principles recommended by the Working Group on Worldwide Unitary Taxation. \textit{Id.} at 1050-51.


\textsuperscript{70} Cal. Revenue & Taxation Code § 25115 (West. Supp. 1987). The fee is
The law also grants United States based multinationals a seventy-five percent tax cut on dividends paid by their foreign subsidiaries. The federal government, as well as foreign governments and corporations, welcomed the passage of the new law, which will take effect on January 1, 1988.

New Hampshire and Idaho also repealed unitary tax laws in favor of the water's edge approach in 1986. Of the three remaining unitary tax states, North Dakota has considered water's edge legislation and was expected to reintroduce it in 1987. Alaska and Montana have no plans to repeal their unitary tax laws. A fourth state, Massachusetts, was studying plans to reinstate worldwide equal to 0.03 percent of the corporation's California property, payroll and sales. The law applies to domestic international sales corporations, foreign sales corporations, and subpart F income, although it does not include possessions corporations or 80-20 corporations. Unitary Taxes: Sen. Mathias Says California Law "Superseded" Federal Legislative Effort, DAILY TAX REP. (BNA) No. 176, at G-1 (Sept. 11, 1986).

71 Unitary Taxes: California G. Deukmejian Signs Bill Reforming State's Unitary Tax Law, DAILY TAX REP. (BNA) No. 173, at G-3, G-4. Domestic corporations had lobbied for the provision to offset a loss of competitive advantage with respect to multinational corporations. Id.

72 Id. For instance, the United Kingdom issued a statement in which it heralded the bill as a "major step" toward the abolition of worldwide unitary taxation. "The California legislation is particularly significant in view of the size of the state's economy and its importance to the United Kingdom as a location for investment." Id. The government later announced it would not impose retaliatory tax provisions on United States firms from unitary tax states. Unitary Taxes: U.K. Says It Will Not Seek To Retaliate Against U.S. Corporations, DAILY TAX REP. (BNA) No. 244, at G-4 (Dec. 19, 1986); see generally, supra note 66. Congress also delayed action on its anti-unitary tax measures in response to California's law. Senator Mathias, a co-sponsor of the original bill, announced that the debate was closed for at least a few years. Unitary Taxes: Sen Mathias Says California Law "Superseded" Federal Legislative Effort, DAILY TAX REP. (BNA) No. 176, at G-1 (Sept. 11, 1986).


76 Unitary Tax: California Panel Soon to Consider Unitary Tax Reform Bill; Other States Slow to Act, DAILY TAX REP. (BNA) No. 129, at G-1, G-2 (July 7, 1986).

77 Alaska opposes any change because of the drop in oil prices and the resulting decline in state revenue. Id.

78 Montana also opposes the change and will "fight" any federal initiative aimed at imposing the change to water's edge. According to state officials, unitary tax equalizes the taxation of large and small corporations. Id. at G-2-G-3.
unitary taxation and was expected to take some action in 1987. As of November 1987, however, Massachusetts had not yet addressed the issue. 79

B. Income Tax Treaties and Protocols

1. Instruments of Ratification Exchanged

During 1986 the United States exchanged instruments of ratification regarding tax treaties with Barbados, 80 the Federal Republic of Germany (West Germany), 81 and the People’s Republic of China. 82 The United States-Barbados treaty, for which instruments were exchanged on February 28, 1986, 83 provides for maximum tax rates at the source on payment of dividends and interest and prevents double taxation of income. 84 Because Barbados is a developing country which has never before been a party to an income tax treaty with the United States, the agreement provides Barbados with broader rights in taxing business property and certain types of personal income than are given to most developed countries. 85 The treaty is in effect for taxable years beginning as of January 1, 1984. 86

The treaty sparked controversy in October 1986. The agreement grants an exemption from United States excise taxes on insurance

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79 A special commission was appointed to study whether to reinstate unitary taxation. The commission was expected to issue findings in January of 1987. As of November 1987, the legislature had not acted on the study. Id. at G-3.


84 State Department Press Release, reprinted in id.

85 Id.

86 Tax Treaty with Barbados, supra note 80, at art. 28.
premiums paid to foreign insurance concerns, prompting anxiety that offshore insurance companies may relocate from Bermuda to Barbados. The Senate Foreign Relations Committee has requested that the Treasury Department renegotiate the provision to eliminate the tax exemption.⁷⁷

The United States also exchanged instruments of ratification for an estate and gift tax treaty with West Germany on June 27, 1986.⁸⁸ The treaty, which is similar to United States treaties already in force with the United Kingdom and with France, allows the country of domicile to tax estates and gifts, provided that the country gives a credit for taxes paid to the other contracting state. The treaty also sets out rules for determining legal domicile and the tax liability for persons who are residents of both countries, to alleviate double taxation of those individuals.⁹⁹ The treaty takes effect for the estates of persons dying and for gifts made on or after January 1, 1979.⁹⁰

Following the signing of a supplementary protocol, the United States and the People’s Republic of China exchanged instruments of ratification with respect to an income tax treaty on October 22, 1986.⁹¹ The treaty reduces tax liability for United States firms’ earnings, which were taxed at twenty percent prior to the agreement.⁹² In addition, the treaty enables United States residents to work for United States firms in China for 183 days before becoming subject to Chinese income tax.⁹³

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⁷⁷ Letter from United States Senator Claiborne Pell to Treasury Secretary James A. Baker, III, reprinted in 3 Tax Treaties (CCH) ¶ 9834. The three senators who signed the letter expressed concern over the impact of the provision on the competitive position of Bermudian insurance companies. The Senators recommended renegotiation of the provision to eliminate the competitive advantage for Barbadian companies. Id.


⁹⁹ Technical Explanation of the Convention between the United States of America and the Federal Republic of Germany, 2 Tax Treaties (CCH) ¶ 3067R. The treaty is patterned after the model estate and gift tax treaty published by the Treasury Department on December 8, 1980. Id.

⁹⁰ Tax Treaty with Germany, supra note 81, at art. 17.


⁹³ Tax Treaty with China, supra note 82, at art. 13.
Ratification of the treaty had been delayed pending the signing of a supplementary agreement between the contracting nations. In a protocol added to the treaty in May of 1986, the parties agreed that residents of third countries could not benefit from the treaty by channeling investments in one contracting nation through the other. The protocol is designed to prevent treaty-shopping by residents of third countries. Following ratification, the treaty entered into force November 21, 1986, for taxable years beginning on or after January 1, 1987.

2. Tax Treaties Signed and Awaiting Approval

As of November 1987, the Senate had not yet ratified proposed treaties with Bermuda, Denmark, Sri Lanka, and Tunisia. In addition, the Senate had not acted upon two treaties with the Netherlands, one regarding Aruba and the other concerning the Netherlands Antilles.

The proposed treaty with Bermuda, signed in July 1986, would exempt Bermudian insurance companies from United States income and excise taxes if the companies did not operate a permanent office in the United States. The Senate blocked ratification of
the treaty pending a resolution of the dispute between Barbadian and Bermudian insurance companies.103

The governments of the United States and Denmark signed a new income tax treaty on June 17, 1980, to replace the treaty currently in force. The Senate Foreign Relations Committee cleared the proposed treaty in 1985, but several senators have blocked further action on the treaty.104

The tax treaties with Sri Lanka and Tunisia represent the United States Treasury Department’s efforts to maintain tax-reducing treaties with the nation’s trade partners.105 Both treaties are the first such agreements to be negotiated with the United States.106

The proposed treaties with the Netherlands regarding Aruba107 and the Netherlands Antilles108 would replace treaties currently in treaty also provides for mutual assistance in tax matters, which assistance includes sharing tax information. The scope of the information exchanged under the treaty is similar to that required under the Caribbean Basin Economic Recovery Act. In addition, the United States contemplates signing a tax information exchange agreement to qualify Bermuda for convention tax deductions under the Internal Revenue Code. Id.

103 Tax Treaties: Senators Seek Renegotiation of Barbados Accord, Insurance Tax Break Hit, DAILY TAX REP. (BNA) No. 207, at G-1 (Oct. 27, 1986); see generally supra note 87 and accompanying text.


105 Tax Legislation, supra note 104.

106 Letter of Transmittal on the Sri Lanka Treaty from President Reagan to the Senate (Oct. 2, 1985), reprinted in 3 TAX TREATIES (CCH) ¶ 7292XN; Letter of Transmittal on the Tunisian Treaty from President Reagan to the Senate (Mar. 13, 1986), reprinted in 3 TAX TREATIES (CCH) ¶ 7806. Both treaties are based on model treaties published by the Treasury Department and the Organization for Economic Cooperation and Development. Since both Sri Lanka and Tunisia are developing countries, however, the treaties provide broader rights to tax for source countries than do the model treaties. Id.

107 Tax Treaties: U.S., Netherlands Sign New Accord on Aruba, Treasury Dept. Announces, DAILY TAX REP. (BNA) No. 156, at G-5 (Aug. 13, 1986). The treaty covers both federal income and federal excise taxes and is designed to prevent treaty shopping by residents of third countries. One exception to these limits on treaty benefits set out in the agreement is certain mutual funds established in one of the contracting states. These mutual funds will be entitled to the treaty benefits irrespective of the residence of the funds’ owners. Id. at G-5-G-6.

108 Highlights of the Netherlands Antilles Income Tax Treaty, 2 TAX TREATIES (CCH) ¶ 5897A. Since the 1986 Tax Reform Act was expected to affect several
effect. The present treaties will terminate in January of 1988.\textsuperscript{109}

3. Caribbean Basin Initiative Agreements

In December 1986, the United States signed information exchange agreements with the governments of Grenada and Jamaica under the Caribbean Basin Economic Recovery Act of 1983.\textsuperscript{110} These agreements help United States investors in those countries obtain Caribbean Basin Initiative benefits. The Jamaican pact became effective immediately upon signing, but the Grenada treaty will not take effect until Grenada enacts the necessary legislation.\textsuperscript{111}

The Caribbean Basin Initiative program, under which the United States may provide unilateral duty-free treatment of its imports of eligible goods from the designated countries,\textsuperscript{112} has been criticized. The governments of several Caribbean Basin countries object to the structure of the program, which they believe cannot fulfill the objectives of the Act.\textsuperscript{113} A number of United States industry groups

\begin{footnotes}
\item U.S. Terminates the Extension of the U.S.-Netherlands Tax Treaty to Netherlands Antilles and Aruba, 3 Tax Treaties (CCH) ¶ 9817.
\item Tax Treaties: U.S. Signs CBI Information Exchange Agreements with Jamaica and Grenada, Daily Tax Rep. (BNA) No. 247, at G-2 (Dec. 24, 1986). Both treaties satisfy the criteria of the Caribbean Basin Economic Recovery Act. The Grenadan agreement also sets out provisions concerning the deductibility of expenses for attending foreign conventions and the opportunity for Grenada to receive certain Puerto Rican investment funds. Some of these benefits were already available in Jamaica under the United States-Jamaica income tax treaty. Id.; see also U.S., Jamaica Sign Tax Information Exchange Agreement, 3 Tax Treaties (CCH) ¶ 9841 (text of agreement); U.S., Grenada Sign Tax Information Exchange Agreement, 3 Tax Treaties (CCH) ¶ 9842.
\item Trade Policy: House Ways-Means Panel to Hold Oversight Hearings on Caribbean Basin Initiative, Daily Tax Rep. (BNA) No. 27, at LL-1 (Feb. 10, 1986) [hereinafter Oversight Hearings on CBI]. The program also permits deductions for business expenses incurred while attending a convention in a designated Caribbean nation, if the country signs an agreement with the United States for exchange of tax information. Id.; see also Caribbean Basin Initiative Model Exchange of Information Agreement Released, 3 Tax Treaties (CCH) ¶ 9920.
\item Trade Policy: U.S. Official Provides Update on Tax Agreements under Caribbean Program, Daily Tax Rep. (BNA) No. 43, at LL-8-LL-9 (Mar. 5, 1986). The Ambassador from Barbados praised the intent of the program but argued that it "is having and will have only a marginal effect on economic revitalization." Ambassador Laurie noted
\end{footnotes}
also have expressed strong objections to the program.\textsuperscript{114} The House Ways and Means Oversight Subcommittee undertook a study of the program's effectiveness, and legislation on the program is pending in Congress.\textsuperscript{115}

4. Treaties Under Negotiation

As of the end of 1986, the United States had not yet signed tax treaties with Belgium, Finland, India, Ireland, the Netherlands, Nigeria, Sweden, Switzerland, Thailand, and Trinidad and Tobago. Treaties with these counties remain in various stages of negotiation in November 1987.\textsuperscript{116}

C. Regulations

1. Final Regulations

In Treasury Decision 8090,\textsuperscript{117} the Service issued rules for determining whether a domestic corporation operating in a United States possession such as Puerto Rico has a "significant business presence" with respect to a single product to qualify the corporation

that the program excludes many products which represent the greatest growth potential for Caribbean economies. He recommended that certain imports of textiles be exempted from duties and quotas and that the United States provide technical assistance to the management and marketing segments of the Caribbean Basin private sector.

St. Lucia Ambassador Joseph Edmunds and Dominican Republic Ambassador Eulogio Santaella also commended the goals of the program. Santaella observed, however, that the program is thwarted by the United States restrictions on sugar imports. In addition, the program does not distinguish between smaller island nations and the larger Latin American countries. \textit{Id.}

\textsuperscript{114} \textit{Id.} Representatives from the leather and footwear industries and the textile and apparel industries oppose certain Caribbean Basin trade benefits. \textit{Id.}


\textsuperscript{116} \textit{Status of Treaty Negotiations, 3 Tax Treaties (CCH) ¶ 9015.}

\textsuperscript{117} 1986-2 C.B. 105. The regulations were issued in response to changes in the tax law made by the Tax Equity and Fiscal Responsibility Act of 1982. \textit{Id.}
for a possession tax credit. The decision also provides rules to implement the cost sharing and profit split elections. The new regulations clarify the meanings of such terms as "product" and "contract manufacturing," which were not fully defined in Internal Revenue Code section 936.

2. Temporary Regulations

The Service issued temporary regulations concerning international aspects of Internal Revenue Code section 338 stock acquisitions in Treasury Decision 8074. Section 338 permits a corporation which acquires the stock of another corporation, or "target," in a qualified stock purchase to elect to have the target treated as if it sold all its assets at fair market value on the date of acquisition and repurchased the assets as a new corporation the following day for an amount equal to the price paid for the target's stock and any of its liabilities. Section 338 excludes foreign affiliates of the target from the consistency rules provided in the section. The new temporary regulations provide that a foreign corporation is not excluded from the status of a target affiliate, although certain foreign corporations may be excluded pursuant to a "transitional exclusion election" or a prospective "regular exclusion election." The regulations also provide special rules for controlled foreign corporations.

The Service also issued temporary regulations relating to transfers of property by United States persons to foreign corporations pursuant to a corporate organization, reorganization, or liquidation.

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118 Id. at 107, 109-10.
119 Id. at 106-07, 108; see I.R.C. § 936 (1986). Section 936 grants to a domestic corporation which derives both 65% of its gross income from the active conduct of a trade or business within a U.S. possession and 80% of its gross income from sources within the possession, a credit against the tax attributable to the sum of the taxable income from the conduct of business or the sale or exchange of substantially all the assets used in the trade or business and the qualified possession source income. I.R.C. § 936(a) (1986).
120 1986-1 C.B. 126 (citing I.R.C. § 338). The Service also issued a notice of proposed rulemaking concerning section 338. The Service proposed that the regular exclusion election permitted under the temporary regulations be eliminated in the final regulations. I.R.S. Notice LR-35-84, 1986-1 C.B. 814.
122 Id. The regular exclusion election causes all excludible foreign target affiliates to be excluded from the status of target affiliates. Id. at 127-28; see supra note 120 regarding the status of the regular exclusion election provision.
123 Id. at 133-35.
in Treasury Decision 8087. Section 367 of the Internal Revenue Code provides that such transfers of property to foreign corporations are taxable exchanges, unless the property will be used in the active conduct of a trade or business outside of the United States. The regulations set out tests for qualifying under the activity conduct exemption and clarify the rules for recognition of gain or loss. In addition, the regulations provide rules concerning the information to be reported.

3. Proposed Regulations

The Service has issued "long-awaited" proposed regulations concerning the recapture of overall foreign losses in claiming credits against United States income taxes for foreign tax payments. The proposed regulations set forth rules for determining a taxpayer's overall foreign losses in a taxable year. In general, a taxpayer sustains an overall foreign loss when his gross income from sources outside the United States is exceeded by the deductions allocated to that income. If he has sustained an overall foreign

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126 T.D. 8087, 1986-1 C.B. 175, 176-77. For instance, transfers of inventory, installment obligations, foreign currency, intangible property, and leased property are always subject to taxation, regardless of whether the property will be used in the active conduct of a trade or business. Also, special rules apply to the incorporation of a foreign branch with previously deducted losses. Such losses must be recaptured by recognizing the gain realized on the transfer of the assets of the branch. Id.

127 Id. at 177, 198-202.

128 I.R.S. Notice LR-3-77, 1986-1 C.B. 711; Tax Credits: Proposed IRS Rules Would Require Special Accounts to Keep Track of Foreign Losses, DAILY TAX REP. (BNA) No. 16 (Jan. 24, 1986). The regulations correspond to a 1976 provision in the Code which requires a taxpayer to count as U.S. income a portion of foreign losses claimed in a prior year when foreign tax credits reduce U.S. tax on related foreign income in a future year. This so-called recapture of foreign losses, which also is triggered when a possessions credit is sought, is designed to prevent taxpayers from getting a double tax break—one for a foreign loss and one for payments of foreign taxes in a subsequent year on income generated by activities related to the loss. The Tax Reform Act of 1976 is quite clear, but the technical mechanics for recapturing foreign losses were left to the IRS. Id.

129 I.R.S. Notice LR-3-77, 1986-1 C.B. 711, 713. The regulations set out seven types of foreign losses, including Section 904(d) interest income, foreign trade income, DISC dividend income, and other foreign-source income, which are referred to as
loss, he is required by the regulations to maintain an overall foreign loss account in order to track recaptured losses from year to year. The proposed regulations provide rules for particular recapture issues, including net operating loss carrybacks and recapture of losses from domestic and foreign trusts.

The Service published proposed regulations defining the term "qualified possession source investment income" for purposes of the possessions tax credit. The proposed regulations provide generally that interest and certain dividends derived by a domestic corporation which is engaged in active trade or business in Puerto Rico are attributable to investment in Puerto Rico if the interest or dividends qualify for exemption from Puerto Rican income tax. The proposed regulations reflect recent changes in the Puerto Rican tax laws regarding tax exemptions.

Proposed partnership rules issued by the Service would exempt some foreign partnerships from filing returns. Foreign partnerships which conduct no business in the United States and derive no income from sources within the United States are not required to file returns unless at least twenty-five percent of income, gain, loss, deduction or credit of the partnership is allocable to a United States person or persons. The regulations also address interests held by indirect partners.

The Service announced that the branch profits tax enacted in 1986 generally will not be imposed on the section 351 incorporation or the complete termination of a foreign corporation's United States trade or business or on certain liquidations or reor-

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131 Id. at 714-16, 718-28.
133 Id. at 729-30.
136 Id. The Service recognized the ambiguity inherent in the term "indirect partner" and requested comments on the rule. Id. at 778.
ganizations of a foreign corporation that has conducted a United States trade or business. The branch profits tax is a thirty percent tax imposed on a foreign corporation's after-tax United States earnings which are not reinvested in the corporation's United States business. The new rules limit the imposition of the tax to further the purpose of the section in equalizing the tax treatments of United States branches and subsidiaries of foreign corporations.

In December 1986, the Service published several advance notices regarding international tax problems under the 1986 Act. In Notice 87-3, the Service announced the release of regulations concerning the withholding tax that must be collected when foreign persons dispose of real property interests within the United States. The rules generally require withholding from the person who makes a payment relating to a distribution attributable to the disposition of the property interest.

The Service issued an advance notice concerning United States-dollar interest-rate swaps. The notice contains source rules for swap income and swap expense attributable to United States-dollar interest-rate swaps where one party resides in the United States. All swap income attributable to a United States trade or business will be sourced in this country and deemed connected to the United States trade or business. Otherwise, a taxpayer may elect to source the swap income by reference to the residence of the recipient.

As announced in Notice 87-5, the Service will promulgate regulations to implement the 1986 repeal of the General Utilities

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139 Branch Profits Notice, supra note 138, at G-5.

140 I.R.S. Notice 86-17, 1986-2 C.B. 379. The rules are in effect until regulations are prescribed. Id. at 380.


142 Foreign Investor Law Notice, supra note 141, at G-7.


144 Id.

doctrine and thus require recognition of gain or loss by a foreign subsidiary liquidating corporation on the distribution of property to an eighty percent foreign corporate parent.\textsuperscript{146} Foreign corporations may be exempt from recognizing gain or loss if the corporate assets do not include United States real property, the assets are used by the foreign subsidiary to conduct a trade or business in the United States, or recognition of gain or loss violates a treaty.\textsuperscript{147}

The Service also issued a notice to provide taxpayers with guidance on foreign tax credit rules.\textsuperscript{148} The notice sets out the effective dates of the amendments and addresses the characterization of distributions and section 951(a)(1)(B) inclusions of earnings of a foreign corporation in taxable years beginning before January 1, 1987. The notice also discusses high tax income and look-through rules for distributions.\textsuperscript{149} The Service issued the notice to implement the transitional provisions in lieu of regulations, which could not be issued for several months.\textsuperscript{150}

\textbf{D. Revenue Rulings and Procedures}

\textbf{1. Controlled Foreign Corporations}

In Revenue Ruling 86-33,\textsuperscript{151} the Service ruled that, for purposes of calculating the limitation on subpart F income under Code section 952(c),\textsuperscript{152} a controlled foreign corporation (CFC) which receives a dividend distribution from another CFC within the same chain of foreign corporations, is required to increase its earnings and profits for the tax year by the amount of the distribution.\textsuperscript{153} The fact that the distribution is not taxed to the recipient corporation does not preclude the distribution from increasing earnings and profits.\textsuperscript{154}


\textsuperscript{147} Liquidations Notice, supra note 146, at G-1.

\textsuperscript{148} I.R.S. Notice 87-6, 1987-3 I.R.B. 8.

\textsuperscript{149} \textit{Id.}


\textsuperscript{151} 1986-1 C.B. 287.

\textsuperscript{152} I.R.C. § 952 (1984).

\textsuperscript{153} 1986-1 C.B. 287.

\textsuperscript{154} \textit{Id.} Section 964(a) of the Code and Regulation 1.964-1(a) provide that the earnings and profits of a foreign corporation shall be computed as if the corporation were domestic. If the distribution received would require an adjustment or allocation of basis, the transaction would be governed by section 312(f)(2). \textit{Id.} at 289.
In Revenue Ruling 86-131, the Service announced the proper method for adjusting earnings and profits of a CFC to reflect a distribution of property to a domestic shareholder when the property's adjusted basis exceeds its fair market value. The earnings and profits are reduced to represent the loss to the CFC.

The Service held in Revenue Ruling 86-155 that income from the engineering, fabrication, and installation of offshore drilling platforms will be classified as foreign base company sales or service income pursuant to the standards set forth in section 1.954-1(f)(2) of the regulations. Thereafter, gross income will be determined in accordance with section 1.61-3(a) of the regulations.

2. Domestic International Sales Corporations

In Revenue Ruling 86-132, the Service announced the "base period T-bill rate" for 1984-1986 to be applied in the taxation of domestic international sales corporations (DISC) income to shareholders. DISC shareholders are required yearly to pay interest in an amount equal to the product of the shareholder's DISC-related deferred tax liability and the base period T-bill rate.

The Service held in Revenue Ruling 86-144 that the moratorium on the application of section 1.861-8 of the regulations

156 Id. at 136-37. The method for such a determination is as follows:
[T]otal earnings and profits will be adjusted: first, by reducing the section 959(c)(1) component, to the extent thereof, by the fair market value of the property distributed; second, by reducing the section 959(c)(2) component, to the extent thereof, by any excess of the fair market value of the distributed property over the total section 959(c)(1) component; and third, by reducing the section 959(c)(3) component by the difference, if any, between the section 312(a)(3) adjustment and the reductions in the section 959(c)(2) components to reflect the application of section 312(a)(3). Id. Had the fair market value of the property distributed to the shareholder exceeded the adjusted basis as held by the CFC, the CFC would recognize gain to the extent of the appreciation, thereby increasing its earnings and profits.

158 Id.; see also Treas. Reg. § 1-954-1(f)(2) (as amended in 1984). The general criterion in classifying income is the predominant character of the transaction: whether it is a single integrated transaction or a series of separate business transactions pursuant to the same contract or arrangement. Id.
159 1986-2 C.B. 134, 135; see also Treas. Reg. § 1.61-3(a) (as amended in 1973).
162 1986-2 C.B. 101. The moratorium was established under the Economic Recovery Tax Act of 1981 and was extended under the Tax Reform Act of 1984. Id.
does not affect the calculation of combined taxable income of a DISC or a FSC and its related supplier. The regulation governs the allocation and apportionment of expenses and deductions, such as research and development expenses. The Service noted that the moratorium was not intended to modify the amount of DISC benefits derived from export transactions and thus does not apply to the calculation of combined taxable income.163

3. Rulings Issued Pursuant to Income Tax Treaties

In Revenue Ruling 86-145,164 the Service defined the term “tax year concerned” as used in the United States-United Kingdom Income Tax Convention, as the tax year in which personal services are performed rather than the tax year in which compensation for those services is received.165

In Revenue Ruling 86-156,166 the Service held that rentals for photocopy machines derived by a Netherlands corporation from its wholly-owned United States subsidiary are exempt from United States income tax as business profits under the United States-Netherlands Income Tax Convention. The Service found the rentals constituted industrial or commercial profits for the Netherlands company, which profits could not be attributed to a permanent establishment in the United States.167

4. Miscellaneous Rulings

In Revenue Ruling 86-6,168 the Service determined that a domestic corporation which owns one hundred percent of the stock of a Netherlands Antilles corporation may withdraw a portion of its paid-in capital contribution, thereby increasing the subsidiary’s debt-to-equity ratio, without jeopardizing the subsidiary’s separate corporation status. Using the test enunciated in Revenue Ruling

163 Id. at 102-03; Treas. Reg. § 1.861-8 (as amended in 1984).
165 Id. A United Kingdom resident was in the United States for more than 183 days in 1985. During that time he worked for a United Kingdom employer which had no permanent establishment in this country. He did not receive compensation for his services until 1986, during which year he spent only thirty days in the United States. The Service ruled that, for purposes of the 183-day limitations period for tax exemption, the taxpayer’s “tax year concerned” was 1985. His income was, therefore, fully taxable by the United States. Id.
167 Id.
168 1986-1 C.B. 286.
73-110, the Service cautioned that the subsidiary's debt-equity ratio could not exceed five to one without transforming the bona fide nature of the debt obligation.

The Service determined in Revenue Ruling 86-76 that interest income from savings deposits held in a domestic branch of a United States bank which is received by a domestic estate and transferred to nonresident alien beneficiaries in the year of receipt is not from United States sources. Thus, it is not taxable by the United States in the hands of the beneficiaries. If the income is not distributed in the year of receipt, it is considered income to the estate and is subject to taxation by the United States.

For purposes of the foreign tax credit, the Service ruled in Revenue Ruling 86-1341 that investment incentives or WIR premiums granted by the Netherlands reduce Netherlands income taxes accrued for the taxable year in which the incentives were allowed. The Netherlands grants investment incentives to its residents and to non-residents who operate in the country through a permanent establishment; these incentives or premiums are excluded from taxable income. Since they are not actually taxed by the Netherlands, the Service reasoned that the incentives should not qualify for the foreign tax credit.

5. Revenue Procedures

In Revenue Procedure 86-39, the Service updated its list of foreign countries in which adverse conditions may preclude United States citizens residing in those countries from qualifying for the foreign residency requirements. Qualifying individuals residing in foreign countries may exclude from gross income foreign earned income and housing costs if they establish that they are bona fide residents of another country or have been in the country for the

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171 1986-1 C.B. 284.
172 Id. This ruling amplified the Service's earlier announcement in Revenue Ruling 81-244, in which the Service determined that interest income received by a nonresident alien beneficiary from a domestic simple trust was not United States source income. Id. at 285; see generally Rev. Rul. 81-244, 1981-2 C.B. 151.
174 Id. at 105. If the premiums are recaptured in a later year, however, they are treated as an increase in the Netherlands income tax accrued or paid for the taxable year in which the liability for the recaptured premium is paid or accrued. Id.
the requisite period of time. The Service grants the same exclusion to individuals who were forced to leave qualifying foreign countries because of war, civil unrest, or similar adverse conditions. Fourteen countries qualify under the new ruling, including El Salvador, Iran, Iraq, and Libya.

E. Cases

1. Cases Arising Under Treaties

During 1986, United States courts had the opportunity to interpret United States treaty provisions in three separate cases. In two instances, disputes arose over tax treaty provisions which provide exemptions from tax liability. The third case construed income tax exemptions as set out in the Panama Canal Treaty.

United States taxpayers employed by the Panama Canal Commission pursuant to the Panama Canal Treaty are subject to United States federal income tax, according to a unanimous opinion issued by the Supreme Court in O'Connor v. United States. The taxpayers were working for the Commission, a government agency which operates the Canal for the United States. Under the treaty and an agreement signed in conjunction with the treaty, the rights and legal status of United States citizens shall be governed by the Implementation Agreement. The Agreement provides that United States citizens are exempt from paying taxes on income received

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177 Rev. Proc. 86-39, 1986-2 C.B. 701. The other qualifying countries are Afghanistan, Argentina, Bolivia, Chad, Colombia, Grenada, Kuwait, Lebanon, Sudan, and Uganda. The list includes the relevant dates for the periods of adverse conditions. Id. at 702.
179 O'Connor v. United States, 107 S. Ct. 347 (1986). Justice Scalia delivered the opinion for the Court. Id.
180 Id. at 349. From 1904 to 1979, the United States exercised sovereignty over the Panama Canal and the surrounding ten mile wide Panama Canal Zone under the Isthmian Canal Convention. Under the Panama Canal Treaty, ratified in 1978, Panama regained sovereignty over the Canal and Zone. The United States retained the right to operate the Canal through 1999. The governing body for the United States is the Panama Canal Commission, a government agency supervised by a nine-member Board, four of whose members are Panamanians proposed by the government of Panama. Id.
as a result of their work for the Commission.\textsuperscript{182} Pursuant to the provisions in the Agreement, the taxpayers contended that their Commission salaries were exempt from both Panamanian and United States taxation.\textsuperscript{183}

The Court construed the treaty provisions as referring only to taxes payable in Panama.\textsuperscript{184} The Court reasoned that the absence of the phrase "in the Republic of Panama" in the provisions of the Agreement relating the legal status of United States citizen-employees in the Canal Zone, evidences the United States intent to impose tax liability on the taxpayers.\textsuperscript{185} The Court examined the negotiating history of the treaty and Agreement but could not find sufficient evidence to support the taxpayers’ theory.\textsuperscript{186}

In October of 1986, a United States district court held in \textit{Norstar Bank of Upstate New York v. United States,} that the provision of the tax code stating that the gross estate of a decedent includes all real or personal property, wherever situated,\textsuperscript{187} does not conflict

\textsuperscript{182} Id. at Art. XV. The relevant portions of the Agreement provide:
1. By virtue of this Agreement, the Commission, its contractors and subcontractors are exempt from payment in the Republic of Panama of all taxes, fees or other charges on their activities or property.
2. United States citizen employees and dependents shall be exempt from any taxes, fees or other charges on income received as a result of their work for the Commission. Similarly, they shall be exempt from payment of taxes, fees or other charges on income derived from sources outside the Republic of Panama.

\textit{Id.}

\textsuperscript{183} O’Connor v. United States, 107 S. Ct. 347, 349 (1986). Taxpayers also based their argument on 26 U.S.C. section 894(a), which provides that "[i]ncome of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle." I.R.C. § 894(a) (1982), \textit{reprinted in O’Connor,} 107 S. Ct. at 349.

\textsuperscript{184} \textit{O’Connor,} 107 S. Ct. at 350. The Court compared the provisions in Article XV to Article XVI of the Implementation Agreement, which concerns import duties and is understood to refer only to \textit{Panamanian} import duties. \textit{Id.}

\textsuperscript{185} \textit{Id.} The Court noted that taking the taxpayers’ arguments to their logical extreme would result in exempting the taxpayers from liability for any tax, including U.S. gift and inheritance taxes and federal income taxes imposed on all income from sources outside Panama. \textit{Id.}

\textsuperscript{186} \textit{O’Connor,} 107 S. Ct. at 347. The Court did not address a provision in the 1986 Tax Reform Act, which states that nothing in the treaty or the Implementation Agreement exempts a U.S. citizen or resident from any U.S. tax, thereby avoiding the constitutional questions posed by retroactive income taxation. Tax Reform Act of 1986, Pub. L. No. 99-514, § 1232(a), 100 Stat. 2085, 2563-64 (1986); \textit{Supreme Court: American Employees at Panama Canal Held Subject to U.S. Tax,} \textit{DAILY TAX REP.} (BNA) No. 214, at G-1 (Nov. 5, 1986).

\textsuperscript{187} I.R.C. § 2031(a) (1982). The section provides that "[t]he value of the gross
with the tax treaty between the United States and France with respect to French real estate of a United States citizen who died in France. The treaty, which governs estate and inheritance taxes between the countries, provides for a credit for taxes paid in the other country with respect to property situated in the other country. Under Article IV of the treaty, a contracting nation generally cannot tax property in the other nation, although that article expressly does not apply to taxes imposed by the United States on its deceased citizens.

The trustee of the decedent's estate claimed that the tax code provision requiring inclusion in the estate of all property could not apply to the estate in question, since the provision would cause the realty to be subject to double taxation in contravention of the treaty. The trustee argued that any amendments in the tax code made subsequent to ratification of the treaty that would result in tax consequences different from those resulting under the code and treaty at the date of ratification would violate the treaty and thus be ineffective. The court disagreed, stating that a treaty, similar to a constitution, is drafted to withstand changing conditions and incorporate amendments to the tax codes of the signatory nations. Hence, under the amended Internal Revenue Code, the realty must be included in the estate, although the estate will receive a credit for any estate taxes paid on the realty in France.

The United States Tax Court ruled in a third case involving tax exemptions for withholding of interest under the United States-

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192 Norstar Bank, 644 F. Supp. at 1116.

193 Id. Since the Code provision relating to inclusion of personalty in the estate is unchanged since the signing of the treaty, the personalty was and is includible in the gross estate. Id. at 1115 n.4.
Netherlands income tax treaty\textsuperscript{194} that the taxpayer filed sufficient forms to support its exemption.\textsuperscript{195} The taxpayer in \textit{Casanova Co. v. Commissioner} claimed an exemption from withholding for the payment on interest to a Netherlands Antilles corporation in 1980. The Code requires thirty percent withholding on payments of certain types of income to foreign corporations.\textsuperscript{196} The taxpayer claimed exemption from that requirement under the treaty, which exempts from taxation such interest,\textsuperscript{197} on Forms 1042 and 1042S.\textsuperscript{198} After receiving a notice of deficiency for the 1980 returns, the taxpayer filed supplementary forms in 1984 specifying that the payee corporation qualified for exemption under the treaty provisions.\textsuperscript{199} The court ruled that the filing of these forms, even though it did not occur for three years, was sufficient to exempt the taxpayer from withholding requirements.\textsuperscript{200} The court noted that neither the code sections nor the treaty as amended specify the type of documentation required and the timing thereof. In the absence of such express provisions, the taxpayer's filings were timely.\textsuperscript{201}

2. State Taxes Affecting International Business

In 1986, the Supreme Court rendered decisions in two cases involving state taxes impacting international business. The Court

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\textsuperscript{194} Convention with Respect to Taxes on Income and Certain Other Taxes, Apr. 29, 1948, United States-Netherlands, 62 Stat. 1757, T.I.A.S. No. 1855 [hereinafter Netherlands Tax Convention].
\textsuperscript{195} \textit{Casanova Co. v. Comm'r}, 87 T.C. 214 (1986).
\textsuperscript{196} \textit{Id.} at 217-18. I.R.C. section 1441 requires thirty percent withholding on certain payments to nonresident aliens. I.R.C. section 1442 imposes the same tax on payments to foreign corporations. I.R.C. §§ 1441, 1442 (1986). Withholding agents are required to make annual returns regarding all income subject to withholding, including income exempted from withholding by reason of treaties, on Form 1042 (U.S. Annual Return of Income Tax to be Paid at Source) and Form 1042S (Income Subject to Withholding Under Chapter 3, Internal Revenue Code.) Treas. Reg. § 1.1461-2 (as amended in 1984); see \textit{Casanova Co.}, 87 T.C. at 218.
\textsuperscript{198} \textit{See supra} note 196. Neither party disputed that these were incorrect forms. \textit{Casanova Co.}, 87 T.C. at 219-22.
\textsuperscript{199} The required forms are Treasury Form 1001 (Ownership, Exemption or Reduced Rate Certificate) and Form VS-4 (a Netherlands Antilles certificate specifying ownership of the payee corporation.) \textit{Id.} at 221.
\textsuperscript{200} \textit{Casanova Co. v. Comm'r}, 87 T.C. 214, 222.
\textsuperscript{201} \textit{Id.} at 224.
\end{footnotesize}
considered an ad valorem personal property tax imposed on imports stored under bond in a customs warehouse and not designed for foreign markets, as well as a fuel tax imposed on aviation fuel sold to foreign airlines.

In *R.J. Reynolds Tobacco Co. v. Durham County*, the Court held that North Carolina's imposition of a nondiscriminatory ad valorem property tax on imported tobacco held in customs-bonded warehouses prior to domestic manufacture and sale does not violate either the Import-Export clause of the United States Constitution or due process and is not preempted by federal law. The Court distinguished the case from its decision in *Xerox Corp. v. County of Harris*, in which it held that federal law preempted state ad valorem personal property taxation on imported goods stored in a customs-bonded warehouse and destined for foreign markets. The Court determined that the imposition of a tax placed the foreign tobacco on an equal footing with domestic tobacco, which is also subject to an ad valorem tax during the two-year aging period.

In ruling on the impact of the tax on the Import-Export Clause, the Court studied the nature of the tax imposed. The Court noted that the tax does not interfere with federal regulation of foreign commerce, since it affects imported and domestic goods alike, nor does the tax impair a significant source of federal revenue.

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203 *Id.* at 507-10; Xerox Corp. v. County of Harris, 459 U.S. 145 (1982). Whereas the Xerox imports were destined for foreign markets, the tobacco which R.J. Reynolds imported was intended for domestic manufacture and consumption. *R.J. Reynolds*, 107 S. Ct. at 509.
204 *Id.*. The Court reasoned that, while state property taxation may deter an importer whose goods are designed for transshipment in foreign countries from using that state's facilities, particularly when the importer receives an exemption from customs duties on all exports, similar taxation would not deter an importer like Reynolds who stores the imported goods for aging for up to two years before processing it. *Id.* The Court also relied on an earlier case, *McGoldrick v. Gulf Oil Corp.*, 309 U.S. 414 (1940), in which the Supreme Court had permitted local taxation only of refined materials intended for domestic consumption, not those designed for reexport. *R.J. Reynolds*, 107 S. Ct. at 512.
205 The Clause provides, "No State shall, without the consent of the Congress, lay any Imposts or Duties on Imports or Exports, except . . ." (The exceptions do not apply to these facts.) U.S. Const. art. I, § 10, cl. 2.
206 *R.J. Reynolds*, 107 S. Ct. at 513-14. In *Michelin Tire Corp. v. Wages*, 423 U.S. 276 (1976), the Court abandoned its earlier theory that the Import-Export Clause proscribed all forms of state taxation on imports and instead focused on the nature of the tax at issue—whether it constitutes an impost or duty. *Id.*
or replace the federal duty with one of its own duties. Instead, the Court determined the tax is a means for apportioning fire and police protection, which has only an incidental impact on foreign commerce. The Court thus ruled that the state’s ad valorem tax does not violate the Import-Export Clause.\(^{207}\)

The Supreme Court similarly upheld a Florida tax imposed on the sale of aviation fuel, as applied to fuel sold to foreign airlines which may be used in international air traffic, in *Wardair Canada, Inc. v. Florida Dep’t of Revenue.*\(^{208}\) Florida imposed the tax on all sales of aviation fuel, regardless of the airline’s volume of business within the state or whether the fuel was used to fly outside the state.\(^{209}\) A Canadian airline challenged the tax on Commerce Clause\(^ {210}\) and Federal Aviation Act\(^ {211}\) grounds.

The Court addressed the Federal Aviation Act preemption challenge only briefly. The Court noted that the Act evinces no legislative intent to preempt state taxation, but instead expressly permits “sales or use taxes on the sale of goods and services.”\(^{212}\) The Court therefore determined that Congress invited the type of tax which Florida imposed.\(^ {213}\)

The Court focused much of its discussion on the dormant interstate Commerce Clause challenge. Applying the tests announced in *Complete Auto Transit, Inc. v. Brady*\(^ {214}\) and *Japan Line, Ltd. v. County of Los Angeles*,\(^ {215}\) the Court found no evidence that

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\(^{207}\) *Id.* at 515. The Court also briefly discussed and rejected a due process challenge to the tax, since “the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state.” *Id.* (quoting Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940)).

\(^{208}\) *Wardair Canada, Inc. v. Florida Dep’t of Revenue*, 106 S. Ct. 2369 (1986).

\(^{209}\) FLA. STAT. § 212.08(4)(A)(2) (1985); *Wardair Canada*, 106 S. Ct. at 2371.

\(^{210}\) “Congress shall have Power... To regulate Commerce with foreign Nations, and among the several States.” U.S. CONST. art. I, § 8, cl. 3.


\(^{212}\) *Id.* at § 1513(b), reprinted in *Wardair Canada*, 106 S. Ct. at 2372.

\(^{213}\) *Wardair Canada, Inc. v. Florida Dep’t of Revenue*, 106 S. Ct. 2369, 2372 (1986).

\(^{214}\) *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). The *Complete Auto* test consists of four questions: “is the tax applied to an activity with a substantial nexus with the taxing State; is the tax fairly apportioned; does the tax discriminate against interstate commerce; is the tax fairly related to the services provided by the State.” *Id.* at 279, reprinted in *Wardair Canada*, 106 S. Ct. at 2373.

\(^{215}\) *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979). When the state tax allegedly impedes the federal government’s authority to regulate foreign commerce, the court must ask two additional questions: “first, whether the tax,
the tax threatened the government's authority to treat foreign countries uniformly. The Court repeatedly stressed the clear congressional intent to permit state taxation of aviation fuel, as evidenced by the number of Canadian provinces and American states which impose similar taxes. Therefore, the Court found the tax is valid under the Commerce Clause.

3. Excise Tax on Tax-Avoidance Transfers

In Stern v. United States, the United States district court for the district of Nevada held that a transfer of appreciated stock to a foreign situs trust in exchange for a private annuity was not subject to excise tax as a transfer in trust with retention of income. Code section 1491 generally imposes a tax on a transfer of stock to a foreign trust, in order to prevent taxpayers from transferring appreciated property offshore without paying capital gains tax. Revenue rulings issued with regard to this section have stated that the section does not apply to an arms length exchange of stock for an annuity, the present value of which is equal to the fair market value of the stock. The court, relying on former findings that the transfer at issue was at arms length in that the taxpayers notwithstanding apportionment, creates a substantial risk of international multiple taxation, and, second, whether the tax prevents the Federal Government from speaking with one voice when regulating commercial relations with foreign governments. Id. at 451, reprinted in Wardair Canada, 106 S. Ct. at 2373.

216 Wardair Canada, 106 S. Ct. at 2374.
217 See. e.g., id. at 2374, 2375.
218 Id. at 2375.
219 Id. at 2375-76. Justice Blackmun dissented, stressing the need for a "consistent and coherent foreign policy" under the sole authority of the federal government. Id. at 2378-79 (Blackmun, J. dissenting) (quoting South-Central Timber Dev., Inc. v. Wunnicke, 467 U.S. 82, 91 (1984)).
220 Stern v. United States, 650 F. Supp 16 (D. Nev. 1986) (Stern III). This case was preceded by two other lawsuits involving the same parties: Stern v. United States, 563 F. Supp. 484 (D. Nev. 1983) (referred to as Stern I), and Stern v. Comm'r, 747 F.2d 555 (9th cir. 1984) (Stern II).
221 Stern III, 650 F. Supp. at 18-19. At the time of the stock transfers, I.R.C. section 1491 imposed an excise tax of 27 1/2 percent of the excess of the value of stock transferred, over its adjusted basis, on a transfer of stock by a U.S. citizen to a foreign trust, a foreign partnership, or a foreign corporation. I.R.C. § 1491 (1976), reprinted in Stern III, 650 F. Supp. at 18. The motivation behind the tax was to deter the avoidance of capital gains tax. Id. at 19 (quoting H.R. REP. No. 658, 94th Cong., 2d Sess., reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS 2897, 3102 and 3467).
followed all trust formalities, concluded that the section 1491 excise tax was not applicable to the transfer.

4. Tax Shelters

In Danbury, Inc. v. Olive, the United States district court for the Virgin Islands exempted from both United States and Virgin Islands taxation a United States holding company headquartered in the Virgin Islands. The Virgin Islands Tax Code mirrors the Internal Revenue Code, since the Virgin Islands has no independent power to enact tax laws. The corporation, which is not organized under Virgin Islands laws but is headquartered there, generated income during the relevant years from United States limited partnership distributions and interest. The corporation thus claimed it owed no taxes to the Virgin Islands since its income came from foreign sources, and it owed no United States taxes, since those taxes were satisfied under the Virgin Islands tax code.

The court agreed, noting that the relevant Internal Revenue Code provision, section 1642, states that permanent residents of the Virgin Islands pay tax on all income to the territory, thus fulfilling their federal tax obligations. In contrast, non-inhabitant foreign entities in the territory are taxed only on income derived from the Virgin Islands. Although the court recognized that the situation presented a curious anomaly, the court felt compelled to enforce the literal meaning of the statutes. Hence, the corporation was exempt from taxation on all income.

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223 Stern v. United States, 650 F. Supp. 16, 20 (D. Nev. 1986). For example, the trustee, not the taxpayer, controlled the trust's investments. Although the taxpayers could remove the trustee without cause, they must appoint concurrently a qualified successor. Id.

224 Id.


227 Danbury, Inc., 627 F. Supp. at 515-16. The governments of both the United States and the Virgin Islands had known of the tax loophole for several years. Although several corporations utilized the loophole, Danbury was the first case to reach judicial determination. Id: at 516 n.5.


230 Danbury, Inc., 627 F. Supp. at 519. The Court felt the effect of § 882 in
The Tax Court also decided a case involving tax shelters. In *Glass v. Commissioner*, the court found the "London Options Transactions" into which the taxpayers entered, lacked economic substance and constituted a sham, such that the taxpayers could not deduct their losses. The transactions involved a two-year series of commodity trades conducted by broker/dealers operating on the London Metal Exchange. The taxpayers employed either an option-straddle or, less frequently, an option-hedge to recognize ordinary losses in one year and defer capital gains to later taxable years. The broker/dealers were fixing prices in order to guarantee these losses on the option premiums. In addition, the broker/dealers manipulated the commissions, the margins, and the

favor of foreign corporations filing in the Virgin Islands was overlooked. The court noted, however, that it had no authority to close the loophole; only Congress and the President can remedy the situation. *Id.*

*Glass v. Comm'r*, 87 T.C. 1087 (1986). It is said to be the largest single consolidation of cases in the history of the Tax Court, since it involved over 1400 taxpayers claiming deductible losses in excess of $100 million over five years, resulting in assessed deficiencies in excess of $61 million. *Id.* at 1153.

*Id.* at 1156-57. The option-straddle transactions operated as follows. First, shortly after "putting on" or establishing the straddle, the taxpayer closed out the legs by purchasing and selling identical offsetting positions. The premium to buy the option which closed out the sold option would exceed the premium received on the sold option, resulting in an overall net loss on the sold option leg. Conversely, the taxpayer's premium on the sale of the option closing out the purchased option would exceed the premium paid for the purchased option, thereby giving the taxpayer a net gain on the purchase option leg. These losses and gains were reported as ordinary loss and short-term capital gain for the year. The taxpayer next engaged in a switch transaction by closing out the "loss leg" through the purchase or sale of an identical offsetting position and replacing it with a new position with a different delivery date. The net loss was reported as a short-term capital loss for year one. Finally, in the following year, the taxpayer would close out both legs of the futures straddle by offsetting trades. The net gain, approximating the loss incurred on the earlier switch transaction, was either a short-term or long-term capital gain. The taxpayer thus realized ordinary loss in one year and deferred capital gains to year two. *Id.*

*Id.* at 1157-58. In option-hedge transactions, the sale of a call or put option was "hedged" by the purchase or sale of a futures contract. The taxpayer then closed out the options position at a net loss by purchasing identical offsetting options. Simultaneously, he would hedge the initial futures contracts with additional ones, thus forming futures straddles. In a later year, the taxpayer closed out these straddles at a gain approximately equal to the earlier losses incurred. The taxpayer, again, realized ordinary losses in one year and deferred capital gains for a future year. *Id.*

*Id.* at 1161.

*Glass v. Comm'r*, 87 T.C. 1087, 1161. For instance, they charged lump-sum commissions in advance of trade without knowing how much trading would be done.
Because the broker/dealers engaged in so much manipulation of the key factors for determining gain and loss in the transactions taken as a whole, the taxpayers could assure themselves of the desired tax consequences. Therefore, the court ruled, the transactions were a factual sham calculated to achieve a tax-avoidance objective, and any losses incurred were not deductible.

5. Foreign Tax Credits

The courts decided a series of cases regarding Gulf Oil Corporation in 1986. In *Gulf Oil Corp. v. Commissioner (Gulf I)*, the tax court awarded Gulf a percentage depletion deduction and a foreign tax credit for income taxes paid to Iran pursuant to an agreement executed between the corporation and Iran regarding the exploration, production, refining and sale of Iranian oil and gas. The validity of Gulf's claim depended on whether Gulf had an "economic interest in the oil or gas" under the 1973 amended agreement, as provided by Code section 901(f) and defined in

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In addition, the dealers charged varying rates and often did not charge any commissions. *Id.*

*Id.* Trading occasionally began before the initial margin was received. The broker/dealers never required any maintenance margin and often required no margin of any kind. *Id.*

A contango is the difference between the (lesser) cash price for immediate delivery and the (higher) price for future delivery. This differential is a product of interest rates. The contangos were adjusted without regard to the interest rate in order to arrive at a predetermined outcome. *Id.*

Under the test in *Smith v. Commissioner*, the relevant transaction for determining the validity of the scheme is the entire commodity tax straddle scheme. *Glass*, 87 T.C. at 1163 (quoting Smith v. Comm'r, 78 T.C. 350, 390-91 (1982)).

Glass, 87 T.C. at 1177. Since the straddle transactions were a sham, the taxpayers were not required to report any gains recognized in year two and thereafter as taxable income. *Id.*

Other 1986 cases in which Gulf was a party are: Gulf Oil Corp. v. Comm'r, 87 T.C. 135 (1986) (losses claimed under abandonments and retirements of oil and gas leases in the Gulf of Mexico are not deductible under section 165); Gulf Oil Corp. v. Comm'r, 87 T.C. 324 (1986) (intangible drilling costs for platforms in the Gulf of Mexico and the North Sea are deductible under section 263); Gulf Oil Corp. v. Comm'r, 87 T.C. 548 (1986) (increases in payable balances owed to two foreign controlled subsidiaries represent earnings of a controlled foreign corporation invested in United States property).

Gulf Oil Corp. v. Comm'r, 86 T.C. 115 [hereinafter Gulf I].

* I.R.C. 901(f) (as amended in 1984) reads:

> [T]he amount of any income, or profits, and excess profits taxes paid or accrued during the taxable year to any foreign country in connection with the purchase and sale of oil or gas extracted in such country is not to be considered as tax for purposes of . . . this section [providing for tax credits]
the regulations.\textsuperscript{243} Under the predecessor to the 1973 agreement, Gulf had had an economic interest in the oil and gas.\textsuperscript{244} The court determined that Gulf had an "economic commitment to look to production of the mineral for income,"\textsuperscript{245} which meets the standards of the investment test for economic interest. Although Gulf was merely a member of a joint stock company which performed the drilling and production of the minerals, it nevertheless retained substantial control over production. In addition, Gulf was required to make certain payments and investments, which could only be recouped by production of minerals.\textsuperscript{246} Since Gulf thereby had an economic interest in the oil and gas, it was entitled to the percentage depletion deduction and foreign tax credit claimed.\textsuperscript{247}

In a related case, \textit{Gulf Oil Corp. v. Commissioner (Gulf II)},\textsuperscript{248} the Tax Court held that a discount granted to Gulf as part of a total package of commercial agreements reflecting the ongoing relationship between Gulf and Kuwait's post-nationalization government was not additional compensation for the nationalization of the Kuwait Concession, and that income taxes which Gulf paid to Kuwait under the terms of the agreement were reportable as a deduction, not as a credit. Gulf had received the discount under a crude oil supply agreement executed contemporaneously with a Nationalization Agreement,\textsuperscript{249} under which latter agreement Gulf

\textsuperscript{243} Treas. Reg. § 1.611-1(b)(1) (as amended in 1973). A taxpayer has an economic interest when he has "acquired by investment" an interest in a mineral and secures income derived from the extraction of the mineral. He must be dependent on the extraction for a return of his capital. \textit{Id.}, quoted in \textit{Gulf I}, 86 T.C. at 132. Several cases have further defined the term "economic interest." See \textit{Kirby Petroleum Co. v. Comm'r}, 326 U.S. 599 (1946); \textit{Thomas v. Perkins}, 301 U.S. 655 (1937); \textit{Palmer v. Bender}, 287 U.S. 551 (1933); \textit{Gibson Products Co. v. United States}, 637 F.2d 1041 (5th Cir. 1981); \textit{Weaver v. Comm'r}, 72 T.C. 594 (1979).

\textsuperscript{244} \textit{Gulf I}, 86 T.C. at 122, 132.

\textsuperscript{245} \textit{Id.} at 134 (citing \textit{Comm'r v. Southwest Exploration Co.}, 350 U.S. 308 (1956)).

\textsuperscript{246} \textit{Gulf Oil Corp. v. Comm'r}, 86 T.C. 115, 134-36 (1986) [\textit{Gulf I}]. For instance, the consortium paid operating expenses and financed most of the operations, under the supervision of the National Iranian Oil Company. The court focused on the extent of financial and operational arrangements performed by Gulf. \textit{Id.}

\textsuperscript{247} \textit{Id.} at 136.

\textsuperscript{248} \textit{Gulf Oil Corp. v. Comm'r}, 86 T.C. 937 (1986) [hereinafter \textit{Gulf II}].

\textsuperscript{249} \textit{Id.} at 943-47. Under the Nationalization Agreement, Kuwait had purchased Gulf's subsidiary's interest in a Concession, which managed oil production in Kuwait, for $25,250,000 on December 1, 1975. Contemporaneously with the signing of the
had relinquished its interest in the Kuwait Concession.\textsuperscript{250} The crude oil supply agreement and the Nationalization Agreement were separate agreements which did not cross-reference each other and which received differing treatments by the Kuwaiti government.\textsuperscript{251} As the court noted, had Kuwait granted the discount as additional compensation, it would have violated OPEC policies; instead, Kuwait continually asserted that the additional agreements were not compensation for the nationalization of the Concession.\textsuperscript{252} The court therefore concluded that the value of the discount was not additional compensation for the nationalization of the Kuwait Concession.\textsuperscript{253}

The court also addressed a foreign tax credit claimed by Gulf under Code section 901,\textsuperscript{254} for income taxes payable to Kuwait over the term of the crude oil supply agreement which were attributable to the discounts. Gulf did not contend it had an economic interest\textsuperscript{255} under section 901; instead, it argued that the limitations on foreign tax credits do not apply to taxes paid on the proceeds of nationalization.\textsuperscript{256} Since the court had determined that the dis-
counts did not constitute consideration for nationalization, the court disallowed the foreign tax credit.\textsuperscript{257}

\textsuperscript{257} \textit{Gulf II}, 86 T.C. at 961-62.
II. Trade Controls

A. Export Controls

1. Drug Export Amendments of 1986


The Drug Export Amendments allow the exportation of certain unapproved new drugs and biologicals by United States manufacturers, actively seeking the approval of such drug or biological in the United States, to foreign countries which permit the use of such drugs or biologicals.4 One stated purpose of the amendments is to open foreign markets to United States pharmaceutical and biotechnology manufacturers, thus encouraging domestic research and manufacture of these products.5

To prevent the distribution of untested and potentially dangerous drugs, the bill limits exports to only those countries having an established and sophisticated drug approval system.6

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2 Id. at §102.
3 See S. Rep. No. 225, 99th Cong. 2nd Sess. 4, reprinted in 1986 U.S. Code Cong. & Admin. News 6298, 6301. The implicit prohibition against the export of “new drugs” and “new animal drugs” arose with the reenactment of the Food, Drug and Cosmetic Act in 1938. Id. Section 801(d)(i) of the Act, reenacted in 1938, authorized the shipment of unapproved substances under the act if certain conditions were met, it did not however make any mention of post 1938 “new drugs” and “new animal drugs.” Id. The result of this omission has been construed to prohibit the export of unapproved “new drugs” and “new animal drugs” under the 1938 Food, Drug and Cosmetic Act. Id.
6 Act of Nov. 14, 1986, Pub. L. No. 99-660, § 802(b)(4)(i), 100 Stat. 3746 (1986). The bill specifies the following countries as permitted importing countries: Australia; Austria; Belgium; Canada; Denmark; Federal Republic of Germany; Finland; France; Iceland; Ireland; Italy; Japan; Luxembourg; The Netherlands; New Zealand; Norway; Portugal; Spain; Sweden; Switzerland; and the United Kingdom. Id. at § 802(b)(4)(A).
as sophisticated, the system must minimally require: independent review of drugs for safety and effectiveness; regulatory regimes to insure the quality, purity, and strength of drugs; and adequate reporting systems and approval withdrawal machinery to deal with adverse drug reactions.\footnote{7} Under the bill, United States manufacturers must file an application for permission to export goods with the Secretary of the Department of Health, Education, and Welfare ninety days prior to any shipments.\footnote{8} This application must identify the drug and its country of destination, as well as certify that the proposed country of destination has approved the use of such drug.\footnote{9} In addition to the initial application, the bill mandates periodic reporting to the Secretary concerning any withdrawal of approval for the use of such exported drug in the importing country.\footnote{10} Finally, the bill provides for greater latitude in exportation of drugs or biologicals to prevent or treat tropical disease.\footnote{11} Such drugs may be exported based upon a finding of the Secretary that the drug is safe and effective in the prevention or treatment of a tropical disease present in the importing country.\footnote{12}

2. Federal Technology Transfer Act of 1986

On October 20, 1986, President Reagan signed into law the Federal Technology Transfer Act of 1986.\footnote{13} The act, amending the Stevenson-Wydler Technology Innovation Act of 1980,\footnote{14} is designed to “improve the transfer of commercially useful technologies from the Federal laboratories and [sic] into the private sector.”\footnote{15}

\footnote{9} Id.
\footnote{10} Id.
\footnote{12} Id.
\footnote{15} S. Rep. No. 283, 99th Cong. 2d Sess. 1, \textit{reprinted in} 1986 U.S. Code Cong. & Admin. News 3442. The United States government spent approximately $18 billion in fiscal year 1986 on research and development in over 700 Federal laboratories. \textit{Id}. These laboratories have produced over 28,000 patents, however, only 5 percent of these patents have been licensed. \textit{Id}.
The legislation contemplates federal agencies entering into cooperative research and development agreements with other federal agencies, state and local agencies, as well as private concerns.\(^\text{16}\) While the legislation encourages such joint ventures, it mandates that laboratory directors give preference to United States businesses which agree to produce products which result from the joint research and development within the United States.\(^\text{17}\) The legislation does allow the involvement of foreign owned and controlled business in such joint ventures; however, in addition to the preference to United States businesses the laboratory director must consider whether the government of the foreign owned business permits United States interests the same opportunity to enter into joint research and development ventures.\(^\text{18}\)

B. Sanctions

1. Libyan Sanctions

On January 7, 1986, after declaring a national emergency in response to terrorist acts attributed to Libya,\(^\text{19}\) President Reagan issued a series of executive orders imposing sweeping economic sanctions against Libya.\(^\text{20}\) The President’s first order, Executive Order 12,543, came on January 7, 1986 and mandated a total ban on all United States trade with Libya. The order specifically prohibited any imports from Libya to the United States and banned all exports from the United States to Libya with the exception of humanitarian aid.\(^\text{21}\) In addition to

\(^\text{17}\) Id. at § 12(c)(B)(4)(b).
\(^\text{18}\) Id.
the trade ban, the order prohibited any travel between the two nations and prohibited the performance of any contracts "in support of any industrial or other commercial or governmental project in Libya" by United States persons.

Following the actions of January 7, the President issued Executive Order 12,544 placing a freeze on all property interests held by Libya's government in the United States.

The sanctions' greatest impact could effect the estimated 35 United States oil companies operating in Libya, by forcing a total halt on all economic activity carried on in Libya. In an attempt to prevent an economic windfall to the Libyan government as a result of the divestiture order, the Administration issued exemptions to the immediate application of the orders to certain companies operating in Libya. Under the provisions of the exemptions all profits earned by companies operating in Libya would be held in an escrow account controlled by the United States government until the company ended all operations in Libya.

2. Syrian Sanctions

The White House announced on November 14, 1986, that the President has decided to broaden economic sanctions against Syria, "in response to Syria's continued support for international terrorism.

The new actions tighten controls on the export of any items currently considered to be controlled for national security purposes. Additionally, Syria is no longer eligible for participation in Export-Import Bank programs, and an air transport agreement between the two nations will be terminated. As a second facet of the broadened

22 Exec. Order No. 12,543, §§ 1(c) & (g), 51 Fed. Reg. 875 (1986).
23 Id. at § 1(e).
25 Economic Sanctions, supra note 21, at 60.
26 U.S. Firm's Profits from Libya to be Held in Escrow Account by Federal Government, 3 Int'l Trade Rep. (BNA) 213 (Feb. 12, 1986). State Department officials said that some 15 to 20 companies applied for the extensions including: Marathon Oil, Conoco Oil, Amerada Hess, Occidental Petroleum, and W.R. Grace. Id.
27 Id. In May, the President set a June 30 deadline for the cessation of all activities. President Reagan Sets June 30 Deadline for Oil Companies to Divest Libyan Assets, 3 Int'l Trade Rep. (BNA) 649 (May 14, 1986).
economic sanctions, the administration informed United States oil companies that it considered "their continued involvement in Syrian oil operations inappropriate under these circumstances." 29

The new export controls will become effective on publication of implementing regulations. While such regulations are still forthcoming, it is expected the regulations will observe the sanctity of pre-existing contracts, and the regulations are not expected to have any extraterritorial effect. 30

3. African Sanctions

On October 2, 1986, following a congressional override of President Reagan's veto, 31 the Comprehensive Anti-Apartheid Act of 1986 became law. 32 The stated purpose of the Act is to help in "bring[ing] an end to apartheid in South Africa and lead[ing] to the establishment of a non-racial democratic form of government. 33

The Act affects a full range of economic activities between the United States and South Africa. The Act prohibits any new investments in South Africa businesses except for firms owned by black South Africans. 34 The Act further bars any new bank loans to the South African government or its agencies 35 and prohibits United States banks from accepting any deposits from those entities. 36

In the area of trade, the Act bans the importation of Krugerrand gold coins, 37 South African steel and iron, 38 as well as uranium and

29 Id. See also, Administration Announces Economic Moves Against Syria, Citing Terrorism Support, 3 INT'L TRADE REP. (BNA) 1382 (Nov. 19, 1986).
30 Id.
33 Id. at 1089.
34 Id. at 1102. 1985 figures showed $1.3 billion in remaining United States investments. 132 CONG. REC. H 8661 (daily ed. Sept. 29, 1986).
37 Anti-Apartheid Act, supra note 32, at 1099. 1984 figures showed imports valued
coal, and also any agricultural products. The Act further bans the exportation from the United States of any computers to South African agencies enforcing apartheid and also any petroleum exports. Finally, the Act terminates landing rights in the United States for South African Airways.

Congress passed legislation making technical amendments to the law on October 18, 1986. On October 27, 1986, President Reagan issued an Executive Order establishing responsibilities for implementation of the Act, with implementing regulations being published in mid-November, 1986.

at $486 million, and 1985 figures showed $101 million of imports before an executive order banned the importation of Krugerrands on October 11, 1985. 132 CONG. REC. H 8661 (daily ed. Sept. 29, 1986).


Coal imports to the United States totaled $43.4 million in 1985, while uranium imports equalled $140 million. 132 CONG. REC. H 8661 (daily ed. Sept. 29, 1986).

Imports of fruit and vegetable products totaled $52 million in 1985 with some $129 million of related products imported. 132 CONG. REC. H 8661 (daily ed. Sept. 29, 1986).

Anti-Apartheid Act, supra note 32, at 1099.

Id. at 1105.


A. Customs User Fee

President Reagan signed into law the Omnibus Budget Reconciliation Act of 1985 on October 21, 1986. The Act included provisions establishing a new customs user fee designed to provide revenues to fund Customs Service operations. The new fee takes the form of an ad valorem user fee to be paid by the importer of record of any merchandise “formally entered, or withdrawn from a warehouse, for consumption.” Between December 1, 1986 and September 30, 1987, the fee equalled 0.22% of the merchandise’s appraised custom value. Under the Act, the post-September 30 fee is to be at a rate of at, or below, 0.17%. The exact rate will be determined by the Secretary of Treasury in accordance with the level of funding required to support the commercial operations of the Customs Service. The fees remain in effect until September 30, 1989. The new fees apply to all merchandise which enters the commerce of the United States for consumption regardless of whether the mer-

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2 Id. at § 8101.
3 Customs Regulations Amendments Regarding Ad Valorem User Fees, 51 Fed. Reg. 43,188, 43,189 (1986) (to be codified at 19 C.F.R. part 24) [hereinafter Customs Regs.] The new fee applies only to merchandise imported for consumption. Thus, any articles which are sent overseas for partial assembly and then shipped back to the United States are exempt from the fee. Synopsis of New Laws Creating User Fees, Setting New Procedures Released by Customs, 3 INT’L TRADE REP. (BNA) 1134, 1135 (Oct. 15, 1986) [hereinafter Synopsis].
5 Budget Act, supra note 1, at § 8108(a)(10). The lower fee was adopted based on the assumption that any start up costs of the program would have been absorbed during the first 10 months at a higher fee level of 0.22%. Conference Report, supra note 4, at 4035.
6 Budget Act, supra note 1, at § 8101(a)(10).
chandise enters duty-free or is eligible for tariff preferences. The Act provides an exemption from the fee for merchandise that enters from an insular possession of the United States. Also exempt are products from those countries included in the category of Least Developed Developing Countries and those countries included within the Caribbean Basin Economic Recovery Initiative.

The new fees drew an immediate and hostile response from Canada and other exporting nations. Claiming the new customs fee were an illegal surcharge under Article VIII of the General Agreement on Tariffs and Trade (GATT), Canada brought a protest under Article XXIII of the GATT seeking a resolution of the issue. The United States responded that the ad valorem fee merely seeks to raise revenues necessary to cover the costs of services being rendered by the Customs Service and as such are proper under Article VIII. Although the

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7 Customs Regs., supra note 3, at 343.
8 Budget Act, supra note 1, at § 8101(a)(9).
10 President Signs Budget Bill With Customs Fee As Canadian Officials Threaten Retaliation, 3 INT’L TRADE REP. (BNA) 1227, 1278 (Oct. 22, 1986).
11 Canada, EC Attack New U.S. Customs User Fee at GATT Council, Charge it is discriminatory, 3 INT’L TRADE REP. (BNA) 1301, 1302 (Oct. 29, 1986) [hereinafter Canada].
13 Canada, supra note 11, at 1320; see also Agreement Concerning Automobile Products, Mar. 9, 1965, United States-Canada, 17 U.S.T. 1372, T.I.A.S. No. 6093.
14 Canada, supra note 11, at 1302; Conference Report, supra note 4, at 4034.
United States agreed to enter into talks concerning the issue, to date no timetable for such talks has been set.\textsuperscript{14}

\textbf{B. Trademark Owner Entitled to Destroy Counterfeit Goods}

In \textit{Fendi v. Cosmetic World Ltd.},\textsuperscript{15} the United States District Court for the Southern District of New York held that a trademark owner is entitled to destroy counterfeit goods seized pursuant to the 1984 anti-counterfeiting amendments to the Lanham Act.\textsuperscript{16}

Fendi, an Italian fashion merchandiser, brought suit against Mario and Paolo Vincelli, owners of Cosmetic World Limited, alleging defendants violated the Trademark Counterfeiting Act of 1984 by engaging in the importation and sale of imitation products bearing plaintiff’s trademark.\textsuperscript{17} The suit sought injunctive relief, treble damages, and additionally sought the destruction of all counterfeit goods seized from the defendant under an earlier \textit{ex parte} order of the court.\textsuperscript{18}

The court, based on defendant’s deposition in which he admitted to the importation and sale of counterfeit products, readily granted the plaintiff summary judgment on the issue of liability.\textsuperscript{19} In light of its finding on the liability issue the court granted a permanent injunction against the defendant barring any future dealing with goods bearing the plaintiff’s trademark. The court further awarded the plaintiff treble damages and attorneys fees in the action.\textsuperscript{20}

\begin{itemize}
\item \textsuperscript{14} \textit{Canada, supra} note 11, at 1502.
\item \textsuperscript{15} \textit{Fendi v. Cosmetic World Ltd.}, 642 F. Supp. 1143 (S.D.N.Y. 1986).
\item \textsuperscript{17} \textit{Fendi}, 642 F. Supp. at 1144. Fendi manufactured a wide variety of fashion merchandise, including furs, pocketbooks and leather apparel. \textit{Id.} at 1145. Fendi sold its products in the United States through a very select number of retail outlets. \textit{Id.} The manufacturer holds two United States trademarks, “FENDI” and “FF,” which have been extensively advertised and represent prestigious symbols in fashion. \textit{Id.} After gaining an \textit{ex parte} seizure order, Fendi seized more than 1,000 items bearing counterfeit Fendi trademarks at the defendants premises. \textit{Id.}
\item \textsuperscript{19} \textit{Fendi}, 642 F. Supp. at 1145.
\item \textsuperscript{20} \textit{Id.} at 1146-47.
\end{itemize}
In addition to the injunctive relief and monetary damages, however, the court determined the plaintiff could destroy the counterfeit goods which it had earlier confiscated based upon the 1984 amendment to 15 U.S.C. § 1118.\textsuperscript{21} In reaching this finding, the court noted that prior to the 1984 amendments Section 1118 explicitly provided only for "the destruction of infringing trademarks and the instrumentalities used to produce such trademarks."\textsuperscript{22} The court recognized however, that the 1984 amendments added to the section language indicating before any "articles" seized under the amended Section 1116(d) could be destroyed, notice must be given to the appropriate United States attorney.\textsuperscript{23} The reason for such notice being to allow the government an opportunity to object to destruction of the articles if such articles may be evidence of a crime.\textsuperscript{24}

The plaintiff asserted, based solely on the language of the amendment which refers to the destruction of "articles," it could properly destroy any products bearing an unauthorized trademark.\textsuperscript{25} The court disagreed with the plaintiff's assertion, citing the fact that Congress did not specifically amend the section to include the destruction of anything other than infringing marks and the machinery used to produce them.\textsuperscript{26} Contrasting this inaction with Congress' affirmative amending of the Criminal Code to allow government prosecutors in criminal cases the right to destroy the counterfeit goods,\textsuperscript{27} the court

\textsuperscript{21} Id.
\textsuperscript{22} Id. Prior to the 1984 amendments, 15 U.S.C. § 1118 read in pertinent part:

[T]he court may order that all labels, signs, prints, packages, wrappers, receptacles, and advertisements in the possession of the defendant, bearing the registered mark or any reproduction, counterfeit, copy, or colorable imitation thereof, and all plates, molds, matrices, and other means of making the same shall be delivered up and destroyed.


\textsuperscript{23} Fendi, 642 F. Supp at 1146. The 1984 amendment to 15 U.S.C. § 1118 added the following:

The party seeking an order under this section for destruction of articles seized under section 1116(d) of this title shall give ten days' notice to the United States attorney . . . and such United States attorney may, if such destruction may affect evidence of an offense against the United States, seek . . . or participate in any hearing . . . with respect to such destruction.


\textsuperscript{24} Id.
\textsuperscript{25} Fendi, 642 F. Supp. at 1146.
\textsuperscript{26} Id.
\textsuperscript{27} Id. The amendment to the Criminal Code is codified at 18 U.S.C. § 2320, which reads in pertinent part: "Upon a determination by a preponderance of the evidence that any articles in the possession of a defendant in a prosecution under this section bear counterfeit marks, the United States may obtain an order for the destruction of such articles." 18 U.S.C. § 2320 (1982 & Supp. III 1985).
declined to follow the plaintiff's reasoning in support of a right to destruction of infringing goods in civil cases.

In reaching its ultimate determination that counterfeit goods could be destroyed in a civil action under 15 U.S.C. § 1118, the court relied upon the legislative history of the amending legislation. This legislative history, in the form of a Joint Explantory Statement, stated the amendment clearly allows the destruction of actual goods under the criminal amendments. The statement went on to add "[t]his provision gives the court the same options it has in ordering destructions under 15 U.S.C. § 1118." Based upon this statement, the court found that Congress intended the court to have the power to order the destruction of the actual goods, as well as the infringing trademarks in a civil case.

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28 Fendi, 642 F. Supp. at 1147.
30 Fendi, 642 F. Supp. at 1147.
IV. EXPORT FINANCING

A. Eximbank Act Amendments

In October 1986, President Reagan signed into law the 1986 Amendments Act amending the Export-Import Bank (Eximbank) Act of 1945 (the 1945 Act). The 1986 Amendments Act extended the Eximbank's charter for six years and authorized appropriations for fiscal year 1987. The Amendments Act contains a broad range of provisions intended to improve the competitiveness of the Bank, to ensure that it is aggressive in support of United States exports and to provide new tools for Bank support.

The 1986 Amendments Act added the "Tied Aid Credit War Chest," which is intended to eliminate the trade practice of mixing foreign aid with export credit. The war chest permits the Eximbank, in conjunction with the Secretary of the Treasury, to provide grants from the Tied Aid Credit Fund to supplement the financing of a United States export in three sets of circumstances: when the exporter has a "reasonable expectation" that another country may have used mixed credit financing to support its competitor; when the exporter exports to markets which engage in or support mixed credit financing; and when other circumstances exist such that the grant of tied aid credit financing would further the purposes behind the provision.

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3 1986 Amendments Act, § 14, 100 Stat. 1200, 1204. The charter now extends until September 30, 1992. Id. According to President Reagan, the extension of the charter sends a message to the "exporting community and foreign suppliers that American exporters will continue to be able to compete vigorously for business throughout the world." Statement by President Ronald Reagan upon Signing H.R. 5548 (Oct. 15, 1986), reprinted in 1986 U.S. CODE CONG. & ADMIN. NEWS 2478.
4 The budget for fiscal (FY) 1987 direct loans consists of $145,259,000. 1986 Amendments Act, § 13, 100 Stat. 1200, 1204.
6 1986 Amendments Act, § 19, 100 Stat. 1200, 1205; H.R. CONF. REP. No. 956, reprinted in 1986 U.S. CODE CONG. & ADMIN. NEWS 2472, 2475-76. President Reagan had urged the adoption of the provision in order to combat mixed credit financing offered by other countries. As noted in the Conference Report, the War Chest may be used both offensively to take markets from other countries and defensively to protect American exports from other countries' mixed credit financing. Id.
7 1986 Amendments Act, § 19, 100 Stat. 1200, 1205-08. The Eximbank may combine grants from the fund with any type of export financing, guarantee or
This section of the 1986 Amendments Act further requires semi-annual reports to Congress on the status of the tied aid credits.\(^8\)

Section 20 of the Amendments Act authorizes the Eximbank to make interest subsidy payments\(^9\) under President Reagan's proposed I-Match program.\(^10\) The bank may make interest subsidy payments to private lenders for the benefit of export loans which require below-market financing to compete with foreign subsidized financing.\(^11\) The Bank may utilize the interest-matching program only upon meeting three conditions. First, the Bank may make the payments only from funds appropriated for the purpose. Second, the Bank must have the authority to loan directly at least $700,000,000 for that fiscal year. Third, the Bank may not score any loan guarantees for such payments as budget authority.\(^12\) The I-Match program is in effect for two years.\(^13\)

Other important sections of the 1986 Amendments Act prohibit aid to certain countries or under certain circumstances. Section 9 specifically prohibits aid to Angola in connection with any export of goods or services, with the exception of food or agricultural com-

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\(^8\) Id. The reports include information on the "predacious" financing offers made by other countries during the preceding six months, details of any retaliatory financing by the Eximbank, and descriptions of the action the United States has taken or may take to discourage the financing. \(\text{Id.}\)

\(^9\) Id. at § 20, 100 Stat. 1200, 1209-10.


\(^12\) 1986 Amendments Act, § 20, 100 Stat. 1200, 1209.

\(^13\) Id. The Comptroller General must issue a study on the I-Match program's effectiveness eight months prior to its termination. Id.
The Amendments Act further includes a statement of policy towards United States business transactions in Angola.\(^\text{15}\) In addition, the Eximbank may not guarantee, insure, or extend credit to "Marxist-Leninist countries," as defined in the Act.\(^\text{16}\) The Act specifies circumstances in which United States trade may be affected adversely and denies the Eximbank the authority to extend credit or guarantees in such instances. The Bank is prohibited from financing production of any commodity for export by other than the United States if world markets have a surplus of the commodity, or such production is likely to cause substantial injury to United States producers.\(^\text{17}\) The Amendments Act recommends similar restrictions for other multilateral development banks.\(^\text{18}\) In addition, the Bank must make an impact analysis regarding each proposed loan or guarantee and its effect on persons who may be substantially adversely affected by the making of the loan.\(^\text{19}\)

The 1986 Amendments Act contains several provisions designed to enhance the competitiveness of the Eximbank within the financing world. The Bank may impose reasonable fees to cover the costs of seminars and publications it provides\(^\text{20}\) and also may charge credit application fees.\(^\text{21}\) The Amendments Act directs the Eximbank to

\(^{14}\) Id. at § 9, 100 Stat. at 1203.

\(^{15}\) Id. at § 21, 100 Stat. at 1210. Congress stated that United States business interests are in direct conflict with United States foreign policy by aiding the Marxist Popular Movement for the Liberation of Angola. Congress requested that the President consider restricting United States business interests in Angola under the provisions of the Export Administration Act of 1979. Id.

\(^{16}\) Id. at § 8, 100 Stat. at 1201-03. The section lists thirty countries which are rebuttably presumed to be Marxist-Leninist countries. If the President determines that a listed country no longer fits within the category, however, that country may receive aid. In addition, if the President makes a determination that financing for one particular transaction within a listed country is in the national interest, the Eximbank may grant credit. Id.

\(^{17}\) Id. at § 11, 100 Stat. at 1204.

\(^{18}\) Id. at § 22, 100 Stat. at 1210-11. Section 22 instructs the United States directors of the International Bank for Reconstruction and Development, the International Development Association, the International Finance Corporation, the Inter-American Development Bank, the International Finance Corporation, the Inter-American Development Bank, the International Monetary Fund, the Asian Development Bank, the Inter-American Investment Corporation, the African Development Bank, and the African Development Fund to impose similar restrictions. Id.

\(^{19}\) Id. at § 12, 100 Stat. at 1204.

\(^{20}\) Id. at § 2, 100 Stat. at 1200.

\(^{21}\) Id. at § 3, 100 Stat. at 1200. The credit application fee must be competitive with the average fee charged by foreign competitors, and the borrower or exporter must have an option to pay the fee at the outset or over the term of the loan. Id.
improve its medium-term financing program\(^{22}\) and to offer multiple-exporter risk protection.\(^{23}\) The Act provides instruction on matching foreign official export credits in the United States\(^{24}\) and clarifies the program's access rules.\(^{25}\) Other amendments set out in the 1986 Act make technical corrections to the 1945 Act.\(^{26}\)

**B. Eximbank Activities**

In 1986 Eximbank revealed a new export credit insurance policy, as well as plans to encourage private domestic banks to participate more fully in export financing. The new export credit insurance policy, introduced in October, is designed to enable United States exporters to obtain Foreign Credit Insurance Association's (FCIA)\(^{27}\) export

\(^{22}\) *Id.* at § 4, 100 Stat. at 1200-01. Section 4 directs the Eximbank to improve the competitiveness of its medium-term financing program, to facilitate access to the program, to increase the participation of private capital sources, and to enhance the program's support of United States exports. The Bank must comply with the directives and report back to Congress by April of 1988. *Id.*

\(^{23}\) *Id.* at § 6, 100 Stat. at 1201. The section provides:

The Bank shall provide, through creditworthy trade associations, export trading companies, State export finance companies, export finance cooperatives, and other multiple-exporter organizations, medium-term risk protection coverage for the members and clients of such organizations. Such coverage shall be made available to each such organization under a single risk protection policy covering its members or clients.

*Id.* Notwithstanding this provision, the Bank may continue to assess creditworthiness in its normal manner, since Congress expressly intended not to limit the Bank's authority to deny requests for financing. *Id.*; see H.R. CONG. REP. No. 956, reprinted in 1986 U.S. CODE CONG. & ADMIN. NEWS 2472, 2473.

\(^{24}\) 1986 Amendment Act, § 15, 100 Stat. 1200, 1204. Under the 1945 Act, Eximbank may offer financing to United States suppliers who are losing sales in the United States market because of credit subsidies from other foreign governments. Section 15 of the Amendments Act is designed to deter foreign producers from entering United States markets by way of these predacious subsidies. H.R. CONG. REP. No. 956, reprinted in 1986 U.S. CODE CONG. & ADMIN. NEWS 2472, 2475.

\(^{25}\) 1986 Amendments Act, §§ 7, 10, 100 Stat. 1200, 1201, 1203. Section 7 states that financing is available to entities which are neither banks nor United States persons. *Id.* at § 7, 100 Stat. at 1201. Section 10 authorizes "unrestricted" transfer of medium-term and long-term obligations insured or guaranteed by the Eximbank. *Id.* at § 10, 100 Stat. at 1203. Read together, the two sections require the Bank to "permit transfers by and to the widest range of potential capital sources." H.R. CONG. REP. No. 956, reprinted in 1986 U.S. CODE CONG. & ADMIN. NEWS 2472, 2474.


\(^{27}\) The Foreign Credit Insurance Association (FCIA) is an unincorporated association of insurance companies which acts as a private-sector agent of the Eximbank in insuring lesser-value exports.
credit insurance for individual short-term transactions. Eximbank simultaneously issued a revised bank deductible policy, which also reflects the transition to a short-term, single transaction policy.

In addition, Eximbank revealed plans to lure commercial banks into export financing. The Bank has established a certification program under which domestic banks can obtain special training in Eximbank programs, ultimately leading to certification. Under the program, certified banks are required to maintain information manuals on their own program operations to assure continued compliance with Eximbank policies.

C. Cases

In Enterprise Tools, Inc. v. Export-Import Bank of the United States, the Eighth Circuit held that a policy of credit insurance issued by Eximbank and FCIA does not provide coverage for the value of goods confiscated by the Mexican government. Enterprise had purchased a "comprehensive services export credit insurance policy" from FICA, which provided for indemnification for losses incurred by reason of political risks as defined in the policy. The Mexican government seized the trucks which were being used in Enterprise's petroleum hauling business. Eximbank denied the claim on the grounds that the policy covered only credit losses, not asset losses. The Eighth Circuit agreed. Applying ordinary insurance law,

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28 Eximbank Unveils New Individual Short-Term Insurance Policy to Increase U.S. Exports, 3 INT'L TRADE REP. (BNA) 1246 (Oct. 15, 1986). The new policy enables exporters for the first time to insure only a single transaction, rather than all export credit sales together. FCIA sets premium rates on these policies on a case-by-case basis, with minimum policy premiums on various types of transactions. Id.

29 Id. The bank deductible policy, similar to the insurance policy, is available on a transaction-by-transaction basis, with terms and conditions much like those of the FCIA insurance policy. Id.

30 Leaner, More Innovative Exambiank Seeking Commercial Banks for More Expert Finance, 3 INT'L TRADE REP. (BNA) 971 (July 20, 1986). Over two hundred United States banks have completed the certification program. According to a statement issued by Eximbank's President and Chairman John Bohn, Jr., the program is designed both to encourage commercial banks to enter the field of export financing and to provide more innovative approaches for exporters seeking funding. Id.


32 Id. at 440-41. The policy stated that Eximbank would indemnify the insured for losses in connection with covered services following the occurrence of such events as a revocation of export license, the cancellation of authority for imports, war, passage of laws prohibiting importation, and requisition or confiscation of the business. Id.
the court found the policy expressly limited Eximbank’s exposure to the insured’s accounts receivable.\textsuperscript{33} In addition, the court found that although some government agencies have insurance policies which cover investments in tangible assets overseas, neither Eximbank nor FCIA provide such policies.\textsuperscript{34}

In response to a summary judgment motion in Hamilton Bank v. Export-Import Bank of the United States,\textsuperscript{35} the district court for the eastern district of Pennsylvania held that FCIA insurance policies issued to Hamilton for coverage on loans extended to Mexican companies required the actual shipment of goods in order to invoke coverage. Hamilton had extended loans, insured by FCIA’s comprehensive export credit insurance policies, to various Mexican companies. The policies provided indemnification for losses incurred in connection with “eligible shipments” of products from the United States to the buyers, once the insured provided “best evidence” of a political risk loss.\textsuperscript{36} Contrary to the insured’s assertion, the court found that the term “eligible shipments” means the actual shipment of goods.\textsuperscript{37}

The court also discussed Eximbank’s and FCIA’s claims of sovereign immunity. The two organizations asserted they were immune from suit as a government agency (Eximbank) and its agent (FCIA).

\textsuperscript{33} \textit{Id.} at 441. The United States District Court, Eastern District of Arkansas, had found the policy ambiguous and thus construed it to cover assets, as well as credits. \textit{Id.} at 439. The Court of Appeals, however, noted that the policy only provides two types of coverage—commercial credit risks and political risks. Although the court noted that construction of “confiscation” or “expropriation” may be subject to different interpretations, the “loss” was intended to be measured by the specific amounts owed to the insured under its contract with its customers when political events resulted in nonpayment of the contract price. \textit{Id.} at 440-41. Furthermore, as the court noted, credit insurance policies usually cover only uncollected accounts and do not apply to asset protection. \textit{Id.} at 441.

\textsuperscript{34} \textit{Id.} at 442. Most of these insurance policies are available only from private insurers. Eximbank’s “comprehensive” policy covers a variety of events which could precipitate credit losses abroad but excludes coverage for noncredit losses. \textit{Id.}


\textsuperscript{36} \textit{Id.} at 199 (quoting language from the Political Risks section of the policies).

\textsuperscript{37} \textit{Id.} at 200. Hamilton alleged that such an interpretation was contrary to the language of the policy, or, alternatively, that the policy was inherently ambiguous. In addition, Hamilton stated that the court’s interpretation of the policy would vitiate the underlying purpose of Eximbank’s insurance coverage. The court, however, stated that it could not hold in favor of Hamilton simply because the holding might facilitate future export financing. \textit{Id.} at 199-200. The court determined that a material issue of fact existed as to whether the goods were shipped, finding summary judgment to be inappropriate. \textit{Id.}
The court noted that Eximbank as a governmental agency was only subject to suit under the Federal Tort Claims Act. The court, however, reserved judgment on FCIA's official immunity, which the court found was dependent on whether FCIA was acting within the scope of its authority.

D. Mixed Credit Talks

The Organization for Economic Cooperation and Development (OECD) sponsored several international discussions on the much-debated issue of mixed credits during 1986, but the participating nations did not resolve all their conflicts. The United States wants to raise the floor of the grant element of tied aid from the OECD's figure of twenty-five percent, which was the floor amount through 1986, to fifty percent.

The European Community (EC) reached an agreement on its mixed credit position. The EC position, similar to the United States stance, calls for an increase in the minimum floor amount to fifty percent for the poorest countries. The EC Ministers agreed that wealthy countries should not receive any foreign aid in their financing packages. The EC position would raise the minimum floor over a two

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38 Id. at 202-03.
39 Id. at 203. FCIA had not claimed it was immune under the theory of sovereign immunity. Such a claim would appear to be precluded, following the Eighth Circuit's holding in Rochester Methodist Hospital v. Traveler's Insurance Co., 728 F.2d 1006 (8th Cir. 1984) (fiscal intermediaries may not avail themselves of the doctrine of sovereign immunity).
40 OECD Mixed Credit Talks Show No Progress But Agreement Reached on Civil Aircraft, 3 INT'L TRADE REP. (BNA) 158, 159 (Jan. 29, 1986). The OECD set the twenty-five percent figure. Over the past few years, offers with a very low percentage of foreign aid have increased significantly. The United States opposes the policy and hopes that a higher floor would discourage excessive government intervention in foreign trade deals by significantly increasing the cost of government participation. Id. at 159.
41 In March 1987, the OECD nations agreed to raise the minimum floor level from twenty-five percent to thirty percent on July 1, 1987, and to thirty-five percent on July 1, 1988. They also agreed to replace the ten percent fixed discount rate by a differentiated rate. The proposal was subject to ratification by the member countries. OECD Nations Ratify Agreement to Limit Use of Tied Aid in Subsidized Official Credits, 4 INT'L TRADE REP. (BNA) 366 (Mar. 18, 1987).
42 The EC countries are Belgium, Denmark, Federal Republic of Germany, France, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, and United Kingdom.
43 EC Nations Agree on Mixed Credits Position, but Success at OECD Talks Still Not Assured, 3 INT'L TRADE REP. (BNA) 458 (Apr. 9, 1986).
The Ministers also agreed to negotiate for a variable discount factor. The announcement of the EC agreement, the OECD met in June of 1986, and issued a "statement of intent" to raise the minimum floor aid element in financing packages. The participating countries were unable to determine a minimum grant level, but they did resolve to "test" various formulas in 1986 to facilitate the determination.

In subsequent meetings, however, the OECD failed to reach an agreement on the mixed-credit issue. Japan opposed the differential rate system for determining the discount factor, which would increase its costs for providing the same level of tied-aid credit. According to a statement issued in October of 1986, the countries have reached an agreement to raise the minimum aid floor to a higher, as yet undetermined amount. Japan, however, blocked further negotiation with respect to the discount factor, thereby halting the discussions. Negotiations are due to resume in January of 1987.

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43 *Id.* The EC's proposed rules would have raised the floor amount immediately to thirty percent, with an additional increase in May 1987 to thirty-five percent. *Id.*

44 *Id.* at 459. The current discount factor is set at ten percent. The EC Ministers proposed that the discount factor be linked to movements in world market interest rates. This system would increase significantly the cost for making mixed-credit packages in low interest rate nations such as Switzerland, Japan, the Netherlands, and West Germany. During the bargaining session, the Netherlands and Germany voted against the variable discount factor; they were voted down by the other ten countries, whose high interest rates make the variable discount factor more appealing. *Id.*

45 *OECD Countries Commit to Increase Discipline in Tied-Aid Export Credits, Raise Aid Element,* 3 INT'L TRADE REP. (BNA) 738 (June 4, 1986). According to the press release, "[t]he participants generally expressed their firm intention to increase discipline in the field of tied-aid credit, inter alia, by increasing the concessionality of tied aid." *Id.*

46 *Id.*

47 *OECD Countries Fail to Agree on Mixed Credits, Stall Over Discount Factor,* 3 INT'L TRADE REP. (BNA) 1245 (Oct. 15, 1986). Japan's commercial interest rate at the time was between five and six percent. Under the fixed ten percent discount rate, Japan could make the loan at its lower rate and claim the difference was "aid." *Japan Blasted by U.S. Treasury Official for Blocking OECD Agreement on Tied Aid,* 3 INT'L TRADE REP. (BNA) 1276 (Oct. 22, 1986).

48 *Id.* The OECD countries have agreed tentatively to raise the grant element to thirty-five percent. The United States maintains that the floor should be raised further and is continuing to negotiate its stance with the EC. *Id.*

49 *Id.* United States Assistant Treasury Secretary Robert Cornell noted that "any compromise on tied aid must include two factors: an increase in the minimum grant element (to make it very expensive for countries to use aid for commercial purposes) and a more equitable discount system for measuring the grant element." *Id.* Japan's
E. Miscellaneous Developments

Canadian officials released a study recommending that the government abolish the Export Development Corporation (EDC), which is the country's export financing agency. The report demonstrated that the costs of EDC's program exceeded any benefits felt by Canadian exporters, and also noted that the centralization of EDC operations limits access to its programs. In addition, the report stated that Canada may not need to subsidize exports to match foreign subsidies and support domestic firms. Even if such subsidization is necessary, the private sector may provide cheaper financing, according to the report. The task force members forwarded the study to a parliamentary committee for further recommendations on whether to implement the study's proposals.

The United States announced a proposed new program to allow United States exporters to apply for payment guarantees against losses caused by foreign banks' payment defaults. The sponsor of the program is the Agriculture Department's Commodity Credit Corporation. The proposal would provide coverage for exporters who sell their goods on deferred payment terms of three to ten years,

refusal to negotiate one of the essential elements effectively barred any agreement.  

Id.

30 OECD Mixed Credit Talks Postponed One Month to Permit More Time to Study New Proposals, 3 INT'L TRADE REP. (BNA) 1513 (Dec. 17, 1986). Officials from several countries met informally in December and later presented new proposals for study to the OECD countries. United States officials were hopeful that the proposals would yield a general agreement at the next OECD meeting. Id. at 1513-14.


52 Id. The program is used mainly by organizations in Ontario and Quebec. Over an eleven-year period, one company accounted for twenty-five percent of all financing disbursements, and a second company entered into more than forty different financing transactions. Id.

53 Id. The report pinpointed the lack of verifiable data regarding the advantages of public financing. The report stated it could find no evidence that public sector financing is cheaper or that private sector financing provides less coverage. Also, according to the report, the task force doubted EDC's evidence that its export financing programs "generate" more benefits than average government expenditures. The study intimated that a needless duplication of services for exporters by various federal organizations makes all the programs less effective and more expensive. Id.

54 Id.

55 CCC Proposal Offers Payment Guarantees to U.S. Exporters for Up to Ten Years, 3 INT'L TRADE REP. (BNA) 616 (May 7, 1986).

56 Id. The Commodity Credit Corporation, or CCC, already offers exporter programs for short-term (three years or less) financing arrangements. Id.
with repayment secured by an "approved" foreign bank. The program would also permit the Commodity Credit Corporation to explore alternative methods of satisfying defaults, including adjustable rates of interest payable by the Commodity Credit Corporation.\textsuperscript{57}

\textsuperscript{57} \textit{Id.} Under the proposed program, United States exporters would submit applications to CCC for payment guarantees. If the credit terms are for less than a three-year period, the coverage would be provided by current programs. Longer-term financing would be covered by this program. The CCC anticipates the new program will promote the export of United States agricultural products by facilitating exporters' ability to obtain payment guarantees. \textit{Id.}
V. TRADE ADMINISTRATION

A. Multi-Fiber Arrangement Extended

On August 1, 1986, following a "stopping of the clock" by negotiators to avoid a July 31 deadline for the expiration of the previous Multi-Fiber Arrangement (MFA),1 negotiators from 54 nations agreed on a new amended MFA which will continue in effect until July 31, 1991.2 The MFA is a textile trade agreement, under the auspices of the General Agreement on Tariffs and Trade (GATT), which exempts international trade in textiles from GATT's free trade rules and provides a framework for bilateral agreements establishing restrictions on textile exports from Third World producers to industrialized countries.3 The latest extension, the third since the MFA was adopted in 1974,4 covers approximately half of the world's $100 billion annual trade in textiles.5

The new MFA includes, at the insistence of the United States,6 new provisions which bring under the agreement the exportation of new vegetable fibers, such as ramie, a popular linen-like material.7 The clauses relating to the vegetable fibers drew strong objections from the delegations of India and China, both of whom export the product. In response, both countries expressed reservations to the agreement.8

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3 Last-Minute Agreement, supra at note 2; see also Survey, Annual Survey of Developments in International Trade Law: 1985, 16 GA. J. INT'L & COMP. L. 469, 517 n.78. (1986) [hereinafter Annual Survey].
4 Annual Survey, supra note 3, at 517. The MFA, initially adopted in 1974, was previously extended in 1978 and 1982. Id.
5 Last-Minute Agreement, supra note 2.
7 Protocol, supra note 2, at 7.
8 Last-Minute Agreement, supra note 2, at 995. In response to the reservations of China and India the United States in an unprecedented move made a formal objection to the reservations. Id. In the opinion of a GATT spokesman, if such
Other measures affected under the new amendments include a provision allowing the extension of quotas beyond the previous one-year limit without a new finding by the Textile Surveillance Body that a market disruption exists. During this period of extension import expansion will be limited to 6% in most cases. A second clause, proposed by the producing developing countries, sought the phasing out of the MFA and the application of the general free trade rules of GATT in the area of textile trade. No specific date has been set for any phase out.

The successful negotiation of a new MFA in addition to several key bilateral textile trade agreements enabled the Reagan administration to garner enough votes in the House of Representatives to sustain a presidential veto of the Textile and Apparel Trade En-
The enforcement Act of 1985 (H.R. 1562). The proposed legislation, passed by Congress and quickly vetoed by President Reagan in 1985, sought to impose strict country quotas for every category of textile imports. The House vote to override the presidential veto of HR 1562 came on August 6, 1986, shortly after the conclusion of the MFA negotiations and several major bilateral agreements. The attempted override failed, by an eight vote margin, to gain the required two-thirds votes to block the veto.

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15 House Key Votes, 44 CONG. Q. 1836, 1838 (Aug. 9, 1986). The vote was 276-189. Id. To override the presidential veto would have required a two-thirds vote of those present and voting which in this case was 284 members. Id.
VI. UNFAIR TRADE PRACTICES

A. Antitrust

1. Certificate of Antitrust Immunity Vacated

On January 3, 1986, a United States district court in Horizons International, Inc. v. Baldridge,¹ decided that an antitrust immunity certificate granted to a joint venture, without reasoned analysis by the Secretary of Commerce and the Attorney General of five relevant competitive and legal issues, is "arbitrary, capricious, and an abuse of discretion."²

The case is the first to seek judicial review of a grant of antitrust immunity under the Export Trading Company Act of 1982.³ The Act was designed to increase United States exports of products and services by encouraging more efficient export trade cooperation and without producing anticompetitive conduct in the domestic market.⁴ To accomplish these goals, the Act provides that the Secretary of Commerce, with the concurrence of the Attorney General, must certify that the proposed export activities will not have anticompetitive effects in the domestic market.⁵

The court vacated the grant of an export trade certificate of review to Chlor/Alkali Producers International, a joint venture composed of four major producers of two industrial chemicals, chlorine and

² Id. at 1562. The complaint was filed February 22, 1985 by Horizons International, Inc., a California company engaged in the business of purchasing, marketing, and reselling caustic soda, chlorine, and chlorine derivatives, and Kencham, Inc., a Pennsylvania firm providing marketing and consulting services to traders in the industry. Id.; see Grant of Certificate of Antitrust Immunity to Joint Export Venture is Vacated by Court, 3 INT'L TRADE REP. (BNA) 82 (January 15, 1986).
⁵ Horizons Int'l, Inc., 624 F. Supp. at 1561. The purpose of certification is to minimize uncertainty regarding liabilities for joint export activities by providing an advance ruling of their immunity under the antitrust laws. Id. at 1562. The act has four certification standards, which require that export conduct not: (1) result in a substantial lessening of competition or restraint of trade, (2) unreasonably enhance, stabilize, or depress prices, (3) constitute unfair trade methods of competition, and (4) include any act that may reasonably be expected to result in resales in the United States. Id. at 1563 (construing 15 U.S.C. § 4013(a)).
alkali. The court concluded the plaintiff's evidence raised questions posing genuine issues of material fact regarding Chlor/Alkali's eligibility for certification. The court remanded the matter to the Secretary of Commerce and the Attorney General to consider: (1) the history of anticompetitive conduct in the chlor-alkali industry, (2) earlier consent decrees, (3) the risk of domestic pricing, (4) product market definition, and (5) the low level of chlorine exports.

2. Japanese Antitrust Litigation

After 16 years of litigation, Japanese television manufacturers charged with conspiring to dump their products in the United States at artificially low prices were granted summary judgment on Sherman Act and Antidumping Act claims raised by two of their United States counterparts. On remand from the United States Supreme Court, the United States Court of Appeals for the Third Circuit, reconsidering the case of In re Japanese Electronic Products Antitrust Litigation, found no new evidence to support the conspiracy claim.

In this case, two United States television manufacturers alleged a massive 20-year conspiracy by Japanese companies to drive American manufacturers of consumer electronic products, primarily televisions, out of business. This objective was allegedly accomplished by a two-

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7 Id. at 1562-63. The Court found the plaintiffs presented evidence relevant to their claim that Chlor/Alkali is not eligible for a certificate of review. That evidence includes outstanding consent decrees generated by past antitrust litigations that "may bar the very conduct permitted by the certificate;" an extensive Federal Trade Commission proceeding pending against a member of the certified joint venture regarding possible anticompetitive practices in the market of chlorine and alkali-related products; minimal exports of chlorine that "arguably evidences its inclusion in the certificate as a cover for domestic anticompetitive collusion;" and finally, a "rather checkered past" of antitrust violations in the chlor-alkali industry that "is continuing to this day." Id. at 1561-62.


10 807 F.2d 44 (3d Cir. 1986).


pronged "unitary" conspiracy, consisting of a concerted scheme to raise, fix and maintain artificially high prices for television receivers sold by defendants in Japan and, at the same time, to fix and maintain artificially low prices for television receivers exported to and sold in the United States.\(^{13}\)

The district court granted summary judgment for the defendants finding the admissible evidence did not raise a genuine issue of material fact as to the existence of the alleged conspiracy, and that any inference of conspiracy was unreasonable.\(^{14}\) In resurrecting the case, the Third Circuit found that sufficient evidence existed to permit an inference that most of the defendants participated in a conspiracy violative of United States antitrust law.\(^{15}\)

In *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*\(^{16}\), however, the United States Supreme Court found that the circuit court used improper summary judgment standards to reinstate the charges and disallowed much of the evidence relied upon by the Third Circuit.\(^{17}\) The Court emphasized that the United States firms cannot recover antitrust damages for any conspiracy alleging supracompetitive pricing in Japan because the American firms would benefit from, rather than be injured by, any conspiracy to raise the market price of consumer electronic products.\(^{18}\) The Court added that where the factual context

\(^{13}\) *Zenith Radio Corp.*, 513 F. Supp. 1120.


\(^{16}\) 106 S. Ct. 1348 (1986).

\(^{17}\) *Matsushita Elec. Indus. Co.*, 106 S. Ct. at 1355-62. The Court outlined the proper standard in evaluating a motion for summary judgment in this case: The United States firms "must establish that there is a genuine issue of material fact as to whether [the Japanese manufacturers] entered into an illegal conspiracy that caused [the United States firms] to suffer a cognizable injury." *Id.* at 1355-56; see *Supreme Court Holds Wrong Standard Used to Resurrect Japanese TV Cases*, 3 INT'L TRADE REP. (BNA) 436 (April 2, 1986).

\(^{18}\) *Matsushita Elec. Indus. Co.*, 106 S. Ct. at 1354. Likewise, the United States firms are precluded from recovery of damages for a conspiracy to impose non-price
of a case "renders [the United States firms'] claim implausible—if the claim is one that simply makes no economic sense—[the United States firms] must come forward with more persuasive evidence to support their claims than would otherwise be necessary."19 The Court remanded the case to the court of appeals "to consider whether there is other evidence that is sufficiently unambiguous to permit a trier of fact to find that [the Japanese manufacturers] conspired to price predatorily for two decades despite the absence of any apparent motive to do so."20

The Third Circuit Court of Appeals upheld summary judgment for the defendants on both the Sherman Act and the Antidumping Act claims.21 The court concluded that no evidence existed in the record supporting an inference of a predatory pricing conspiracy among the defendants in the United States market other than that which the Supreme Court has already held to be legally insufficient.22

B. Countervailing Duties

1. Reasonable Indication of Injury Standard Upheld

The International Trade Commission's preliminary injury standard focusing on "reasonable indication" of injury has been approved by the Court of Appeals for the Federal Circuit in American Lamb Co. v. United States.23 The Court of Appeals ruled that the Court of

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restraints "that have the effect of either raising market price or limiting output," such as the five-company rule which limits distribution and check pricing which establishes minimum prices. Id.

19 Id. at 1356.
20 Id. at 1362.
22 Id. at 48. The Third Circuit explained that in light of the Supreme Court's opinion, the plaintiffs are foreclosed from arguing on remand that the defendants had a motive to conspire to fix low prices in the United States. The Supreme Court conclusively held that the defendants had no such motive, and this holding, as law of the case, is binding on the Third Circuit. Id. at 47. In the Third Circuit's view, the Supreme Court left open only "a consideration of evidence other than pricing practices in the American market, conduct in the Japanese market, and agreements respecting customer allocation in the American market. Such evidence, moreover, must suffice to overcome the law of the case that there was no motive to conspire." Id. The Third Circuit concluded the plaintiffs' evidence "amount[s] to no more than an argument that the Supreme Court majority erred in its conclusion that no fact finder could draw an inference of conspiracy to price predatorily." Id. at 48.
23 785 F.2d 994 (Fed. Cir. 1986). See 19 U.S.C. § 1673b(a) (1982), which embodies the "reasonable indication of injury" standard. Under this statute, the Commerce Department's preliminary determination as to "less than fair value" sales must be affirmative when it has "a reasonable basis to believe or suspect" that exporters are selling the merchandise under investigation at less than fair value. Id.
International Trade acted improperly when it instructed the Commission to make affirmative determinations where the Commission found the "mere possibility" of injury. The case originated in April 1984 based on petitions filed by three domestic lamb producers alleging that imports of lamb meat from New Zealand were being subsidized and then sold in the United States at less than fair value. In May 1984, the Commission determined there was no "reasonable indication" of injury or threat of injury to the domestic industry. On appeal, the Court of International Trade determined that the Commission could not weight conflicting evidence in making a preliminary determination that material injury existed and remanded the case to the Commission.

The Court of Appeals for the Federal Circuit granted the Commission's petition for this interlocutory appeal to determine whether the weighing of all evidence in applying the "reasonable indication" standard in a preliminary investigation was permissible. Applying normal agency review standards, the appeals court approved the Commission's consideration of conflicting evidence in making its preliminary determination and expressly rejected the trade court's use of the "mere possibility" of injury standard. The Court of Appeals

24 American Lamb Co. v. United States, 785 F.2d 994, 1001-02 (Fed. Cir. 1986); see CA FC Reverses Trade Court, Says ITC Used Proper Test in Preliminary Investigations, 3 INT'L TRADE REP. (BNA) 299 (Mar. 5, 1986).
25 American Lamb Co., 785 F.2d at 996-97.
28 American Lamb Co., 785 F.2d at 997.
29 A reviewing court must accord substantial weight to an agency's interpretation of a statute it administers. Id. at 1001.
30 Id. at 1001-04. The Court of Appeals explained:

Since the enactment of the 1974 Act, ITC has consistently viewed the statutory "reasonable indication" standard as one requiring that it issue a negative determination ... only when (1) the record as a whole contains clear and convincing evidence that there is no material injury or threat of such injury; and (2) no likelihood exists that contrary evidence will arise in a final investigation. That view, involving a process of weighing the
concluded: "We are unable to join the [trade] court in its view that the statutory phrase 'reasonable indication' means the same as a mere 'possibility,' or that it suggests 'only the barest clues or signs needed to justify further inquiry.' The statute calls for a reasonable indication of injury, not a reasonable indication of need for further inquiry."31

The appeals court also found that the Commission's approach fully complied with congressional intent32 as indicated in 19 U.S.C. § 1673b(a) (1982), and directed the Commission to use "the best information available" in applying the "reasonable indication" standard.33 Pointing to the language of the trade court in Budd Co. Railroad Division v. United States,34 the Court of Appeals stated that the Commission cannot conduct a "thorough investigation" if it is limited to reviewing only such evidence as might support the petition.35

2. Cumulation of Like Products Required

In Bingham & Taylor v. United States,36 the Court of International Trade held that amendments to the Trade and Tariff Act of 198437 evidence but under guidelines requiring clear and convincing evidence of "no reasonable indication," and no likelihood of later contrary evidence, provides fully adequate protection against unwarranted terminations.

Id. at 1001.

31 Id. The court noted that although "[o]ne writing on a clean slate might find the court's rasoning fully acceptable, ... a 'court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation.'" Id. (quoting Chevron U.S.A., Inc. v. Natural Resources Defense Council, 467 U.S. 837, 843 (1984)).

32 Id. at 1002.


34 507 F. Supp. 997, 1000 (Ct. Int'l Trade 1980). In Budd Co. Ry. Div., domestic manufacturers of rail passenger cars and components brought action contesting preliminary determinations by the International Trade Commission of no reasonable indication of material injury. The Court of International Trade held that the International Trade Commission failed to comply with its statutory duty to conduct thorough investigation with respect to domestic manufacturer's dumping claims. The antidumping proceedings were remanded to Commission for further consideration of information included in administrative record as well as best information which would have been available at the time of the original investigation. Id. at 997.

35 American Lamb Co., 785 F.2d at 1003.


(iv) Cumulation—For purposes of clause (i) [volume] and (ii) [price], the
require the cumulation of imports from two or more countries of like products "subject to investigation" which compete with one another and with a like domestic product, regardless of whether the investigations relate to dumping, countervailing duties, or both. 38

This dispute arose out of five simultaneously initiated investigations involving iron constructions castings. The International Trade Commission made affirmative preliminary injury rulings with respect to antidumping investigations of Brazil, Canada, India, and the Peoples Republic of China. 39 In a countervailing duty determination involving only Brazil, the Commission found a reasonable indication of injury with respect to heavy iron construction casting, but made a negative determination with respect to light castings. 40

The International Trade Commission, in making its preliminary affirmative determinations in the dumping cases, cumulated the impact of imports from the four countries on the domestic industry. In the countervailing duty case, however, the Commission refused to cumulate the impact of the imports subject to the antidumping investigations with the impact of imports subject to the Brazilian countervailing duty investigations. 41

The trade court framed the primary issue in this case as whether Section 612(a)(2) of the Trade and Tariff Act of 1984 requires the Commission "to cumulatively assess the volume and effect of imports of like products subject to both anti-dumping and countervailing duty investigations." 42 The court held that cumulation was required to do so and remanded the case to the Commission. 43

Commission shall cumulatively assess the volume and effect if imports from two or more countries of like products subject to investigation if such imports compete with each other and with like products of the domestic industry in the United States market.


38 Bingham & Taylor v. United States, 627 F. Supp. 793, 795 (Ct. Int'l Trade 1985); see CIT Requires Cumulation of Like Products in Dumping, Countervailing Duty Cases, 3 INT'L TRADE REP. (BNA) 276 (Feb. 26, 1986) [hereinafter CIT Requires Cumulation].

39 Bingham & Taylor, 627 F. Supp. at 794.

40 Id.; see 50 Fed. Reg. 27,498 (1985); see also Cases Involving Iron Construction Castings From Four Countries Continued by Commission, 2 INT'L TRADE REP. (BNA) 843 (June 26, 1985).

41 Bingham & Taylor, 627 F. Supp. at 794 (citing Iron Construction Castings From Brazil, Canada, India, and the People's Republic of China, U.S.T.C. Public. 1720, 12 (June 1985)).

42 Id.; see Trade and Tariff Act of 1984, supra note 37.

While the court found no specific language on "cross-cumulation"\(^4\) in the legislative history of the 1984 Act, it concluded that Congress intended for cumulation to be broadly applied in unfair trade practices.\(^4\) The court found the combined impact from both dumped and subsidized imports may be injurious, stating "[t]he effects of injury from different types of unfair trade practices upon the domestic injury are identical—it makes no difference to a domestic producer whether it loses sales because foreign [products] are dumped or because they are subsidized."\(^4\) The trade court added that failure to cumulate would lead to toleration of an "obvious loophole" with "no apparent justification."\(^4\)

3. Countervailing Duty Law Not Applicable to Non-Market Economies

In *Georgetown Steel Corp. v. United States*,\(^4\) the Court of Appeals for the Federal Circuit ruled that United States countervailing duty law does not apply to alleged subsidies granted by countries with nonmarket economies.\(^4\)

The International Trade Administration, in two separate opinions, made negative countervailing duty rulings and held, as a matter of

\(^4\) The term "cross-cumulation" refers to the aggregation of less than fair value (dumped) and subsidized imports from two or more countries for purposes of volume and price analysis. *Id.* at 794 n.1.

\(^4\) *Id.* at 796. The court felt "constrained to conclude in the instant case that the Commission's refusal to cumulate is indeed contrary to the statute, its purpose, and legislative intent." The district court referred to the House Ways and Means Committee Report which stated: "The Committee believes that the practice of cumulation is based on the sound principle of preventing material injury which comes about by virtue of several simultaneous unfair acts of practices." *Id.* at 796 (citing H.R. REP. NO. 725, 98th Cong., 2d Sess. 37, *reprinted in* 1984 U.S. CODE CONG. & ADMIN. NEWS 4910, 5127, 5164) (emphasis added). The court concluded:

In keeping with the foregoing views, Congress broadly required cumulation of the injurious effects of "simultaneous unfair acts or practices" if certain conditions are met. Further, there is no suggestion in the language of the 1984 statute or in its legislative history that the Commission separately consider the injurious effects of one type of unfair practice from those of another type of unfair practice.

Bingham & Taylor, 627 F. Supp. at 796.

\(^4\) *Id.* The court also rejected the Commission's arguments that the United States had enacted separate injury tests under the GATT Subsidies and Antidumping Codes, and that certain countries were not permitted the benefit of the injury test in subsidy cases. *Id.* 797-98.

\(^4\) *Id.* at 799; see CIT Requires Cumulation, *supra* note 38.

\(^4\) 801 F.2d 1308 (Fed. Cir. 1986).

\(^4\) *Id.* at 1314-16; see CA FC Rules Countervailing Duty Law Does Not Apply to Non-Market Economies, 3 INT'L TRADE REP. (BNA) 1161 (Sept. 24, 1986).
law, that Section 303 of the Tariff Act of 1930\textsuperscript{50} was inapplicable to non-market economies.\textsuperscript{51} The Court of International Trade consolidated review in the two cases and reversed the Commerce Department's rulings, holding that the countervailing duty law covers nonmarket economies.\textsuperscript{52} According to the trade court, the Administration's premise "that subsidy can only exist in a market economy" constituted "fundamental error."\textsuperscript{53}

The Court of Appeals for the Federal Circuit, on appeal from the trade court, noted that Section 303 is substantially unchanged from the first general countervailing duty statute Congress enacted in 1897. The court explained that at the time of the original enactment no nonmarket economies existed and consequently, Congress had no occasion to address the application of countervailing duty law to these countries. Since that time, however, Congress has reenacted Section 303 six times without making any significant changes to the

\textsuperscript{50} Section 303 of the Tariff Act of 1930, as amended, 19 U.S.C. § 1303 (1982), which authorizes the levy of countervailing duties, provides as follows:

Whenever any country... or other political subdivision of government... shall pay or bestow, directly or indirectly, any bounty or grant upon the manufacture or production or export of any article or merchandise manufactured or produced in such country... or other political subdivision of government, then upon the importation of such article or merchandise into the United States, whether... imported directly... or otherwise... there shall be levied and paid, in all such cases, in addition to any duties otherwise imposed, a duty equal to the net amount of such bounty or grant, however the same be paid or bestowed.


\textsuperscript{51} Georgetown Steel Corp. v. United States, BDI F.2d 1308, 1310 (Fed. Cir. 1986); see 49 Fed. Reg. 19,374 (1984). In November 1983, the appellees, Georgetown Steel Corporation and Continental Steel Corporation filed two countervailing duty petitions alleging that imports of carbon steel wire rod from Czechoslovakia and Poland were being "subsidized" and therefore subject to countervailing duties under Section 303. While the wire rod cases were pending, Amax-Chemical, Inc. and Kerr-McGee Chemical Corp. filed petitions alleging that the Soviet Union and East Germany had provided subsidies for potash imported into the United States. After deciding the wire rod cases, Commerce rescinded the investigations in the potash cases on the grounds that both countries had non-market economies. \textit{Id.} at 23,428-29.


\textsuperscript{53} \textit{Continental Steel Corp.}, 614 F. Supp. at 550. The trade court stated that "[t]he only purpose of the countervailing duty law [was] to extract the subsidies contained in merchandise entering the commerce of the United States in order to protect domestic industry from their effect... [and that] its effectiveness [was] clearly intended to be complete and without exception." \textit{Id.} at 553.
issue before the court. According to the court, "[t]hat fact itself strongly suggests that Congress did not intend to change the scope or meaning of the provision it had first enacted in the last century."

The appeals court concluded, based upon the purpose of the countervailing duty law, the nature of nonmarket economies, and Congressional action addressing the issue in antidumping statutes, that the economic incentives and benefits provided by nonmarket economy countries for the export of products to the United States "do not constitute bounties or grants under section 303 of the Tariff Act of 1930, as amended." The court noted that while the "alleged subsidies" might encourage exporting entities in nonmarket economy countries "to accomplish the economic goals and objectives the central planners set for them, they do not create the kind of unfair competitive advantage over American firms against which the countervailing duty act was directed."

C. Dumping

1. Price Differential May Establish Importer Knowledge of LTFV Sales

In *ICC Industries, Inc. v. United States*, the Court of International Trade held a price differential between the price from a state-controlled economy and the price from a market economy of 22 percent sufficient to establish knowledge on the part of the importer that the product is being sold at less than fair value (LTFV) for purposes of a "critical circumstances" determination.

In 1983, both the Commerce Department and the International Trade Commission initiated investigations to determine whether potassium permanganate imports from the Peoples Republic of China (China) were being dumped in the United States and whether such imports injured the domestic industry. The Department of Commerce,

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54 *Georgetown Steel Corp.*, 801 F.2d at 1314.
55 *Id.* at 1316. The court stated "Those statutes indicate Congress intended any selling by non-market economies at unreasonably low prices should be dealt with under the antidumping law." *Id.* at 1316 (referring to the Trade Act of 1974, Pub. L. No. 93-618, 88 Stat. 1978 (1975) (codified at 19 U.S.C. § 1673-1673(i) (1982)).
56 *Georgetown Steel Corp.*, 801 F.2d at 1314.
57 *Id.* at 1315-16. The Court added that "even if one were to label these incentives as a 'subsidy,' in the loosest sense of the term, the governments of those nonmarket economies would in effect be subsidizing themselves." *Id.* at 1316.
59 *Id.* at 38-39; see *Size of Price Differential May Establish Importer Knowledge of LTFV Sales, CIT Rules*, 3 INT'L TRADE REP. (BNA) 466 (Apr. 9, 1986).
in its final affirmative determination of sales at less than fair value, found that "critical circumstances" existed under 19 U.S.C. § 1673d(a)(3) therefore permitting the retroactive imposition of antidumping duties. In making its final injury ruling, the International Trade Commission also determined that retroactive duties were necessary to prevent a recurrence of material injury. This action challenged those agency determinations which gave retroactive effect to the imposition of antidumping duties on importations of potassium permanganate from China.

The trade court, citing the lack of any history of dumping involving the Chinese products, noted a determination of "critical circumstances" depends upon the existence of massive imports and a finding of knowledge of less than fair value sales on the part of importers. This case specifically challenged the imputed knowledge attributed to the importers by the trade court.

The Court of International Trade concluded that a price differential standing alone may be sufficient to impute knowledge on the part of the importer that the product is being sold at less than fair value.

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Critical Circumstances determinations.

If the final determination of the administering authority is affirmative, then that determination, in any investigation in which the presence of critical circumstances has been alleged under section 1673b(e) of this title, shall also contain a finding of whether—

(A)(i) there is a history of dumping in the United States of elsewhere of the class or kind of merchandise which is the subject of the investigation, or

(ii) the person by whom, or for whose account, the merchandise was imported knew or should have known that the exporter was selling the merchandise which is the subject of the investigation at less than its fair value, and

(B) there have been massive imports of the merchandise which is the subject of the investigation over a relatively short period.

ICC Indus., Inc., 632 F. Supp. at 37.


63 Id. at 38; see 19 U.S.C. § 1673d(a)(3), supra note 60.

64 ICC Indus., Inc., 632 F. Supp. at 39. The Commission's critical circumstance determination was also challenged for failing to separately find a casual link between the massive imports and the material injury. This argument was rejected by the trade court. Id. at 40-41.
Considering the structure of the international market, the nature of the commodity and its source, the trade court determined the magnitude of the price differential in this case sufficient to impute such knowledge to the importer.\textsuperscript{65} Citing the possibility that without imputing knowledge the law could not cope with the first occurrence of a massive dumping of imports from a state-controlled economy, the court concluded that such a determination appears to be an unavoidable exercise of agency expertise in an emergency situation.\textsuperscript{66}

2. ITA Lacks Power to Alter Scope of Finding During Section 751 Review

The Court of Appeals for the Federal Circuit, in \textit{Alsthom Atlantique v. United States},\textsuperscript{67} held that the scope of an antidumping determination established by the Treasury Department cannot be altered by the International Trade Administration (ITA) during the course of a Section 751 review.\textsuperscript{68}

The case arose from a 1970 antidumping investigation by the Treasury Department involving large power transformers from France.\textsuperscript{69} In 1971, the Treasury amended its notice of the antidumping pro-

\textsuperscript{65} \textit{Id.} at 39. The trade court expounded:

Accordingly, it may fairly be said that, even considering that there is no immediately ascertainable market value in the home market of a state-controlled economy and even absent any knowledge of how fair market value would ultimately be calculated for the country of production, the importers should have known that the price was 'too good to be true' and too low to emerge unscathed from administrative scrutiny. \textit{Id.}

\textsuperscript{66} \textit{Id.} The court noted the Commerce Department’s concern “that if it cannot make inferences and attribute knowledge of dumping based on knowledge of price differentials, massive injurious imports from state-controlled economies can enter with impunity during the first dumping investigation of a product from those countries.” \textit{Id.}

\textsuperscript{67} 787 F.2d 565 (Fed. Cir. 1986).

\textsuperscript{68} \textit{Id.} at 571; see \textit{ITA Lacks Power to Alter Scope of Finding During § 751 Review, Appeals Court Holds, 3 INT’L TRADE REP. (BNA) 407 (Mar. 26, 1986). Section 751 requires an annual administrative review of all countervailing and antidumping duty orders and a determination of the amount of any such duty. The results of the review, together with notice of any duty to be assessed, are to be published in the Federal Register. See 19 U.S.C. § 1675 (Supp. III 1985).

\textsuperscript{69} \textit{Alsthom Atlantique v. United States}, 787 F.2d 565, 566 (Fed. Cir. 1986). Westinghouse Electric Corporation filed a petition which cited the possibility that large power transformers from France were being sold, or were likely to be sold, at less than fair value within the meaning of the Antidumping Act of 1921, as amended. The investigation included an investigation of the Alsthom Savoisienne, the corporate predecessor of Alsthom Atlantique. \textit{Id.} at 566-67.
ceedings to include all types of large power transformers, including shunt reactors. Following the transfer of authority for administering the antidumping provisions from the Treasury to the Commerce Department, the ITA conducted its first administrative review for the period 1972 to 1980. The ITA determined that shunt reactors were clearly within the scope of the original Treasury determination and held that the scope of the antidumping finding could not be changed during a Section 751 administrative review.

Alsthom Atlantique appealed the ITA determination to the Court of International Trade. In January 1985, the trade court ruled that the ITA did have authority to modify an antidumping duty order during a Section 751 review, and that the agency should not "be forced to follow an erroneous Treasury order" under such circumstances.

The Court of Appeals concluded the trade court erred in finding the ITA had the authority to change the scope of the Treasury's determination during a Section 751 review. The appeals court concluded that although the ITA has the power, during a section 751 review, to determine whether an unclassified article is within the scope of an original Treasury finding, "the ITA cannot change the scope of an underlying antidumping determination when Treasury has specifically included the article within the scope of its underlying determination."

70 Id. at 567. The amendment stated that the Antidumping Proceeding Notice applied to "all types of transformers rated 10,000 KVA or above, . . . including but not limited to shunt reactors." 36 Fed. Reg. 11,308 (1971).


72 Alsthom Atlantique, 787 F.2d at 568; see 47 Fed. Reg. 10,268 (1982).


74 Alsthom Atlantique, 787 F.2d at 570-71. The appeals court, after analyzing the Transitional Rules which changed the administration of antidumping law from Treasury to the Commerce Department, also concluded that the trade court should have dismissed Alsthom's appeal as untimely and should have been made only after exhausting the administrative procedures set forth by 19 U.S.C. §1514-1515 (1980). Id. at 569.

75 Id. at 571 (emphasis in original).
3. Recalculation of LTFV Margins Necessary Where International Trade Commission Changes Scope of Case

The Court of International Trade, in Badger-Powhatan v. United States, held that the Commerce Department should recalculate less than fair value (LTFV) margins when it is determined that only a subclass of the dumped merchandise sold at LTFV is causing injury to the United States industry.

In 1984, a domestic producer of brass fire protection products filed an antidumping petition alleging that imports of such products were being, or were likely to be, sold in the United States at less than their fair value. The petition specified a group of seven products allegedly sold at LTFV.

The International Trade Administration (ITA) announced its final affirmative determination of sales at LTFV for all seven products. In 1985, the International Trade Commission (ITC) issued its final injury determination but found that only two of the seven products under investigation caused or threatened to cause material injury. When the antidumping duty order was issued, it specified that it applied only to the two products the ITC found to cause injury. The duty margin adopted, however, was based on sales of all seven products. Plaintiff brought this action arguing that the estimated antidumping duty deposit rate should be based solely on the weighted-average LTFV margin for the two product categories identified in the antidumping order.
The Court of International Trade stated the issue as "whether Congress intended that a LTFV recalculation occur in a situation in which the injury determination narrows the potential scope of an antidumping order and information is available in the administrative record from which to perform the recalculation."

The trade court found that the only guidance as to calculation is provided in the overview provision, Section 1673. The statute provides that once an affirmative LTFV determination and material injury determination are made as to certain merchandise, "then there shall be imposed upon such merchandise an antidumping duty . . . in an amount equal to the amount by which the foreign market value exceeds the United States price for the merchandise." The court added that it "has defined the term 'such merchandise' as merchandise which is both in a class of merchandise being sold at LTFV and which is causing material injury to a domestic industry." Thus, the trade court concluded, the antidumping duty actually imposed should be based, as far as is possible, on the LTFV margin for the merchandise that is actually subject to the duty.

The trade court noted that the statute does not explicitly refer to the question of recalculation when the ITA and ITC final determinations vary in scope. In light of the legislative history supporting recalculation, however, the court concluded "the statutory scheme requires that estimated antidumping duties be as closely tailored to actual antidumping duties as is reasonable given data available to ITA at the time the antidumping order is issued."

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83 Id. at 1369.
85 Badger-Powhatan, 633 F. Supp. at 1370 (emphasis in original).
86 Id. at 1370; see Badger-Powhatan v. United States, 608 F. Supp. 653, 656 (Ct. Int'l Trade 1985).
87 Id. at 1371.
88 Id. at 1371.
89 Id. at 1373. The court recognized the "Supreme Court's admonition that in filling interstitial silences in statutes courts must proceed with caution and attend to the view of the administrative entity appointed to enforce the statute." Id. at 1371 (citing Ford Motor Credit Co., v. Milhollin, 444 U.S. 555, 565 (1980)). The trade court, however, noted that "in giving weight to an administrative determination, a court should consider not only its consistency with other pronouncements but the validity of the reasoning underlying it." Id. In reviewing the three cases cited by the parties to analyze ITA's decision-making in this area, the court determined that "there is no consistency and ITA offers no explanation for the inconsistency." Id. The court concluded that "if there is an agency practice to be given weight in this case, the court is simply at loss as to what that practice is." Id. at 1372.
4. Commerce Department’s De Minimus Standard Invalid

In *Carlisle Tire & Rubber Co. v. United States*, the Court of International Trade found the Commerce Department’s use of a 0.5 percent *de minimus* standard in dumping investigations invalid because it was not promulgated in accordance with the notice and comment provisions of the Administrative Procedure Act. This case originated from a 1983 dumping investigation based on petitions filed by plaintiffs, domestic producers of inner tubes. In June 1984, the International Trade Administration made a final negative determination of sales at less than fair value (LTFV) of imports from the Republic of Korea. This action challenging that negative determination was filed in 1985.

The Court of International Trade specifically refused to decide whether the antidumping law allows the Commerce Department to issue a rule that a particular *ad valorem* percentage is *de minimus* in all cases. The court held that any such rule must be promulgated in accordance with the notice and comment provisions of the Administrative Procedure Act. In this case, Commerce had failed to meet this requirement and therefore such a standard is not a “rule.” The trade court added that even though there is no “rule” that margins less than 0.5 percent are *de minimus*, Commerce may find that margins of approximately .45 percent are *de minimus* in this

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91 Id. at 423; see Commerce’s 0.5 Percent De Minimus Standard In Dumping Cases Found To Be Invalid By CIT, 3 INT’L TRADE REP. (BNA) 692 (May 21, 1986).
92 Carlisle Tire & Rubber Co. v. United States, 622 F. Supp. 1071 (Ct. Int’l Trade 1985). In July 1983, seven domestic producers petitioned the Commerce Department on behalf of the domestic inner tube industry alleging that inner tubes from Korea were, or were likely to be, sold in the United States at less than fair value; that these imports were materially injuring, or threatening to injure, a domestic industry; and that an antidumping duty should be imposed under 19 U.S.C. § 1673 (1982). Id. at 1072.
94 In October 1985, the CIT affirmed the ITA’s ruling but remanded for further information on verification of the weight of Korean inner tubes. *Carlisle*, 622 F. Supp. at 1083. The Commerce complied with the new verification requirements. In an unpublished December 1986 Department Opinion, the trade court found that the government had not sufficiently addressed arguments concerning conflicting sets of weights for the same merchandise in making drawback adjustments. The trade court directed the government to address whether dumping margins greater than *de minimus* would result if lower drawback adjustments were used by Commerce. *Carlisle* & Rubber Co. v. United States, 634 F. Supp. 419, 421 (Ct. Int’l Trade 1986).
95 *Carlisle*, 634 F. Supp. at 423. The Administrative Procedure Act’s notice and comment provisions are contained in 5 U.S.C § 553 (1982).
investigation. To do this, the court emphasized, Commerce must explain the basis for its decision.  

D. Trade Agreements

1. United States-Japan Semiconductor Agreement

The United States and Japan reached a five-year semiconductor accord July 30, 1986, designed to promote the sale of United States semiconductors to Japan and to prevent the dumping of chips by the Japanese in both United States and third markets.

The agreement was reached just in time to prevent a final antidumping ruling by the Commerce Department on certain Japanese semiconductors and a presidential determination in the Section 301 case brought in 1985 by the United States industry. As a result of the accord, both the Section 301 investigation and the pending an-

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9 Carlisle, 634 F. Supp. at 423. The trade court noted that Commerce has recognized that margins under 0.5 percent may not be de minimus and that small margins may be important in making such determinations. Id. at 423-24.

97 President’s Statement, 22 WEEKLY COMP. PRES. DOC. 1031 (Aug. 4, 1986); see United States, Japan Reach Five-Year Deal on Chips, Administration Dropping Dumping, § 301 Cases, 3 INT’L TRADE REP. (BNA) 994 (Aug. 6, 1986) [hereinafter U.S., Japan Reach Five-Year Chips Deal]. The agreement will run through July, 1991. Id.

98 U.S., Japan Reach Five-Year Chips Deal, supra note 97. The Commerce Department announced preliminary findings that EPROMS (erasable programmable read only memories) and 256K DRAMS (dynamic random access memories) were being dumped in the United States by Japan. ITA Finds LTFV Sales of Semiconductors, Chips Accord Sought Before Nakasone Visit, 3 INT’L TRADE REP. (BNA) 329 (Mar. 12, 1986); ITA Issues Affirmative Ruling on 256K Chips From Japan, Effort to Settle Cases Escalated, 3 INT’L TRADE REP. (BNA) 372 (Mar. 19, 1986). The International Trade Commission had already imposed antidumping duties against 64K DRAMS following a final affirmative injury ruling May 27, 1986. The final ruling of EPROMs was scheduled for July 30, 1986, and the final on 256K DRAMS August 1, 1986, which could have resulted in the imposition of additional duties. ITC Finds Injury From Japanese 64K DRAM Chips, Raising Pressure on Japan to Settle Dispute, 3 INT’L TRADE REP. (BNA) 716 (May 28, 1986).

99 19 U.S.C. § 2411(a) (Supp. III 1985). Section 301 of the Trade Act of 1974 with its companion sections 2412-16, provide for the enforcement of United States rights in response to unfair foreign trade practices. Under these procedures, a party may file a complaint with the United States Trade Representative requesting the President to take appropriate action to counter the discriminatory practices of which the party has complained. Id.

tidumping cases will be suspended by the Administration.\footnote{101}

Under the terms of the accord, the United States is expected to realize a "steady increase" in access to the Japanese market over the next five years.\footnote{102} The Japanese government has promised to encourage Japanese producers and users of chips to take advantage of the increased availability of foreign-made products in their markets. Specifically, the agreement contemplates a variety of actions by Tokyo to encourage Japanese purchases of United States chips which include: (1) establishing an organization to help foreign producers to increase sales in Japan; (2) promoting long-term relationships between Japanese semiconductor purchasers and foreign manufacturers through joint product development with Japanese customers; and (3) providing full and equitable access for foreign companies to patents resulting from government sponsored research and development in this area.\footnote{103}

The agreement addresses the issue of dumping by providing that Tokyo will monitor costs and prices on chips exported to the United States, and Japanese chips exporters will submit company and product-specific cost and export price data to the Japanese government. If the United States believes a monitored Japanese product is being dumped in United States markets at prices less than company-specific fair value, and provides the Japanese government with supporting information, the United States may request immediate consultations with Tokyo.\footnote{104}

The United States government retains the right to institute antidumping cases based on available information. Moreover, the Commerce Department may terminate the agreement and immediately impose antidumping duties should a Japanese firm engage in future dumping or otherwise violate the suspension agreement.\footnote{105}

\footnote{101} U.S., Japan Reach Five-Year Chips Deal, supra note 97.
\footnote{102} Id. at 995. Although the new agreement does not stipulate a specific schedule for increasing United States exports to Japan, the United States Trade Representative expects current United States sales of about $600 million a year, or 8.5 percent market share, will increase to about $1 billion to $2 billion, or approximately 20 percent of the Japanese market over the five years covered by the agreement. Id.
\footnote{103} Id. at 995.
\footnote{104} Id. Japan also promised to monitor costs and export prices on chips shipped by Japanese firms to third countries. Id. at 994.
\footnote{105} Id. Following the United States-Japan semiconductor agreement, the European Community on November 20, 1986 challenged the legality of the agreement, arguing that the pact would have to be amended to consider most favored nation status in order to be compatible with the rules of GATT. EC Raises Challenge at GATT to Legality of United States-Japan Semiconductor Trade Accord, 3 INT'L TRADE REP. (BNA) 1429 (Nov. 26, 1986).
2. United States-Canada Softwood Lumber Settlement

The United States and Canadian governments reached a December 31, 1986 settlement to end a United States countervailing duty action on Canadian softwood lumber. The agreement involves immediate implementation by Ottawa of a 15 percent export tax that is to be gradually phased out as provincial softwood timber (stumpage) fees are increased by the same amount. In return, United States lumber producers will drop their countervailing duty complaint against Canada before the Commerce Department was due to issue its final subsidy ruling in the case.  

The case began when The Coalition for Fair Lumber Imports, a coalition of United States lumber companies, filed a petition in May 1986 with the International Trade Commission requesting that a countervailing duty of 32 percent be imposed on imports of Canadian softwood lumber to offset the effect of alleged subsidies. In October 1986, the Commerce Department issued its preliminary determination that Canada subsidized softwood lumber exports to the United States. The department's finding of a 15 percent subsidy margin, however, was lower than expected by the United States lumber industry.

In rendering its preliminary determination, the Commerce Department found that the pricing practices of Alberta, British Columbia, Ontario, and Quebec for harvesting softwood timber constitute subsidies because they are provided at preferential prices to a specific industry or group of industries. The Commerce Department also determined that 16 other programs provide subsidies to Canadian producers and exporters of softwood lumber to the United States.

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107 International Trade Commission Votes 5-0 to Continue Canadian Lumber Investigation, 3 INT'L TRADE REP. (BNA) 855 (July 2, 1986).

108 Commerce Finds Canadian Lumber Subsidies Preliminarily, Margin Lower Than Expected, 3 INT'L TRADE REP. (BNA) 1275 (Oct. 22, 1986) [hereinafter Commerce Finds Canadian Lumber Subsidies Preliminarily].

109 Id. The finding, if upheld in the final determination, would have overturned a 1983 Commerce finding that the stumpage programs were not a subsidy. United States officials argued that new facts and law have emerged since the 1983 ruling to justify the finding. The most recent investigation preliminarily found that the provinces exercise considerable discretion in awarding stumpage rights. Discretion is one of the standards in making a specificity determination, but this issue was not examined in the 1983 case. More importantly, Commerce noted that the Court of International Trade, in Cabor v. United States, 620 F. Supp. 722 (Ct. Int'l Trade
The International Trade Commission, however, never issued a final subsidy decision as a result of the accord.\footnote{10}

3. United States-European Community Semifinished Steel Agreement

The United States and the European Community have formally approved an agreement limiting EC exports of semifinished steel to the United States market for the next three and one-half years.\footnote{11} The agreement will enable the Community to drop its curbs on United States imports of fertilizer, paper, and animal fats, which were imposed in January 1986 after the United States unilaterally limited imports of EC semifinished steel to 600,000 tons per year.\footnote{12}

Under the accord, imports of EC semifinished steel to the United States will be restricted to 300,000 tons for the last six months of 1986, 620,000 tons in 1987, 640,000 tons in 1988, and 520,000 tons for the first nine months of 1989 when the pact would expire.\footnote{13} The state-owned British Steel Corp. would be allowed to continue to export 200,000 tons of semifinished steel to its United States subsidiary in Tuscaloosa, Alabama.\footnote{14}

The European Community ratified the agreement in July 1986,\footnote{15} but the Reagan Administration withheld formal approval pending the...

\footnotetext[10]{10}{U.S., Canadian Softwood Lumber Accord, supra note 106.}
\footnotetext[11]{11}{Agreement With EC on Semifinished to Enter into Force Sept. 15, According to Official, 3 INT'L TRADE REP. (BNA) 1104 (Sept. 10, 1986) [hereinafter Agreement on Semifinished]. The agreement enters into force September 15, 1986. Id.}
\footnotetext[12]{12}{Agreement on United States Quotas for EC Semifinished Exports Will End Limitations on United States Products, 3 INT'L TRADE REP. (BNA) 854 (July 2, 1986) [hereinafter United States Quotas]. This dispute erupted in mid-1985 when United States and EC negotiators were drafting a renewal of the 1982 accord limiting EC carbon steel exports to the United States market. The agreement excluded semifinished steel, but provided for formal consultations between the two sides if imports of semifinished steel escalated. The dispute remained unresolved, and the United States imposed formal quotas on EC semifinished steel imports. The EC retaliated because the United States made a unilateral decision instead of going through the consultation process. Id.; see Survey, Annual Survey of Developments in International Trade Law: 1985, 16 GA. J. INT'L & COMP. L. 469, 520-21 (1986).}
\footnotetext[13]{13}{Agreement on Semifinished, supra note 111.}
\footnotetext[14]{14}{United States Quotas, supra note 112. Total EC semifinished steel exports to the United States averaged about 900,000 tons a year in 1984 and 1985. Id.}
\footnotetext[15]{15}{EC Industry Ministers Give Final Approval to Accord on Semifinished Exports to United States, 3 INT'L TRADE REP. (BNA) 916 (July 16, 1986). The internal...}
outcome of negotiations aimed at settling the 16-year-old dispute over exports of United States citrus fruit to the Community.\textsuperscript{116}

E. Section 301

1. United States-Korean Section 301 Settlement

The United States and South Korea reached a settlement on July 21, 1986 of the section 301\textsuperscript{117} cases brought against Seoul concerning intellectual property and insurance. The Section 301 complaints were initiated last fall by President Reagan in an effort to open foreign markets for United States firms in the service sector and to gain intellectual property rights protection.\textsuperscript{118}

Under the insurance agreement, United States firms will be able to underwrite both life and non-life insurance in Korea.\textsuperscript{119} This is an import accomplishment since both Korea and Taiwan have been among the most closed markets in the world to the United States insurance industry.\textsuperscript{120}

During the course of the intellectual property investigation, the United States had taken issue with Seoul for its policies regarding patent, copyright, and trademark protection.\textsuperscript{121} The agreement on Community deal approved July 9, 1986 gives 50 percent of the non-British EC quota to West Germany, while the remaining 50 percent will be divided among steel producers in the Netherlands (15 percent); France (14.5 percent); Belgium-Luxembourg (13 percent); the United Kingdom (4.5 percent); and Italy (3 percent). Id.\textsuperscript{116}

Agreement on Semifinished, supra note 111; see EC Foreign Ministers Ratify Trade Agreement Aimed at Resolving United States Citrus-Pasta Dispute, 3 INT'L TRADE REP. (BNA) 1316 (Oct. 29, 1986).

\textsuperscript{117} See supra note 99 (explaining § 301 of the Trade Act of 1974).

\textsuperscript{118} United States, Korea Settle Intellectual Property, Insurance Cases, More Talks Set with Brazil, 3 INT'L TRADE REP. (BNA) 937 (July 23, 1986) [hereinafter United States, Korea Settle Cases]. The United States Administration has made it clear that it is willing to bring additional Section 301 cases against other countries in order to open up foreign markets to United States firms. Settlement of Korean Intellectual Property, Insurance Cases Seen, But No Deal with Brazil, 3 INT'L TRADE REP. (BNA) 771 (June 11, 1986). This agreement is expected to reduce the likelihood of additional Section 301 complaints against Seoul. United States, Korea Settle Cases, supra.

\textsuperscript{119} United States, Korea Settle Cases, supra note 118.

\textsuperscript{120} Taiwan Agrees to Open Market Further to United States Insurance Firms, Move Hailed as 'Major Step', 3 INT'L TRADE REP. (BNA) 1101 (Sept. 10, 1986). Within months of the United States-Korean insurance agreement, the Taiwanese government agreed to significantly increase United States access to Taiwan's insurance market. Id.

\textsuperscript{121} Korean § 301 Intellectual Property, Insurance Cases Near Resolution, No Brazilian Deal Seen, 3 INT'L TRADE REP. (BNA) 890 (July 9, 1986). The United States has complained that under Korea's current law protection for chemicals and pharmaceuticals is limited to process patents; that United States works are not protected under Korea's copyright laws; and that it is difficult to protect trademarks because of the complex restrictions on licensing agreements. Id.
intellectual property stipulates that the Korean government will present to its National Assembly comprehensive copyright bills that will include coverage of traditional literary works, sound recordings, and computer software. In addition, Seoul will present to the legislature a bill to amend the patent laws and ease requirements on trademark licenses. Finally, the United States and Korea have agreed to establish consultative mechanisms to discuss matters covered under the agreements.

122 U.S., Korea Settle Cases, supra note 118. Seoul also plans to take steps to join the Universal Copyright Convention and the Geneva Phonograms Convention next year. Id.
123 Id. The measure will provide coverage for chemical and pharmaceutical products and for new uses of these items. On trademarks, the Korean officials have removed requirements for technology inducement as a condition for accepting applications for trademark licenses, and have repealed export requirements on goods covered by trademark licenses. Id.
124 Id. Such consultations will be held under the authority of the Korean-United States Economic Consultation Trade Subgroup. Id.
VII. AGRICULTURE

A. Citrus-Pasta Dispute

On October 27, 1986, the European Community (EC) ratified the trade agreement negotiated with the United States during the summer of 1986 concerning United States citrus fruit exports to Western Europe. The trade accord is aimed at resolving the long-standing United States Citrus-Pasta dispute with the European Community.¹

The dispute between the United States and the European Community emerged in the early 1970's when the EC lowered tariffs on citrus fruit exports from certain Mediterranean countries, claiming such to be a form of economic aid.² The dispute escalated in 1985 when the United States imposed heavy tariffs on imports of EC pasta in retaliation for alleged discrimination against its citrus fruit exports to Western Europe and a violation of the General Agreement on Tariffs and Trade (GATT).³ Early in 1986, however, the United States offered a concession in the dispute, by promising not to challenge present or future preferential trade agreements between the EC and non-EC Mediterranean countries.⁴

¹ EC Foreign Ministers Ratify Trade Agreement Aimed at Resolving United States Citrus-Pasta Dispute, 3 INT'L TRADE REP. (BNA) 1316 (Oct. 29, 1986) [hereinafter Citrus-Pasta Dispute].

² These non-EC Mediterranean countries include: Algeria, Cyprus, Egypt, Israel, Jordan, Lebanon, Malta, Morocco, Syria, Tunisia, Turkey, and Yugoslavia. EC Moves to Drop Trade Restrictions on United States Citrus and Walnuts as Pasta Dispute Settled, 3 INT'L TRADE REP. (BNA) 1024 (Aug. 13, 1986) [hereinafter EC Moves to Drop Trade Restrictions].

³ Id. The United States claimed the increased tariffs on EC pasta products were in retaliation for the EC's refusal to accept a General Agreement on Tariffs and Trade dispute panel recommendation which came out against the EC practice giving preferential access to Mediterranean citrus producers. Reagan Imposes Stiff Tariffs on Pasta Imports to Retaliate Against European Citrus Move, 2 INT'L TRADE REP. (BNA) 835 (June 26, 1985). The EC Commission has continued to block full Council consideration of the ruling, arguing that dispute panels should be “referees” and not judges of international trade disputes and that its preferential trade accords with certain Mediterranean countries are essentially political and fall outside the jurisdiction of the GATT. Citrus-Pasta Dispute, supra note 1; see EC Officials React Strongly to Letter Seeking Compensation in Citrus Dispute, 2 INT'L TRADE REP. (BNA) 835 (June 26, 1985).

⁴ Citrus-Pasta Dispute, supra note 1. The agreement states that the United States now recognizes that preferential accords “provide important opportunities for economic development and political stability in the Mediterranean region,” and that the United States consequently will not contest them as inconsistent with Article XXIV of GATT. EC Moves to Drop Trade Restrictions, supra note 2.
Under the agreement signed August 10, 1986, the Community agreed in principle to reduce tariffs on imports of certain United States citrus products, including grapefruit, lemons, certain sweet oranges, frozen orange juice, as well as almonds and roasted ground nuts. In return, the United States agreed to corresponding reductions in levies on imports of various EC food products including anchovies, cheese, satsuma oranges, olives, capers, cider, paprika, and olive oil. Following the signing of the accord, however, several citrus fruit-producing countries of the EC held up Community ratification of the accord, arguing that it could damage their agricultural industries. At the October 27 meeting of the EC foreign ministers in Luxembourg, those countries dropped their initial opposition to ratification after the EC Commission assured them that their interests would be satisfactorily addressed in managing the accord.

B. Canadian Countervailing Duty on United States Corn

In a preliminary determination announced November 7, 1986, Revenue Canada instituted a landmark countervailing duty on United States corn exports to Canada. Revenue Canada's imposition of a 67 percent tariff against United States grain corn exports to Canada is the first countervailing duty ever imposed by Canada against imports from another country, and is believed to be the first such action against the United States by one of its trading partners.

On July 2, 1986, the Canadian government formally launched a countervailing duty investigation based on a complaint by the Ontario

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5 *EC Moves to Drop Trade Restrictions, supra* note 2. The United States and the European Community failed to settle the related dispute over EC subsidies to European pasta exporters, which the EC raised by at least 200 percent after the United States imposed higher duties on imports of European pasta in 1985. *Id.*

6 *Id.* Leading the attack were Spain and Italy, the two EC countries whose products would stand to be the most affected by the settlement. Spain's concerns focused on reduced EC tariffs on imported United States almonds and citrus fruits and the allegedly insufficient guarantees of improved access to the United States market for olives and olive oil. *Spain, Italy Oppose Citrus-Pasta Accord, Threaten to Prevent Its Implementation*, 3 INT'L TRADE REP. (BNA) 1053 (Aug. 20, 1986). Italy claimed the accord would seriously damage its exports of citrus fruits, especially lemons. *Id.*

7 *Citrus-Pasta Dispute, supra* note 1.

8 *Canadian Countervailing Duty on United States Corn May Set Off Fight Against 1985 Farm Bill*, 3 INT'L TRADE REP. (BNA) 1358 (Nov. 12, 1986) [hereinafter *Canadian Countervailing Duty*]. Canada's Agriculture Minister stated the landmark countervailing duty could form the basis for further challenges of subsidies provided by the United States under the 1985 Omnibus Farm Bill and Food Security Act of 1985. *Id.*
Corn Producers Association. The Association alleged subsidies on United States corn harmed Canadian production and forced reduced returns to producers, suppression of prices, loss of market share and export sales, and increased pressure on Canadian government agricultural support programs.9

Revenue Canada announced its preliminary determination finding that the United States subsidizes corn exports, and such subsidies cause material injury to the production of like goods in Canada.10 In its decision, Revenue Canada considered a large number of programs provided by the United States government and by the state governments of corn-producing states.11 Of these programs, five were found to confer a significant subsidy on corn in violation of the General Agreement on Tariffs and Trade, most notably the United States government’s Feed Grain Program.12

C. United States—EC Interim Agreement on Farm Trade

On July 2, 1986, the United States Administration announced that a provisional agreement had been reached between the United States and the European Community concerning agricultural trade with Spain.13 The agreement temporarily resolves the dispute which erupted earlier in the year when Spain, upon accession to the EC, replaced

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9 Countervailing Duty Investigation Launched to Determine if United States Corn Exports Subsidized, 3 Int’l Trade Rep. (BNA) 893 (July 9, 1986).
10 Canadian Countervailing Duty, supra note 8. The preliminary determination by Revenue Canada will be considered by the Canadian Import Tribunal, which will have up to 120 days to determine whether the subsidized corn is causing material injury to Canadian producers. Id.
11 Revenue Canada considered 64 United States federal government programs and programs operated by 14 state governments. Id.
12 Id. The Feed Grain Program is comprised of commodity loans and purchases, deficiency payments, diversion payments, and Commodity Credit Corp.’s general and administrative expenses and acreage limitation. The other federal programs allegedly violating the GATT include the Great Plains Conservation Program, Storage Facilities and Equipment Loans, Reserve Storage Payments, and the Federal Crop Insurance. In its Statement of Reasons, Revenue Canada explained that these United States subsidy programs for grain corn have created overproduction and high inventories in the United States. These conditions have forced a significant decline in the United States price for grain corn while the subsidy programs have protected American producers from the deflated prices. Id.
its system of fixed tariffs with the EC's system of variable levies.14

Under the July 1986 accord, the EC agreed to a six-month delay in the imposition of higher tariffs on United States agricultural exports to Spain.15 The Community also agreed to guarantee the purchase of a quota of certain United States agricultural products at reduced tariff levels.16 In return, the United States agreed to postpone plans to institute retaliatory tariffs effective July 1, 1986, on a variety of EC products.17 Attempts to reach an overall settlement of the dispute will continue within the General Agreement on Tariffs and Trade.18

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14 United States-EC Farm Trade Agreement, supra note 13. Under the EC enlargement agreement to include Spain and Portugal, effective January 1, 1986, both countries were required to replace their system of fixed tariffs with the EC's system of variable levies on March 1, 1986. See United States Protests March 1 Date For Import Levies on Agricultural Shipments to Spain, Portugal, 3 INT'L TRADE REP. (BNA) 236 (Feb. 19, 1986) [hereinafter United States Protests Import Levies].

15 United States-EC Farm Trade Agreement, supra note 13. The agreement allows United States exports of corn and sorghum to Spain to continue while further negotiations are conducted under the General Agreement on Tariffs and Trade. White House Statement, supra note 13. The EC's system of variable import levies averages over 100 percent on imports of corn and sorghum. They represent increases from levels as low as 20 percent under the fixed tariff system, and have the effect of shutting the United States out of the Spanish market for these agricultural products. The United States has demanded compensation for lost sales, estimated at up to $600 million annually. United States-EC Farm Trade Agreement, supra note 13.

16 United States-EC Farm Trade Agreement, supra note 13. According to the agreement, if United States imports to Spain of corn, sorghum, corn gluten feed, distiller draft, and citrus pellets between July and the end of 1986 fall below 234,000 tons per month "the Community will take the necessary measure to permit the import into the EC of the shortfall by means of a reduced-levy quota." If imports to Spain fail to reach the specified level, the EC will reduce levies to guarantee the sale of corn to other EC countries to make up the shortfall in sales to Spain. Id.

17 White House Statement, 22 WEEKLY COMP. PRES. DOC. 573 (Apr. 7, 1986). On March 31, 1986, President Reagan had announced his intention to take retaliatory action absent progress in negotiation, including import quotas and tariff increases which would have affected white wine, beer, liquor, cheese, vegetables, chocolate, candy, and fruit juices. See United States-EC Farm Trade Agreement, supra note 13.

18 The United States argues the implementation of the variable levies system without negotiations on compensation for possible trade loss would be a violation of Article XXIV of GATT.
VIII. INTELLECTUAL PROPERTY

A. United States Implements Chapter II of the Patent Cooperation Treaty

Legislation requested by the Reagan Administration to implement Chapter II of the Patent Cooperation Treaty was enacted by Congress on October 17, 1986. The treaty, to which the United States and thirty-eight other countries are parties, provides for a centralized filing procedure and a standardized application simplifying the process of patenting the same invention in different member nations. The United States ratified the Treaty with reservations on November 27, 1973. The reservations dealt with Chapter II of the Treaty. Chapter II gives a patent applicant a total of 30 months before the applicant must decide whether to proceed with national patent protection in the individual member countries. Secondly, it provides for an international preliminary examination report on the patentability of the invention.

Citing progress in the "harmonizing [of] patent application and processing procedures around the world," the lack of which was a

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5 Id.
7 28 U.S.T. 7645 (Presidential Proclamation that "[u]nder Article 64(1)(a), the United States shall not be bound by the provisions of Chapter II of the Treaty.")
basis for the 1973 reservations to Chapter II, the Senate gave its advice and consent to withdraw the reservation on Chapter II of the Treaty. Congress later established new domestic legislation in conformity with that action.

The Act will become effective as domestic law on the same date that Chapter II of the treaty enters into force with respect to the United States. Under article 64(6)(b) of the treaty the date of entry into force will occur three months after the date of notification of the withdrawal of the reservation is received by the Director General of the World Intellectual Property Organization.

B. Gray Market Goods Litigation

In Coalition to Preserve the Integrity of American Trademarks v. United States, the Court of Appeals for the District of Columbia Circuit held that Customs Service regulations permitting the importation of "gray market" goods manufactured by a foreign company

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12 Id. at § 9.
14 790 F.2d 903 (D.C. Cir. 1986) [hereinafter COPIAT].
15 A good working definition of "gray market goods" is found in the Court of Appeals decision in COPIAT:

These are goods manufactured abroad bearing legitimate foreign trademarks that are identical to American trademarks. This situation typically arises when a foreign producer creates an American subsidiary which then registers the American trademark. Both the Foreign producer and its American subsidiary often wish distribution in the United States to be exclusively controlled by the American subsidiary. If, however, the price at which the American subsidiary sells the good exceeds the price at which the goods are sold abroad, other importers have an obvious incentive to purchase the goods abroad (typically from a third-party who has legitimately purchased directly from the foreign producer) and resell them in the United States — perhaps without certain associated services or warranties — at a price below that charged by the American subsidiary.

COPIAT, 790 F.2d at 904; see also Olympus Corp. v. United States, 792 F.2d 315, 317 (2d Cir. 1986), aff'g, 627 F. Supp. 911 (E.D.N.Y. 1985).
related to the United States trademark holder violates the statutory restrictions against nonconsentual importation of trademarked goods found in 19 U.S.C. § 1526(a), and are therefore invalid.\textsuperscript{16}

The plaintiff, Coalition to Preserve the Integrity of American Trademarks (COPIAT)\textsuperscript{17}, a trade association, brought suit against the United States\textsuperscript{18} seeking to compel the Customs Service to exclude certain gray market goods from the United States. COPIAT claimed Customs Service regulations\textsuperscript{19} permitting the nonconsentual importation of goods manufactured by a foreign company related to the United States trademark holder conflicted with the broad prohibition against the importation of trademarked goods without the consent of the United States trademark holder found in 19 U.S.C. § 1526(a),\textsuperscript{20} and were therefore invalid.

\textsuperscript{16} COPIAT, 790 F.2d at 905.

\textsuperscript{17} The Coalition to Preserve the Integrity of American Trademarks (COPIAT) is a trade association and lobbying group whose membership includes United States manufacturers and distributors of trademarked products. The stated legislative interests of the group are "[those] issues relating to the importation of items bearing U.S. trademarks." See COPIAT, 790 F.2d at 904; see generally 1984 CONG. Q. ALMANAC, 8-D (1984) (COPIAT's registration as a Congressional lobbying group).

In addition to COPIAT, two individual members of the group, Cartier, Inc. and Charles of the Ritz Group Ltd. joined as plaintiffs in the suit. See COPIAT, 790 F.2d at 904.

\textsuperscript{18} Additional named defendants included Donald T. Regan, Secretary of Treasury, and William Van Raab, Commissioner of the United States Customs Service. Id.

In addition to the above named defendants, 47th Street Photo, a discount retailer of camera and video equipment, and K-Mart Corporation (K-Mart), a mass merchandiser and retail operator joined the suit as intervener-defendants. Id. Both interveners were engaged in importing gray market goods and thus had a substantial interest to be protected in the litigation. Id.; Wall St. J., May 7, 1986, at 44, col. 3.

\textsuperscript{19} The Customs Service regulations found at 19 C.F.R. § 133.21 (c)(1)-(3) provide that restrictions relating to the importation of trademarked goods do not apply where:

- (1) Both the foreign and the U.S. trademark or trade name are owned by the same person or business entity;
- (2) The foreign and domestic trademark or trade name owners are parent and subsidiary companies or are otherwise subject to common ownership or control (see §§ 133.2(d) and 133.12(d)).
- (3) The articles of foreign manufacture bear a recorded trademark or trade name applied under authorization of the U.S. owner.

19 C.F.R. § 133.21(c)(1)-(3) (1986).

\textsuperscript{20} 19 U.S.C. § 1526(a), the statute upon which Plaintiff relies and which is generally recognized as applicable, provides as follows:

(a) Importation prohibited

Except as provided in subsection (d) of this section, it shall be unlawful to import into the United States any merchandise of foreign manufacture
The Court of Appeals, reversing the district court which found the Customs service regulations to be a valid interpretation of 19 U.S.C. § 1526(a), found that Congress intended the protections of 19 U.S.C. § 1526(a) to be broadly applied and that the exceptions created by the Customs Service regulations were therefore invalid. In so finding, the court rejected Custom Service assertions that it possessed the authority to interpret § 1526(a) under its regulatory powers, finding that the regulations conflicted with Congress' intent to broadly protect trademark holders and were therefore invalid. The court also rejected claims that Congress had legislatively acquiesced in the Custom Services interpretation of § 1526(a) by not addressing that interpretation.


21 COPIAT, 598 F. Supp. 844 (D.D.C. 1985). The district court in COPIAT found:

It is clear from the existing regulations [19 C.F.R. § 133.21], that the Customs Service, as the agency charged with the administration of the law pertaining to . . . imports, has chosen to protect the owners of . . . trademarks against imports of goods bearing genuine trademarks . . . only in those instances in which the owners have not authorized the application of the trademark abroad. . . . To the contrary, in those instances in which owners have authorized the application of the trademarks abroad, the Customs Service has not affected protection. The Customs Service interpretation of the statute . . . is long standing and consistent.

Id. at 852. Based upon this finding the district court held the regulations to be valid. Id.

22 COPIAT, 790 F.2d at 913 ("Section 526 [§ 1526] confers an absolute, unqualified property right upon American companies."); see generally 64 CONG. REC. 11, 602-05 (1922) (Senate debate on Section 526).

23 COPIAT, 790 F.2d at 913 ("In light of the language of the statute, its legislative history and purpose, . . . we conclude that Section 526 cannot be limited in the manner that Custom's has attempted.")

24 Id. at 908. In support of the proposition that the ultimate power of statutory interpretation lies with the judiciary, the COPIAT court cited the United States Supreme Court's decision in Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc. holding: "[t]he judiciary is the final authority on issues of statutory construction and must reject administrative constructions . . . contrary to congressional intent." Id. at 905 n.5 (citing Chevron, U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 843 (1984)).

25 COPIAT, 790 F.2d at 916.
while Congress amended the trademark protection legislation. Based upon these findings the court held that plaintiffs were entitled to a declaratory judgment that the Customs Service regulations in question are contrary to § 1526(a) and are therefore unlawful.

The decision of the District of Columbia Circuit Court added to the group of conflicting decisions on the validity of the Customs Service regulations, as such, the United States Supreme Court granted certiorari to hear this case and resolve the issue.

C. Unauthorized Importation of Lawfully Produced Book Prohibited by § 602 of the Copyright Act

In a case of first impression, a federal district court in *Hearst Corp. v. Stark* held that section 602 of the Copyright Act bars the unauthorized importation of books lawfully produced abroad. Plaintiffs, a group of publishers, were assignees of the United States copyrights on some eighteen literary works. In addition to being published in the United States the titles were also lawfully published in the United Kingdom under that country's copyright laws.  

26 *COPIAT*, 790 F.2d at 917 (Congress has no duty to correct inconsistent administrative interpretations). Specifically, the court rejected the appellee's assertion that Congress ratified the Customs regulations in 1978 by not changing "a well known administrative interpretation" when it enacted the Customs Reform and Simplification Act. *Id.* (Congress merely amended the statute, so no adoption occurred.)

27 *COPIAT*, 790 F.2d at 918.

28 *COPIAT*, 790 F.2d at 905. The *COPIAT* decision conflicts with the decision of other circuits addressing the issue of the validity of the Customs Service regulations. See *Vivitar Corp. v. United States*, 761 F.2d 1552 (Fed. Cir. 1985); *Olympus Corp. v. United States*, 792 F.2d 515 (2nd Cir. 1986).


31 Section 602(a) of the Copyright Act of 1976 provides in pertinent part:

- Importation into the United States, without the authority of the owner of the copyright . . . of copies . . . of a work that have been acquired outside the United States is an infringement of the exclusive right to distribute copies . . . under section 106, [and is] actionable under section 501.

17 U.S.C. § 602(a) (1976). Section 501 provides that anyone who violates any of the exclusive rights of the copyright owner as provided by section 106, or who imports copies into the United States in violation of section 602, is an infringer of the copyright. *Hearst*, 639 F. Supp. at 975.

32 *Hearst*, 639 F. Supp. at 970.

33 *Id.* at 972. The works included The Oxford American Dictionary among others. *Id.* at n.3.

34 *Id.* at 972.
fendant, a bookseller, purchased the books in issue from a United
Kingdom wholesaler and then imported and sold the books in the
United States.\textsuperscript{35} Hearst filed suit for infringement based on a violation
of 17 U.S.C. § 602, seeking injunctive relief and monetary
damages.\textsuperscript{36} Stark asserted several defenses to the application of the statute,
namely: (1) section 602 should not apply to defendant's importation
of books legitimately produced outside the United States, (2) the
"first sale rule" protects the defendant's activities, and (3) section
602, if applicable, violates the First Amendment of the Constitution.\textsuperscript{37}

Addressing the defendant's first assertion, the court, after exam-
inining the statutory framework of the Copyright Act and section 602's
legislative history held "section 602 clearly provides that it is an
infringement of United States copyrights for books that have been
acquired outside the United States, however lawfully, to be imported
into the United States."\textsuperscript{38} Examining the defendant's claim that the
"first sale rule"\textsuperscript{39} precludes the application of section 602 in the case;
the court denied the rule's applicability to cases under section 602
in light of Congress' intent by section 602 to preclude the importation
of copyrighted works lawfully produced elsewhere.\textsuperscript{40} Further, the court
found that even if the "first sale" doctrine was to be applied to
section 602 in general, it is to be applied narrowly only encompassing
the sale of a particular copy of a work and not, as is the case here,
the sale of large quantities of copyrighted works.\textsuperscript{41}

\textsuperscript{35} Id.
\textsuperscript{36} Id. at 973. Hearst alleges the distribution of the eighteen titles, to which it
claims exclusive United States distribution rights, violates 17 U.S.C. § 602 by in-
fringing on a right to distribute and under 17 U.S.C. § 601 derivitively infringes
on the copyright to those titles. Id.
\textsuperscript{37} Id. at 975; see also Nintendo, Inc. v. Elcon Indus. Inc., 594 F. Supp. 937,
943-44 (E.D. Mich. 1982) (Copyright infringement to import video game circuit
boards lawfully produced in Japan).
\textsuperscript{38} \textit{Hearst}, 639 F. Supp. at 975. In reaching its conclusion, the court first examined
the statutory language of section 602 finding, "it is apparent from the words of
the statute 'copies', 'work', and 'copyright', that the section can apply to books as
well as to other forms of artistic expression." Id. While finding no ambiguity in
the language of section 602, the court went on to state its belief that Congress did
not intend to provide an exception to the prohibitions of section 602 for books
lawfully produced outside the United States. \textit{Id.}
\textsuperscript{39} The "first sale rule" provides in pertinent part: notwithstanding section 106,
the owner of a particular copy of a work which is lawfully made may sell that copy
without the authority of the owner of the copyright. 17 U.S.C. § 109(a) (1982)
(emphasis added).
\textsuperscript{40} \textit{Hearst}, 639 F. Supp. at 977.
\textsuperscript{41} Id.
In considering the defendant’s constitutional claim, the court set out to strike a balance between the First Amendment rights of the public and the copyright owners rights under the Copyright Act which was enacted under the authority of Article I, section 8 of the Constitution. Noting the absence of any cases which invalidated any section of the Copyright Act on First Amendment grounds, the court cited with approval Congress’ effort to strike a balance of rights in the form of section 602 of the Copyright Act. The court ultimately found that section 602 did not infringe upon First Amendment rights, but rather encouraged and protected such rights.

The court granted Hearst’s motion for summary judgment finding that defendants infringed on Hearst’s copyright by violating the import restrictions of section 602, and awarded both injunctive relief and monetary damages to the plaintiff.

D. Showing of Patent Infringement Sufficient for § 337 Complaint

In Corning Glass Works v. International Trade Commission, the Court of Appeals for the Federal Circuit held the injury requirement of section 337 of the Tariff Act of 1930 satisfied by a mere showing

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42 Stark contended that some of the imported books were out of print in the United States thereby making them unavailable except for the defendants importation of those titles. On this basis the defendant assert First Amendment grounds for allowing the books to be distributed. Hearst, 639 F. Supp. at 977.

43 Id. Article I, Section 8 of the United States Constitution provides that: The Congress shall have Power . . . to promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries. U.S. CONST. art. 1. § 8.

44 Hearst, 639 F. Supp. at 977-78 (citing Nimmer on Copyright, § 1.10[B][2]

45 Hearst, 639 F. Supp. at 978. The court reasoned that section 602 preserved the copyright owner’s right to “retain creative control” over his work, thus ultimately promoting free expression. Id.

46 Id. at 982.


48 Section 337 states: Unfair methods of competition declared unlawful.

49 Unfair methods of competition and unfair acts in the importation of articles into the United States, the effect or tendency of which is to destroy or substantially injure an industry, efficiently and economically operated in the United States, are declared unlawful, and when found
of patent infringement resulting from the importation of the goods which the plaintiff sought to exclude.\textsuperscript{50}

The petitioner, Corning Glass Works (Corning), a domestic manufacturer of optical waveguide fibers,\textsuperscript{51} sought to exclude certain optical waveguide fibers, manufactured in Japan, from importation into the United States.\textsuperscript{52} The International Trade Commission (ITC) determined the imported fibers did in fact infringe on Corning's patents, yet refused to order exclusion of the goods.\textsuperscript{53} The commission based its refusal to exclude the good on a lack of any showing by Corning that the goods had "any effect, or tendency to destroy or substantially injure" a domestic industry.\textsuperscript{54}

On appeal to the Federal Circuit, Corning asserted the ITC erred at law in its interpretation of the substantial injury requirement.\textsuperscript{55} Corning asserted the proper test for determining injury under section 337 to be "whether the acts of the infringer have resulted, or will result in, 'conceivable losses of sales.'"\textsuperscript{56} Addressing Corning's "conceivable loss" assertion, the court first recognized the non-binding effect of an agency's statutory interpretation upon the court, but went on to note the propriety of deference by the court to such an

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\textsuperscript{50} Corning, 799 F.2d at 1572.

\textsuperscript{51} Corning Glass holds United States patents on both the product and process of production of optical waveguide fibers which are presently in great demand by the telecommunications industry. \textit{Id.} at 1562-63.

\textsuperscript{52} Corning's complaint initiated an ITC investigation in April of 1984. \textit{Id.} Corning sought to exclude, under section 337, optical waveguide fibers produced by the Sumitomo Electronics Industries of Japan and distributed in the United States by Sumitomo Electric U.S.A. \textit{Id.}

\textsuperscript{53} The ITC, through an administrative law judge, found that Sumitomo infringed Corning's patents. \textit{Id.} at 1563. The Commission, however, noted that the market for optical waveguide fibers was burgeoning and that domestic production could not be expanded to meet the demand. \textit{Id.} at 1564. The Commission further determined that Sumitomo's market share from imports to be "well under 1%." \textit{Id.}

\textsuperscript{54} Corning, 799 F.2d at 1564.

\textsuperscript{55} Corning, 799 F.2d at 1564-65. The court rejected as misdirected the petitioners statement of issues on appeal which sought a review of the factual findings of the Commission. \textit{Id.} at 1564. The court defined its proper function in reviewing the ITC's interpretations to be deciding "whether the Commission's definitions or standards are reasonable in light of the language, policies, and legislative history of the statute." \textit{Id.} at 1565 (emphasis in original) [cits. omitted].

\textsuperscript{56} Corning, 799 F.2d at 1568.
interpretation where the agency is charged with administering the statute at issue.57

The court determined that Congress intended the "extreme and internationally provocative remedy" contemplated under section 337 to be implemented "only when [it] is compelled by strong economic reasons."58 Accordingly, the court held that section 337 did not function as a mere extension of private rights under the patent statute, but required both an infringement and independent proof of distinct injury to a domestic market.59

While rejecting Corning's proposed test as "statutorily impermissible" the court refused the opportunity to establish a judicial standard of the proper quantum of injury that must be shown in order to gain relief under section 337.60 In the absence of a judicially established standard, the court deferred substantial injury decisions to the ITC citing the agency's expertise and statutory responsibility in the subject area.61 The court went on to enunciate the proper scope of review of ITC decisions by the court as "whether the commission's decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment."62

57 Corning, 799 F.2d at 1565 (citing United States v. Riverside Bayview Homes, Inc., 106 S. Ct. 455, 461 (1985)).
58 Corning, 799 F.2d at 1566 (citing S. REP. No. 1298, 93rd Cong., 2d Sess. 199 (1974)).
59 Corning, 799 F.2d at 1567.
60 Corning, 799 F.2d at 1568.
61 Id.
62 Id. (citing Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 416 (1971)).
IX. JURISDICTION

A. California Supreme Court Finds Non-Resident Component Part Manufacturer Subject to Long-Arm Jurisdiction

In *Asahi Metal Industry Co. v. Superior Court of Solano County,* the California Supreme Court, reversing a state appellate court, held that a non-resident manufacturer of component parts making no direct sales in the state, but which could foresee the components they manufactured being incorporated within a finished product sold in California was subject to the long-arm jurisdiction of the California courts.

The case arose out of a products liability action brought against Cheng Shin, a Taiwanese motorcycle tire manufacturer. Cheng Shin sought to cross-claim against Asahi, a Japanese manufacturer of tire valve assemblies incorporated into Cheng Shin tires, seeking indemnity in the original action. Asahi moved to quash service of process based on a lack of jurisdiction citing the lack of any direct contacts with California, the forum state.

On appeal, the California Supreme Court reversed an appellate court decision granting a writ of mandamus which ordered the trial court to quash service of summons against Asahi. A majority of the California Supreme Court found the minimum contacts test set

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2 *Asahi Metal Indus. Co. v. Superior Court of California, Solano County, 194 Cal. Rptr. 741 (Cal. Ct. App. 1983).*
3 *Asahi, 39 Cal. 3d at 35, 702 P.2d at 543, 216 Cal. Rptr. at 385.*
4 *Id.* California law allows a defendant in a negligence action to file a cross-complaint for comparative indemnity. *See* American Motorcycle Assoc. v. Superior Court of Los Angeles County, 20 Cal. 3d 578, 578 P.2d 899, 146 Cal. Rptr. 182 (1978). The case against Cheng Shin, the tire manufacturer, and other defendants was settled and dismissed, leaving only Cheng Shin's third party action for indemnity. *Arguments Made to Supreme Court on Reach of State Jurisdiction Over Foreign Producer,* 3 INT'L TRADE REP. (BNA) 1365, 1366 (Dec. 12, 1986) [hereinafter *Arguments*].
5 *Asahi, 194 Cal. Rptr. at 742.* Asahi's president asserted that Asahi had no office, agents, or employees in California, that it maintained no spare parts and gave no advice on maintenance, sales, or use in California, nor did it advertise or solicit business or own property in California. *Id.* at 743.
6 *Asahi, 39 Cal.3d at 48, 702 P.2d at 556, 216 Cal. Rptr. at 398.*
forth in *World-Wide Volkswagen v. Woodson* and its progeny had been satisfied, thus supporting jurisdiction over Asahi in California.\(^7\)

The majority held minimum contacts established where a non-resident component parts manufacturer had substantial indirect business in the state as a result of the incorporation of its products within a finished product known to be sold in the forum state.\(^8\)

On March 3, 1986 the United States Supreme Court granted certiorari\(^9\) to hear the case.\(^10\)

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\(^7\) *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286 (1980).

\(^8\) *Asahi*, 39 Cal.3d at 48, 702 P.2d at 556, 216 Cal. Rptr. at 398.

\(^9\) Id. The court based its decision on the foreseeability that Asahi's valves would enter California. Id. ("Given the substantial nature of Asahi's indirect business with California, and its expectation that its product would be sold in the state, Asahi should reasonably have anticipated begin haled into court here.") In addition to the minimum contacts test of *World-Wide Volkswagen* the court addressed the "stream of commerce" theory established in *Gray v. American Radiator & Standard Sanitary Corp.* Id. (citing Gray v. American Radiator & Standard Sanitary Corp., 22 Ill. 2d 432, 176 N.E.2d 761 (1961)). The court found Asahi's knowledge that its valves would be incorporated into a finished product sold in California to be analogous to the manufacturer in *Gray* who had knowledge of the distribution system organized to sell its products. Id. at 49. ("Although Asahi did not design or control the distribution system which ultimately brought its products to California, it knew of, and derived economic benefit from that system.")

\(^10\) *Asahi*, 106 S. Ct. 1258. Questions presented to the Supreme Court are: (1) Is mere awareness of Japanese manufacturer that substantial number of Taiwanese manufacturer's finished products are sold in California adequate to establish requisite contacts giving California court personal jurisdiction over it? (2) Is requisite interest of California established by declared intention of California Supreme Court to apply California law to relationship and transactions of two alien manufacturers and by assertion of consequential interest in orderly administration of California laws? Id., *California's Assertion of Jurisdiction over Foreign Part Producer Will be Reviewed*, 3 INT'L TRADE REP. (BNA) 309, 310 (Mar. 5, 1986). The oral arguments on the case were heard on November 5, 1986. See Arguments, supra note 4.

\(^11\) [Eds. Note: Subsequent to the time period covered by this survey, the United States Supreme Court reversed the decision of the California Supreme Court in this case. *Asahi Metal Industry Co., Ltd. v. Superior Court of California, Solano County*, 107 S. Ct. 1026 (1987).]

In an opinion written by Justice O'Connor, a majority of the Court rejected the California court's holding that minimum contacts are satisfied by a showing of foreseeability on the part of a manufacturer that its products will make their way into the forum state. Id. at 1032-33. Rejecting the foreseeability test, a plurality of the Court endorsed the "purposeful availment" test first enunciated in *Burger King Corp. v. Rudzewicz*, 471 U.S. 462 (1985), as the proper test of jurisdictional contacts required to satisfy the Due Process clause. Id. at 1033 ("The 'substantial connection,' between the defendant and the forum state necessary for a finding of minimum contacts must come about by an action of the defendant purposefully directed toward the forum state.") (emphasis original). The Court held "[t]he placement of a product into the stream of commerce, without more, is not an act of the defendant pur-

In Lannom Manufacturing Co., Inc. v. International Trade Commission, the Court of Appeals for the Federal Circuit held that the International Trade Commission (ITC) is not authorized to determine the validity of a patent in a section 337 action where the defense of invalidity has not been raised.

Lannom Manufacturing Company ("Lannom") filed a complaint with the ITC under section 337 of the Tariff Act of 1930, alleging the importation of certain softballs infringed on a patent held by Lannom. Only one of the named respondents, Diamond Sports, filed a response to the complaint, alleging the invalidity of Lannom's patent barred any infringement action. A settlement reached between Lannom and Diamond Sports terminated the investigation as to Diamond Sports.

At a subsequent hearing, Lannom, relying upon the presumptive validity of its patent, sought default judgments against the remaining
respondents. Rejecting the motion for default judgment, the administrative law judge found Lannom’s patent claims invalid, thus preventing any infringement actions. After a review, the full Commission upheld the administrative law judge’s decision.

On appeal to the Federal Circuit, Lannom asserted that the ITC erred in finding the patents invalid where none of the respondents raised the defense of invalidity available under section 337(c). Lannom asserted that in the absence of a defense of invalidity, the presumption of validity set out in 35 U.S.C. § 282 controls and validity of the patent should not be in issue.

The court, upholding Lannom’s position, rejected the ITC’s assertion that under the Trade Act of 1974 the Commission, in the public interest, must investigate the validity of every patent brought before it for enforcement. The court held the proper scope of the ITC’s authority to be narrower than the view espoused by the Commission. In support of its holding the Court cited a Senate Report

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A patent shall be presumed valid. Each claim of a patent . . . shall be presumed valid independently of the validity of other claims. . . . The burden of establishing invalidity of a patent or any claim thereof shall rest on the party asserting such invalidity.


Lannom, 799 F.2d at 1574. At the initial hearing only Lannom and an ITC investigatory attorney appeared before the administrative law judge. The role of the ITC attorney, under 19 C.F.R. § 210.4(b) & (c), is to represent the Commission as an impartial investigator. The ITC attorney has no client, and presents no affirmative case.

Id. at 1514. The ALJ found Lannom’s patents were invalid for their failure to comply with 35 U.S.C. §§ 103 and 112. Sections 103 and 112 require that a product seeking to be patented must be “distinct” and a “non-obvious” enhancement of the prior art. See 35 U.S.C. §§ 103 and 112 (1982 & Supp. III 1985).

Lannom, 799 F.2d at 1574-75. The Commission asserted that its authority to determine the validity of all patents brought before it lies in the fact that section 337 is a trade statute, not “merely” a patent statute, and as such the public interest required that all patents be tested. Id. at 1575.


Trade Act of 1974, Pub. L. No. 93-618, 88 Stat. 1978 (1975). The Trade Act expanded the authority of the Commission in section 337 actions by adding § 1337(c) which states in pertinent part: [t]he commission shall determine . . . whether or not there is a violation of this section. All legal and equitable defenses may be presented in all cases.” Id.

Lannom, 799 F.2d at 1579. The Commission posited that in order to accept the Commission’s view on the proper scope of its authority, the court must find that Congress intended the 1974 Act to expand the Commission’s authority to review patent validity beyond the power granted to the district courts to effect such a review. Id. at 1576.

Id.
on the Trade Act\textsuperscript{28} which stated "[in] reviewing the validity and enforceability of patents, for the purposes of section 337, [such should be done] in accordance with the contemporary legal standard when such issues are raised."\textsuperscript{29}

Based on its finding that the ITC did not possess authority to \textit{sua sponte} invalidate patents, the court held "[i]n actions before the Commission as in courts . . . [a patent] . . . is presumptively valid, and its validity need not be reestablished if validity is not raised as a defense in a section 337 action."\textsuperscript{30}

\textit{Paul G. Justice}

\textit{Hilda H. King}

\textit{John R. Schneider}


\textsuperscript{29} Lannom, 799 F.2d at 1577 (citing Senate Report, at 196) (emphasis original).

\textsuperscript{30} Lannom, 799 F.2d at 1578-79.