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Couseling Mexican Exporters to the United States

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COUNSELING MEXICAN EXPORTERS TO THE UNITED STATES*

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I. El Derecho Ajeno

On 21 March 1806, in the village of San Pablo Guelatao, was born one of the greatest statesmen of our hemisphere. From his parents, who died when he was three years old, he learned a powerful truth. They taught it to him in Zapotec: "*La hrappá tizháa tangá que beneê tan gáana lá a llaágna.*" When he was twelve he began to learn Spanish, and proudly translated his powerful truth into a sentence that has coalesced with his memory: "*El respeto al derecho ajeno es la paz.*"[1]

"Peace is respect for the rights of others." That is the way we usually express, in our language, the powerful truth of Benito Juárez. But it has also another, simpler meaning. The *Real Academia* tells us that *respeto* means not only "respect" but "consideration," that *derecho* is also "law," *ajeno* means "far away," and *paz* can be rendered as "tranquility." It does little violence to Juárez's sentence to say: "Peace of mind comes from paying attention to the foreign law."

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1. The anecdote and Zapotecan equivalent are from Germán Arciniegas, America in Europe 161.

That rendering of Juárez's truth is the golden rule for counseling Mexican exporters to the United States. Superficially such a rule seems unnecessary. Those Mexican exporters are sophisticated men and women, thoroughly acquainted with the North American world, who drive General Motors, dress Brooks Brothers, and vacation Disneyland as naturally as their Yankee colleagues. Films and television have saturated their minds, like ours, with the lifestyle projections of Hollywood and Madison Avenue. The exporters are therefore incredulous when their U.S. lawyer suggests that they have more to learn about U.S. culture.

Nevertheless, the superficial similarities in style and taste between Mexico and the United States mask profound cultural differences that are powerfully replicated in their brusquely incongruous legal systems. Therefore, the only way for the Mexican exporter to achieve peace of mind is to pay careful attention to the *derecho ajeno*—in particular, to six adamant aspects of foreign law in the export market of the United States. Three of those aspects are similar to what the exporter's Mexican business environment taught him to expect. The other three are so dissimilar as to constitute fierce cultural shocks.

II. Litigiousness

The fiercest cultural shock the Mexican exporter encounters in the U.S. market is its sheer litigiousness. That characteristic of U.S. society has grown, in two centuries, from a quaint rambunctiousness to an immense social and economic malaise. Ninety percent of all civil jury cases in the world are tried in the United States; we spend $30 billion dollars a year just suing each other.[2] Between 1975 and 1985, U.S. liability awards in general rose 401%, and the number of product liability cases before our federal courts increased by 1,000%.[3]

Mexico is not like that. In Mexico civil actions do not go to juries, liability awards are typically for trifling sums, and, most significantly, serious public issues are resolved, not by litigation, but by political pressure and economic clout. Therefore, the export executive is unprepared for the hair-trigger resort to litigation and the devastating jury awards of the United States.

Anticipating and defending against those risks is a principal objective of the export structure—the interrelated configuration of

2. Address by L. A. Iacocca to the American Bar Association, San Francisco, California, at 9 (August 10, 1987).
3. *Id.*

corporations and contracts by which the Mexican enterprise achieves its presence in the U.S. market.[4] Essentially the structure's strategy is to wall off the main Mexican enterprise from involvement in the United States. Thus, the manufacturing source of the product and its facilities for distribution in Mexico continue to function in—and only in—Mexico. Operations in the United States are restricted to a separate subsidiary corporation whose function is to limit the liability of the manufacturing parent to the resources it has invested in that subsidiary.

The manufacturing parent and its export subsidiary are related only by share ownership and by contracts consistent with their roles. Thus, the parent contracts to supply the subsidiary, in Mexico, with export products; the subsidiary exports the products, warehouses them as needed in the United States, and resells them to distributors, dealers or consumers, directly or through consignees.

Among the guidelines to consider in planning such an export structure are the jurisdictional laws of the states in which the export subsidiary will resell. A broadly inclusive example is the Texas Long-Arm Statute,[5] which subjects to suit in Texas any foreign corporation that (1) "contracts by mail or otherwise with a Texas resident and either party is to perform the contract in whole or in part in this state," (2) "commits a tort in whole or in part in this state," or (3) "recruits Texas residents, directly or through an intermediary located in Texas, for employment inside or outside this state." To the extent possible only the export subsidiary, and not the manufacturing parent, is allowed to engage in any activity that could be caught in those jurisdictional jaws.

In the few reported cases that dealt with foreign corporate exporters to Texas, preliminary sales operations and spot intrastate sales of detained goods, but not export sales made by sporadic local sales solicitation, were held sufficient to support local jurisdiction. Cases that sustained local jurisdiction in the analogous situation of interstate sales to Texas have considered it jurisdictionally sufficient for the seller to maintain a sales representative in Texas, negotiate or conclude sale contracts in Texas, or perform sales-related functions in Texas. Mere interstate delivery, however, is traditionally not enough.

4. Discussed in Checklist § 1(a).
5. Cited and discussed in Checklist § 1(b).

There are two other helpful resources for delineating the contractual perimeters between manufacturing parent and export subsidiary. One is *Incoterms*, the International Chamber of Commerce's rules for the interpretation of basic trade terms. The second is the Vienna Convention on the International Sale of Goods. The adherence of Mexico to the Convention is not effective until January 1, 1989, and the adherence of the United States is subject to the reservation that the Convention will not automatically apply, by rules of private international law, between a U.S. resident and the resident of a non-adhering nation. Nevertheless, the Convention may be incorporated by reference in Mexico-U.S. contracts or usefully consulted as a check-list for their provisions.

When disputes cannot be avoided, they can at least be diverted to modes of confrontation less problematical than lawsuits at unexpected venues. This is one of the rare problem areas in which there is a helpful treaty relationship between Mexico and the United States. Both nations adhere to the U.N. Arbitration Convention of 1958, and thus are reciprocally obliged to enforce agreements to arbitrate and to recognize arbitration awards. This permits the export subsidiary to require, by carefully drawn arbitration clauses, that disputes arising under its commercial contracts be resolved exclusively by arbitration.

In the sober aftermath of Bhopal we realize, of course, that some liabilities will pierce the most meticulously constructed corporate and contractual veils. The most ruthlessly penetrating is product liability.[6] Against it, the only safe precaution is for the export subsidiary to obtain, or require its distributors to obtain, product liability insurance that protects both the export subsidiary and its Mexican manufacturing parent.

The principal product liability guidelines are two recent decisions of the United States Supreme Court. *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286 (1980), permitted product liability jurisdiction to be asserted over any foreign exporters that delivered their products into the "stream of commerce" with the awareness that they would be purchased by consumers in the forum state. *Asahi Metal Industry Co., Ltd. v. Superior Court of California*, 107 S. Ct. 1026 (1987), shields from that rule component manufacturers who sell to primary manufacturers abroad. For direct exporters, however,

6. Discussed in Checklist § 1(c).

insurance is the only reliable precaution against U.S. product liability claims.

III. States' Righteousness

The second cultural shock the Mexican exporter encounters in the U.S. market is states' rights.

To the exporter's U.S. counsel, those words "states' rights" are mere echoes of an antebellum past-*political* words, to be declaimed on San Jacinto Day or snarled in Judge Bork's confirmation hearings, but not *legal* words, fit for LEXIS, registration statements, closing opinions, and the like. In counsel's jaundiced eyes the interstate commerce clause and a vigorous federal judiciary have well nigh emasculated the Tenth Amendment, making of the United States, for business purposes, a unitary nation. But to the Mexican exporter it seems otherwise. He planned to introduce his product into one foreign nation, but to his astonishment he finds that he confronts fifty-one of them: fifty corporation laws; fifty Certificate of Authority statutes; fifty franchise taxes; fifty state legislatures, judiciaries, and executives; and, to make it even more forbidding, a fifty-first wall of federal taxes, laws, and government surrounding all the rest.

Mexico, by contrast, is a highly centralized nation. Its constitutión is labeled "federal" but there the federalism ends: one corporation law, one law for the establishment of foreign enterprise, central control of most taxes, and an honored tradition of national domination of the nominally separate states. Small wonder the exporters are stunned by the diffused and discordant system of state authority they encounter north of the Rio Grande.

To address their consternation, the best technique is to see the United States through the eyes of the Mexican exporters—as fifty different markets, planning carefully in advance, in terms of compliance with key state laws, which of the fifty the exported product will enter. Absent special licensing requirements, those key state laws are, essentially, Certificate of Authority laws, franchise taxes, and taxes generally.

The Texas Certificate of Authority law,[7] for example, allows the export subsidiary to own local bank accounts; to sell in Texas through "independent contractors"; to create, receive, and collect debts; to

7. Cited and discussed in Checklist § 4(a).

transact business in interstate commerce; and to conduct "isolated transactions"—all without obtaining a Certificate of Authority to "transact business" in Texas. Cases applying those principles confirm that no Certificate of Authority is required to sell into Texas by interstate shipment on the basis of purchase orders obtained in Texas but accepted outside. Consignment sales in Texas by out-of-state consignors are similarly held to be exempt.

Historically, the Texas franchise tax system[8] has been nearly as indulgent. The statute simply says that franchise taxes must be paid by any corporation that has a Texas Certificate of Authority or "does business" in Texas. The published franchise tax rulings hold that interstate commerce sales into Texas do not constitute "doing business" provided they are not obtained by consignment or regular solicitation within the state. But the Rules promulgated by the Comptroller General are tighter. They say that "performing a contract in Texas" or "having employees, independent contractors, agents or other representatives in Texas" who "provide or induce sales of the foreign corporation's goods or services" is enough. Most sweeping of all is the Rule of "constitutional nexus," which became effective in 1986. It provides that, "A corporation is doing business in Texas, for purposes of [franchise tax], when it has constitutional nexus with Texas for the purpose of franchise taxation." The result is to extend asserted franchise tax jurisdiction over Mexican exporters to the very limit allowed states by the U.S. Constitution.

Regarding the movement of goods, that limit was drawn by the U.S. Supreme Court's "original package" cases (*Brown v. Maryland* and *Low v. Austin*) as refined by *Michelin Tire Corp. v. Wages*, and *Japan Line, Ltd. v. County of Los Angeles*.[9] Those decisions exempt from state taxation a vehicle or instrumentality of foreign commerce, but allow a state to impose a non-discriminatory tax on goods-imported or domestic-that have come to rest in a warehouse within the state.

As to international operations generally, a broad view of state taxing authority was taken in the "unitary tax" decisions of the United States Supreme Court—*Bass*, *Mobil*, and most recently the *Container Corporation* case[10]—but the outrage of foreign exporters and investors persuaded states not to impose "unitary tax" to that

8. Cited and discussed in Checklist § 4(b).
9. Cited and discussed in Checklist § 4(c).
10. Cited and discussed in Checklist § 4(d).

authority's full extent. The dozen "unitary tax" states dwindled to three. Consequently, "unitary tax" is one states' rights monster the Mexican exporter has diminishing reason to fear.

IV. The Ghost of Adam Smith

There is a third culture shock of the *derecho ajeno*—the foreign law of the United States—which to the Mexican exporter is the most alien of all. It is the ghost of Adam Smith. A fundamental stage direction of the U.S. legal drama is the rule that its commercial actors should behave like freely-competing, profit-motivated, private-enterprising characters from *The Wealth of Nations.*

It is ironic that the world's largest market should thus ordain a cultural attitude so incongruous to the business habits of most of the remainder of the world. With the rules of the game in the Mexican market, the contrast is especially stark. There, state enterprise is supreme, state intervention is the norm, and the few means of production that have remained in private hands enjoy monopolies and oligopolies that would make Adam Smith blush to the roots of his powdered periwig.

Hence the dismay on Mexican exporters' faces when they learn that, north of the Rio Grande, they must play by the strange Yankee rules of competitive free enterprise. They confront those rules, principally, in three areas.

One is the federal antitrust laws.[11] Exports to the United States are covered, directly or indirectly, by the basic provisions of the Sherman Act regarding combinations, the Federal Trade Commission Act regarding unfair competition, and the Clayton Act regarding acquisitions. Exporters are explicitly addressed in the Wilson Tariff Act regarding price-fixing in imported goods, and the Robinson-Patman amendments to the Clayton Act regarding price discrimination and exclusive dealing. And once Mexican products have reached the United States they are subject, like domestic products, to general antitrust rules affecting exclusive distributorships, tying clauses, resale price maintenance, and territorial and customer restrictions.

A second area in which the Mexican exporter confronts the free-trade mandates of the U.S. market is antidumping.[12] Here the United States imposes on the Mexican product an additional import duty

11. Cited and discussed in Checklist § 5(a). *See also* Checklist § 5(d) (Section 337 exclusion) and § 5(e) (franchise and business opportunity laws).
12. Discussed in Checklist § 5(b).

equal to the amount by which its value in the foreign market exceeds its U.S. market price. The technicalities of that determination are complicated, and the administrative procedures for assessing and collecting the resulting duties are elaborate. The only saving grace is that to impose antidumping duties, "material injury" to a U.S. industry must be shown. For Mexican exporters to the United States, the antidumping law is a serious challenge because in many product lines decades of protected import substitution have resulted in Mexican market prices higher than what the U.S. traffic will bear.

A third area of U.S. legislation haunted by the ghost of Adam Smith is countervailing duties.[13] Here the law assesses penalty duties, not to offset lower prices, but to compensate for government subsidies from which the product benefited in its country of origin. This law bears heavily on Mexican exports because of the high degree of intervention by the Mexican government in all segments of the Mexican economy. Fortunately for the Mexican exporter, a 1985 agreement between Mexico and the United States places Mexican products within the protected category against which U.S. countervailing duties may not be assessed unless the claimant also proves "material injury" to a U.S. industry.

Any one of those three haunts of Adam Smith—antitrust, antidumping, and countervailing duties—is sufficient to bankrupt an export enterprise that depends upon the market distortions it forbids. Against that fate the only practical strategy of the Mexican exporter is to analyze, candidly and in advance, the extent to which the export venture will depend upon practices or subsidies those laws oppose. If the project relies upon a trade distortion that is likely to be successfully challenged under the antitrust laws, it is better never initiated. If the project's implementation is vulnerable to antidumping or countervailing duties, those duties and the adversarial cost of their being imposed must be budgeted into the project. In many cases an export structure that does not attract such penalties can be devised.

V. Familiar Foes

Not all of the legal problems of the U.S. market are cultural shocks to the Mexican exporter. There are three familiar foes.

For example, there is federal income taxation. To the extent it is unfamiliar, that unfamiliarity is due not to any conceptual difference

13. Discussed in Checklist § 5(c).

between Mexico and the United States on the subject of income taxes, but to the radical changes wrought by the U.S. Tax Reform Act of 1986.

In the first place, the 1986 Act so reduced U.S. income tax rates that, compared to Mexico, the United States is now a low tax jurisdiction.[14] That means that today's tax-structuring of Mexican exports to the United States must be more sophisticated than merely shifting profit-centers from the United States to Mexico.

More fundamentally, the "dividend equivalent tax" initiated by the 1986 Act has reversed the structural rule-of-thumb for Mexican export operations in the United States. Previously, when the United States had a thirty percent tax on dividends paid abroad but no corresponding tax on the remittance of branch profits, the best corporate structure for investors (like Mexicans) unprotected by a general tax treaty with the United States was usually the U.S. branch of a non-U.S. corporation. Given the "dividend equivalent tax" of the 1986 Act, for investors without treaty protection there is now, in effect, a thirty percent annual tax on remittable branch profits. Consequently, the standard tax-favored structure for a Mexican export distribution operation in the United States has become a U.S. corporation.[15]

The second element of the U.S. legal landscape familiar to the Mexican exporter is trademarks.[16] Unfortunately they are so familiar that sometimes they are ignored. Many a Mexican export project has foundered on failure to establish in advance proprietary name-identification of the export product in the United States.

For Mexican exporters, the third familiar element of U.S. law is that traditional hobgoblin of transnational traders, *la aduana*. As a checkpoint and duty-exacter, Customs functions in the United States much as in other countries. To cope with it, the exporters' best technique is to shadow-box their entries in advance with an experienced customs broker, making mock-ups of their intended shipping documents and seeking the product classification that produces the lowest duty.[17] Besides import duties, Customs also enforces a myriad

14. Discussed in Checklist § 3(d).

15. The elements of such structures are discussed in Checklist § 3(a) (the absence of a general Mexico-U.S. tax treaty), § 3(b) (U.S. statutory tax-liability for export income), and § 3(c) (the "dividend equivalent" tax).

16. Discussed in Checklist § 2.

17. Those classifications changed in January 1988 when the Harmonized Code replaced the venerable U.S. Tariff Schedule as the classification key.

of exclusionary laws, from the required country-of-origin markings to anti-pirating and the massive remedies of Section 337 against "unfair" imports.[18]

VI. The Significance of Exports

Counseling the Mexican exporter to the United States consists, therefore, of addressing, from the unique perspective of the exporter's needs, the six areas of the *derecho ajeno*—the foreign law of the United States—that the exporter confronts: to his eyes, the unsurprising confrontations of income taxes, trademarks, and customs; and the surprising confrontations of liability-insulation, state business regulations, and the free-market rules of antitrust, countervailing duties, and antidumping. Taken by itself each of those areas is an isolated legal problem, but solving them all creates a broadly-conceived export program whose significance is much greater than the sum of its parts.

In the same measure, the export sales such a program can achieve have a significance much greater than the black numbers they add to the Mexican exporter's earnings statement. We live in an age where powerful forces of history are striving to make of North America, if not a common market, at least a continent of mutually supportive economies. Mexico's decision to join GATT was a giant step in that direction.[19] The free-trade agreement between Canada and the United States,[20] and the trade and investment discussions between Mexico and the United States,[21] are encouraging indications

18. Discussed in Checklist § 6.

19. On August 24, 1986, Mexico became the 92nd member of the General Agreement on Tariffs and Trade. Its accession protocol undertook to eliminate the import licensing system, reduce certain tariffs, and phase out official import prices as a basis for tariff rates. *See* 3 Int'l Trade Rep. (BNA) at 977 (July 30, 1986).

20. The Canada-U.S. Free Trade Agreement was signed on January 2, 1988. If approved by the U.S. Congress and the Canadian Parliament it will, among other matters, (1) eliminate, over ten years, all tariffs between the two nations, (2) raise, over four years, "threshold" (restricted) levels of U.S. investment in Canada to Can. $150,000,000 per transaction, and eliminate completely "threshold" levels of indirect U.S. investment in Canada, and (3) improve reciprocal access for services and energy, agricultural and automotive products. The objectives and negotiating procedures of the Agreement are discussed in Business America, October 28, 1987, at 2.

21. On November 6, 1987 the United States and Mexico signed a "framework agreement" that obligates each nation, within 30 days after a request from the other, to consult on any issue between them related to trade or investment. Scheduled for discussion within the first 90 days were sectoral issues involving textiles, agricultural products, steel products, foreign investment, intellectual property, and electronic products. The text of the agreement is reproduced in 4 Int'l Trade Rep. (BNA) at 1410 (November 11, 1987).

of similar momentum. The durable institution of *maquila* is a practical example of pragmatic cooperation to the same end. By establishing a Mexican economic presence within the rapidly integrating market of our continent, the Mexican exporter not only increases Mexico's share of that market but also adds multinational stability to the new economic reality of a commercially interrelated North America.