Vanderbilt Journal of Transnational Law

Volume 11
Issue 2 *Spring 1978*

Article 1

1978

# Commerce Department Regulations Governing Participation by United States Persons in Foreign Boycotts

Paul McCarthy

John F. McKenzie

Follow this and additional works at: https://scholarship.law.vanderbilt.edu/vjtl

Part of the International Trade Law Commons

## Recommended Citation

Paul McCarthy and John F. McKenzie, Commerce Department Regulations Governing Participation by United States Persons in Foreign Boycotts, 11 *Vanderbilt Law Review* 193 (2021)
Available at: https://scholarship.law.vanderbilt.edu/vjtl/vol11/iss2/1

This Article is brought to you for free and open access by Scholarship@Vanderbilt Law. It has been accepted for inclusion in Vanderbilt Journal of Transnational Law by an authorized editor of Scholarship@Vanderbilt Law. For more information, please contact mark.j.williams@vanderbilt.edu.

# Vanderbilt Journal of Transnational Law

VOLUME 11 SPRING 1978 NUMBER 2

# COMMERCE DEPARTMENT REGULATIONS GOVERNING PARTICIPATION BY UNITED STATES PERSONS IN FOREIGN BOYCOTTS

*Paul McCarthy**
*John F. McKenzie***

TABLE OF CONTENTS

I. INTRODUCTION .................................... 194
II. JURISDICTIONAL SCOPE ............................ 196
  A. *Definition of United States Person* ............ 197
  B. *Involvement of United States Commerce* ...... 199
  C. *Intent* ........................................ 201
III. SUBSTANTIVE PROHIBITIONS OF THE REGULATIONS ...... 201
  A. *Export Sales Transactions Involving Firms Incorporated In and Domiciled Within the United States* .......................... 202
  B. *Operations of Foreign Branches, Subsidiaries, and Affiliates of United States Firms* ......... 215
  C. *Activities of United States Persons Residing in Boycotting Country* ...................... 219
  D. *Letter of Credit Transactions* ............... 225
IV. EVASION ......................................... 230
  A. *Sham Transactions and Formal Compliance* .............................. 231

* Partner, Baker & McKenzie, Chicago, Illinois. A.B., 1961, Cornell University; J.D., 1964, University of Michigan; M.C.L., 1966, University of Chicago.
** Associate, Baker & McKenzie, San Francisco, California. B.A., 1969, Williams College; J.D., 1976, Harvard Law School. The authors wish to acknowledge a number of their colleagues who made substantial contributions to the preparation of this article, and in particular, wish to thank Edward E. Dyson of Baker & McKenzie, Washington, D.C., and Frederick E. Henry of Baker & McKenzie, Chicago, Illinois, for their invaluable assistance in the preparation of this article.

B. *Substantial Compliance but Boycott Motivated* .... 234
C. *Avoidance of Boycott Requirements in the Middle East* .... 236
V. CRITICAL DATES .... 236
VI. PENALTIES .... 239
VII. CONCLUSION .... 240
APPENDIX I .... 243
APPENDIX II .... 245

## I. INTRODUCTION

On June 22, 1977, President Carter signed into law the Export Administration Amendments Act of 1977.[1] The most significant provisions are those governing American participation in international boycotts of countries with whom the United States maintains friendly trading relations.[2] These antiboycott provisions are not self-enforcing. They direct the President or his delegate, the Secretary of Commerce, to issue regulations prohibiting certain kinds of boycott-related conduct.[3] In accordance with this statutory direction, the Commerce Department issued proposed regulations on September 23, 1977, and invited public comment.[4] One hundred seventy-eight persons, firms, and organizations responded with written comments. Final regulations (hereinafter referred to as the "Regulations") were issued and immediately effective on January 18, 1978.[5]

1. Export Administration Amendments of 1977, Pub. L. No. 95-52, 91 Stat. 235. These amendments reenact with revisions the Export Administration Act of 1969, Pub. L. No. 91-184, 83 Stat. 841 (codified at 50 U.S.C. app. §§ 2401-13). This statute expired September 30, 1976. Section 101 of the Export Administration Amendments of 1977 extends the 1969 Act as if it had not expired.

2. The amendments and the regulations do not apply to actions taken in response to foreign boycotts in which the United States participates. Export Administration Amendments of 1977, Pub. L. No. 95-52, § 201(a), 91 Stat. 244 (to be codified at 50 U.S.C. app. § 2403-1a). Thus, for example, a United States exporter will not be subject to the penalties provided for by the Amendments if it agrees to take boycott-related action with respect to Rhodesia. *See* 15 C.F.R. § 385.3 (1977) (total embargo on export and re-export of United States-origin goods and services to Rhodesia); 31 C.F.R. §§ 530.101-.809 (1977) (Rhodesian Sanction Regulations).

3. Export Administration Amendments of 1977, Pub. L. No. 95-52, § 201(a), 91 Stat. 244 (to be codified at 50 U.S.C. app. § 2403-1a).

4. 42 Fed. Reg. 48,559 (1977).

5. 43 Fed. Reg. 3508 (1978) (to be codified in 15 C.F.R. § 369.1-.5). The

This article outlines the most important of the Regulations and highlights areas that are likely to give rise to major problems for firms that are engaged in trade or business with countries that participate in an international boycott not sanctioned by the United States. Differences between the proposed and final Regulations are discussed. The article will also examine the persons and transactions that are subject to the Export Administration Amendments Act of 1977[6] (hereinafter referred to as the "Act") and then discuss certain of the most significant prohibitions of the Act. Although much of the discussion in this article, like most of the discussion in the legislative consideration of the statutory antiboycott provisions,[7] is set forth in terms relating to the Arab boycott of Israel, the Regulations are written in general terms and are, therefore, applicable to all international boycotts in which the United States does not participate. Problems in this regard are most likely to be encountered with Pakistan and Nigeria.

The Act and the Regulations are not the only laws regulating boycott-related conduct. Sections 908, 952, 995, and 999 of the Internal Revenue Code impose certain penalties on income generated by transactions involving boycott-related conduct.[8] These tax provisions may be expected to have a continuing impact on the activities of the United States multinationals doing business with the Arab world. The tax provisions are in many cases different from or inconsistent with the proposed regulations, since they only penalize *agreements* to comply with the boycott, not unilateral acts. Moreover, the tax provisions are likely to have their greatest impact on the foreign operations of American companies, which are the operations most likely to avoid being subject to the Act

Regulations could become effective no earlier than their receipt by the Federal Register office at 4:39 p.m., Eastern Standard Time. The Regulations supplement and amend the current antiboycott provisions of the Export Administration Regulations, 15 C.F.R. § 369.1-.5 (1977).

6. Export Administration Amendments of 1977, Pub. L. No. 95-52, 91 Stat. 235.

7. H.R. REP. No. 190, 95th Cong., 1st Sess. 4-6 (1977), *reprinted in* [1977] U.S. CODE CONG. & AD. NEWS 1138-77; S. REP. No. 104, 95th Cong., 1st Sess. 16-28 (1977); SUBCOMM. ON OVERSIGHT & INVESTIGATIONS, HOUSE COMM. ON INTERSTATE & FOREIGN COMMERCE, 94TH CONG., 2D SESS., THE ARAB BOYCOTT AND AMERICAN BUSINESS (Subcomm. Print 1976) [hereinafter cited as SUBCOMM. ON OVERSIGHT].

8. The Treasury Department issued "Guidelines" in question and answer form interpreting these provisions in November 1976. These Guidelines were revised in August 1977 and further revised in January 1978. All references herein are to the January 1978 Guidelines, 43 Fed. Reg. 3454 (1978), which became effective on February 13, 1978.

under one or more of the exceptions provided therein. A comparison of the Export Administration Amendments Act of 1977 and the Tax Reform Act of 1976 is included in Appendix II. This summary is intended merely to facilitate comparison of the two laws and should not be relied upon for any other purpose.

In addition, seven states have enacted antiboycott laws, although the effect of state law in this field is greatly diminished by the preemptive provisions of the Act.[9] Companies may also run afoul of the antitrust laws of the United States and federal civil rights acts in connection with certain boycott-related conduct. Such laws are not affected or limited by the Act. To effectively plan in this area, companies must consider all of these laws and regulations, although the Act and the Regulations thereunder will be of greatest significance. The difficulties between the tax and criminal consequences of certain matters discussed herein have been noted for the convenience of companies planning their Middle East operations, but no attempt has been made to deal comprehensively with all situations that may constitute boycott participation or cooperation for tax purposes.

## II. Jurisdictional Scope

The prohibitions of the Act and the Regulations apply to the activities of all "United States persons" as that term is defined in the Act and Regulations, to the extent that those activities involve the interstate or foreign commerce of the United States.[10] The Regulations prohibit United States persons from knowingly taking or agreeing to take certain actions, discussed in part III *infra*, "with intent to comply with, further, or support" an unsanctioned boycott.[11] Each of these jurisdictional considerations will be discussed in turn.

9. Export Administration Amendments of 1977, Pub. L. No. 95-52, § 205, 91 Stat. 248 (to be codified at 50 U.S.C. app. § 2403-1a). California has specifically amended its antiboycott statute to conform to the federal standard established by the Export Administration Amendments and accompanying regulations. *See* Cal. Bus. & Prof. Code § 16721.6 (Deering Supp. 1978) (Act of Sept. 17, 1977, ch. 859, 1977 Cal. Adv. Legisl. Serv. 1215-16). The effect of this amendment is to provide state, as well as federal, penalties for violations of federal antiboycott standards.

10. Export Administration Amendments of 1977, Pub. L. No. 95-52, § 201(a), 91 Stat. 244 (to be codified at 50 U.S.C. app. § 2403-1a); 43 Fed. Reg. 3512, 3514 (1978) (to be codified in 15 C.F.R. §§ 369.1(b), (d)).

11. Export Administration Amendments of 1977, Pub. L. No. 95-52, § 201(a), 91 Stat. 244.

### A. *Definition of United States Person*

The Act defines a United States person as:

> any United States resident or national (other than an individual resident outside the United States and employed by other than a United States person), any domestic concern (including any permanent domestic establishment of any foreign concern) and any foreign subsidiary or affiliate (including any permanent foreign establishment) of any domestic concern which is controlled in fact by such domestic concern, as determined under regulations of the President.[12]

The Regulations' definition of "United States person" is somewhat more detailed, and includes individual citizens of the United States as well as partnerships, corporations, companies, and associations organized under the laws of the United States or of the several states.[13] Similarly, the Regulations include as "United States persons" foreign citizens presently residing in the United States and the permanent United States establishment or branch of any foreign firm that is registered to do business in the United States or in one or more of the several states.[14] Finally, the definition includes any foreign branch, affiliate, or subsidiary of a domestic concern that is "controlled in fact by [that] domestic concern."[15] An understanding of the "controlled in fact" concept is critical since only such controlled in fact non-United States firms will be subject to the Act even if their activities involve United States commerce.

Under the Regulations,[16] a foreign subsidiary or affiliate of a domestic concern (*i.e.*, a United States corporation, trust, partnership, or other person other than an individual or sole proprietorship) will be presumed to be controlled in fact by that person, and thus subject to the antiboycott prohibitions of the Regulations, if (1) more than 50 percent of the outstanding voting securities of the foreign firm is owned or controlled, directly or indirectly, by the United States person;[17] (2) more than 25 percent of the foreign

12. *Id.* § 204.
13. 43 Fed. Reg. 3513 (1978) (to be codified in 15 C.F.R. § 369.1(b)(iii)).
14. *Id.* (to be codified in 15 C.F.R. § 369.1(b)(iv)).
15. *Id.* (to be codified in 15 C.F.R. § 369.1(b)(v)).
16. *Id.* (to be codified in 15 C.F.R. § 369.1(c)).
17. Since the Regulations refer to direct, indirect, and beneficial stock ownership, *id.* (to be codified in 15 C.F.R. § 369.1(c)(2)(i)-(ii)), it is possible, though by no means certain, that determination of whether a foreign firm is controlled in fact by a United States person will be made in accordance with stock ownership

firm's voting securities is owned or controlled, directly or indirectly, by the domestic concern and no other person owns or controls an equal or larger percentage; (3) the foreign firm is managed by the domestic concern under an exclusive management contract; (4) a majority of the foreign firm's directors are also directors of the United States person; or (5) the domestic concern has the authority to appoint a majority of the foreign firm's board of directors or its chief operating officer. In the absence of facts creating such a presumption the burden of proving that a domestic concern nonetheless controls a foreign concern falls on the government.

These tests are less rigid than those contained in the proposed regulations. Under the proposed regulations, ownership of more than 50 percent created a conclusive presumption of control. Under the Regulations, all conclusive presumptions have been removed, except that all foreign branches of a domestic concern are deemed to be controlled in fact. Moreover, the treatment of joint ventures is more realistic; there is no presumption of control unless the domestic concern is the largest stockholder and owns 25 percent or more of the outstanding voting securities, although such a presumption may arise if two or more domestic concerns, each holding less than a 25 percent interest, act in concert to control a foreign concern.

The application of these principles to joint ventures still involves certain difficulties. In the Regulations, "control" is defined as the authority or ability to establish general policies or to control day-to-day operations.[18] Thus, the various tests seem designed to determine whether the United States participant has the authority to manage the joint venture entity independently of the non-United States participant. Under this approach, however, a joint venture in which both participants have a 50 percent interest could be "controlled" by no one or "controlled" by both participants. If the United States person has a veto over actions of the joint venture, it would possess at least a negative form of control. Whether a United States person should be responsible for merely failing to block an action over which he had a veto power is questionable. In no event, however, should the United States participant in a joint venture be held responsible for a boycott-related activity of the joint venture if it or its representative did not cause the joint

---

rules similar to the stock attribution rules of the Internal Revenue Code. The Guidelines do not contain any such rules, however. *See, e.g.*, I.R.C. §§ 318, 958.

18. 43 Fed. Reg. 3513 (1978) (to be codified in 15 C.F.R. § 369.1(c)(1)).

venture to enter into the boycott-related activity and did not possess the legal right to prevent the activity in question. Thus, for example, if the non-United States participant in a joint venture has the right independently to bind the joint venture entity and enters into a boycott-related agreement on behalf of the joint venture, it would appear that the United States participant should not be held responsible for this act regardless of whether the United States participant would be presumed to control the venture under one of the "rebuttable presumptions."

The application of these presumed control principles is reasonably clear in a parent-subsidiary situation or where affiliation is established through a common shareholder in the form of a corporation, partnership, or other entity. If a foreign firm is owned by one or more individual United States shareholders, the situation is less clear. Such a foreign firm would not appear to be a "subsidiary" of a United States "concern," a term that does not seem to include an individual as used in the Act.[19] If, however, a foreign and a United States company are engaged in a related business, there is a risk that the foreign company might be deemed to be an "affiliate" of the domestic concern and, therefore, a United States person. The examples given in the Regulations reaffirm the principle that indirect ownership or control is sufficient to bring a foreign firm within the jurisdiction of the Act and Regulations. Thus, if *A*, a foreign corporation, is 51 percent owned by *B*, another foreign corporation, which in turn is 51 percent owned by *C*, a United States corporation, both *A* and *B* will be presumed to be controlled in fact by *C*, and therefore subject to United States antiboycott regulations.[20]

### B. *Involvement of United States Commerce*

The Act does not apply to the activities of United States persons when no foreign or interstate commerce of the United States is involved in the activity in question. This exception is only available, however, to United States persons residing abroad, principally branches and subsidiaries of United States companies and foreign joint ventures that are controlled in fact by United States persons. If any part of a transaction or activity involves United States commerce, other than certain "ancillary" activities, discussed *infra*, the entire transaction will be "in commerce" for purposes of the Regulations.

---

19. *See id.* at 3514 (to be codified in 15 C.F.R. § 369.1(c), example (xi)).
20. *See id.* (to be codified in 15 C.F.R. § 369.1(c), example (x)).

There are two basic tests for determining whether United States commerce is involved. First, all exports and other transactions or activities of United States persons in the United States are covered.[21] Furthermore, participation by the head office, parent corporation, or United States affiliate other than the provision of ancillary services in the boycott-related transaction or activity will "taint" the entire transaction.[22] Thus, if the United States parent or affiliate provides such services or financial support for the primary benefit of the boycott country customer, such as a product warranty or financial guarantee, the entire transaction is in United States commerce; but if the services are essentially for the benefit of a subsidiary or affiliate, such as general legal, technical, or financial services (including drafting of a sales contract, general technical assistance, or credit or financial evaluations of an order), only the ancillary services and not the underlying transactions are within United States commerce. Similarly, if products or components are supplied by the affiliated United States company or any other United States exporter to fill an order directed to the project in question, United States commerce is involved.

The second basic test for determining whether United States commerce is involved focuses on the origin of tangible products. Parts or components supplied by a United States source must not be earmarked for particular boycott-related projects, and must be "further manufactured, incorporated into, refined into or reprocessed into another product" outside the United States to avoid the involvement of United States commerce.[23] The extent of manufacture, incorporation, refinement, or processing is not defined in the Regulations. As a limited exception to this rule, resales of American-made items that are drawn from a general inventory and that are indistinguishable from foreign-made goods are not covered if it can be shown that the foreign inventory then on hand is sufficient to fill the order.[24]

In practice, companies can expect to encounter great difficulty in avoiding involvement of United States commerce. Although foreign subsidiaries may operate quite independently, they do not normally operate in a vacuum, totally isolated from the United States parent. It is unlikely that all contact with the United States can be avoided by foreign affiliates in connection with specific

---

21. *Id.* (to be codified in 15 C.F.R. § 369.1(d)).
22. *Id.* at 3514-15 (to be codified in 15 C.F.R. § 369.1(d)(8), (10)).
23. *Id.* at 3515 (to be codified in 15 C.F.R. § 369.1(d)(12)(i), (ii)).
24. *Id.* at 3514 (to be codified in 15 C.F.R. § 369.1(d)(8)(iv)).

Middle East transactions. Thus, each transaction or pattern of transactions must be analyzed to ensure that the parent company provides no more than "ancillary" services.

### C. *Intent*

The requirement that the boycott-related activity be undertaken "with intent to comply with, further, or support" an unsanctioned boycott is of little significance. The Regulations treat the boycott as including not only actual refusals to deal with a boycotted country or blacklisted companies, but also the boycott-related requirements imposed by the boycotting countries, such as negative certifications, disclosure of information on activities in Israel, and restrictive provisions in contracts. One is deemed to comply with, further, or support a boycott by furnishing such a certification, providing such information, or signing such a contract. Thus, intent is established merely by showing that the party intended to furnish the certification, supply the information, or execute the contract. For example, a reply to a boycott questionnaire stating, "We have ten facilities in Israel and are building four more," would be a violation. One may not escape the prohibition of the Act by falsely providing a negative certification or agreeing to comply with the boycott without actually intending so to comply. The only person who will be able to show a lack of intent is one who had inadvertently or mistakenly done an otherwise prohibited act.[25]

## III. SUBSTANTIVE PROHIBITIONS OF THE REGULATIONS

Pursuant to the mandate of the Act, the Regulations set out detailed rules governing (a) refusals to deal with boycotted countries and blacklisted persons and firms;[26] (b) discrimination against United States persons on the basis of race, religion, sex, or national origin;[27] (c) furnishing information about the race, religion, sex, or national origin of any United States person;[28] (d)

25. The Regulations contain one example which is difficult to square with the actual language of the Regulations. *See id.* at 3516 (to be codified in 15 C.F.R. § 369.1(e), example (ix)) (a U.S. company would volunteer information about its non-disciminatory business policies in order to attempt to be removed from a boycott blacklist). This example is extremely dangerous because it leaves open the question of what the result would be, if upon receiving the unsolicited information, the boycott office asks follow-up questions.

26. *Id.* at 3517 (to be codified in 15 C.F.R. § 369.2(a)).

27. *Id.* at 3520 (to be codified in 15 C.F.R. § 369.2(b)).

28. *Id.* (to be codified in 15 C.F.R. § 369.2(c)).

furnishing information about business relations with or in a boycotted country, with boycotted country nationals and firms, and with blacklisted persons and firms;[29] (e) furnishing information about charitable or fraternal organizations that support the boycotted country;[30] and (f) implementing letters of credit that contain boycott-related language or that require boycott-related certifications.[31] An extended general discussion of the Regulations' antiboycott "do's and don'ts" would serve little useful purpose because many of the prohibitions are relevant only in factual circumstances that rarely arise, at least in the context of the Arab boycott of Israel.[32] Therefore, this article focuses on the effect of the Regulations on specific kinds of conduct requested or required by Arab countries as part of the Arab boycott of Israel. For ease of analysis, the discussion is organized according to the nature of United States or related firms' commercial contacts with boycotting countries.

### A. *Export Sales Transactions Involving Firms Incorporated In and Domiciled Within the United States*

The most common context in which a United States firm comes in contact with the Arab boycott of Israel is in export sales transactions. The paradigm transaction is one in which a United States-based manufacturer or trading company solicits and receives from Arab buyers orders for goods of United States origin. The United States firm may be requested to participate in the Arab boycott or to provide boycott-related information at one or more of the following stages of the transaction: (1) solicitation of orders; (2) receipt of a purchase order; (3) contract negotiation; (4) perfor-

29. *Id.* at 3521 (to be codified in 15 C.F.R. § 369.2(d)).

30. *Id.* at 3522 (to be codified in 15 C.F.R. § 369.2(e)).

31. *Id.* at 3523 (to be codified in 15 C.F.R. § 369.2(f)).

32. Much of the attention of the proposed regulations is directed at prohibiting boycott-related discrimination against American citizens on the basis of race, religion, or national origin. *See id.* at 3520 (to be codified in 15 C.F.R. § 369.2(b)-(c)). As a matter of fact, however, Arab boycott requests almost never require racial or religious discrimination. A congressional committee's survey of more than 4,000 boycott reports filed with the Commerce Department in 1974 and 1975 revealed that anti-Jewish or anti-Zionist certifications were requested by Arab governments or persons on only fifteen occasions. *See* SUBCOMM. ON OVERSIGHT, *supra* note 7, at 33. Even these fifteen reported cases of requests for religious discrimination certifications may be aberrations because such requests are not found on standard form Arab sales contracts and letters of credit, and because the Arabs adamantly insist that their boycott is directed against Israel and not against members of the Jewish or any other religion.

mance of the contract; or (5) preparation for payment against a letter of credit. By taking or agreeing to take the requested action or by providing requested information the United States firm may run afoul of the prohibitions of the Regulations.

1. Responding to the Arabs' Seven Boycott Questions

When the United States trading company solicits orders or initiates contacts with Arab customers, it may be required to answer various questions about the nature and extent of its contacts, if any, with Israel. This is almost always true, for example, in connection with transactions with the government of Iraq and occasionally in Kuwait. These questions, the so-called "Seven Questions,"[33] require the United States firm to provide information about its plants, branches, offices, or subsidiaries in Israel, its participation in, or representation of, any Israeli-owned firms, its grant of patent, trademark, and know-how licenses to Israeli firms and nationals and its rendering of technical assistance to Israeli firms. Under existing Commerce Department regulations,[34] and under the new proposed reporting rules,[35] the United States firm must report the receipt of the "Seven Questions" to the Commerce Department. Under the Act and the Regulations, responding to the "Seven Questions" is prohibited.[36] The Regulations prohibit United States persons from furnishing any information about their relationship with the boycotted country or with boycotted country nationals and firms.[37] United States firms responding to the "Seven Questions" will, therefore, have committed a violation, even if the responses indicate that the firms in question have commercial ties with Israel and in fact have no intention of severing those ties or that the firm has no commercial relationships with Israel for purely commercial reasons.

33. The Arab's Seven Boycott Questions are set out in Appendix I *infra*. *See Hearings on Multinational Corporations and U.S. Foreign Relations Before the Subcomm. on Multinational Corporations of the Senate Foreign Relations Comm.*, 94th Cong., 1st Sess. 449-52 (1975). *See generally id.* at 442-76.

34. *See* Export Administration Regulations, 15 C.F.R. §§ 369.3(b)(1)(i)-(iv), 369.4 (1977).

35. 42 Fed. Reg. 65,592-98 (1977) (proposed regulations to be codified in 15 C.F.R. §§ 369.6, .7).

36. Export Administration Amendments of 1977, Pub. L. No. 95-52, § 201(a), 91 Stat. 244 (to be codified at 50 U.S.C. app. § 2403-1a); *see* 43 Fed. Reg. 3521-22 (1978) (to be codified in 15 C.F.R. § 369.2(d), examples (i), (iv), (vii), (ix)).

37. 43 Fed. Reg. 3521 (1978) (to be codified in 15 C.F.R. § 369.2(d)).

2. Contract Provisions

(a) *Agreement Not to Ship Goods Produced in, or Containing Parts of Components Produced in, a Boycotted Country.*—In contract negotiations for the sale of United States-origin products to an Arab government or firm, the Arab buyers may demand that the United States seller agree that the goods sold to the Arab government or firm will not be of Israeli origin, nor contain any parts, components, or labor of Israeli origin. Such a provision is properly characterized as a device for enforcing the Arabs' primary boycott of Israel. The legislative history of the Export Administration Amendments Act recognizes the legitimacy of primary boycotts as a device for achieving international political and economic goals,[38] and the Act and Regulations carve out a specific exemption for *primary* boycott-related conduct.[39] As a result, a United States exporter is not prohibited from agreeing not to ship goods of Israeli origin to its Arab customers.[40] The United States exporter may not, however, agree, as part of a sales contract or otherwise, to sever all ties with or engage in an across-the-board refusal to deal with Israel or Israeli firms and persons.[41] In addition, as noted in paragraph 3(b) *infra,* the United States exporter may not certify that the goods supplied are not of Israeli origin after June 21, 1978.

(b) *Agreement to Comply with Boycott Laws.*—Government contracts or tenders in several Arab countries, particularly Iraq, Kuwait, Syria, and, occasionally, Saudi Arabia, contain a clause under which the contractor or supplier agrees to comply with the boycott laws and regulations of the country in question. Entering into an agreement containing such a clause is prohibited under the Act and the Regulations. As government agencies in these countries have in many cases refused to delete such clauses, United States persons may be precluded from selling to or contracting with the governments of these countries. On the other hand, a

38. *See* H.R. REP. No. 190, *supra* note 7, at 4-6. The United States is itself a party to international *primary* boycotts. *See, e.g.,* Export Administration Regulations, 15 C.F.R. § 385.3 (1977) (boycott of Rhodesia).

39. Export Administration Amendments of 1977, Pub. L. No. 95-52, § 201(a), 91 Stat. 244 (to be codified at 50 U.S.C. app. § 2403-1a); 43 Fed. Reg. 3525 (1978) (to be codified in 15 C.F.R. § 369.3).

40. *See* 43 Fed. Reg. 3525 (1978) (to be codified in 15 C.F.R. § 369.3(a-1), example (ii)). Such a "primary boycott" agreement would not constitute boycott participation or cooperation for tax purposes. *See* Guideline I-1, 43 Fed. Reg. 3465 (1978).

41. 43 Fed. Reg. 3525 (1978) (to be codified in 15 C.F.R. § 369.3).

general clause requiring the contractor to comply with the laws and regulations of the Arab country in question is permissible under the Regulations, even if those laws include boycott laws.[42] In certain Arab countries a standard governing law clause designating the laws of the Arab country in question as governing the interpretation and application of the contract has been successfully utilized.

(c) *Agreement Not to Supply Goods Produced by a "Blacklisted" Person or Firm.*—During the 30-year Arab boycott of Israel, various offices in boycott-participating countries have assembled a blacklist of firms, including many American businesses, whose business, charitable, or political ties or policies indicate to the Arabs that they are unfriendly to the Arab cause or overly sympathetic to Israel.[43] In contract negotiations, United States exporters may be asked to agree they will not ship goods manufactured by such blacklisted firms to Arab countries. Such an agreement is prohibited by the Regulations.[44] Similarly, even if the sales agreement does not contain a "no blacklisted manufacturer" provision, if the United States exporter chooses its suppliers of parts, components, and finished products so as to conform with Arab blacklist requirements (*i.e.*, only non-blacklisted suppliers are chosen) the exporter will have violated the prohibitions of the Regulations.[45]

(d) *"Risk of Loss" or ARAMCO Terms.*—Under the proposed regulations, insistence by a United States person that its suppliers agree to a "risk of loss" provision will not violate the Act.[46] Gener-

42. *Id.* at 3518 (to be codified in 15 C.F.R. § 369.2(a)(5)). By contrast, a general agreement to comply with the laws of a boycotting country will constitute boycott participation. *See* Guideline H-4, 43 Fed. Reg. 3463 (1978).

43. The Saudi Arabian blacklist includes more than 1,000 United States and foreign firms. *See Discriminatory Arab Pressure on U.S. Business: Hearings before the Subcomm. on International Trade and Commerce of the House Comm. on International Relations*, 94th Cong., 1st Sess. 147-215 (1975).

44. 43 Fed. Reg. 3519 (1978) (to be codified in 15 C.F.R. § 369.2(a), Agreements to Refuse to Do Business, examples (i)-(ii)). In contrast with this immediate prohibition, the United States exporter may, until June 21, 1978, provide shipping documents certifying that goods contained in the shipment were not produced by a blacklisted person or firm. *See id.* at 3526 (to be codified in 15 C.F.R. § 369.3(b), examples (iv)-(v)). Such an agreement would clearly constitute boycott participation for tax purposes. *See* Guideline M-1, 43 Fed. Reg. 3468 (1978).

45. 43 Fed. Reg. 3518 (1978) (to be codified in 15 C.F.R. § 369.2(a), Refusals to Do Business, example (i)).

46. *See id.* at 3519 (to be codified in 15 C.F.R. § 369.2(a), Agreements to Refuse to Do Business, example (viii)).

ally, "risk of loss" transactions are structured in the following manner: A United States exporter that has received an order from an Arab customer solicits bids from various suppliers in order to fill the order; the exporter is willing to receive bids from any supplier and will buy from that supplier offering the most favorable terms, regardless of the supplier's blacklisted or non-blacklisted status. The exporter, however, requires the supplier to agree to assume the risk of loss and to compensate the exporter for any loss sustained due to a refusal by Arab customs officials to clear the supplier's goods into the Arab country. This has become a standard item in ARAMCO contracts, with the compensation limited to the price of the goods plus freight charges to the destination. A number of commentators argued that such a risk of loss provision was designed solely to eliminate blacklisted companies as suppliers in Arab countries. The Department of Commerce has accepted this argument in part. The final Regulations provide that a risk of loss provision will not itself constitute a violation of the Act, but that it may constitute an evasion. An evasion will be presumed if a United States person commences to require such a term after the effective date of the Act.[47] By contrast, accepting such a risk of loss provision will not constitute participation in or cooperation with the boycott for tax purposes.[48]

### 3. Certification Requirements

The import laws and regulations of most Arab countries have traditionally required boycott certifications of various kinds before admitting goods into the country. Letters of credit issued from Arab countries have similarly required such certifications as a condition of payment. Certain "negative" certifications will ultimately be prohibited under the Act. For tax purposes, however, negative certifications will only constitute boycott participation or cooperation if they are given in a context from which an agreement may be inferred, such as in response to a purchase order or letter of credit.[49] These certification requirements, which differ substantially from country to country, are set forth, *infra*.

47. *See* text accompanying note 151 *infra*.

48. Guideline J-8, 43 Fed. Reg. 3467 (1978).

49. *Compare* Guideline H-32, *id.* at 3465 (negative certification given in response to an import requirement) *with* Guideline H-8, *id.* at 3463 (negative certification given in response to a letter of credit). Only in the latter case will a boycott-related agreement be inferred.

(a) *Positive Certificates of Origin.*—A positive certificate of origin merely identifies the country in which the goods in question were made (*e.g.*, "Made in U.S.A."). Partially in response to American antiboycott legislation, the Central Arab Boycott Office in Damascus, Syria, in early 1977, endorsed the concept of requiring United States companies to supply only positive certificates of origin on export sales from the United States to Arab countries. In response, most Middle East countries have, as a matter of administrative practice, begun to accept such positive certifications[50] although certain consulates and Arab chambers of commerce have continued to require negative statements. United States exporters supplying only positive certificates, simply naming the country of origin, would not run afoul of the prohibition of the proposed regulations.[51] In practice, this approach can involve difficulties. If one is required to certify that goods are *solely* of a certain national origin, it may be necessary to list every country which is the source of any raw material or component. Most letters of credit issued from Arab countries continue to require negative certifications, however. In most Arab countries, boycott certification requirements are determined by government or central bank regulation and normally cannot be waived at the request of the issuing bank's customer. As most transactions with the Middle East involve letters of credit, the above changes in import certification requirements have had only limited practical significance.[52]

(b) *Negative Certificate of Origin.*—Regulations in a number of Arab countries require United States exporters to provide, among export shipping documents or as part of a presentation for payment under a letter of credit, a negative certificate of origin.[53] Such a certificate states that the goods shipped are not of Israeli

---

50. The governments of Oman, Libya, and Iraq have stated, as a matter of official policy, that negative certificates of origin will still be required on export sales to those countries, but in actual practice, Libyan and Omani consulates have legalized export documents containing only positive certification of origin. In contrast, Saudi Arabia has recently modified its boycott regulations with respect to letter of credit transactions so as to require positive rather than negative certificates of origin. *See* Saudi Arabian Monetary Authority Circular M/196 (March 7, 1978).

51. *See* 43 Fed. Reg. 3526 (1978) (to be codified in 15 C.F.R. § 369.3(b), example (ii)).

52. Letters of credit issued recently in Egypt, Bahrain, and Dubai have not contained any negative boycott certification requirements.

53. *See, e.g.*, Egyptian Boycott Law, art. 3, Law No. 506, (1955); DUNN & BRADSTREET, WORLD MARKETING GUIDE 2.915 (1977) (Oman).

origin and contain no parts, components, or labor of Israeli origin. Like the positive certificates of origin requirements, Arab requests for negative certificates are designed to foster the Arabs' primary boycott of Israel. Unlike the positive certificate, however, the negative certificate of origin will ultimately be prohibited by the Regulations.[54] Since one may agree not to supply goods of Israeli origin, prohibiting a negative certificate of origin is illogical. The Department of Commerce apparently felt, however, that this distinction was mandated by the provision of the Act limiting the import and shipping document exception[55] to positive certificates after June 21, 1978. Nevertheless, it is regrettable that the Department did not see fit to permit negative certificates of origin under the broader import requirements exception.[56] Timing is crucial with regard to the provision of negative certificates of origin. Under the Regulations, negative certificates may be provided until June 21, 1978. After that date, requests for information on the origin of goods may be answered only in the affirmative (*e.g.*, "Goods shipped were made in U.S.A." or "These goods are solely of U.S. origin"). The provision of negative certificates after June 21, 1978, is specifically prohibited by the Act.[57]

(c) *"War Risk" Shipping Certifications.*—Among the most common certifications that United States exporters are asked to provide on export sales to Arab countries are "war risk" or "confiscation" certifications. The exporter is required to state (1) that the vessel carrying the exported goods is not an Israeli flag vessel nor a vessel owned by Israeli nationals or firms, and/or (2) that the vessel carrying the exported goods is not scheduled to call

---

54. 43 Fed. Reg. 3526 (1978) (to be codified in 15 C.F.R. § 369.3(b)). The theoretical underpinnings of the Regulations' distinction between positive and negative certificates of origin seem weak. As recognized by the California Attorney General in interpreting California's antiboycott law, CAL. BUS. & PROF. CODE §§ 16721, 16721.5 (Deering Supp. 1978), positive and negative certificate requirements are means of enforcing a primary boycott. OP. CAL. ATT'Y GEN. SO 76/54 (Nov. 24, 1976). *See generally* Flynn & McKenzie, *International Boycotts*, 29 S. CAL. TAX INST. 139, app. (1977). Neither the making of a positive certificate nor the making of a negative certificate involves racial or religious discrimination against United States citizens or a refusal to deal with the boycott target country. *See* Export Administration Amendments of 1977, Pub. L. No. 95-52, § 201(a), 91 Stat. 244 (to be codified at 50 U.S.C. app. § 2403-1a)).

55. Export Administration Amendments of 1977, Pub. L. No. 95-52, § 201 (a), 91 Stat. 245 (to be codified at 50 U.S.C. app. § 2403-1a(4A)(a)(2)(B)).

56. *Id.* (to be codified at 50 U.S.C. app. § 2403-1a(4A)(a)(2)(A)).

57. *Id.* (to be codified at 50 U.S.C. app. § 2403-1a(4A)(a)(2)(B)).

at an Israeli port prior to its arrival at the Arab port of destination.[58] A United States exporter may provide such "war risk" or "confiscation" certifications without incurring criminal penalties under the Act[59] or tax penalties under the tax provisions.[60] The apparent reason for excluding these boycott-related certifications from the prohibition of the Regulations is that requests for such certifications represent a legitimate effort by the Arab purchaser to protect itself against loss due to confiscation by citizens or officials of a hostile power (*e.g.*, Israeli shipowners or Israeli customs officers).[61] Since requests of this kind reflect the Arab buyer's legitimate commercial interest, they are not considered to be boycott-related and, therefore, are excluded from the Act's prohibitions. The Regulations do not, however, specify whether all certifications of nationality and route of a vessel are acceptable or whether an actual state of hostility must be demonstrated.

(d) *Certifications That Goods Are Not to Be Shipped on a Blacklisted Vessel.*—In addition to a blacklist of American and foreign firms that are deemed hostile to the Arab cause, the various Arab boycott offices maintain a blacklist of vessels that have repeatedly called at Israeli ports. Such vessels are banned from calling at ports in countries that are parties to the Arab boycott of Israel. Arab buyers and banks frequently require United States exporters to certify that goods covered by export sales contracts with the Arabs will not be shipped on a blacklisted vessel. The Regulations treat requests for such "blacklisted vessel" certificates

---

58. *See* DUNN & BRADSTREET, *supra* note 53, 2.601 (Iraq), 2.716 (Kuwait); Saudi Arabian Monetary Circular, M/196 (March 7, 1978); *See generally* SUBCOMM. ON OVERSIGHT, *supra* note 7, at 32-34.

59. 43 Fed. Reg. 3526 (1978) (to be codified in 15 C.F.R. § 369.3(b)(2) & accompanying examples). Example (ix) specifically refers to a certification that "the carrier will not call at a port in boycotted country *X* before the [port of unloading]." In practice, letters of credit in Arab countries often require a certification simply that the vessel will not call at an Israeli port, without being limited to an "intermediate" call. *But see* Saudi Arabian Monetary Circular, M/196, § 1(c) (March 7, 1978). Such a general certification of a vessel's route should be avoided if possible since it would go beyond both the language of the Regulations and the rationale of the "war risk" or "confiscation" exception.

60. Guideline M-5, 43 Fed. Reg. 3468 (1978). Treasury officials have expressed doubt whether this exception applies in the absence of an actual state of hostility between the countries in question. Thus, responding to a Pakistani requirement may not fall under Guideline M-5.

61. In this regard, see OP. CAL. ATT'Y GEN. SO 76/54 (Nov. 24, 1976) (interpreting California antiboycott law so as to permit the making of "war risk" and "confiscation" certifications).

as import and shipping document requirements, and because the requested certifications are stated in the negative, they will ultimately be prohibited. United States exporters may provide "blacklisted vessel" certificates until June 21, 1978, but not thereafter.[62]

Recently, certain Middle East countries have begun to accept a "positive" certification that the vessel is "entitled to call at Arab ports." Such a certification is most unusual in commercial practice and appears to be the counterpart of certifying that the vessel is not blacklisted. In a release dated April 21, 1978, the Commerce Department indicated that such a "vessel eligible" certificate would be regarded as a boycott certificate, but stated that so long as the "vessel eligible" certificate was made by the vessel owner (*i.e.*, the steamship company) and not by the letter of credit beneficiary, the certificate would be regarded as a self-certification.[63] As discussed in the following paragraph, self-certifications as to non-blacklist status are not prohibited under the Regulations.

(e) *Certification That Supplier of Goods Is Not Blacklisted (Self-Certification).*—Certain letters of credit and government bid documents and regulations in Arab countries require the beneficiary to certify that it has not been blacklisted, although this is encountered only rarely. Example (ix) under section 369.2(d) of the proposed regulations concluded that the provision of such a "self-certification" was prohibited.[64] The reasoning underlying this prohibition apparently was that the exporter's statement amounts to supplying information about the exporter's past dealings with Israel, and the Act mandates that the Regulations prohibit the provision of information about United States exporters' business relations with boycotted countries. The validity of this reasoning has been questioned by certain commentators. Although the fact that a firm is blacklisted by the Arabs may imply that the firm has had business ties with Israel or with another blacklisted person or firm, the fact that a firm is not blacklisted does not imply that the firm has no business ties with Israel or with blacklisted persons and firms. There are a large number of United States businesses that

62. *See* 43 Fed. Reg. 3526 (1978) (to be codified in 15 C.F.R. § 369.3(b), example (vi)).

63. *See* 43 Fed. Reg. 16969 (1978). This release sets forth the Commerce Department's position with respect to the standard Saudi Arabian letter of credit certification requirements. Those requirements are outlined in Saudi Arabian Monetary Agency Circular M/196 (March 7, 1978).

64. 42 Fed. Reg. 48,565 (1977).

have successfully maintained, and continue to maintain, commercial relations with both Israel and Arab League countries.[65] Example (ix) was amended in the Regulations to refer only to a certification that the beneficiary's supplier is not blacklisted.[66] As discussed *infra,* however, this change is probably limited to situations in which a person is asked to give a certification that by its terms is limited to the blacklisted status of the person making the certification.

(f) *Certification That Supplier of Goods Is Not Blacklisted (Certification Regarding Third Party).*—A beneficiary may be required to certify under a letter of credit that the supplier or manufacturer of the products sold is not blacklisted or that the goods are not supplied by a blacklisted person.[67] When the beneficiary is a trading company, this is clearly a reference to third parties with whom the beneficiary may have dealt in performing the contract. In the case of a manufacturer who incorporates identifiable parts or materials obtained from other parties, such a certification may also refer to third parties. One might argue that a manufacturer who obtained no identifiable components or materials from a third party would merely be making a "self-certification," but this would be extremely dangerous in light of the explicit language of the Regulations.[68] The Regulations classify requests for this kind of "no blacklisted supplier" certificate as a type of import and shipping document requirement,[69] and therefore, such certificates are treated like negative certificates of origin and "no blacklisted vessel" certificates. Thus, exporters may provide certificates regarding the nonblacklisted status of their domestic suppliers until June 21, 1978. After that date, the making of "no blacklisted supplier" certificates will be prohibited.[70]

---

65. *See* SUBCOMM. ON OVERSIGHT, *supra* note 7, at 38 (major United States defense producers with large sales of military equipment to Israel not on Arab blacklist); Turck, *The Arab Boycott of Israel,* 53 FOREIGN AFF. 472, 478-79 (1977).

66. *See* 43 Fed. Reg. 3522 (1978) (to be codified in 15 C.F.R. § 369.2(d), example (x)). *See also id.* at 3524 (to be codified in 15 C.F.R. § 369.2(f), Prohibition Against Implementing Letters of Credit, example (xiv)).

67. For example, Kuwaiti letters of credit typically require a statement that "the producing or supplying company is neither banned by the Arab Boycott Office nor is a subsidiary, nor a sister company of, nor affiliated with, a banned company."

68. *See* 43 Fed. Reg. 3526 (1978) (to be codified in 15 C.F.R. § 369.3(b), example (iv)).

69. *See* discussion of these boycott certifications in section III(A)(3)(d), *supra.*

70. *See* 43 Fed. Reg. 3522 (1978) (to be codified in 15 C.F.R. § 369.2(d),

(g) *Certification of the Identity of the Supplier of Goods, the Carrying Vessel, or the Insurer of the Shipment.*—United States persons may provide their Arab customers with certifications regarding the identity of suppliers of goods and services in connection with the specific transaction. Although identification of manufacturers of exported goods, components incorporated into those goods, and persons providing transportation, insurance, and other services can be used to further the ends of the boycott, there are legitimate commercial reasons for requiring certification regarding the identity of the carrier, the supplier of the shipment, and/or the suppliers of other services. Such persons may be identified in shipping documents both before and after June 21, 1978.[71]

4. Compliance, or Agreements to Comply, with Unilateral and Specific Selection of Suppliers of Goods, Carrying Vessels, Insurers, and Suppliers of Other Services

Instead of requiring United States exporters to enter into boycott-related agreements or to provide boycott or blacklist certifications, Arab buyers sometimes merely direct their American suppliers (1) to obtain goods covered by an export sales contract from a particular manufacturer, (2) to ship the goods on a particular carrier or vessel, (3) to insure the shipment with a particular insurance company, or (4) to obtain other services related to the transaction from a particular person or firm. Within a rather narrow exception to the Regulations' boycott prohibitions, United States persons may comply with such unilateral and specific selections of suppliers of goods and services, even if the United States exporter knows, or has reason to know, that specific selections are, in whole or in part, boycott or blacklist-based.[72] This exception to boycott prohibitions, however, applies only in limited circumstances, which should be understood before complying with an

example (x)). The "no blacklisted supplier" certificate situation should be distinguished from the situation in which the United States exporter agrees, as part of an export sales contract, not to select its suppliers from among those firms that are blacklisted by the Arabs. As indicated in section III(A)(2)(c), the Regulations immediately prohibit the entering into a "no blacklisted supplier" agreement. *See id.* at 3519 (to be codified in 15 C.F.R. § 369.2(a), Agreements to Refuse to Do Business, examples (i)-(ii)).

71. *See id.* at 3526 (to be codified in 15 C.F.R. § 369.3(b), examples (iv)-(vi)).

72. *Id.* (to be codified in 15 C.F.R. § 369.3(c)). Note that a United States person residing in an Arab country may make such selections when he imports specifically identifiable goods for his own use. *See* section III(C) *infra*. No such exception exists under the Tax Guidelines.

Arab request to obtain goods or services from a specific person or firm.

First, the discretion in making the selection must be exercised by the boycotting country buyer.[73] If the United States exporter goes beyond preselection services customarily provided in nonboycott circumstances in aiding its Arab customer in selecting a particular supplier,[74] the exception will not apply. If the United States exporter knows, or has reason to know, that the customer's desire to make such a selection is "boycott-motivated," the exporter may be subject to penalties under the Regulations.[75] Second, the selection must be specific.[76] An instruction from an Arab buyer directing its United States supplier to obtain goods covered by an export sales contract from Company *X* is within this exception,[77] whereas an instruction stating that goods are to be obtained from one of several firms on a customer-provided list of acceptable suppliers is not within the exception. Compliance with the latter instruction will constitute a violation of the Regulations. Third, the selection must be in the affirmative.[78] A United States exporter may comply with an instruction to obtain goods from Company *X*, but the exporter may not comply with an instruction stating that goods are not to be obtained from blacklisted Company *Y*.[79]

With respect to unilateral and specific selection of suppliers of *goods*, including parts and components that are to be incorporated into finished products before being exported to the Arab customer, the goods must be identifiable by source, either by trademark, by other identification on the product or packaging, or by uniqueness of form or design, *at the time of import into the boycotting country of destination.*[80] Thus, if the buyer's selection relates to suppliers

73. 43 Fed. Reg. 3526-30 (1978) (to be codified in 15 C.F.R. § 369.3(c)). Note particularly *id.* at 3528 (to be codified in 15 C.F.R. § 369.3(c)(18), Specific and Unilateral Selection, example (xi)).

74. *Id.* at 3527 (to be codified in 15 C.F.R. § 369.3(c)(6)).

75. *Id.* (to be codified in 15 C.F.R. § 369.3(c)). United States persons receiving what purports to be a unilateral selection relayed by a United States affiliate or procurement agent must request a statement that the selection was actually made by a resident of the boycotting country, rather than the agent. *Id.*

76. *Id.*

77. *See id.* at 3528 (to be codified in 15 C.F.R. § 369.3(c)(18), Specific and Unilateral Selection, examples (i)-(ii)).

78. *See id.* at 3528 (to be codified in 15 C.F.R. § 369.3(c)(18), Specific and Unilateral Selection, example (iv)).

79. *See id.* (to be codified in 15 C.F.R. § 369.3(c)(18), Specific and Unilateral Selection, example (iii)).

80. *Id.* at 3526-30 (to be codified in 15 C.F.R. § 369.3(c)).

of finished trademark-bearing products, the exception may apply. If, on the other hand, the buyer's selection involves suppliers of raw materials that will be unrecognizable in the finished goods, the exception does not apply,[81] and compliance by the United States exporter with such a selection is prohibited. With respect to selection of specific suppliers of *services,* the exception applies only to services that are to be performed, at least in part, in the boycotting country.[82] United States exporters may not comply with boycott-related instructions to deal with a specific firm, if that firm's services are to be performed wholly within the United States. In addition, the performance of at least part of the services in the boycotting country must be customary to the type of transaction involved and a necessary and not insignificant part of the services to be performed.[83] Finally, the exception does not apply when the United States person knows, or has reason to know, that the unilateral selection was made for the purpose of discriminating against another United States person on the basis of race, religion, sex, or national origin.[84] Thus, for example, if the goods covered by an export sales agreement between a United States trading company and an Arab buyer are made by two firms, Companies *A* and *B*, the trading company may not comply with Arab instructions to purchase the goods solely from Company *A* if the trading company knows or has reason to know that Company *A* is being preferred to Company *B* because Company *B* is owned or managed by a United States person of the Jewish faith.[85]

The foregoing restrictions do not apply to the manufacturer, shipping company, or other supplier of goods or services designated by the person making the selection. Nothing in the Regulations prohibits a United States person from supplying its own goods or services even if selected by the buyer for boycott reasons provided the person does not himself take part in any prohibited boycott-related action.[86]

---

81. *Compare id.* at 3529 (to be codified in 15 C.F.R. § 369.3(c)(18), Specifically Identifiable Goods, examples (i), (iii)-(iv)) *with id.* at 3527 (to be codified in 15 C.F.R. § 369.3(c)(18), Specifically Identifiable Goods, example (viii)).

82. *Id.* at 3526-30 (to be codified in 15 C.F.R. § 369.3(c) Suppliers of Services, examples (i)-(vi)).

83. *Id.*

84. *Id.* at 3526-30 (to be codified in 15 C.F.R. § 369.3(c)).

85. *Id.* at 3530 (to be codified in 15 C.F.R. § 369.3(c)(18), Discrimination on Basis of Race, Religion, Sex, or National Origin, example (i)).

86. *Id.* at 3527 (to be codified in 15 C.F.R. § 369.3(c)(2)).

### B. *Operations of Foreign Branches, Subsidiaries, and Affiliates of United States Firms*

Foreign branches, subsidiaries, and affiliates actually controlled by United States firms (hereinafter "foreign firms"), are considered to be United States persons and are subject to the antiboycott restrictions of the Act to the extent that their operations involve United States commerce. The following analysis of the Regulations' impact on foreign firms' operations, therefore, focuses on the concept of "interstate and foreign commerce of the United States."[87] If any part of the transaction involves United States commerce, the entire transaction will be "in commerce" for purposes of the Regulations.[88] By contrast, the antiboycott provisions of the tax law apply to transactions regardless of whether United States commerce is involved.

United States commerce may be involved in a transaction in a number of ways.

#### 1. Purchase of United States-Origin Goods or Components for Resale Pursuant to a Specific Order

Large numbers of American corporations have foreign affiliates that act as distributors in various foreign countries for the United States parent's products. With respect to high value, specialty, or unique design goods, a foreign firm's purchase of United States-origin goods for resale occurs only in response to, or in anticipation of, specific orders for the goods. The Regulations provide that foreign firms' sales transactions to boycotting countries are in United States commerce if the goods sold are acquired from any United States person for the purpose of filling, or in anticipation of receiving, specific orders from boycotting country customers,[89] even if the goods thereafter undergo substantial transformation in the hands of the foreign firm.[90] If in connection with such transactions, the foreign firm engages in boycott-related activity prohibited by the Regulations, the foreign firm may be subject to the statutory penalties.

---

87. The term "interstate and foreign commerce of the United States" is defined in *id.* at 3514-16 (to be codified in 15 C.F.R. § 369.1(d)).

88. *Id.* at 3515 (to be codified in 15 C.F.R. § 369.1(d)(10)).

89. *See id.* at 3515 (to be codified in 15 C.F.R. § 369.1(d), Foreign Subsidiaries, Affiliates, and Other Permanent Foreign Establishments of Domestic Concerns, example (ii)).

90. *See* discussion of the meaning of "substantial transformation" at section III(B)(3), *infra*.

### 2. Foreign Firm's Sale of United States-Origin Finished Goods from General Inventory

It is customary for foreign distributors to purchase large quantities of low value and standardized finished goods from their United States suppliers and stock them in general inventory for later resale. The Regulations provide that transactions involving a foreign firm's sales of United States-origin goods from general inventory are transactions in United States commerce unless the foreign firm substantially alters or manufactures the goods, or incorporates them into other products prior to resale.[91] Thus, for example, if a foreign firm purchases finished hand tools from its United States parent for resale to foreign, including Arab, customers, all such transactions will be "in United States commerce."[92] The result is the same if the products are purchased by the foreign firm from an unrelated United States supplier. The Regulations provide that if non-transformed fungible goods are purchased from United States sources and commingled with goods from non-United States sources, the transaction will be deemed to be in United States commerce unless the foreign firm had in inventory at the time of shipment sufficient non-United States-origin goods to fill the order from the boycotting country.[93]

### 3. Foreign Firm's Purchase of Parts and Components from United States Sources

In contrast to the sale of finished goods, if a foreign firm manufactures goods and purchases parts, components, and raw materials from United States firms, including the corporate parent, the sale of its goods to non-United States customers is generally not considered a transaction in United States commerce.[94] This conclusion is subject, however, to two further qualifications. First, the Regulations distinguish between (1) situations in which the foreign manufacturing firm acquires United States-origin components to

---

91. *See* 43 Fed. Reg. 3516 (1978) (to be codified in 15 C.F.R. § 369.1(d), Foreign Subsidiaries, Affiliates, and Other Permanent Foreign Establishments of Domestic Concerns, example (v)).

92. *See id.* (to be codified in 15 C.F.R. § 369.1(d), Foreign Subsidiaries, Affiliates, and Other Permanent Foreign Establishments of Domestic Concerns, examples (iv)-(v)).

93. *See id.* at 3514 (1978) (to be codified in 15 C.F.R. § 369.1(d)(8)(iv)).

94. *See id.* at 3516 (1978) (to be codified in 15 C.F.R. § 369.1(d), Foreign Subsidiaries, Affiliates, and Other Permanent Foreign Establishments of Domestic Concerns, example (ix)).

stock its parts inventory, and (2) situations in which United States-origin components are acquired for the purpose of filling a specific order. If components are acquired in response to or in anticipation of a specific order, the foreign firm's sale of finished products pursuant to that order will be a transaction in United States commerce.[95] If a foreign manufacturing firm acquires components to stock its parts inventory, however, its sale of finished goods to non-United States customers is not a transaction in United States commerce.[96] For example, assume that a foreign firm manufactures machine tools for distribution in countries other than the United States, and that the machine tools contain components manufactured in the United States by the corporate parent or by some other United States firm. Assume further that the foreign firm manufactures some tools in accordance with standardized designs, stocks them in inventory, and sells them to customers "off the shelf." Other tools are produced only in response to specific orders and in accordance with the customer's specifications. With respect to these specialty goods, assume that the foreign firm normally buys United States-origin components to fill such orders only after the customer has informed the foreign firm of its specific needs, whether or not a formal order has been placed. On these assumptions, the foreign firm's sales of standardized goods to non-United States customers would not be transactions in United States commerce[97] and would not be subject to antiboycott restrictions. By contrast, the foreign firm's sales of specialty items would involve United States commerce,[98] and would, therefore, be subject to antiboycott constraints.

Unfortunately, the Regulations do not indicate the extent to which parts or components must be "transformed" to preclude the involvement of United States commerce. One example listed under the "evasion" section of the proposed regulations implied that the

95. *See id.* at 3514-16 (to be codified in 15 C.F.R. § 369.1(d)).

96. *Id.*

97. *See id.* at 3516 (to be codified in 15 C.F.R. § 369.1(d), Foreign Subsidiaries, Affiliates, and Other Permanent Foreign Establishments of Domestic Concerns, examples (viii), (x)).

98. *See id.* (to be codified in 15 C.F.R. § 369.1(d), Foreign Subsidiaries, Affiliates, and Other Permanent Foreign Establishments of Domestic Concerns, example (ix)). If the foreign firm acquires all components from non-United States sources, none of its sales transactions will be in United States commerce, even if its products incorporate United States-origin technology. *See id.* (to be codified in 15 C.F.R. § 369.1(d), Foreign Subsidiaries, Affiliates, and Other Permanent Establishments of Domestic Concerns, example (xx)).

assembly of components might be sufficient.[99] This should be true if the finished product is appreciably more valuable than the individual components or substantial technical skill is required to complete the assembly. If the finished product is chemically or physically different from its components, such as a liquid transformed from a solid, there should be sufficient transformation. In certain cases, seemingly simple operations might qualify as transformation. For example, the bottling of certain pharmaceutical and medical products involves such complex sterilization procedures that the packaged product may be considered to be substantially different from the same liquid in bulk form.

The second qualification on the general rule that the sale of goods manufactured in foreign countries is not a transaction in United States commerce relates to the principle that if part of a transaction is in United States commerce, the entire transaction is in United States commerce. A transaction in which a United States affiliate of the foreign firm provides only ancillary services (*i.e.*, legal, general, financial, accounting, and similar services that benefit only the foreign firm) is not deemed to be in United States commerce. If, however, a United States affiliate provides services that benefit the customer, such as a performance bond[100] or architectural or engineering services,[101] those services will be deemed to be part of the transaction between the foreign firm and the boycotting country and the entire transaction will be considered to be in United States commerce. Thus, the sale of specialty items *designed* by a United States affiliate would be in United States commerce even if the item was manufactured abroad solely from all components taken from general inventory or components solely of non-United States origin.

4. Boycott-Related Conduct of the Foreign Affiliate Directed by Its United States Parent

Sometimes, a foreign firm that receives a request for boycott-related action or information seeks direction from its United States

99. 42 Fed. Reg. 48,575 (1977) (proposed regulation 15 C.F.R. § 369.4, example (iii)).

100. *See* 43 Fed. Reg. 3516 (1978) (to be codified in 15 C.F.R. § 369.1(d), Foreign Subsidiaries, Affiliates, and Other Permanent Foreign Establishments of Domestic Concerns, example (xiv)).

101. *See id.* (to be codified in 15 C.F.R. § 369.1(d), Foreign Subsidiaries, Affiliates, and Other Permanent Foreign Establishments of Domestic Concerns, example (xii)).

parent corporation on how to respond. Under the proposed regulations, if the United States parent directed the foreign firm's response in connection with a particular transaction, the transaction would be "in United States commerce."[102] If the foreign firm's response involved conduct prohibited by the proposed regulations, the foreign firm would be subject to the statutory penalties. This position has been changed in the Regulations, under which such direction would be deemed to be an "ancillary service" benefitting only the foreign firm. It has been made clear, however, that the act of directing the subsidiary would constitute an act in United States commerce[103] and thus might constitute a violation on the part of the United States parent. United States companies will have to be careful that legal or similar services provided to a foreign subsidiary are couched in terms of "advice" rather than "direction." It might be advisable that no person having managerial authority provide such advice.

### C. *Activities of United States Persons Residing in Boycotting Country*

A number of American firms presently maintain, or contemplate establishing, branch offices or subsidiaries in one or more of the Arab nations that participate in the boycott of Israel. These firms may face the dilemma of being subject to directly conflicting United States and Arab laws. The Regulations, therefore, carve out several narrow exceptions to general antiboycott prohibitions to permit United States firms' foreign affiliates that are bona fide residents of a boycotting country to comply with local law[104] in connection with activities that are carried on exclusively within the boycotting country, to comply with local import laws in the importation of goods, and to unilaterally select suppliers of goods for boycott reasons. These exceptions are limited to branches, subsidiaries, or other United States persons that qualify as bona fide residents of a boycotting country (hereinafter referred to as "resident firms"). A number of factors deemed relevant to a deter-

102. 42 Fed. Reg. 48,561 (1977) (proposed regulation 15 C.F.R. § 369.1(d), Foreign Subsidiaries or Affiliates or Branch Offices, example (viii)).

103. 43 Fed. Reg. 3514 (1978) (to be codified in 15 C.F.R. § 369.1(d)(2)). For a further discussion of the term "ancillary services," *see* section III(B)(4) *infra*.

104. The term "law" includes statutes, regulations, decrees, and the like, but does not include policies not having the effect of law. 43 Fed. Reg. at 3531 (to be codified in 15 C.F.R. § 369.3(f)(1)).

mination of residence are listed in the Regulations.[105] Most important, there must be a legitimate, nonboycott business reason for establishing a branch or subsidiary in the boycotting country before the United States person will be considered a bona fide resident of the boycotting country. A bona fide resident of a boycotting country may legitimately engage in, or agree to engage in, various activities.

1. Responding to the Seven Boycott Questions

In connection with bidding for a sales or construction contract with an Arab government or firm, a United States firm may be asked to furnish its potential Arab customer or client with information about its business dealings, and/or the dealings of its United States corporate parent or affiliate, with or in Israel ("Seven Questions" information). A branch or affiliate that is a bona fide resident of the Arab country requesting the information may provide such information both on its own behalf and on behalf of its United States corporate parent,[106] but the United States corporate parent may not cooperate with or assist its Arab branch or affiliate in responding to requests for "Seven Question" information.[107] Therefore, the foreign affiliate must possess all necessary information to respond to any such questions. Although the resident firm may supply information regarding the corporate group's business dealings with or in the boycott target country, the resident firm may not supply information about any United States person's race, religion, sex, or national origin,[108] nor may it undertake to terminate or avoid such dealings with the boycotted country.

Arab requests for "Seven Question" information from United States corporate affiliates that are already qualified to do business

105. The Regulations list the following factors that will be considered in determining whether a United States company's boycotting country branch or affiliate is a bona fide resident of the boycotting country: (1) physical presence in the country; (2) legitimate business purpose for local presence; (3) continuity of presence; (4) intent to maintain presence; (5) prior residence in the country; (6) size and nature of presence; (7) qualification (registration) to do business in the country; and (8) similar presence in both boycotting and non-boycotting foreign countries in connection with similar business activities. *Id.* (to be codified in 15 C.F.R. § 369.3(f)(2)).

106. *See id.* at 3532 (to be codified in 15 C.F.R. § 369.3(f-1), Activities Exclusively Within a Foreign Country, examples (iii)-(iv)).

107. *See id.* at 3531 (to be codified in 15 C.F.R. § 369.3(f), examples (iii)-(v)).

108. *Id.* (to be codified in 15 C.F.R. § 369.3(f)).

in the requesting country are uncommon.[109] Usually, a United States firm will be asked to provide information regarding its business dealings in Israel and with Israeli nationals at the time that the firm seeks to register a branch or incorporate a subsidiary in an Arab country.[110] Since the firm is not yet a resident in the Arab country, the bona fide resident exception is unavailable. The Regulations, however, establish a limited exception for the provision of "Seven Question" information in connection with efforts to qualify a branch or affiliate to do business in a boycotting country.[111] Under this exception, the representative of a United States firm that seeks to establish a branch or subsidiary in an Arab country may provide officials of that country with boycott information, such as that elicited by the "Seven Questions," while he is present in the Arab country (even if he is not a permanent resident therein) for the purpose of establishing the branch or subsidiary. This exception is only as broad as the exception for bona fide resident branches; therefore, representatives of firms that seek to register a branch in an Arab country may not provide any information regarding the race, religion, sex, or national origin of officers, directors, or employees of the firm or of any other United States person.[112]

### 2. General Compliance with Local Laws

The Act and proposed regulations permit a bona fide resident of a boycotting country to comply with, or agree to comply with, the laws of that country, presumably including boycott laws, in connection with activities exclusively therein.[113] In practice, it will be quite difficult to come within this exception, especially with respect to general agreements to comply with boycott laws, because the activities of a company in carrying out a substantial contract are rarely confined exclusively to a single country. For example, the Regulations indicate that a bona fide resident of a boycotting country may agree not to hire Israeli nationals if it recruits solely within the boycotting country, but not if it recruits

109. But note that Iraq may require such responses in connection with government tenders.

110. This requirement has recently been relaxed, however, in countries such as Egypt and Saudi Arabia. *See* Turck, *supra* note 65, at 476.

111. 43 Fed. Reg. 3531 (to be codified in 15 C.F.R. § 369.3(f), examples (iv), (vi)).

112. *Id.* (to be codified in 15 C.F.R. § 369.3(f)).

113. *Id.* at 3532 (to be codified in 15 C.F.R. § 369.3(f-1)).

personnel outside the boycotting country.[114] Since most companies recruit personnel in the United States, the exception may have little practical significance. An agreement to comply generally with a boycotting country's boycott laws would be particularly dangerous unless the contractor's activities were confined to the boycotting country. If, however, the contractor's only out-of-country activity was procurement of goods or materials rather than services, it could perhaps rely upon a combination of this exception and the "local import laws" exception discussed under subsection 3, *infra*, to justify accepting such a provision. Such an approach must be considered on a case-by-case basis. In general, however, this exception will be of little benefit to United States companies doing business in the Middle East except for answering the so-called "Seven Questions," as discussed under subsection 1, *supra*.

3. Compliance with Local Import Regulations

The customs law and regulations of a number of Arab countries prohibits the importation of goods (1) manufactured in Israel, (2) produced by Israeli persons or firms, or (3) produced by blacklisted firms.[115] The Regulations establish an exception permitting bona fide resident firms to comply and agree to comply with such import laws and regulations under certain limited circumstances.[116] First, the exception applies only to persons and firms that are bona fide residents of a boycotting country.[117] Domestic American firms that conduct their operations (including production for export to Arab countries) to comply with Arab restrictions on import of Israeli or blacklisted American firm goods will have engaged in a boycott-related refusal to do business[118] in violation of the Act. Moreover,

114. *See id.* (to be codified in 15 C.F.R. § 369.3(f-1), Discrimination Against United States Persons, example (i)). Perhaps one could rely on the exception for complying or agreeing to comply with import regulations prohibiting the importation of services provided by Israeli nationals to avoid this limitation, but this example does not consider that exception at all. *See id.* at 3525 (to be codified in 15 C.F.R. § 369.3(a-1)).

115. *See, e.g.*, Egyptian Boycott Law art. 3, Law No. 506, (1955). *See generally* SUBCOMM. ON OVERSIGHT, *supra* note 7, at 3234; Turck, *supra* note 65, at 473-74.

116. *Id.* at 3533 (to be codified in 15 C.F.R. § 369.3(f-2)(1)).

117. *See id.* The tests for determining whether the boycotting country branch or subsidiary of a United States firm is a bona fide resident of the boycotting country are set forth in *id.* at 3531 (to be codified in 15 C.F.R. § 369.3(f)). *See* section III(C) *supra*.

118. *Id.* at 3517-20 (to be codified in 15 C.F.R. § 369.2(a)).

the transaction in which the bona fide resident firm complies with local boycott-related import laws must involve the purchase of goods for the resident firm's *own use* within the boycotting country.[119] Goods are considered to be for the resident's own use if they are (1) to be consumed by the branch or its employees;[120] (2) to remain in the resident firm's possession and used by it; (3) to be placed in work in process inventory and to be further manufactured, incorporated into, refined into, or reprocessed into another product to be manufactured for another; (4) to be used by the resident firm to perform contractual services for another person; or (5) to be directly incorporated into, or permanently affixed as a functional part of, a project being manufactured or constructed for another person. Under the proposed regulations, goods were also deemed to be for a resident's own use if they were to be placed in general inventory for later sales to third parties,[121] but this has been changed in the Regulations.[122] Goods are also not intended for the resident firm's own use if they are purchased on behalf of another or for the purpose of resale to another pursuant to a specific order.[123]

A third requirement of the import regulation exception is that the source of the goods must be identifiable by means of trademark or uniqueness of design at the time of their importation into the boycotting country.[124] Products are not "identifiable" if the producer may only be identified by means of accompanying documentation. Thus, a resident firm may not agree to comply with Arab prohibitions on dealing with blacklisted supplies of raw materials, parts, and components, if such raw materials, parts, or compo-

---

119. *Id.* at 3533 (to be codified in 15 C.F.R. § 369.3(f-2)(6)).

120. An example is the purchase of Pepsi-Cola rather than Coca-Cola for the branch's employee cafeteria because local law prohibits the importation of Coca-Cola (a product of a blacklisted company).

121. 42 Fed. Reg. 48,574 (1977) (proposed regulations) (to be codified in 15 C.F.R. § 369.3(f)(16)(v)).

122. 43 Fed. Reg. 3533 (1978) (to be codified in 15 C.F.R. § 369.3(f-2)(7)). Thus, a purchase by a resident branch that is acting as a local distributor for American manufacturers, or that is acting as a procurement agent for a boycotting country firm or government, would not be for the resident branch's own use. *See id.* at 3534 (to be codified in 15 C.F.R. § 369.3(f-2), Imports for U.S. Person's Own Use, example (vii)).

123. *Id.* at 3533 (to be codified in 15 C.F.R. § 369.3(f-2)(7)).

124. *Id.* (to be codified in 15 C.F.R. § 369.3(f-2)(4)). The rules for determining the nature of specifically identifiable goods are set out in *id.* at 3528 (to be codified in 15 C.F.R. § 369.3(c)(17)). *See generally* section III(A)(4) *supra*.

nents have been sufficiently processed or altered, prior to importation into the Arab country, to make their source unidentifiable. This may constitute a significant limitation on the availability of this exception. As noted above, government contracts in a number of Arab countries require the contractor to comply with all boycott laws and regulations. These laws and regulations prohibit the importation of products manufactured in whole or in part by blacklisted companies. Other government contracts contain prohibitions against the supplying of goods manufactured in whole or in part by blacklisted firms. Since almost every product contains both identifiable and non-identifiable materials or components, any agreement to comply with the import laws of an Arab country may fall outside this exception. Further clarification should be obtained from the Department of Commerce before acting in reliance on this exception with respect to agreements.

A fourth limitation on the import regulation exception is that it applies only with respect to boycotting country laws that prohibit the importation of *goods* produced in whole or in part in the boycotted country or by blacklisted firms. It does not apply to compliance with prohibitions on the supply of services by such firms.[125] The exclusion of services from this exception was apparently an oversight in drafting the legislation, but the Department of Commerce determined that it lacked authority to "correct" this oversight by means of the Regulations. Bona fide residents, like all other firms, may comply or agree to comply with Arab import regulations that prohibit services provided by Israeli nationals or firms, but not with those regulations that prohibit services provided by blacklisted firms. A bona fide resident may act under this exception through an agent, but discretion must be exercised by the resident.[126] This proviso creates significant risks for any United States parent company that wishes to establish that a selection was made unilaterally by its bona fide resident branch or subsidiary. For example, the head office of most engineering firms, who are most likely to seek to take advantage of the exception, routinely play an important role in procurement activities; thus, this exception may have limited practical significance.

A final limitation on the import regulation exception is that a resident firm may not comply or agree to comply with Arab import

125. 43 Fed. Reg. 3533 (1978) (to be codified in 15 C.F.R. § 369.3(f-2)(8)).

126. *Id.* (to be codified in 15 C.F.R. § 369.3(f-2)(3)).

regulations that require discrimination against United States persons on the basis of race, religion, sex, or national origin.[127]

4. Compliance with Boycotting Country Export Shipment and Transshipment Requirements

As part of the primary boycott of Israel, Arab countries prohibit direct and indirect export of Arab-made goods and Arab-origin raw materials to Israel.[128] As indicated above, the legislative history of the Act indicates a recognition of the legitimacy of international primary boycotts,[129] and therefore the Regulations exempt from the boycott prohibitions actions taken in compliance with Arab primary boycott requirements. Specifically, the Regulations permit United States persons and firms to comply, and to agree to comply, with Arab prohibitions on shipment and transshipment of Arab products to Israel, and/or to Israeli persons and firms.[130] This exception is not limited to resident firms. Any United States person may agree to comply with Arab prohibitions on transshipment to Israel.

D. *Letter of Credit Transactions*

The Regulations prohibit United States persons from paying or implementing letters of credit that contain conditions or requirements, compliance with which is prohibited by other substantive antiboycott restrictions.[131] This prohibition is based on a recognition that payment on export sales to Arab countries is usually by means of letters of credit requiring boycott-related certifications. In fact, probably the most common type of boycott-related trans-

---

127. *Id.* (to be codified in 15 C.F.R. § 369.3(f-2)(10)).

128. Sudan, Algeria, Tunisia, and Morocco apparently maintain only a primary boycott of Israel. *See* Turck, *supra* note 65, at 476. *See also* U.S. DEP'T OF COMMERCE, REVIEW OF PRIMARY AND SECONDARY BOYCOTTS EMPLOYED BY COUNTRIES OTHER THAN THE UNITED STATES, *reprinted in Hearings on Discriminatory Arab Pressure on U.S. Business Before the Subcomm. on International Trade & Commerce of the House Comm. on International Relations,* 94th Cong., 1st Sess. 226-27 (1976). Other Arab countries boycott Israel on a primary level, but also extend their anti-Israel activities to secondary and tertiary levels.

129. *See* section III(A)(2) *supra.*

130. *See* 43 Fed. Reg. 3530 (1978) (to be codified in 15 C.F.R. § 369.3(d) & examples (i)-(iv)).

131. *Id.* at 3523 (to be codified in 15 C.F.R. § 369.2(f)(1)). The proscribed letter of credit terms (*i.e.*, boycott certifications) to which the regulations apply are discussed in section III(A)(3) *supra. See also id.* at 3534, (to be codified in 15 C.F.R. § 369.2(f)(1), Prohibition Against Implementing Letters of Credit, examples (i)-(ii), (vi)).

action is that in which an exporter provides a bank with various boycott and blacklist certifications as part of the exporter's presentment for payment under a letter of credit.

The Regulations identify the following six elements necessary to constitute an offense under the letter of credit provisions of the Act:

1. The letter of credit must require, or be conditioned upon, the beneficiary's making prohibited boycott certifications or providing prohibited boycott-related information;[132]
2. The bank implementing the letter of credit must be a United States person, within the meaning of the Regulations;[133]
3. The transaction to which the letter of credit applies must be in United States commerce;[134]
4. The letter of credit beneficiary must be a United States person, within the meaning of the Regulations;[135]
5. The United States bank's conduct must constitute "implementing" the letter of credit;[136] and
6. The United States bank must have the requisite intent to support a boycott.[137]

The Regulations specify in considerable detail the circumstances in which each of these elements will be deemed or presumed to be present. As a result, the elements of a letter of credit offense merit individual consideration.

1. United States Person

For purposes of the letter of credit provisions of the Regulations, the definition of a United States person includes domestic United States banks, foreign branch offices of United States banks,[138] and

132. *Id.* at 3523 (to be codified in 15 C.F.R. § 369.2(f)(1)).

133. *Id. See* section III(D)(1) *infra.*

134. 43 Fed. Reg. 3523 (1978). (to be codified in 15 C.F.R. § 369.2(f)(6); *see* section III(D)(2) *infra.*

135. 43 Fed. Reg. 3523 (1978). (to be codified in 15 C.F.R. § 369.2(f)(6)); *see* section III(D)(2) *infra.*

136. 43 Fed. Reg. 3523 (1978). (to be codified in 15 C.F.R. § 369.2(f)(2)); *see* section III(D)(2) *infra.*

137. 43 Fed. Reg. 3523 (1978). (to be codified in 15 C.F.R. § 369.2(f)(6)); *see also* section II(C) *supra* (general discussion of the Regulations' concept of "intent").

138. 43 Fed. Reg. 3513 (1978) (to be codified in 15 C.F.R. § 369.1(b)(1)(v)); *see id.* (to be codified in 15 C.F.R. § 369.1(b), example (i)); *id.* at 3514 (to be codified in 15 C.F.R. § 369.1(c), example (ix)).

permanent United States establishments of foreign banks.[139] Although not expressly covered in the Regulations, a foreign bank that is "controlled in fact" by a United States bank or other United States persons is also subject to the Act.[140] Thus, foreign banks doing business in the United States and United States banks doing business abroad must monitor their branch operations to ensure that their branches do not become involved in boycott-related activities in United States commerce.

2. Interstate and Foreign Commerce of the United States

The Regulations' definition of letter of credit transaction "in United States commerce" represents a significant departure from the "in commerce" definition set forth in the earlier proposed regulations. A letter of credit transaction will be in United States commerce, and thus subject to the Act, if (1) the underlying transaction to which the letter of credit relates is in United States commerce, and (2) the letter of credit beneficiary is a United States person within the meaning of the Regulations.[141] With respect to these requirements, the Regulations set forth a number of presumptions. Although rebuttable by competent evidence to the contrary, certain presumptions will arise in the following circumstances:

(a) A letter of credit implemented within the United States by a United States bank located in the United States will be presumed to relate to a transaction in United States commerce and to be in favor of a United States beneficiary if it specifies a United States address for the beneficiary;[142]
(b) A letter of credit implemented outside the United States by a United States person located outside the United States will be presumed to relate to a transaction in United States commerce and to be in favor of a United States beneficiary if it (i) specifies a United States address for the beneficiary, (ii) requires documents indicating shipment from the United States, or (iii) requires documents indicating that the goods are of United States origin;[143]

139. *Id.* at 3513 (to be codified in 15 C.F.R. § 369.1(b)(1)(iv)).
140. *See generally id.* (to be codified in 15 C.F.R. § 369.1(c)(1)).
141. *Id.* at 3523 (to be codified in 15 C.F.R. § 369.2(f)(6)). *See also* section II(A) *supra* (definition of "United States person").
142. 43 Fed. Reg. 3523 (1978) (to be codified in 15 C.F.R. § 369.2(f)(7)).
143. *Id.* (to be codified in 15 C.F.R. § 369.2(f)(9)); *see id.* at 3524 (to be codified in 15 C.F.R. § 369.2(f), Implementation of Letters of Credit in United States Commerce, example (iii)).

(c) A letter of credit will be presumed to be in favor of a non-United States beneficiary if it specifies a non-United States address for the beneficiary regardless of whether it is implemented by a United States person or whether it is implemented within the United States;[144] and
(d) A letter of credit will be presumed to relate to a transaction outside of United States commerce if it does not call for documents indicating shipment from the United States or that the goods are of United States origin and the address of the beneficiary is outside the United States.[145]

### 3. "Implementing" a Letter of Credit

Under the Regulations, banks are prohibited from "implementing" any letter of credit that requires the payee or beneficiary to provide prohibited boycott information or certifications. The term "implementing" includes (1) opening or issuing a letter of credit at the request of a client, (2) honoring a letter of credit, (3) paying a draft issued under a letter of credit, (4) confirming a letter of credit, (5) negotiating a letter of credit by purchasing a draft issued thereunder from the beneficiary and presenting the draft to the issuer or confirmer for reimbursement, and (6) taking other action to implement a letter of credit.[146] The term "implementing" does not include merely advising the beneficiary of the existence of a letter of credit in the beneficiary's favor nor does it include taking other ministerial acts.[147] The term "ministerial acts" is not defined in the Regulations, so it is unclear whether merely forwarding the documents required by the credit to the issuing bank and/or transmitting payment from the issuing bank to the beneficiary are ministerial acts. In this regard, it may be significant that the Regulations refer to ministerial acts *to dispose of a letter of credit which it is prohibited from implementing*.[148] While this uncertainty remains, this exception may be of little practical significance.

An example in the Regulations states that a bank may imple-

144. *Id.* at 3523 (to be codified in 15 C.F.R. § 369.2(f)(8)-(10)); *see id.* at 3524 (to be codified in 15 C.F.R. § 369.2(f), Implementation of Letters of Credit in United States Commerce, example (v)).

145. *Id.* at 3523 (to be codified in 15 C.F.R. § 369.2(f)(10)).

146. *Id.* (to be codified in 15 C.F.R. § 369.2(f)(2)).

147. *Id.* (to be codified in 15 C.F.R. § 369.2(f)(4)); *see id.* at 3524 (to be codified in 15 C.F.R. § 369.2(f), Prohibition Against Implementing Letters of Credit, examples (ii), (v), (xii)-(xiii)).

148. *Id.* at 3523 (to be codified in 15 C.F.R. § 369.2(f)(4)).

ment a letter of credit that requires the beneficiary to certify that it is not blacklisted, but the implementing bank may not require the beneficiary to provide such a self-certification because to do so would constitute a refusal to deal with blacklisted persons.[149] The implementing bank would, however, risk liability for breach of contract if it were to make payment on the letter of credit against a non-conforming presentation by the beneficiary. As a result, as a practical matter, it seems most unlikely that any bank would consider implementing such a letter of credit since insisting on strict compliance with the letter of credit terms would constitute a violation of the Regulations and failure to insist on strict compliance would constitute a breach of contract. United States banks that seek to rely on this example should be careful to do so only when the certification required conforms literally to its language. As noted *supra*, a self-certification that the beneficiary making the certification is not blacklisted appears permissible under the Regulations,[150] an interpretation strongly supported by the example. In contrast, an example in another section of the Regulations indicates that a negative certification not limited by its terms to the maker is not permissible after June 21, 1978.[151] Thus, certification that goods are not manufactured or supplied by a blacklisted company may not be made by a United States person after June 21, 1978, even if made by the manufacturer or supplier. Similarly, a letter of credit requiring such a certification may not be implemented by a United States bank after the date.[152]

4. Letter of Credit Transactions Under the Treasury Guidelines

In contrast to the Commerce Department antiboycott guidelines, the Treasury guidelines have little to say about letter of credit transactions. The application of the Internal Revenue Code's antiboycott provisions depends on the taxpayer entering into, or making, an agreement to participate in or cooperate with a foreign boycott not sanctioned by the United States. Guidelines H-29 through H-31 discuss circumstances in which a bank's implementation of a letter of credit will constitute an agreement to

149. *Id.* (to be codified in 15 C.F.R. § 369.2(f), Prohibition Against Implementing Letters of Credit, example (xiv)).

150. *See* section III(A)(3)(e) *supra.*

151. 43 Fed. Reg. 3526 (1978) (to be codified in 15 C.F.R. § 369.3(b), example (iv)).

152. *See* section III(A)(3)(f) *supra.*

engage in boycott-related conduct. Under these Guidelines, banks that confirm, pay, honor, negotiate, open, or otherwise implement a letter of credit that is conditioned upon the beneficiary making a prohibited boycott certification, such as a "no-blacklisted supplier" or "non-blacklisted vessel" certification,[153] will be deemed to be participating in or cooperating with a boycott.[154] Companies that provide certain negative certifications under a letter of credit will be subject to tax penalties[155] even though the same certification might be provided in response to import requirements without incurring such penalties.[156] Like the Regulations, however, the Guidelines permit taxpayer-banks to advise beneficiaries of letters of credit that contain prohibited boycott requirements.[157] If the bank has performed only this ministerial function and has taken no action involving implementation of the letter of credit, the bank will not be deemed to have entered into a prohibited boycott agreement.

## IV. Evasion

One of the more difficult problems posed by the Regulations is the concept of "evasion." Section 369.4 of the Regulations[158] prohibits any United States person from engaging in any transaction or taking any action with the intent of evading any of the other provisions of the Regulations. In particular, actions by United States persons designed to bring other actions or action outside jurisdictional scope of the Regulations are prohibited if the former,

153. Guidelines H-29A, H-29B, 43 Fed. Reg. 3465 (1978). *See generally* Guideline H-8, *id.* at 3463 (making of "no-blacklisted supplier" certificate is a prohibited agreement).

154. *See* Guideline H-29A, *id.* at 3465. One significant difference between the Guidelines and the Regulations as they apply to letter of credit transactions relates to the boycott-related certificates that may be required without running afoul of antiboycott penalties. For example, under the Guidelines, a bank will not be held to have entered into a prohibited boycott-related agreement if it implements a letter of credit conditioned upon the beneficiary's making of a negative certificate of origin. Guideline H-31, *id. See generally* I.R.C. § 999(b)(4)(B). In contrast, under the Regulations, a United States bank may not, after June 21, 1978, implement a letter of credit conditioned upon the beneficiary's making of a negative certificate of origin. 43 Fed. Reg. 3523-24 (to be codified in 15 C.F.R. § 369.2(f), Prohibition Against Implementing Letters of Credit, example (vi)).

155. Guideline H-8, *id.* at 3463.

156. Guideline H-29A, *id.* at 3465.

157. *Id.*

158. *Id.* at 3534-36.

facilitative actions are intended to accomplish an evasion of the regulatory scheme. Thus, structuring a transaction or operation to avoid involvement of United States commerce or to avoid classification of a joint venture company as a United States person may constitute evasion if motivated by a desire to avoid the Act. Moreover, transactions or actions themselves designed to fit the literal terms of one or more of the specified exceptions of the Act are prohibited both as evasions and as violations of other sections if such transactions or actions are not consistent with the intent of those exceptions. Actions taken to evade the Act need not involve United States commerce to constitute a violation of the Act. This is a significant departure from the jurisdictional limitation on the scope of the Act with respect to other prohibitions. As defined and illustrated in both the proposed and final Regulations,[159] the concept of evasion includes the traditional notion of a sham transaction and mere formal compliance with legal requirements. The proposed regulations seemed to indicate that the concept of evasion might also extend to substantial transactions motivated in whole or in part by a desire to avoid the restrictions of the Act. The final Regulations, however, seem to clearly distinguish between avoidance and evasion and permit American companies to plan their operations in the Middle East, especially since the concept of evasion does not extend to actions taken to avoid the Arab boycott itself.

### A. *Sham Transactions and Formal Compliance*

A number of the examples given in the Regulations make it clear that mere formal compliance with the Act, without substantial compliance with its intent, will constitute evasion and thus subject the perpetrator to the sanctions of the Act. Reliance upon any "artifice, device or scheme" or the use of "dummy" corporations or other devices to mask prohibited activities or qualify for an exemption would thus constitute a violation of the Act. For example, if a company includes for the first time information in its annual report concerning its world-wide operations solely for the purpose of providing that information to the boycotting country, an evasion will be found.[160] Similarly, naming a non-United States "dummy" corporation as beneficiary of a letter of credit containing

159. *Compare id.* at 3534-35 (to be codified in 15 C.F.R. § 369.4(b), (e)) *with* 42 Fed. Reg. at 48,575 (1977) (proposed regulation § 369.4).

160. *See* 43 Fed. Reg. 3535(to be codified in 15 C.F.R. § 369.4, example (i)).

prohibited certification requirements would constitute an evasion by both the true beneficiary and the issuing or confirming bank, assuming the bank had knowledge of the "dummy" status of the named beneficiary.[161]

The Regulations contain several examples in which a United States supplier who sells or takes some other action through a third party is deemed to be guilty of evasion. In example (iv), a company ceases all direct sales to a boycotting country in response to the Act's prohibition against providing a negative certification on shipping documents. Thereafter, it makes all sales to a distributor located in a third country, but the supplier's warranty runs directly to the purchaser. The supplier knows that the distributor will make necessary negative certifications. In the example it is concluded that this arrangement constitutes evasion because the distributor is carrying out prohibited activity on the supplier's behalf. It is unclear in this example whether the distributor is acting as a true purchaser and reseller of the products, whether the goods are shipped directly to the Middle East, whether the distributor is a substantial company, whether the entire arrangement is established at the initiative of the United States supplier, or whether the result would differ if the United States company's product warranty did not run to the ultimate customer. Hopefully, it is not intended to characterize all distribution arrangements as evasions.

There are indications that some companies, especially smaller companies, are reaching the conclusion that selling to certain countries in the Middle East is not feasible under the Act. If such a company is approached by a substantial European or Japanese trading company that wishes to act as a distributor for the company's products in the Middle East, a distributorship might be established on normal, commercially reasonable terms with sales handled in the same manner as sales to any other European customer. If no element of a sham, such as participation in negotiations with the customer by the United States supplier or direct shipment to Middle East locations, is present, such an arrangement should not, but unfortunately may, constitute evasion. One might conclude that the United States supplier has not evaded the prohibitions of the Act since it has avoided being in a position in which it may be required to take some action that would further or support a boycott, the very objective of the Act. The fact that

161. *See id.* (to be codified in 15 C.F.R. § 369.4, examples (xv)-(xvi)).

the non-United States company may take some boycott-related action in connection with the resale of the products is irrelevant since the Act does not purport to control the activities of non-United States persons.[162]

Large multinational companies will apparently be permitted to restructure their operations to supply Middle East markets from foreign manufacturing facilities. For smaller companies, however, such restructuring may not be possible. If they are deemed to violate the Act by selling to European companies with knowledge that the products may be resold in the Middle East, smaller companies may well be driven out of the Middle East market. It would be ironic if a restructuring that reduces United States exports was acceptable while a restructuring that preserves United States exports is not.

The proposed regulations permitted United States persons to impose a "risk of loss" clause on its suppliers.[163] A number of commentators argued that such a clause constituted a subterfuge designed to exclude blacklisted companies. The Department of Commerce accepted this argument in part by creating a presumption that the use of this term by purchasers after January 18, 1978, would be boycott-motivated and so constitute an evasion.[164] Such a presumption could only be rebutted by showing that the term is customarily used by the purchaser in nonboycotting countries and that there is a legitimate nonboycott reason for its use. On the other hand, if the United States person customarily required such a clause prior to the effective date of the Act, no such presumption will arise. In practice, a risk of loss term may not always be designed to exclude blacklisted companies. United States companies have been reluctant to supply negative boycott shipping documents and will be prohibited from doing so after June 21, 1978. As a matter of administrative practice, most Middle East countries now accept positive documents, but in most such countries the boycott laws themselves have not been amended. There is always

162. This situation requires a product that can be sold "off the shelf" with no local installation required by the manufacturer. In addition, the distributor must be sufficiently credit-worthy to purchase without having to assign Middle East sales proceeds as security for his purchases. The utility of this approach is further limited by the fact that certain Middle East countries that impose the very stringent boycott requirements, such as Syria and Iraq, also have a policy against purchasing products from anyone other than the manufacturer.

163. *See* section III(A)(2)(d) *supra*.

164. 43 Fed. Reg. 3534-35 (1978) (to be codified in 15 C.F.R. § 369.4(d)).

the risk that administrative practice may again be changed. There are indications, for example, that Libya may return to requiring a negative certificate of origin. Purchasers in the Middle East may wish to protect against the risk that goods cannot be delivered for failure to supply import documents. A risk of loss provision deals with this problem and still permits the seller to obtain payment upon shipment of the goods. Nonetheless, use of a risk of loss clause would create a significant exposure for a United States company regardless of the reason for its use since it will be extremely difficult to overcome the presumption of evasion. This may force United States buyers in Middle East countries to impose more onerous F.O.B. destination terms on American suppliers. Such terms are clearly acceptable under the Regulations.[165]

It is not clear whether the supplier who accepts a risk of loss term will similarly violate the Act. The examples in the Regulations speak in terms of evasion by the purchaser who requires the term. As this is a contract provision imposed on the supplier, it should not constitute a violation by the supplier although it could conceivably be considered aiding and abetting the purchaser's violation. If the purchaser is not a United States person, however, there would be no primary violation of the Act so there would be no aiding and abetting by the supplier. In addition, it is indicated in another context that nothing in the Regulations prohibits or restricts a United States person from filling an order itself even if the selection process has been tainted by boycott.[166]

### B. *Substantial Compliance but Boycott Motivated*

The proposed regulations caused great concern because of the absence of a clear distinction between "avoidance" and "evasion" of the Act. American jurisprudence normally recognizes that a person may plan his operations to avoid the application of a law provided his planning results in substantial compliance and not a mere sham. Such legitimate planning might have been severely hampered by the "evasion" provisions of the proposed regulations. Fortunately, the final Regulations appear to sanction planning by companies wishing to continue doing business in and with the Middle East so long as the planning does not result in a mere sham.

---

165. *See id.* at 3535 (to be codified in 15 C.F.R. § 369.4, examples (xiii)-(xiv)).
166. *Id.* at 3527 (to be codified in 15 C.F.R. § 369.3(c)(2)).

Certain examples contained in the proposed and final Regulations illustrate the different approaches taken by the two versions. Example (iii) of the proposed regulations dealt with a foreign subsidiary that asked its parent company to ship machines unassembled so that the subsidiary might fill orders in the boycotting country from machines assembled abroad, something it could not do if the transaction were subject to the Act. Although this operation would normally take the subsidiary's sales outside of United States commerce, the proposed regulations concluded that this change in procedure would constitute an evasion of the Act. The facts given did not indicate whether the restructuring involved was substantial or merely formal. Example (iii) does not appear in the final Regulations. By contrast, example (vii) of the final Regulations[167] indicates that a company that concludes that it can no longer supply United States-manufactured products to a boycotting country may allow that territory to be serviced by another subsidiary whose sales would fall outside United States commerce, without being deemed to have evaded the Act. Example (vii) would also permit the foreign subsidiary to expand its manufacturing facilities to supply the Middle East. In example (vii), there is no indication that the parent company participated in the foreign subsidiary's decision to expand its manufacturing facilities to sell to boycotting countries although the point is not really emphasized. Since it is unrealistic to suppose that foreign subsidiaries take such steps completely independently, the example probably should not be read to be so limited. The Regulations[168] themselves are not so limited. The same reasoning would presumably apply to a decision to establish a new manufacturing facility abroad so long as the decision is not based solely on boycott considerations and the new subsidiary is not directed to take specific boycott-related actions.

Most multinational companies will probably take steps to supply the Middle East from foreign manufacturing facilities. Such restructuring cannot be accomplished on an ad hoc basis, however. Example (viii) of the final Regulations, reflecting an example given in the Senate Report on the Act,[169] holds that diversion of a purchase order requiring a prohibited negative certification to a foreign facility constitutes an evasion. This may present problems for companies with highly centralized management. For example,

167. *Id.* at 3535 (to be codified in 15 C.F.R. § 369.4, example (xii)).

168. *Id.* at 3535 (to be codified in 15 C.F.R. § 369.4(3)).

169. S. REP. No. 104, 95th Cong., 1st Sess. 27 (1977).

many companies solicit orders through a single sales office for a given region. The orders may actually be filled by a domestic or foreign manufacturing facility at the direction of the head office, based upon such considerations as manufacturing capacity, tax exposure, pricing, and the like. If an order from the Middle East is assigned to a non-United States facility, it may expose the company to a charge of evasion if boycott considerations enter into the decision-making process.

Nonetheless, as a whole, the final Regulations do not appear to require a finding of evasion whenever boycott matters are considered in reaching a legitimate business decision. On the contrary, the Regulations emphasize the need for some business justification unrelated to the boycott rather than the absence of boycott-related motivation. The Regulations do not clearly indicate whether the business-related motivation for the act in question must be equal to or greater than the antiboycott regulation avoidance motivation. At a minimum, however, the requirement of some business justification should probably be understood as meaning substantial business justification. A lesser standard might amount, in practice, to little more than a prohibition of actions or transactions designed solely to avail oneself of a regulatory exclusion or exception. In view of the strong overall policy of both the statute and the Regulations in preventing and deterring most forms of boycott supportive activity, so slight a limitation on attempts to circumvent the regulatory scheme seems unlikely. On the other hand, the final Regulations do not appear to require that nonboycott-related business reasons be preponderant.

Many other questions remain unanswered in this area. For example, the Regulations generally sanction positive certifications, but such a certification could be considered a subterfuge. A certification that a vessel is entitled to call at Arab ports may simply be another way of saying that the vessel is not blacklisted. The Regulations do provide that the same statement in the negative, that a vessel is "not banned from calling at Arab ports," is prohibited.[170]

### C. *Avoidance of Boycott Requirements in the Middle East*

Clearly, a United States person may take steps to avoid complying with the boycott without thereby being guilty of evasion of the antiboycott laws. In fact, avoiding the Arab boycott at its source

170. 43 Fed. Reg. 3526 (1978) (to be codified in 15 C.F.R. § 369.3(b), example (xii)).

is an excellent, though difficult, way to avoid problems under United States law and should not be overlooked by companies trying to continue to do business in the Middle East. In practice, the Arab boycott is encountered in relatively few situations. For example, the import regulations of most Arab countries require certain negative certifications that are prohibited after June 21, 1978. Under current administrative practice, however, these regulations are not enforced in most countries (Iraq and Oman are the principal exceptions). Thus, these regulations do not currently pose any serious difficulties for American companies or their affiliates who police their activities to avoid furnishing unnecessary certifications. There are some indications, however, that the more militant Arab states may return to requiring negative certifications. Letters of credit issued in many Arab countries[171] continue to require negative certifications that will be prohibited under the Act after June 21, 1978. In certain cases, the advising bank may be able to procure an amendment to the letter of credit deleting the negative certification requirement. It is sometimes possible to achieve by amendment what could not be achieved by requesting a deletion on the letter of credit itself. In other countries, government regulations strictly require certain printed requirements[172] and the banks are unwilling to delete them. In those countries, the only alternative is to sell without a letter of credit, usually on open account or on a draft against documents basis. One difficulty with this approach is the credit risk involved. In addition, there may be difficulty in persuading a customer who is accustomed to buying on a letter of credit basis to change this practice.

One must answer the Seven Questions or agree to comply with boycott laws and regulations in order to qualify to do business in, or with the government of, certain boycotting countries. Although difficult perhaps, avoidance is possible in certain countries. For example, answering the Seven Questions may now be avoided when registering a branch in Saudi Arabia. Government contracts containing boycott clauses, including express agreements to comply with the boycott laws of the country and a right reserved to the buyer to approve subcontractors and suppliers, present a further difficulty. Certain Arab governments, including Libya and Saudi

171. Egypt, Saudi Arabia and, where requested, Bahrain, Dubai, and Qatar are the principal exceptions. After consultation with United States Commerce Department officials, Kuwait dropped the negative certificate requirement from its letter of credit standard form.

172. *See, e.g.*, DUNN & BRADSTREET, *supra* note 53, at 2.915.

Arabia, have recently shown a willingness to soften clauses requiring compliance with boycott laws sufficiently to make them legitimate for United States companies, although the substituted clauses may still cause difficulties under the antiboycott provisions of the Internal Revenue Code of 1954.[173] Any attempt to delete or amend such clauses requires difficult and delicate negotiation, however. One alternative to subcontractor and supplier approval clauses suggested by the Act is to have the Arab customer designate the supplier or subcontractor. In practice, however, the customer is unable to do this and would generally refuse any such suggestion. Nonetheless, the possibility that a supplier or subcontractor would be rejected for boycott reasons is fairly remote.

## V. Critical Dates

The Act and the proposed regulations contain several important dates, recognition of which is crucial to an understanding of when various boycott restrictions become effective.

(a) *May 16, 1977.*—The Act and the proposed regulations provide a grace period for boycott-related transactions to permit persons and firms to adjust their business relations with boycotting countries to conform to United States antiboycott legislation. Boycott-related actions taken pursuant to contracts that were binding on or before May 16, 1977, will not be subject to the proposed regulations until after December 31, 1978.[174] In addition, the Regulations provide that this grace period may, upon written application, be extended further, but not later than December 31, 1979, in special circumstances.[175] Decisions on whether to grant this additional one year grace period will be made on a case-by-case basis. It should be noted that letters of credit issued pursuant to transactions that are within the scope of this "grandfather" provision are also entitled to grace period treatment. Thus, if the contract on which the underlying transaction is based was con-

173. In one case, a general undertaking to comply with the laws of a boycotting country was substituted for express boycott language. Such an undertaking is deemed to constitute boycott participation under Guideline H-4, 43 Fed. Reg. 3463 (1978); *cf. id.* at 3518 (to be codified in 15 C.F.R. § 369.2(a)(5)) (agreement to comply generally with laws of boycotting country to assume risk of loss for nondelivery not a *per se* refusal to do business).

174. Export Administration Amendments of 1977, Pub. L. No. 95-52, § 201(a), 91 Stat. 244 (to be codified at 50 U.S.C. app. § 2403-1a); 43 Fed. Reg. 3536 (1978) (to be codified in 15 C.F.R. § 369.5)).

175. 43 Fed. Reg. 3536 (1978) (to be codified in 15 C.F.R. § 369.5)).

cluded on or before May 16, 1977, United States banks may pay, honor, confirm, or otherwise implement letters of credit that contain prohibited boycott requirements until December 31, 1978.[176] A similar exemption is available for a shipping company, insurance company, or freight forwarder with respect to any negative certificate that it may provide pursuant to such a letter of credit or in response to import requirements.[177]

(b) *June 22, 1977.*—The Export Administration Amendments Act of 1977 was enacted.

(c) *January 18, 1978.*—Final Regulations were issued by the Department of Commerce and the Act became effective as of midnight on that date.

(d) *June 21, 1978.*—The provision prohibiting the making of negative certificates (*e.g.*, negative certificates of origin, "no blacklisted vessel" certifications, "self-certifications") has a delayed effective date. Until June 21, 1978, exporters may provide such certificates and banks may implement letters of credit that require such certificates. After June 21, 1978, such conduct is prohibited.[178]

## VI. PENALTIES

The Act provides that willful violations are a criminal offense punishable by a fine up to $25,000 and/or one year in jail for a first offense, and up to $50,000 and/or five years in jail for second and subsequent offenses.[179] Civil penalties of up to $10,000 per violation may also be assessed.[180] In addition, the export privileges of an offender may be suspended or revoked.[181] Since the Act and the Regulations are unprecedented in their scope and potential impact on American multinationals and prohibit conduct that many Americans do not find criminal, one can anticipate that the initial enforcement effort will concentrate on civil actions, including injunctive enforcement actions and consent decrees. The principal exception is likely to be cases involving religious discrimination, quite rare in practice, and willful, blatant violations of the Act

---

176. *Id.* at 3523 (to be codified in 15 C.F.R. § 369.2(f)).

177. *Id.* at 3536-37 (to be codified in 15 C.F.R. § 369.5, example (xi)).

178. Export Administration Amendments of 1977, Pub. L. No. 95-52, § 201(a), 91 Stat. 246 (to be codified at 50 U.S.C. app. § 2403-1a).

179. 50 U.S.C. app. § 2405(a) (1970), *as amended by* Export Administration Amendments of 1977, Pub. L. No. 95-52, § 112, 91 Stat. 240.

180. *Id.* § 2405(3)(1) *as amended by* Export Administration Amendments of 1977, Pub. L. No. 95-52, § 112, 91 Stat. 240.

181. *Id.* § 2405(c)(2)(A).

and Regulations, perhaps involving a subterfuge. Nonetheless, operating a multinational company effectively under an injunction would be extremely difficult and so the threat of such an action, coupled with adverse publicity, is likely to deter most companies from violation of the Act.

## VII. Conclusion

Many problem areas remain for companies planning their operations in the Middle East. The difficult problems raised by the broad definition of "evasion" and its potential impact on planning in this area have already been discussed. In addition, many of the exceptions may have little practical significance for many companies. Thus, for example, a bona fide resident of a boycotting country is permitted to discriminate against blacklisted firms in procuring goods in compliance with local import regulations. In actual practice, however, most companies encounter boycott problems with respect to the formal, or documentary, aspects of the Arab boycott. None of the examples given in the proposed regulations indicates whether a bona fide resident of a boycotting country may legitimately obtain a letter of credit in that country requiring boycott certifications under the local import regulation exception. In any event, even if the resident firm is able to obtain such a letter of credit for purchases from the United States, the supplier would be unable to accept or comply with such a letter of credit. Thus, even those companies that qualify as bona fide residents may be required to conduct their operations to avoid Arab boycott regulations.

Companies that continue to do business in or with the Middle East will be required to adopt operating procedures reasonably calculated to prevent violations of the Act. Such procedures will have to be sufficiently detailed to cover substantially all situations that are likely to be encountered in connection with transactions with or in boycotting countries and drafted in sufficiently practical terms to be usable by operating personnel who handle customer orders or export documentations. Such procedures should also include appropriate instructions to freight forwarders, shipping companies, attorneys, agents, and other service companies that are engaged by a company in connection with Middle East transactions and that might be considered to act on behalf of the company. A company that adopts and enforces such procedures should be able to avoid a violation of the Act even if one of its employees

fails to follow these procedures in a particular transaction and thereby contravenes the Act.

Companies will also find it necessary to analyze their method of operation in the Middle East. Such an analysis should focus on those entities or operations that may not be covered by the Act. For example, foreign manufacturing facilities that do not normally involve United States commerce may be able to avoid being subject to the Act, but, under the Regulations, there is a significant risk that contact with the home office in connection with a particular transaction may cause that transaction to be involved in United States commerce. Since different kinds of contact will have different results under the Regulations, all contacts must be monitored if difficulties are to be avoided. Such planning should not be limited to a consideration of the Act and its impact on Middle East operations. The Act and the Regulations issued thereunder are not the only laws regulating boycott-related conduct, and companies should also consider the potential tax, civil rights, and antitrust aspects of any transaction or activity in Arab countries.

## APPENDIX I

The seven standard questions normally asked by Arab countries concerning a company's relationship with Israel are substantially as follows:

1. Do you have now or ever have had a branch or main company, factory or assembly plant in Israel?
2. Do you have now or ever have had general agencies or offices in Israel for your Middle Eastern or international operations?
3. Have you ever granted the right of using your name, trademarks or copyright or that of any of your subsidiaries to Israeli persons or firms?
4. Do you participate or own or ever have participated or owned shares in an Israeli firm or business?
5. Do you render now or ever have rendered any consultative service or technical assistance to any Israeli firm or business?
6. Do you represent now or ever have represented any Israeli firm or business in Israel or abroad?
7. The above questions must be responded to on behalf of the company itself and all of its branch companies, if any.

The reference to "branch" companies include parents and subsidiaries.

## APPENDIX II

## COMPARISON OF EXPORT ADMINISTRATION AMENDMENTS AND TAX REFORM ACT PROVISIONS

| | EXPORT ADMINISTRATION AMENDMENTS | TAX REFORM ACT |
|---|---|---|
| *Certifications* | | |
| Import requirements | Negative certifications prohibited after 6/21/78. Exception—certification re nationality of vessel and route. | Not boycott participation or cooperation if unilateral, so no agreement (caveat—agreement may be inferred from course of dealing). |
| Letters of credit | Same as import requirements. | Boycott agreement will be inferred after 2/13/78 unless prior binding contract. Certification as to nationality of vessel and route is acceptable. |
| Purchase orders, contract provisions requiring certifications | Same as import requirements. | Boycott agreement will be inferred. |
| Positive certifications | Probably always acceptable. | Probably always acceptable. |
| *Contract Clauses* | | |
| Agreement to comply with boycott laws or do boycott-related act | Prohibited after 1/18/78. | Constitutes express boycott agreement. |
| Agreement to comply with laws of boycotting country generally | Acceptable. | Boycott agreement will be inferred. |
| Governing law clause — law will apply to contract | Acceptable. | Acceptable. |
| "Risk of loss" clause | Prohibited as presumed evasion unless customarily used prior to 1/18/78. | Acceptable. |
| *Unilateral Acts* | | |
| Unilateral refusal to deal for boycott reasons | Prohibited after 1/18/78. | Not boycott participation or cooperation but course of dealing may be evidence of boycott. |
| *Providing Information* | | |
| Providing positive or | Prohibited unless in | Acceptable but suspect— |

| | | |
|---|---|---|
| negative information concerning operations in Israel | commercial context. No information may be provided to boycott office. | may be evidence of boycott agreement. |
| Providing information re race, religion, etc. | Prohibited after 1/18/78. | Acceptable but may be evidence of boycott agreement. |
| *Unilateral Selection by Buyer* | | |
| Selection of specific supplier of goods | Acceptable, if goods identifiable, made unilaterally by buyer in boycotting country. | Generally acceptable. |
| Selection of specific supplier of services | Acceptable, if unilateral and services to be performed in whole or in part in boycott country. | May be acceptable but not covered by Guidelines. |
| Use of "blacklist" or "whitelist" | Prohibited. | Boycott agreement will be inferred. |
| *Other Exceptions* | | |
| Compliance with import requirements | Anyone may comply or agree to comply with prohibition on import of goods and services from boycotted country, *i.e.*, primary boycott only (but may not make any negative certification after 6/21/78). | Same but certification also not covered. |
| Bona fide resident | Bona fide resident of boycotting country may comply with boycott laws concerning activities within boycotting country and may comply with import regulations, including secondary boycott, in importation of goods (not services) for own use (*i.e.*, to consume, transform or incorporate). | No such exception. |
| Compliance with export laws | May comply or agree to comply with prohibition on exports to boycotted country. | Same. |
| *Jurisdicational Scope—Consequences* | | |
| U.S. firms | Covered. | Covered (DISC benefits lost). |
| Foreign branches | Covered only if U.S. commerce involved. | Covered (§ 901 tax credit lost). |

| | | |
|---|---|---|
| Foreign subsidiaries | Covered only if U.S. commerce involved. | Covered (Controlled Foreign Corporations—Subpart F income created and § 902 credit lost). |
| Foreign joint venture | | |
| — 51% or more U.S. ownership | Presumed to be controlled-U.S. person-covered *if* U.S. commerce involved. | Covered (Controlled Foreign Corporation-Subpart F income created and § 902 credit lost). |
| — 50% U.S. ownership | Presumption of control if more than one other shareholder and so may be covered if U.S. commerce involved. | Presumption of participation or compliance by parent (not controlled foreign corporation but § 902 credit lost). |
| — 26%-49% U.S. ownership | Presumption of control if no other shareholder has equal or greater holding in joint venture and so may be covered if U.S. commerce involved. | No presumption—§ 902 credit lost. |
| — 10%-25% U.S. ownership | No presumption of control. | No presumption—§ 902 credit lost. |
| — 0-9% U.S. ownership | No presumption of control. | No presumption—no tax benefits lost. |
| Banks | Covered by act if U.S. commerce involved—may not process letters of credit with boycott provisions or requirements. | Covered—in effect only after 2/13/78 re letters of credit. |
| *Effective Dates and Grace Periods* | | |
| Effective date of act | January 18, 1978. | November 3, 1976. |
| Grace Periods | | |
| — Preexisting contracts | Until 12/31/78 for contracts pre-dating 5/16/77—may be extended to 12/31/79 by applications. | Until 12/31/77 for contracts predating 9/2/76. |
| — Certifications | Until 6/21/78 for shipping documents under letters of credit, etc. | Until 2/13/77 for documents under letters of credit only (but see several effective dates for various versions of Guidelines depending on circumstances). |