

THE PROPER REACH OF TERRITORIAL JURISDICTION: A CASE STUDY OF DIVERGENT ATTITUDES

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I am going to address myself to the subject on a different level than Professor Jennings, as I could not hope to compete with him in his excellent presentation of some of the jurisprudential and philosophical aspects of the subject. Professor Jennings' analysis, of course, really goes to the heart of the difference between the American and the British approach.

The issue can be stated simply as whether the United States tries to go too far in attempting to apply its legislative policy to conduct abroad which has effects on the United States in areas where that nation's policy interest is deemed by the legislative or judicial branches of its Government to override a deeply felt and long-recognized principle: the principle of territoriality.

I am trying to stress two points in that definition: first, that we start from the understanding that the principle of territoriality is essential in relations between states. Carrying that first point a little further brings us to the second point: Certain policies are nevertheless deemed so vital to the economic well-being of our society that our legislature, our executive branch, or our courts feel it necessary to make sure that the policies are effective, even by regulating certain conduct beyond our own borders.

I must emphasize this word "effect." There is no dispute in the American interpretation of international law with the view that American jurisdiction does not extend to conduct abroad which has no effect whatsoever on the United States, its commerce, or its persons.

I will describe a few of the cases in which the United States has gone furthest in claiming jurisdiction over acts performed beyond its borders and point to the alternative theories on which this American practice is based. I will leave for the discussion the debate as to whether the U.S. or the English view is correct. I shall nevertheless state my own views, as this is a subject which, at least from the viewpoint of American lawyers, is open to several different interpretations.

The area, as Professor Jennings said, in which there is controversy is the area of *economic* regulation. There is no real problem with common

crimes and traditional areas in which international law allows some extraterritoriality. The specific fields of law in which the United States has sought to apply its law extraterritorially are antitrust, shipping, securities regulation, income tax, and export control (where it is an application of the U.S. view of its national security interests). It has also claimed the right to reach beyond its borders to obtain documents and evidence to enforce the above-mentioned laws and regulations.

There is no disagreement among exponents of the American view of international law about the principle of territoriality's being the primary basis of jurisdiction. Indeed, the need for basing jurisdiction on territoriality was pointed out by Chief Justice Marshall of the U.S. Supreme Court at a time when the new nation was struggling to defend its sovereignty from interference by a foreign power:

The jurisdiction of the nation within its own territory is necessarily exclusive and absolute. It is susceptible of no limitation not imposed by itself. Any restriction upon it, deriving validity from an external source, would imply a diminution of its sovereignty to the extent of the restriction and an investment of that sovereignty to the same extent in that power which could impose such restriction.

All exceptions therefore to the full and complete power of a nation within its own territories must be traced up to the consent of the nation itself.¹

The case which illustrates the American attempt to reconcile "vital" policy with the principle of territoriality is the *Alcoa* case.² That case had as one of its principal issues a conspiracy through an "Alliance" based on an agreement among several companies of different nationalities to divide the market in aluminum ingot. The question presented to the court was whether the court had jurisdiction to find that a foreign company participating in the "Alliance" was in violation of section 1 of the Sherman Act,³ the basic American antitrust law, given the facts that the agreement was a foreign agreement, that the parties to the agreement were all foreign, and that the policy was in fact being implemented strictly outside the United States. The court determined that

¹The *Schooner Exchange v. McFadden*, 11 U.S. (7 Cranch) 116, 136 (1812). For a more recent statement on the importance of territoriality, see Harfield, *Extraterritorial Application of Law—General Principles*, 1970 A.S.I.L. PROCEEDINGS 130.

²*United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945).

³The Sherman Act § 1, 15 U.S.C. § 1 (1964) provides in relevant part that "[e]very contract, combination . . . or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal"

this arrangement did have a direct effect on imports of aluminum ingot into the United States. Turning to the law the court stated:

[I]t is settled law . . . that any state may impose liabilities, even upon persons not within its allegiance, for conduct outside its borders that has consequences within its borders which the state reprehends⁴

The court then stated its view of the requirements to be met for it to claim subject-matter jurisdiction:

[W]e shall assume that the Act does not cover agreements, even though intended to affect imports or exports, unless its performance is shown actually to have had some effect upon them. Where both conditions are satisfied, the situation certainly falls within⁵

The two elements spelled out by Chief Judge Learned Hand in that decision were *intent to have actual effect* and *actual effect*. It has been argued that the actual decision found the intent from the effects, so that the two elements might be reduced to one. One view espoused in the United States is that international law, as it exists in this field, requires only that there be effects within the Territory. Exponents of this view claim to find its basis in the *Lotus* case.⁶ The other view, expressed by most commentators and in the *Restatement*⁷ (to which I will refer later), is that mere effects within the territory are not enough; the effects must be direct, foreseeable, intended, and must also be substantial; and the conduct and effect must be constituent elements of the activity being regulated. There is some dispute among American commentators as to whether these additional requirements, including intent to have effect within the territory, as stated by Judge Hand, are actually required by international law.

⁴United States v. Aluminum Co. of America, 148 F.2d 416, 443 (2d Cir. 1945).

⁵148 F.2d at 444.

⁶Case of the S.S. "Lotus," [1927] P.C.I.J., ser. A, No. 10.

⁷RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 18 (1965):
Jurisdiction to Prescribe with Respect to Effect within Territory.

A state has jurisdiction to prescribe a rule of law attaching legal consequences to conduct that occurs outside its territory and causes an effect within its territory, if either

(a) the conduct and its effect are generally recognized as constituent elements of a crime or tort under the law of states that have reasonably developed legal systems, or

(b)(i) the conduct and its effect are constituent elements of activity to which the rule applies; (ii) the effect within the territory is substantial; (iii) it occurs as a direct and foreseeable result of the conduct outside the territory; and (iv) the rule is not inconsistent with the principles of justice generally recognized by states that have reasonably developed legal systems.

As the *Alcoa* case illustrates, the Justice Department and the courts have not hesitated in enforcing the antitrust laws to look into economic activity occurring abroad if there have been definable effects on United States commerce or within the territory of the United States. This reflects the feeling that the policy and the assumptions of our antitrust law—that economic prosperity requires maintenance of free and fair competition by prevention of economic concentration and other practices in restraint of free trade—are so important as to warrant extension of the law to conduct abroad in spite of the strong presumption in favor of limiting the application of American law to conduct occurring within its borders.

In recent years, the approach taken in the antitrust field has been extended to securities regulation. Since the Great Depression it has been an important policy of the U.S. Federal Government to protect investors in the United States from the effects of practices in the public sale of stocks and bonds, either directly or on a stock exchange, which would deprive investors of an open and fair transaction. This policy has been implemented by legislation and by regulation through the Securities and Exchange Commission. The SEC has broad investigative powers, the right to compel complete disclosure of all necessary information from those engaged in the sale of securities, and the capacity to bring suit through the Justice Department to enforce the law.

There has been a series of cases which have extended the extraterritorial impact of securities regulation in the United States. In 1960 a New York federal court in the case of *Kook v. Crang*⁸ found a lack of subject-matter jurisdiction in a case brought by a United States investor charging a Canadian broker, not a member of any U.S. stock exchange, with a violation of the Securities Exchange Act.⁹ The transaction was Canadian in every respect. The defendant was registered as a broker-dealer under the Securities Exchange Act. However, in 1965 in a case¹⁰ involving similar facts, the same court held that it had jurisdiction in an action brought by minority shareholders of a U.S. corporation challenging a sale in Canada of a controlling interest in their company by the Canadian defendant. The negotiations and sale had taken place entirely in Canada. The only contacts with the United States were a stockholders meeting that had taken place in New York and use of the United States mails. Nevertheless, the court held that an integral part of the challenged

⁸182 F. Supp. 388 (S.D.N.Y. 1960).

⁹Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-jj (1970).

¹⁰*Ferraioli v. Cantor*, 259 F. Supp. 842 (S.D.N.Y. 1966).

transaction occurred within the United States, and the transaction fell within the reach of the U.S. securities law.¹¹

In an important case, *Schoenbaum v. Firstbrook*,¹² the U.S. Court of Appeals for the Second Circuit found jurisdiction over a transaction involving the sale of shares by one Canadian company to another and a second transaction between the first Canadian company and a Luxembourg bank. Delivery and payment took place in Canada. The offer to buy the shares was mailed from New York, and the shares were listed on the American Stock Exchange, but there was no indication that the transaction was carried out on the American Stock Exchange. The plaintiff was a U.S. stockholder who charged a violation of the Securities Exchange Act of 1934. The Court of Appeals determined that there was a congressional intention

to protect domestic investors who have purchased foreign securities on American exchanges and to protect the domestic securities market from the effects of improper foreign transactions in American securities.¹³

The court felt that this policy overrides the usual presumption against extraterritorial application of legislation as well as specific language in the statute which appears to show a congressional attempt to preclude application of the Act to transactions which involve stocks traded in the United States, but which are effected outside the United States.¹⁴

In another case¹⁵ a federal court held that it had jurisdiction over transactions carried out by a foreign-based mutual fund on the New York Stock Exchange. The only other contact with the U.S. was through phone calls placing orders to buy or sell through a broker in New York.

The foregoing cases show the willingness of the Securities and Exchange Commission and United States courts to apply U.S. law to transactions involving securities quoted on the stock exchange even though the purchase and sale is carried out abroad by foreign persons having no contact whatsoever with the United States. This is comple-

¹¹259 F. Supp. at 846.

¹²405 F.2d 200 (2d Cir.), *rev'd on rehearing*, 405 F.2d 215 (2d Cir. 1968) (en banc) (earlier determination of subject-matter jurisdiction left standing), *cert. denied*, 395 U.S. 906 (1969).

¹³405 F.2d at 206.

¹⁴*See id.* For a useful discussion of *Schoenbaum*, see Note, *Extraterritorial Application of the Securities Exchange Act of 1934*, 69 COLUM. L. REV. 94 (1969).

¹⁵*Roth v. Fund of Funds, Ltd.*, 279 F. Supp. 935 (S.D.N.Y.), *aff'd*, 405 F.2d 421 (2d Cir. 1968), *cert. denied*, 394 U.S. 975 (1969).

mented by the amendment¹⁶ to the Securities Exchange Act of 1934 adopted by Congress in 1964 and implemented by rules that the SEC issued subsequently. The extensive and onerous reporting and other requirements of the Act were extended to apply to all corporations whose securities are traded by use of the mail or any instrumentality of interstate commerce, and which have at least 300 stockholders and total assets exceeding one million dollars. This clearly was intended to apply to foreign corporations with the sole proviso that the SEC could exempt securities of foreign issuers if it found such exemption to be in the public interest and consistent with the protection of investors.

The final regulations issued by the SEC were influenced partly by the protests of interested foreign parties who were given a chance to express their views. They alleviated the burden to some degree, allowing alternative forms of disclosure of information to be substituted for the American disclosure requirements, but basically a foreign issuer must be aware of these requirements, and can be held liable for violation of the Securities Act even for transactions which could have only the most incidental effects within the United States. I am stating it very strongly, but I feel this is how it is likely to be interpreted in practice.

Another area in which the United States has applied the law of extra-territoriality is in its export-control legislation and regulations. This is best illustrated by a case in France which created quite a bit of controversy, particularly among lawyers who must advise American business abroad. This was the *Fruehauf v. Massardy*¹⁷ case decided in France in 1968.

Fruehauf France is a French company, a subsidiary of an American company. At the time of the case, the American parent company owned a majority of the stock and named five of the eight directors on the Board. The president of Fruehauf France, a Frenchman, in what must have appeared a routine transaction to him, signed a contract with Berliet, another French company, to supply equipment. This equipment was to be used by the second French company, the purchaser, in trailers to be shipped to China. The Treasury Department in the United States informed the American stockholders and the American directors that this would be in violation of the Trading with the Enemy Act¹⁸ and the

¹⁶Securities Acts Amendments of 1964, Pub. L. No. 88-467, 78 Stat. 565 (1964).

¹⁷[1968] D.S. Jur. 147, [1965] J.C.P. II 14,274bis (Cour d'appel, Paris). This case is discussed extensively in Craig, *Application of the Trading with the Enemy Act to Foreign Corporations Owned by Americans: Reflections on Fruehauf v. Massardy*, 83 HARV. L. REV. 579 (1970).

¹⁸50 U.S.C. app. §§ 1-39, 41-44 (1964).

regulations thereunder,¹⁹ and ordered them to cancel the contract. The American company did follow those instructions, and the directors and the officers of Fruehauf France were instructed to cancel the contract. There was an attempt to negotiate a termination of the agreement, which Berliet did not accept. The three minority French directors took the case to a French court and obtained an order placing the company in the hands of a temporary administrator for the purpose of carrying out this contract. In order to do this, the French court had to interpret French law so as to assert a corporate interest separate from that of its owners. This interpretation saved the company, which had been threatened with a suit for one million dollars in damages. The suit and the loss of its credit rating would certainly have put Fruehauf France out of business.

The startling aspect of this case is that Fruehauf France was a French company, a French legal person, and that the United States was applying and nearly succeeded in applying American domestic legislation to a purely domestic French transaction.

My description of selected areas of extraterritorial application of U.S. substantive law was intended to show the outer limits, how far U.S. law is reaching beyond its own territorial jurisdiction and invading areas normally within the exclusive jurisdiction of other sovereign governments. A direct conflict with foreign governmental policies and interests has occurred in those instances in which attempts have been made to implement U.S. laws by trying to compel the production of documents or other information from abroad. The most famous case in this area involves the First National City Bank and its branch in Germany.²⁰ In connection with an investigation into possible violations of the antitrust laws, the Justice Department obtained a subpoena for documents relating to the operations of the German branch of the American bank. The documents were in the possession of the German bank, which was placed in a difficult situation. The advice which the bank received, and to which testimony was given before the court, was that it would be a violation of German law for the bank to produce those documents. However, the German law involved was not a statute (which would have been a valid ground for the bank to deny the documents to the U.S. Justice Department). It was German common law, which can be waived by agreement of the bank and the customer. It is fairly clear that such a waiver could

¹⁹Transaction Control Regulations, 31 C.F.R. §§ 505.01-.60 (1969).

²⁰United States v. First National City Bank, 396 F.2d 897 (2d Cir. 1968).

not be obtained in this case. The argument was made also to the American court that the German branch bank or its representatives might be subject to criminal penalties. However, this was not convincing to the court since it related to a possible contempt citation which was not likely to be invoked. The Justice Department presented a German law expert who testified that in his opinion the court's order compelling production of the documents would be a complete defense to any eventual German legal penalties against the German branch bank. The court did a thorough job in reaching its decision. It studied all the elements of foreign and American law, but finally concluded that there was not a clearly enough articulated policy under German law for it to refrain from ordering the defendants to produce the documents. The court held the defendants in contempt of American law for having refused to produce the documents at the previous request of the Justice Department.

The cases to which I have referred are illustrations of how unrestrained the American assertion of extraterritorial jurisdiction can be. Any effects within the United States may be deemed enough to give the United States jurisdiction over conduct occurring outside its borders.

At its worst, our assertion of the right to regulate transactions, normally subject exclusively to jurisdiction of other sovereign nations, takes on the appearance of legal imperialism, the insolence of the most powerful nation in the world in disregarding others to satisfy its own purposes. In most cases, however, it is no more than manifestation of the deep American attachment to the policies involved—antitrust, fair trading in securities, fair shipping practices—and the concern that these policies not be eroded from abroad in a world in which our American involvement transcends its borders in every economic domain.

Although as an American I am very much aware of the importance of these policy considerations and in sympathy with their furtherance, I am nevertheless concerned by the consequences and the implications of our unilateral attempts to apply our law to conduct and to persons abroad beyond the norms that are commonly recognized by the community of nations.

Americans doing business abroad are often placed in an intolerable position. In the first place, a situation like the one in the *Fruehauf*²¹ case places the Americans involved in direct contradiction to the foreign trade policy and domestic commercial interests of the country in which they are being allowed to operate on an equal basis with local nationals. In

²¹[1968] D.S. Jur. 147, [1965] J.C.P. II 14,274bis (Cour d'appel, Paris).

more extreme situations, like the one in *United States v. First National City Bank*,²² the Americans can be placed in a situation where any action they take will violate the laws of either the United States or the other country. Nor does it seem fair that foreign citizens are exposed to the danger of finding themselves in violation of U.S. law and perhaps subject to criminal penalties, even though their conduct is completely in accordance with the laws of the country or countries in which they live and do business.

More important than individual jeopardy are the effects which such extraterritoriality may have on American foreign policy. During a four-year period from 1964 to 1968 there were 72 protests from 13 foreign governments at assertions of extraterritorial jurisdiction by the Federal Maritime Commission, which either directly or through the courts sought to obtain statistical and financial data from abroad in accordance with section 21²³ of the U.S. Shipping Act. This has produced some defensive and retaliatory measures such as the U.K. Shipping and Commercial Documents Act of 1964,²⁴ which instructs any minister of the Crown to prohibit any U.K. person from complying with a foreign order to produce commercial documents not within the foreign jurisdiction if it would constitute "an infringement of the jurisdiction which, under international law, belongs to the United Kingdom."²⁵ I feel that the end result of that kind of unilateral attempt to regulate conduct beyond the borders of the United States can only be an erection of barriers to American investment and business abroad through a series of unilateral responses to foreign governments which will hamper the kind of free trade from which American companies and the American economy benefit. Indeed, it negates internationally the very philosophy behind the policies that we are trying to maintain through our extraterritorial measures.

Finally, and most seriously of all, there is no way in my view of denying that an invasion of sovereignty occurs from this kind of action on the part of American legislative, administrative, and judicial organs. In our modern world, as contacts multiply and as international commerce develops, it is more important than ever to protect the sovereignty of trading nations, while at the same time sustaining the free-trade policies which ensure the economic well-being both of the United States and

²²396 F.2d 897 (2d Cir. 1968).

²⁴46 U.S.C. § 820 (1964).

²⁵Shipping Contracts and Commercial Documents Act 1964, c. 87.

²⁶Shipping Contracts and Commercial Documents Act 1964, c. 87, § 2.

of the whole world. For this reason I can only endorse what Professor Jennings was suggesting at the end of his presentation—that some kind of international solutions be found. However, I do not endorse the feeling that the United States must in the meantime abandon its significant economic policies where extraterritorial conduct is involved in an important way. I do believe that there should be voluntary restraint on its part, wherever possible.

The attitude towards extraterritorial application of municipal law espoused by most English and continental lawyers is too restrictive for the transnational realities of modern commerce. I mentioned earlier the more general view of the law on the question of extraterritorial jurisdiction shared by a majority of American legal scholars. It is stated in section 18 of *Restatement Second of the Foreign Relations Law of the United States* which recognizes extraterritorial jurisdiction over conduct abroad if the conduct and its effects are constituent elements of the activity being regulated and if the effects within the territory are direct, foreseeable, and substantial. In addition the rule of law being applied must be generally recognized internationally. The application of these criteria combined with a policy of restraint where the sensitive interests of another nation are involved would be less harsh than the current U.S. approach.

There has been some suggestion that this issue of extraterritoriality should be viewed as a conflicts of law problem, which would mean that foreign states should interpose, whenever it is important enough, their own views of what the law should be or what limits should be placed on attempts by the United States to have its law apply within their borders. This has been done in a certain number of cases. The Netherlands have in their Economic Competition Act of 1956²⁶ an express prohibition on complying with a foreign state's measures or decisions relating to regulation of competition-dominant positions or conduct restricting competition. I have already mentioned U.K. response to the U.S. Shipping Act's requirement to produce financial data. In *British Nylon Spinners v. Imperial Chemicals Industries Ltd.*,²⁷ the British court ordered specific performance of a contract that had been outlawed by an American antitrust decree. Such measures interpose the policy of the foreign government to the extraterritorial application of U.S. law in creating a situation of clearly concurrent jurisdiction.

²⁶Law of June 28, 1956, *as amended*, Nederlandse Wetgeving IIC, no. 54 (1971).

²⁷[1953] Ch. 19 (C.A. 1952).

The conflicts of law approach has merit in that it tells the court, asked to assert extraterritorial jurisdiction, the importance of the issue to the other nation. The court can then weigh the competing interests. The criteria have been set forth as follows:

Where two states have jurisdiction to prescribe and enforce rules of law and the rules they may prescribe require inconsistent conduct upon the part of a person, each state is required by international law to consider, in good faith, moderating the exercise of its enforcement jurisdiction, in the light of such factors as

- (a) vital national interests of each of the states,
- (b) the extent and the nature of the hardship that inconsistent enforcement actions would impose upon the person,
- (c) the extent to which the required conduct is to take place in the territory of the other state,
- (d) the nationality of the person,
- (e) the extent to which enforcement by action of either state can reasonably be expected to achieve compliance with the rule prescribed by that state.²⁸

In these cases where the conflicts of law approach is possible, this statement of the law appears most satisfactory. It is a mistake, however, to view this approach as a full solution since a sense of positive assertion of jurisdiction by the foreign government does not mean lack of interest or acceptance of the right of others to regulate within its purview.

In conclusion, I will summarize the defense put forth to the charge that American practice is in violation of international law. It is argued that international law has not evolved clear and generally recognized standards for the economic conduct which is usually involved. In the absence of such standards and where the Congress of the United States has seen fit to articulate a policy important enough to overcome the presumption against extraterritorial application of municipal law, the courts of the United States have jurisdiction to rule upon conduct beyond its borders which has effects within the United States.

In further defense, it is argued that a great deal of self-restraint is exercised. The courts will not place a foreign citizen or a foreign corporation in a position where it must violate the law of its home country. It is only in those situations where no clear policy has been stated, where the state has not interposed its own statutory policy, that the American

²⁸RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 40 (1965).

courts have felt free to expand their own rulings to fill the vacuum with their own findings.

The argument that there is restraint is summarized by a former General Counsel of the Federal Maritime Commission. He lists in order the approaches taken by the Federal Maritime Commission:

[The Federal Maritime Commission tries] persuasion, conciliation, diplomatic exchange, intergovernmental conferences, international agreements, and, only failing these efforts, [tries] coercion. Foreign governments are consulted, their views are given consideration, concessions and accommodations are made.²⁹

I would like to close by referring to a recent decision³⁰ of the Swiss Supreme Court which ordered the Swiss Federal Tax Administration to furnish the U.S. Internal Revenue Service with information from the books and records of a Swiss bank on allegedly questionable dealings between the bank and an unnamed American citizen. This decision was an implementation of the recent Swiss/United States Income Tax Convention.³¹ This kind of internationally negotiated agreement provides a solution which does away with unilateral extraterritoriality with its violation of the sovereignty of another state. I would hope that through bilateral and, hopefully in the future, multilateral conventions, rules can be agreed upon—rules of international law which obviate the necessity for extraterritorial application of municipal law in areas where national governments are jealous of their sovereignty. Obtaining their consent to application of U.S. laws to events that occur within their territories having effects within the United States is a better way to achieve the goals sought to be achieved by extraterritoriality.

²⁹May, *The Status of Federal Maritime Shipping Regulation under Principles of International Law*, 54 GEO. L.J. 794, 847-48 (1966) (footnote omitted).

³⁰X v. Fed. Tax Administration, CCH 1971 STAND. FED. TAX REP., U.S. TAX CAS. (71-1, at 86,566) ¶ 9435 (Swiss Fed. Sup. Ct. Dec. 23, 1970).

³¹Convention with Switzerland for the Avoidance of Double Taxation with respect to Taxes on Income, May 24, 1951, art. XVI, para. 1, [1951] 2 U.S.T. 1751, T.I.A.S. No. 2316, 127 U.N.T.S. 227.