Extraterritoriality of Export Controls

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S U M M A R Y

This thesis provides an overview of the complex problems related to the extraterritoriality of export controls.

In the last decades when trade became increasingly international, the tendency of governments to use trade embargoes as a political tool grew considerably. Since the effect of trade controls largely depends on the importance of the affected trade, the regulating State commonly interprets its jurisdiction in broad terms. Thus, the number of conflicts between countries concerning the extent of their jurisdiction increased. This thesis focuses on some pivotal cases and analyzes the different principles suggested to solve the problems.

Based on a territorial concept of sovereignty, it finally suggests a doctrine of evasion. The fundamental idea of the doctrine has already been applied in the tax laws of several countries. It is designed to close legislative loopholes.

It is believed that this doctrine, if applied, would strike an acceptable compromise between the interests of the parties concerned: the regulating State could evaluate the risks and costs involved in sanctioning other countries; the business community would be granted a higher degree of certainty in assessing the political risk involved in a commercial engagement with foreign partners and, finally, the sovereignty of foreign States would remain unimpeded.

R E S U M E

La présente thèse donne un apercu des problemes complexes se rapportant à l'extraterritorialite de mesures étatiques de controle à l'exportation.

Durant les dernieres décennies, le commerce est devenu de plus en plus international; de meme, les etats ont marqué une tendence accrue à se servir de mesures d'embargo comme instrument politique. Comme l'effet de mesures de controle sur le commerce depend surtout de l'importance de ce dernier, l'état imposant des mesures regulatoires aura tendance à interpreter sa jurisdiction en termes larges. De ce fait, le nombre de conflits concernant l'étendue de leurs jurisdictions respectives s'est intensifié.

Cette thèse examine plusieurs cas modèles et analyse les différents principes etablis par la jurisprudence pour résondre les problemes poses.

Sur la base d'un concept de souverainete territorial, elle propose finalement une *doctrine of evasion*. Le principe fondamental de cette doctrine a deja ete applique dans la législation fiscale de plusieurs états. Elle est destinee à remplir des lacunes legislatives.

Il est soutenu que cette doctrine, si appliquee, aboutirait à un compromis acceptable pour toutes les parties en cause: l'état imposant des mesures regulatoires pourrait evaluer leur couts et risques; la communaute des affaires aurait plus de sureté pour apprécier les risques politiques de relations commerciales avec des partenaires etrangers et, en dernier lieu, la souverainete des autres etats ne serait pas enfreinte.

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Preface

"The collapse of export control" announced the New York Times on June 12, 1987.[1] In a special report it was disclosed that the Japanese Toshiba Machine Company, a subsidiary of Toshiba Corporation, and the Norwegian stateowned Kongsberg Vaapenfabrikk had jointly agreed to sell, and had delivered to the Soviet Union between 1980 and 1984 high technology equipment designed to build ship propellers. According to Western secret services, the machinery purchased by the Soviets helped them resolve one of the major deficiencies of their submarine fleet: the noise produced by the submarine propellers. The alleviation of this noise problem makes it more difficult to detect Eastern Bloc submarines. According to estimates by the United States Department of Defence, the re-establishment of their technological edge will cost at least $ 8 billion.[2]

Although illegal exports to the Soviet Union are not uncommon,[3] the Toshiba case was out of the ordinary for

1 D.E.Sanger, "A Bizarre Deal Diverts Vital Tools to Russians" New York Times (12 June 1987) A1.
2 The study mentions the possibility that, under adverse circumstances, costs could rise to $ 60 billion U.S. Pentagon officials believe, however, that the lower figure is more realistic. See P.T.Kilborn, "Submarine Case to Lift U.S. Costs" New York Times (29 July 1987) D1.
3 Under the Reagan administration, special units were established to investigate violations of export regulations in a systematic manner. The "Inter-Agency-Task-Force" set up by the Pentagon receives the assistance of "Operation Exodus" which is working under the auspices of the United States Customs Services. In cooperation with Western allies, these special units appear to be highly successful in enforcing export control regulations and in preventing illegal exports. For details see "Operation Exodus" Der Spiegel (20 July 1987) 101.

several reasons. First, the size of the deal[4] was significantly larger than the usual illegal export.[5] Secondly, all companies involved in the deal knew that the export was illegal and the acquisition of any equipment for quieter submarines was high on the list of priorities of the Soviet Minister of Defence.[6] Thirdly, the entire deal was carried through with a business-as-usual mentality. No personal profit was made by the managers negotiating the contract. Apparently, the sole motivation to enter into the contracts with the Soviets lay in the increased profits which would result. The Norwegian corporation was struggling for survival because of a shortage of orders; the Japanese company, however, did not face similar problems.[7]

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4 The equipment is worth more than $ 34 million U.S. Toshiba Machine Corporation sold four propeller-milling machines in two instances, each worth $ 17 million U.S. See D.E.Sanger, "More Toshiba Tools Said to Reach Soviet" New York Times (19 June 1987) D1 and *supra* note 1 at A1.

5 A three-year joint investigation by the special task forces described above in Footnote 2 called "Operation Aspen Leaf" led to the indictment of five non-Americans, four West Germans and one Austrian, who were under long time suspicion of illegally exporting American goods for foreign interests following a transaction to Cuba involving non-military equipment totalling less than $ 35,000 U.S. See J.Gerth, "Five Foreigners Indicted in Illegal Export "Sting"" New York Times (11 August 1987) D2.

6 See *supra* note 1 at D10.

7 For details see D.E.Sanger, "Toshiba Details Trail of Crime in Sale of Machinary to Soviet" New York Times (10 September 1987) A1 and *supra* note 1 at D10.

The outrage in the United States in response to the disclosure of this deal was immense.[8] The timing could not have been more unfavourable for the Japanese. The American Congress was already considering economic measures in retaliation for improper business practices by Japanese companies. Now it was felt that the Japanese companies were even unscrupulous enough to sell Western security for profit and that the Japanese government had considerably facilitated the circumvention of internationally agreed controls by failing to adequately enforce them.[9] Lenin's

8 The American response received wide coverage when ten members of Congress ceremoniously smashed a Toshiba radio in front of the Capitol. This demonstration of American anger provoked a similar response from Japan. B.Crossette, "... while the Japanese Rethink Trade Stance" New York Times (6 July 1987) 37. The American Conservative Union called for a nationwide consumer boycott of Toshiba products. Representative Helen Delich Bentley, one of the House members who supported the boycott call, said: "Treachery by any other name is still treachery, though if it had another name it would be Toshiba or Kongsberg." See S.F.Rasky, "Official Scorn for Import Ban" New York Times (2 July 1987) D3.

9 Only 30 inspectors review 200,000 applications a year. This disproportion may explain why it was not discovered that TDP 70/110, the catalogue number referred to in the application for an export permit does not appear in Toshiba Machine's sales brochures. Moreover, the machinary loaded in Japan and shipped to the Soviet Union did not fit the description of the equipment. As long as the statements in the application form appeared to be in accordance with the then valid export control regulations, no further inquiry was made by the Japanese authorities. In view of this practice, the Japanese government is not in a position to allay suspicions that its confidence in its family-like relationship with Japanese corporations had often been abused prior to this incident. In fact, further investigation revealed that the flow of high technology from Toshiba Machine to the Soviet Union has begun as early as 1974. See *supra* note 1

well known prophecy that "when the time comes to hang the capitalist class they will compete with each other to sell us the rope" appeared to have come true.[10]

Once the dust had settled, the consequences of this breach of export controls were considered. The State Department opposed the idea of punishment because no American citizen, company or technology was involved. Instead, it focused on measures preventing future violations of export control regulations by strengthening international agreements.[11] The Japanese Government seemed to have followed the same pattern. After the first largely emotional response of resentment at being wrongly, or at

at D10 and D.E.Sanger, "Bigger Roles of Toshiba Unit and Kongsberg Cited" New York Times (29 July 1987) D2.

10 According to a study based on an internal investigation of Toshiba Machine by the parent company, the President of Toshiba Machine, Masanobu Hisano, had instructed his employees "to do what had to be done to get the business". It was necessary to forge documents, and to vet and burn potentially incriminating files. See D.E.Sanger, "Toshiba Details Trail of Crime in Sale of Machinery to Soviet" New York Times (10 September 1987) A1.

11 This position did not result in inactivity. On July 8, 1987, the United States Department of Commerce refused to renew the export license of Toshiba's American subsidiary, Toshiba International. From that date on, the company has been required to apply for a separate license each time a foreign transaction is planned. See S.Chiara, "Tokyo Official Plans U.S. Visit on Toshiba Case" New York Times (13 July 1987) D2. Furthermore, the Pentagon awarded the American Zenith Corporation a $ 104 million contract to provide the military with laptop computers, a major setback for Toshiba Corporation which was considered the early favourite to win it. See D.E.Sanger, "Zenith gets $104 Million U.S. Order" New York Times (12 August 1987) D1.

least unduly severely, accused,[12] Japan realized that the sale of high technology equipment to the Soviet Union regardless of its function will endanger its own security as well as that of other countries.[13]

After lengthy discussions, Congress and the President agreed to include sanctions against Toshiba and Kongsberg in the *Omnibus Trade and Competitiveness Act* of 1988.[14] In part II of the subtitle concerning export controls cited as the *Multilateral Export Control Enhancement Amendments Act*, the importation of all products produced by Toshiba Machine Corporation and Kongsberg Trading Company into the United States is prohibited for a period of three years.[15] Obviously in response to the pressure from the business community, the ban on the importation on products is limited to the subsidiaries involved with the deal with the Soviet Union. Their parent companies, Toshiba Corporation and Kongsberg Vaapenfabrikk, are only subject to relatively less severe sanctions. For a period of three years, a prohibition will be imposed on contracting with, and procurement of products and services

12 According to observers, Japan felt that the American Congress generated the climate of a "witchhunt" without substantial evidence. Referring to the involvement of the Norwegian company Kongsberg in the incident and the showy destroyal of a Toshiba radio by Congressmen - a mere photo opportunity in American eyes - the Japanese found it "rather interesting that the Congress did not smash Norwegian sardine tins, only the Toshiba radios". See S.Chira, "Japan's Steps to Soften U.S. Anger on Toshiba" New York Times (18 July 1987) 37.

13 See S.Chira, "Nakasone Asserts Toshiba Betrayed Japan With Sales", New York Times (15 July 1987) A1.

14 Act of August 23, 1988, Pub.L.No.100-418; reproduced at (1989) 28 I.L.M.15.

15 Sec.2443 (a) (1) (A).

from, Toshiba Corporation and Kongsberg Vaapenfabrikk, by any department, agency, or instrumentality of the United States government.[16]

The Toshiba case contains all the elements which, in the past, have caused a substantial amount of controversy among Western allies.[17] The central issue is how to resolve the conflict between national security and business relationships with potential enemies or countries with different ideologies.

The need to impose export controls was felt first in the aftermath of World War II when the two superpowers, the United States of America and the Soviet Union, emerged and divided most of the rest of the world into spheres of influence. As a result from the rivalry between the blocs, permanent tensions arose - at times relaxed, at others sharpened - which are reflected in the economic relations between East and West. In an attempt to foster a free world trade market and guarantee national security at the same time, the United States developed a system which made all foreign transactions subject to export control licensing. Based on wartime experiences with the *Trading With The Enemy Act*[18], the *Export Control Act* of 1949[19]

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16 Sec.2443 (b).

17 In particular, the pipeline sanctions in 1982 aggravated tensions between the United States and its European allies. For details see *infra* chapter III note 11 and accompanying text.

18 October 6, 1917 (Ch.106, 40 Stat.411). The Act remained in force until 1976 when it was replaced by the *International Emergency Economic Powers Act* (50 U.S.C.App. ss.1701-06). The original Act authorized the President "during the war or during any other period of national

established the first comprehensive system of export control.[20] At the same time, in an effort to safeguard the enforcement capacity of its domestic regulations, the United States sought an agreement on an common list of controlled goods with some of their Western allies, whose economies were slowly recovering. The United States remained the driving force[21] behind the newly established Consultative Committee (CoCom) despite the fact that its headquaters are located in Paris, France. The Committee's main tasks are consultations with regard to the enforcement

emergency declared by the President" to prohibit any kind of economic activity with the designated countries or nationals of them. Communist China (from 1950 to 1969), North Korea (from 1950), North Vietnam (from 1954) and Cuba (from 1962) made the list.

19 Act of Feb.28, 1949 (Ch.11, 63 Stat.7). For a legal analysis of the Act see H.J.Berman & J.P.Garson, "United States Export Controls - Past, Present, and Future",(1967) 67 Colum.L.Rev.791 at 794 and P.H.Silverstone, "The Export Control Act of 1949: Extraterritorial Enforcement", (1959) 107 U.Pa.L.Rev. 331.

20 Reportedly, the Soviet Union employed an extremely complex and time-consuming export control system. Before any export license is granted, the prior availability of the good in the West and the inferior quality of the Soviet product must be proven to the KGB. See H.Levine,"Technology Transfer: Export Controls versus Free Trade", (1986) 21 Tex.Int'l L.J.373. Since information concerning sensitive issues such as national security is not freely available from the Soviet Union, it remains to be seen whether the recent change of leadership will influence the Soviet export control system. However, high technology products from the Soviet Union never ranged high on the list of priorities of Western importers.

21 The United States underlined its capacity for persuasion by adopting the *Mutual Defense Assistance Control Act* of 1951, commonly known as the Battle Act, honouring its sponsor congressman Laurie Battle. The purpose of this Act was to prevent nations that exported strategic items to Communist countries from receiving American aid.

of controls, the granting of permission for exceptions and the revising and updating of control lists.[22] During the Korean War (1950 - 1953), four new members, including Canada and the Federal Republic of Germany, joined CoCom. Today, all NATO allies with the exeption of Iceland, as well as Japan and Australia, are membes of the Consultative Group.

The *Export Control Act* of 1949[23] has been succeeded by the *Export Administration Acts* of 1969 and 1979[24]. Both Acts have broadened the President's authority to enforce export controls by increasing the number of corporations subject to them.[25] Export controls, originally thought of as a measure to protect Western security, now play a major role as a foreign policy tool. The United States have used the denial of trade as an

22 For a discussion of the legal status and procedures of CoCom see *supra* note 19 at 834. For a very thorough analysis of CoCom's achievements and inherent weaknesses see P.Webster, "CoCom: Limitations on the Effectiveness of Multilateral Export Controls", (1983) Wis.Int'l L.J.106.

23 Pub.L.No.91-184, 83 Stat.841. The new name for the Act seems to indicate a change of substance, but in fact, the change serves only cosmetic purposes. See W.S.Surrey & P.Wallace jr., *A Lawyer's Guide to International Business Transactions*, Philadelphia 2d ed 1977 at 149 and T.W.Hoya, "The Changing United States Regulations of East - West Trade", (1973) 12 Colum.J.Transnat'l L.1.

24 Pub.L.No.96-72, 93 Stat.503 (Sept.29, 1979).

25 The U.S. Congress recognized the President's constitutional authority to impose sanctions, but made it clear that the extent to which the President may exercise this power depends on the purpose of sanctions. Accordingly, the *Export Administration Act* of 1979 was divided into two parts: National security and foreign policy. For details see *infra* chapter II note 54 and accompanying text.

instrument of foreign policy in the area between the exercise of military power and the mere expression of moral outrage. In recent years, they have resorted to economic sanctions at an ever increasing pace,[26] frequently to promote human rights,[27] but also to punish countries suppor-

26 The United States have been called "the Olympic Champion in imposing political trade controls through a combination of persuasion, inducement, and threat of sanction". A.F.Lowenfeld, "...sauce for the gander": The Arab Boycott and the United States Political Trade", (1977) 12 Tex.Int'l L.J.25.

27 Under the Carter administration (1977-1980), the United States sought to enforce human rights, supporting its position with the threat of sanctions. In 1978, when Soviet authorities put two of the best known dissidents, Alexander Ginzburg and Anatoly a.k.a. Natan Sharansky, on trial, the American government responded inter alia by denying to Sperry Rand Corporation an export permit for a computer purchased by the official Soviet news agency TASS which supposedly wanted it for coverage of the 1980 Moscow Olympic Games. For a discussion of all measures see K.W.Abbott, "Trading Links to Political Goals: Foreign Policy Export Controls in the 1970's and the 1980's", (1981) 65 Minn.L.Rev.739 at 790 and J.F.Murphy & A.T.Downey, "National Security, Foreign Policy and Individual Rights: The Quandary of United States Export Controls", (1981) 30 I.C.L.Q.791 at 810. At the same time the Carter administration withdrew any aid for development and refused granting any export license to Uganda when the government's record of torture and other human rights violations became known. For details see Note, "The Legitimacy of the United States Embargo of Uganda", (1979) 13 J.Int'l L.& Ec.651. In 1980, following the Soviet invasion of Afghanistan, the American government imposed an almost comprehensive embargo that included the prohibition of high technology sales and of the intended sales of 25 million tons of grain, as well as the boycott of the Moscow Olympic Games. In a second move, it prohibited the export of all olympic-related from Cola to stuffed animals (the "Misha" dolls, mascots of the Moscow Olympic Games). See H.E.Moyer jr. & L.A.Mabry: "Export Controls as Instruments of Foreign Policy: The History, Legal Issues, and Policy Lessons of Three Recent Cases", (1983) 15 L.&

ting terrorists.[28] Although the European countries generally refuse to impose economic sanctions for political purposes, they have acted inconsistently with their principle twice recently.[29] The frequent use of economic

Pol.Int'l Bus.1 at 27 and Note, "Foreign Policy Controls under the Export Administration Act of 1979: The Embargo Following the Soviet Invasion in Afghanistan", (1983) Wis.Int'l L.J.185. The list of target nations in recent years includes Iran after the obvious government approval for the hostage taking of American diplomats in Tehran, the Soviet Union when the American government tried to stop, or, at least, slow down the pipeline project as a protest against the declaration of Martial Law in Poland, and South Africa for its slow movement towards the abolition of Apartheid. For a very comprehensive discussion of the factual and legal situation in the Iran - hostage affair see A.F.Lowenfeld, *International Economic Law vol.III, Trade Control for Political Ends*, New York 2d ed. 1983 at 537, and R.Carswell, "Economic Sanction and the Iranian Experience", (1982) 60 For.Aff.247 and Moyer/Mabry *supra* at 8. For a analysis of the pipeline affair see *infra* chapter III note 11 and accompanying text. For an account of the experiences with sanctions against South Africa compare M.J.Mehlmann, T.M.Milch & M.V.Toumanoff, "U.S. Restrictions on Exports to South Africa", (1979) 73 A.J.I.L.581 and R.Paretzky, "The United States Embargo Against South Africa: An Analysis of the Laws, Regulations, and Loopholes", (1987) 12 Yale J.Int'l L.133.

28 In 1986, the United States imposed sanctions against Libya after the finding of evidence that linked the activities of the North African country and a series of terrorist attacks on the airports in Paris and Rome and of a discotheque in Berlin. See J.P.Bialos & K.I.Juster, "The Libyan Sanction: A Rational Response to State-Sponsered Terrorism", (1986) 26 Va.J.Int'l L.799.

29 On April 16, (1982), following the occupation of the Falkland Islands by Argentinian troops claiming the territory, the European Community (EEC) imposed an embargo against Argentina. The EEC took the position that the islands in question belonged to the United Kingdom. After considerable pressure from the public, the EEC finally reached an agreement (September 16, 1986) to ban

sanctions would argue the effectiveness of these measures; to most observers, however, the record seems rather weak.[30]

Differing attitudes towards economic sanctions, the differing assessments of their consequences for their own economies, and, perhaps, the proximity of Western Europe to the Soviet Bloc, have led to unilateral American action to achieve their worldwide goals. As long as the United States restricted its jurisdiction strictly to its territorial limits, American embargoes enabled non-American competitors to strengthen economic ties to Eastern Bloc purchasers. These competitors sometimes replaced American companies not only in the short term, but as suppliers in the long run. Unable to obtain support for its goals, the United States began to extend its jurisdiction by a broader definition of national companies that included subsidiaries of American companies incorporated under foreign law and, applying a control theory, foreign companies the majority of whose were held by American nationals or corporations. Furthermore, they sought to impose American regulations on foreign companies that either obtained American goods by licensing, or were using American technology or goods to

the import of gold coins (Krugerrand), iron and steel products from South Africa. They prohibited further investment in South Africa by European companies. See Note, "EEC Sanctions Against South Africa: The Common Commercial Policy and Delimination of the EEC's Power", (1987) 10 B.C.Int'l & Comp.L.Rev.119 and W.Meng, "Die Kompetenz zur Verhängung von Wirtschaftssanktionen", (1982) 42 ZaöRV 780.

30 See e.g. *supra* note 27 at 826; M.Doxey, "International Sanctions in Theory and Practice", (1983) 15 Case W.Res.J.Int'l L.273.

manufacture products on their own.[31] European governments took the position that this broad view of jurisdiction is incompatible with international law and an intrusion on their sovereignty.[32] The potential conflict culminated in open controversy among the CoCom-partners when the United States decided to place an embargo on the supply of equipment for the pipeline project, which several European firms - led by the West German Ruhrgas AG - had already contracted to provide.[33] This embargo was, at least officially, a response to the perceived responsibility of the Soviet Union for the enactment of martial law in Poland.[34] It was thought that the threat of severe penalties for those corporations breaching it, including prison terms for management, fines, and import bans on their products, would force companies located in Europe to value the market opportunities and abide by the embargo. When it became obvious that European companies were opposing the embargo the United States Department of Commerce issued orders temporarily denying export privileges to the majority of

31 This extension was easy to achieve by giving the regulatory phrase "persons subject to the jurisdiction of the United States" a broad interpretation.

32 See for example the EEC Comments on the United States Regulations Concerning Trade with the U.S.S.R., reprinted in (1982) 21 I.L.M.891 and (1984) 27 G.Y.I.L.554.

33 For a description of the complex contractual relationships see K.Bockslaff, "The Pipeline Affair of 1981/82: A Case History", (1984) 27 G.Y.I.L.28.

34 However, this link seemed to many observers incorrect since the United States had always opposed the pipeline deal because of potential security risks. The Americans believed that European reliance on Soviet gas could be converted into a weapon in an emergency situation.

the West European companies involved.[35] The "European" companies were outraged and, backed, or in two countries even ordered,[36] by their governments, continued to honour their contracts while at the same time challenging the American order. Before a decision was rendered by the American courts, President Reagan lifted the ban, indicating that the United States will in future seek cooperation rather than confrontation with its allies in export control matters.[37]

The Toshiba case, five years later, appears to be the first opportunity to judge whether the pipeline conflict has effected a change of American policy.

Looking at the judicial content of these conflicts, mainly from an international law perspective, this thesis will attempt to determine the limits of jurisdiction in the area of export control. Finally, it will present a set of rules, derived from principles of international law, which it is hoped would, if accepted, result in a less

35 Those companies were: Dresser (France) S.A., Creusot - Loire S.A., Nuovo Pignone S.p.A., John Brown Engineering Ltd., AEG - Kanis Turbinenfabrik GmbH and Mannesmann Anlagenbau AG.

36 The British government, based on its authority under the *Protection of Trading Interest Act* of 1980, ordered its companies not to comply with the American embargo. Order reprinted in (1982) 21 I.L.M.834. The French government confiscated all products manufactured for the pipeline and shipped them to the Soviet Union. The *Ordonnance no. 59/63 du 6 Janvier 1959*, Dalloz 59, 212 empowered the government to do so.

37 See "Radio Adress to the Nation by President Reagan, East - West Trade Relations and the Soviet Pipeline Sanctions", reprinted in (1983) 22 I.L.M.349.

troubled world of international trade, one in which economic and political power no longer rule. More predictablity and certainty would also be of immeasurable value for companies of all sizes[38] and would support a less restricted world trade. Security interests would not suffer while "the spirit of commerce" would have a chance to prove Alexander Hamilton's often quoted "tendency to soften the manners of men and extinguish those inflammable humors which have so often kindled into wars."

38 The deterrent effect of the dispute over jurisdiction on small- and medium-sized companies tends to be forgotten. The ever-present likelihood of sanctions and, hence, of potentially wasted expenses in developing a long-standing business relationship with Eastern Bloc's state-run companies are, at least for American companies, a factor to be considered before the first dollar is spent.

Chapter I: The Legitimacy of Economic Measures under International Law

The question of the compliance with international law of the use or the threat of use of economic pressure has long been debated. State positions on this issue divide roughly between developing and developed countries. One of the reasons for the disapproval of the use of economic sanctions on the part of developing countries may be the perception that this tactic remains a privilege of developed countries. Looking at their long-term economic positions and their bleak economic future, they fear being relegated to the status of permanent victims of such sanctions.[1] Economically advanced countries understand the right to impose sanctions as part of their national sovereignty as the right to regulate all areas of their economy in the way they wish.

In general, the right of a state to regulate its foreign trade has never been doubted. Even the signatories to the General Agreement on Tariffs and Trade (GATT), which aim to abolish all obstacles to free trade, do not question the legitimacy of existing regulations such as tariffs,

1 In the 1970's, the oil-producing countries organized in OPEC, however, demonstrated the power of commodity-producing countries. In a joint undertaking, these Third World countries boycotted Israel and countries with friendly relations with Israel quite successfully. Their influence began to diminish when other countries, notably Norway and the United Kingdom, succeeded in extracting North Sea oil.

inspections, and quantitative and qualitative restrictions[2]. The key question is whether the regulation of export becomes illicit when directed against a particular country or countries for purposes of diplomatic pressure. Any attempt to answer this question must begin with the distinction between the effect and the intent of an economic measure. The lawfulness of any measure can only be judged by the purpose pursued by the government. The promotion of domestic trade seems clearly to be a right within the sovereign prerogative. Any economic activity by the state designed to improve the competiveness of domestic industries - such as tax incentives - can, if successful, have an incidental effect on the interests and industries of other countries. On the other hand, it may sometimes be a matter of foreign policy to attempt to hinder other countries in the pursuit of their interests. In some cases, it will be difficult to single out one particular purpose of an economic measure. Therefore, one writer suggests focussing on the predominant purpose as decisive.[3] The major weakness of this proposal lies - as he admits - in the fact that, today, no forum exists to apply such a test. The United Nations Security Council was initially designated to fulfill this function.[4] However, in view of

2 J.D.Muir, "The Boycott in International Law", (1974) 9 J.Int'l L.& Ec. 187 at 192; reprinted in: R.Lillich, *Economic Coercion and the New International Economic Order*, Charlottesville, Va. 1976) [hereinafter Lillich].

3 D.W.Bowett, "Economic Coercion and Reprisals by States", (1972) 13 Va.J.Int'l L. 1 at 5 reprinted in Lillich *supra* note 2 at 7.

4 Compare articles 39 and 42 which give the Security Council the right to determine any breach of the peace and to

the deep divisions between its permanent members, each of whom holds a veto on council decisions, the possibility that it might fulfill such a function has been almost completely eliminated[5]. Bowett[6] conceives of an institution similar to the panel provided under s. XXIII of the GATT to settle disputes between members[7]. His optimism that such an authority would create a body of "case law", seems, however, to be without much foundation. The model procedure has proved lengthy and ineffective and, as a result, has rarely been initiated despite numerous violations of the GATT. From time to time, though, the panel does agree to issue non-binding recommendations.

decide what measures are appropriate to maintain or restore international peace and security. Article 41 contains a list of the measures including complete or partial interruption of economic relations.

5 The permanent members are the five states which first developed nuclear weapons: the United States, The Soviet Union, The United Kingdom, France, and Communist China.

6 See *supra* note 3 at 4.

7 S.XXIII (1) GATT reads: "If any contracting party should consider that any benefit accruing to it directly or indirectly under this Agreement is being nullified, or impaired or that the attainment of any objective of the Agreement is being impeded as the result of
(a) the failure of another contracting party to carry out its obligations under this Agreement, or
(b) the application by another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement, or
(c) the existence of any other situation,
the contracting party may, with a view to the satisfactory adjustment of the matter, make written representations or proposals to the other contracting party or parties which it considers to be concerned. Any contracting party thus approached shall give sympathetic consideration to the representations or proposals made to it."

Efforts to create a judicial body which would determine the purpose of an economic measure only become relevant when it is established that the use of economic pressure intended to effect a change in another country's behaviour is not in accordance with international law.

In the view of many eminent jurists, the development of international law has contradicted those who, in the past, have denied it the status of law[8]. Pointing to frequent violations and the lack of enforcement, these critics treated rules of international law either as a matter of convenience ("gentlemen's agreement") or as a model for a utopian world. However, these views do not recognize the achievements in the codification of previously customary practice, and its transformation into national law as treaty obligation. These acts of transformation often confer enforceable rights on nationals of the countries who enact them. Authorities and procedures have been established in increasing numbers to guarantee the compliance of nations with norms of international law. At least those norms which have a legal foundation and a practical justification have to be regarded as norms with a binding effect[9]. In particular, the United Nations Charter has been acknowledged as a primary source of international law, a characterization which is justified by its virtual

8 See Comment, "The Use of Non-Violent Coercion: A Study in Legality under Article 2 (4) of the Charter of the United Nations", (1974) 122 U.Pa.L.Rev.983 at 986.

9 *Id.* at 987

universality[10]. Through the act of signing the Charter, member nations of the U.N. accept its principles and rules as obligatory.

With regard to economic pressure, the key provision in the U.N. Charter is article 2 (4). This section reads as follows: "All members refrain in their international relations from the threat or use of force against the territorial integrity or political independence of any state, or in any other manner inconsistent with the purposes of the United Nations...".

Article 2 (4) of the U.N. Charter has already been declared dead[11]. Franck argues that the "wide disparity between the norms [the U.N. Charter] sought to establish and the practical goals the nations are pursuing in defense of their national interest"[12] has prevented the realization of the system of international cooperation conceived by the framers of the U.N.Charter. Henkin, however, rejected Franck's approach judging the vitality of a

10 Article 93 of the United Nations Charter stipulates that all members become ipso facto parties to the Statute of the International Court of Justice. Art. 38 of this statute recognizes international conventions as a primary source of international law. The United Nations Charter as the one convention which almost all nations have agreed upon, enjoys a special position at international law.

11 T.M.Franck, "Who killed Art. 2 (4)? or Changing Norms Governing the Use of Force by States", (1970) 64 A.J.I.L.809.

12 *Id.* at 837

law by counting the number of times it is violated[13]. His objection seems to be correct. The validity of the prohibition of theft in the Criminal Code, for example, is not doubted when the number of charges of pickpocketing rises. Moreover, the assumption that laws have a deterrent effect is widely accepted, although the degree of deterrence is hard to measure. In Henkin's view, art.2 (4) of the U.N. Charter is necessary to remind people of their long-term fundamental national interest in peace keeping[14]. It is submitted that the effects of art. 2 (4) of the U.N. Charter go beyond that. The general attitude towards war has altered dramatically since the beginning of this century. The changing character of war, with its greatly increased impact on civilian populations and, in particular, the ability of the superpowers to destroy the world completely, have certainly contributed to the notion of war as evil. War is no longer indulged as freely, as it was in the past; this change of attitude is reflected in art. 2 (4) of the U.N. Charter.

The relevance of art. 2 (4) of the U.N. Charter to the use of economic pressure, however, is "doubtful"[15]. This issue has been subject of long discussion.

13 L.Henkin, "The Reports of the Death of Art. 2 (4) Are Greatly Exaggerated", (1971) 65 A.J.I.L.544.
14 *Id.* at 548
15 D.W.Bowett, "International Law and Economic Coercion", (1976) 16 Va.J.Int'l L. 245, reprinted in Lillich *supra* note 2 at 87.

Art. 31 of the Vienna Convention on the Law of Treaties stipulates the method of interpretation of treaty provisions. A provision has to be construed grammatically, systematically, logically in the light of its object and purpose[16].

A look at the word "force" does not solve the issue since an analysis of the word in the official U.N. languages English, French, Spanish, Russian, and Chinese

16 Art. 31 of the Vienna Convention on the Law of Treaties provides:

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
2. The context for the purpose of the interpretation of atreaty shall comprise, in addition to the text, including its preamble and annexes:

(a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;

(b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

3. There shall be taken into account together with the context:

(a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provision;

(b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation,

(c) any relevant rules of international law applicable in the relations between the parties.

4. A special meaning shall be given to a term if it is established that the parties so intended.

(Art. 111 of the U.N. Charter) reveals that the interpretation of "force" as economic pressure is covered in all of them[17]. The context must be considered next. The threat of economic sanctions must potentially be able to erode "the teritorial integrity or political independence of another nation". Brosche cited the Arab oil embargo and the pressure from the United States on Chile during the Allende government (1970 - 1973) as prime examples of the effectiveness of economic force[18]. Whether this assessment is correct or not, no one doubts that economic force can have devastating consequences for the well-being of another country.

A look at the language chosen by the drafters of the U.N. Charter does not help clarify the problem; rather it confuses the issue. Apparently not ignorant of the vagueness inherent in the use of the word "force" alone, the term "armed forces" is used in the preamble and in art. 41, which sets out the powers of the Security Council. Art. 44 of the U.N. Charter, however, contradicts the impression that the framers were aware of the possibilities of interpretation[19]. At first glance, a broader inter-

17 H.Brosche, "The Arab Oil Embargo and United States Pressure Against Chile: Economic and Political Coercion and the Charter of the United Nations", (1974) 7 Case West.Res.J.Int'l L. 3 at 19; reprinted in Lillich *supra* note 2 at 283.

18 *Id.* at 6 (Arab oil embargo) and 11 (Chile)

19 Art. 44 reads: When the Security Council has decided to use *force* it shall, before calling upon a member not represented on it to provide armed forces in fulfillment of the obligations assumed under Art. 43, invite that member, if the Member so desires, to participate in the

pretation of "force" would seem to be warranted since no specific kind of force is mentioned, but a reading of the content makes it obvious that in fact "armed forces" is meant. To argue that this is the exception to the rule[20] appears to be arbitrary. One can merely conclude that the drafters were not diligent enough to use the terms "force" and "armed force" in a coherent way that would leave no doubt how the terms must be construed.

In the next step of the analysis, the wider context and the purposes of arts.1 and 2 of the U.N. Charter have to be taken into account. It has been argued that such a teleological interpretation results in the prohibition of the threat or use of economic force[21]. In their view, the end set out in the Charter of achieving "international cooperation in solving international problems of an economic, social cultural, or humanitarian character"[22], becomes meaningless if states are entitled to apply measures such as economic sanctions unilaterally. This conclusion, however, goes too far. In a world where the proposed system of dispute settlement, i.e. the U.N.

decision of the Security Council concerning the employment of contingents of that Member's armed forces. (emphasis added)

20 See *supra* note 11 at 987

21 J.J.Paust & A.P.Blaustein, "The Arab Oil Weapon - A Threat to International Peace", (1974) 68 A.J.I.L.410 at 422; reprinted in Lillich *supra* note 2 at 121. See also I.F.I.Shihata, "Destination Embargo of Arab Oil: Its Legality under International Law", (1974) 68 A.J.I.L. 591 at 626; reprinted in Lillich *supra* note 2 at 153.

22 Art. 1 (3) of the U.N.Charter.

Security Council, has been paralyzed, the unilateral pursuit of the goals of the U.N. Charter is, in my view, preferable to the promotion of inactivity and to waiting for a time when the U.N. system has a chance to be realized [23].

After having compared the League of Nations Covenant and the U.N. Charter extensively, one writer concluded that, under the latter document, states are generally under no obligation to use their economy to engage in a crusade for the cause of international law [24], but that, should a state decide to use its economic resources coercively against another state, it is under an obligation to do so in the interest of the community at large as stated by the U.N. Charter [25].

23 So S.N.Smith, "Re 'The Arab Oil Weapon'": A Skeptic's View", (1975) 69 A.J.I.L. 136: "Further I have little doubt that the day will come when an activity such as the oil boycott will be held, by the judgment of the world community, to constitute a violation of law in the strictest sense of the word. In this way, Paust and Blaustein may be prophets or, perhaps more appropriately, visionaries. Here is precisely the point, however: that time has not yet come."

24 S.C.Neff, "The Law of Economic Coercion: Lessons from the Past and Indications from the Future", (1981) 20 Colum.J.Transnat'l L. 411 at 436. The situation is different if the Security Council, authorized under arts. 39 and 41 of the U.N.Charter decides that economic sanctions shall be applied against a nation which threatens the peace. For the view suggesting that, given the inactivity of an international body, there is not only a right, but a duty of nations to promote human rights unilaterally by imposing economic pressure see *supra* Preface note 27 (Note) at 672.

25 R.B.Lillich, "Economic Coercion and the International Legal Order", (1975) 51 Int'l Aff. 358, reprinted in Lillich *supra* note 2 at 71. He presented a slightly

This view is consistent with the two main arguments against the complete prohibition of economic force. The first argument stresses the nexus between articles 2 (4) and 51 of the U.N. Charter. Art. 51 provides: "Nothing in the present Charter shall impair the inherent right of individual or collective self-defense if an armed attack occurs against a Member of the United Nations, until the Security Council has taken measures to maintain international peace and security...". It is obvious that article 51 of the U.N. Charter permits the use by states of armed forces as a measure of self-defense. Given that "economic sanctions" are not mentioned in art. 51 of the U.N. Charter, a broad interpretation of "force" would lead to the absurd result that an attacked nation could legitimately defend itself by ending life, while sanctions aiming at the economic interests of the attacking country - by comparison, certainly, the milder means - would violate the U.N. Charter. The only way to construe the Charter in a reasonably coherent way lies in an interpretation that narrows the scope of the word "force" in art. 2 (4) of the U.N. Charter.

different position suggesting the "overall interest of the world community" as the standard against which to judge the legitimacy of economic measures. The consequences would be similar since the "overall interest of the world community" should regularly coincide with the expressed goals of the United Nations.

Attempts to explain the meaning of article 51 of the U.N. Charter differently are not convincing. There is no indication in the wording of the article that would support a narrow reading restricting its scope on the question of the lawfulness of an anticipatory armed attack[26]. According to Paust and Blaustein, the right of armed self-defense should be limited to situations involving prior acts of armed aggression. This interpretation assumes a great deal of naivete on the part of the framers of the U.N. Charter, if in the age of nuclear threat, they expected a target state to wait idle and watch a hostile country's preparations for war.

The legislative history of a provision a supplementary consideration under art. 32 of the Vienna Convention on the Law of Treaties, indicates to most writers that economic force should not be outlawed [27]. At the foundation conference in San Francisco, the Brazilian delegation submitted the phrase "and from the threat or use of economic measures" as an amendment to art. 2 (4) of the U.N. Charter[28]. This proposal was rejected by a vote of 26 to 2, for most writers a clear indication that the founding members were not willing to prohibit the use of economic measures. Brosche, however, attempts to explain this vote in another way, based on the session reports of the

26 See *supra* note 8 at 998 and note 24 at 416.
27 W.Kewenig & A.Heini, *Die Anwendung wirtschaftlicher Zwangsmassnahmen im Volkerrecht und im Internationalen Privatrecht*, Berichte der Deutschen Gesellschaft für Vöelkerrecht, No.22, Heidelberg 1982 at 11.
28 6 U.N.C.I.O.Dcs. 559 (1945)

inaugural conference[29]. He concludes, on the basis of a statement by a United States delegate who had mentioned that the phrase "or in any other manner" was designed to insure that there were no loopholes, that a broad interpretation is possible. Upon more careful consideration though, the remarks of the American delegate appear in a different light. I think that he meant that, unless the words in question were part of the text, states would have been justified to attack other countries as long as these acts were not directed against the target country's territorial integrity or political independence. English grammar and the position of the phrase in the sentence clearly support this view.

Another attempt to find support for the prohibition of economic coercion in the U.N. Charter focusses on art. 2 (3)[30]. This article requires nations to settle disputes by peaceful means[31]. Blum concluded that only an interpretation which prohibits every use of force is consistent with this fundamental obligation. If this premise is correct, art. 2 (4), which explicitly prohibits the use of force, is *ipso facto* superfluous. Beginning an analysis from the plain meaning of the words, "peace" and "war" are antonyms. Hence, the duty to employ peaceful

29 See *supra* note 17 at 22
30 Y.Z.Blum, "Economic Boycott in International Law", (1977) 12 Tex.Int'l L.J.5.
31 Art. 2 (3) of the U.N.Charter reads: "All Members shall settle their international disputes by peaceful means in such a manner that international peace and security, and justice, are not endangered."

means of dispute settlement corresponds to a prohibition of the use of military force in such a situation. Unfortunately, the wording of art. 2 (3) of the U.N. Charter is as vague as that of art. 2 (4).

Some authors have examined U.N. Resolutions in search of support for a prohibition of economic force. They have no binding character[32]; even under the Statute of the International Court of Justice, U.N. Resolutions are not deemed to be a source of international law[33]. They may, however, indicate general principles of customary law[34]. The "Declaration on Principles of International Law concerning Friendly Relations and Co-operation among States in Accordance with the Charter of the United Nations"[35] is the result of an important understanding between the Western states and the developing countries[36]. These

32 I.Brownlie, *Principles of Public International Law*, Oxford 3d ed 1979 at 14; G.W.Haight, "The New International Economic Order and the Charter of Economic Rights and Duties of States", (1975) 19 Int'l L.591 at 597: "Under the U.N. Charter the General Assembly may discuss and make recommendations, but it is not a law-making body, and its Resolutions, no matter how solemnly expressed or characterized, nor how often repeated, do not make law or have binding effect."

33 Compare art. 38 of the Statute of the International Court of Justice.

34 R.B.Lillich, "The Status of Economic Coercion under International Law: United Nations Norms", (1977) 12 Tex. Int'l L.J 17 at 29: "The body of Resolutions as a whole ... undoubtedly provide a rich source of evidence."

35 G.A.Res. 2625 (XXV); U.N.Doc. A/8028 (1970).

36 See *supra* note 17 at 25; Rosenstock, "The Declaration of Principles of International Law concerning Friendly Relations", (1971) 65 A.J.I.L.713.

principles do not make the use of economic force illegal *per se*, thereby confirming the Western view that art. 2(4) of the U.N. Charter does not cover "economic force"; however, such use would violate the principle of non-intervention[37]. At first glance, such an outcome would seem to support the position that the use of economic force is illegal at international law, since economic sanctions are intended to change another country's behaviour in its internal or external affairs and, will thus almost inevitably interfere with the target country's independent decision-making, i.e. its sovereignty. The principle of non-intervention has been accepted repeatedly; in particular, Resolution 2131 (XX), the "Declaration on the Inadmissibility of Intervention in the Domestic Affairs of States and the Protection of their Independence and Sovereignty"[38] is considered a milestone. However, section 2 of this declaration makes it clear that what is prohibited is not the use of economic force *per se*. It is evident from the wording of the section that the purpose of the sanctions is decisive for the determination of its legitimacy: "No State may use or encourage the use of economic, political or any other type of measures to coerce another state in order to obtain from its subordination of

37 Not every economic measure which influences another country will constitute intervention. "The action of intervention presupposes not only a constraint on the recipient, but also the intention on the part of the intervening party to apply force." See *supra* note 30 at 14 and 33.

38 G.A.Res. 2131 (XX), U.N.Doc. A/6014 (1965)

the exercise of its sovereign rights and to secure from it advantages of any kind."

During the course of preparation of the Vienna Convention on the Law of Treaties, the International Law Commission discussed the same topic[39], i.e. the legitimacy of economic force under international law. The crucial point was whether the term 'force' in Art. 49 of the Draft Convention should include economic pressure. Art. 49 reads as follows: "A treaty is void if its conclusion has been procured by the threat or use of force in violation of the principles of international law embodied in the Charter of the United Nations". The Western nations objected to the inclusion of economic force as endangering the stability of treaty relationships and the doctrine of *pacta sunt servanda* by deterring potential investors. The provision would thus work against the long term interests of the less stable developing countries which had favoured a prohibition of economic pressure in anticipation of such benefits as the abolition of obligations entered into by previous governments. In the end, the Western view was accepted and the proposed Art. 49 was adopted unchanged as Art. 52 of the Vienna Convention on the Law of Treaties.

39 For details of the lengthy process of negotiation and the change of positions see: C.E.Partridge jr., "Political and Economic Coercion: Within the Ambit of Art. 52 of the Vienna Convention on the Law of Treaties", (1971) 5 Int'l Law.755; R.D.Kearney & R.E.Dalton, "The Treaty on Treaties", (1970) 64 A.J.I.L.495 and *supra* note 17 at 27.

In conclusion, it does not seem that art. 2 (4) of the United Nations Charter outlaws the use of economic force. The principle of non-intervention prohibits states from using economic measures intended to change the target nation's behaviour. Intervention, however, may be justified if the target nation is violationg its obligation under international law. Given the ineffectiveness of the collective enforcement mechanisms through international institutions as provided by the U.N. Charter, states may unilaterally pursue the goals laid down in the U.N. Charter and may, therefore, employ economic measures.

Chapter II: Western System of Export Control

This chapter provides a brief history of American export control legislation and an overview of the Western system of accomodating its national controls. The legislation of the United States is of particular interest for three reasons. First, the extensiveness of American controls is not matched by any other Western country.[1] Secondly, no other nation employs trade controls for political ends so often. Quite deservedly, the United States has been called the "Olympic champions in imposing political trade controls" [2]. Third, no other government attempted to comply foreign governments comply with its export control system.

The history of United States legislation of export control is characterized by attempts to reconcile two, often conflicting, objectives. In general, nations

1 For a short description of the Soviet system see *supra* Preface note 20; for a comparison with the legislation of other countries see H.Dahl, "United States Restrictions on High Technology Transfer: Impact Abroad and Domestic Consequences", (1987) 26 Colum.J.Transnat'l L.27 (mentioning export control legislation of Spain, France and the United Kingdom); B.E.Carter, "Looking for a Better Way: The Sanction Laws of Key United States Allies". (1987) 19 N.Y.U.J.Int'l L.& Pol.865; R.Baker & R.Bohlig, "The Control of Exports - A Comparison of Laws of the United States, Canada, Japan, and the Federal Republic of Germany", (1966) 1 Int'l Law.163; see also W.Hein, "Economic Embargoes and Individual Rights under German Law", (1983) 15 L.& Pol.Int'l Bus.40.

2 *Supra* Preface note 26 at 33.

consider the establishment of an export control system because by involuntarily contributing to a potential enemy-nation's ability it threatens its own security. Further, the denial of access to certain goods is often used to meet specified foreign policy goals, i.e. influence a target nation's behaviour towards the desired conduct. On the other hand, the United States has always been anxious to promote international trade because of benefits to job security and overall economic stability. By definition, any export control system impairs the economic competitiveness of domestic exporters and, thus threatens ambitious economic objectives as the reduction of a huge trade deficit.

Export controls based on national security concerns are exempted under Art.XXI from the application of the rules of the General Agreement on Tariffs and Trade (GATT). It is believed that this GATT provision represents the largest obstacle for universal free trade.[3]

Although no American ever doubted the paramount importance of national security, the discussion concerning the strategy for the most efficient export control system has not calmed down. The apparent tardiness of the American government to adjust the established export

3 D.D.Knoll, "The Impact of Security Concerns upon International Economic Law", (1984) 11 Syr.J.Int'l L. & Com.567. See also M.Rom, "Export Controls in GATT", (1984) 18 J.World Trade L.125.

control system to the ever-changing conditions of international trade always caused vocal concern in the business community. However, the government's reaction will always be slow because of "inescapable realities" [4]: Reliable information about economic and military conditions in the Soviet Union is difficult to obtain. The potential harm caused by an error in favour of no restriction will subsequently increase defence costs and greater security risks, while an error in favour of imposing unnecessary restrictions may be corrected by merely lifting the ban. It is practically impossible to re-embargo a decontrolled item. An individual export unlikely to have much impact may create a precedent. In response to complaints from the business community, the American legislation underwent several changes over the years. Therefore, the following part concentrates on the structural changes of the control system.

Roots of the American export control legislation can be traced back to the Spanish - United States War of 1898.[5] Later, the *Trading With The Enemy Act* [6], enacted during World War I, authorized the American president to

4 *Supra* Preface note 27 (Abbott) at 796.

5 A joint resolution of Congress authorized the President "to prohibit the export of coal or other material used in war from any seaport of the United States until otherwise ordered by the President or by Congress" (Joint Resolution of April 22, 1898; No.25, 30 Stat.739). It should be noted that the history of export controls reaches back, at least, to the Napoleonic wars. See M.Doxey, *Economic Sanctions and International Enforcement*, New York 2d ed. 1980.

6 Ch.106, 40 Stat.411.

prohibit any kind of economic activity in the absence of a license. When the United States became actively involved in World War II, Congress passed an *Act to Expedite the Strengthening of the National Defense* [7] whose scope was broadened from military equipment to the export of all goods at the end of the war.

In 1949, at the height of the so-called Cold War, the United States Congress established the first comprehensive system of export control, the Export Control Act.[8] Under this Act, the Executive - at all times an office administered by the Department of Commerce [9] - may regulate the export of all goods regardless of destination. This, it did, exempting only trade with Canada from the onerous process of licensing. In marked contrast to the Federal Republic of Germany, United States companies still have no (permanent) right to export.[10] The German government may

7 Ch.508, 54 Stat.712. For details see *supra* Preface note 19 at 792.

8 Act of February 28, 1949, Pub.L.No.81-11, 63 Stat. 7.

9 It is somewhat ironic that the Department of Commerce, by definition striving for the promotion of trade, was selected to safeguard trade controls as well. Cecil Hunt, then Assistent General Counsel for International Trade, U.S.Department of Commerce, thought his job requires a "split personality": "I should come equipped with a mask from ancient theatres so I could flip to one side and show my benign visage as a trade promoter and then quickly flip to the other side to show the scowl of the regulator and enforcer." Quoted from C.Hunt, "The United States Antiboycott Law and Other Export Controls", (1984) 14 Ga.J.Int'l L.& Comp.L.445.

10 Under the German Foreign Trade and Payments Law (*Aussenwirtschaftsgesetz*, BGBl 1961 I 481 including changes; 1971 I 2141), companies are entitled to be compensated

impose embargoes, but is under the legal obligation to pay compensation to those companies directly hurt by their imposition. An equivalent American legislation including the obligation to compensate embargo hurt domestic companies would certainly moderate U.S.Congress in its tendency to resort to political trade controls.[11]

Under the Export Control Act and Regulations, licenses were generally required for any export. Since it would have been extremely onerous to scrutinize every export transaction in advance, the Export Control Regulations introduced two types of licence, the general and the validated license. The general license was not a license in the literal sense. Rather, it was a regulation granting permission to export without a specifically issued document. The exporter, however, was obliged to submit a so-called "Shipper's Export Declaration" containing a precise description of the product, together with a list of all the parties of the transaction including the ultimate destination of the good.

for losses incurred as a consequence of a government imposed embargo. See *supra* note 1 (Hein).

11 For further arguments in favour of compensation see D.E.DeKieffer, "The Purpose of Sanctions", (1983) 15 Case W.Res.J.Int'l L.205; *id.*, "Foreign Policy Export Controls: A Proposal for Reform", (1986) 11 N.C.J.Int'l L.& Com.Reg.39.

The validated license is, conversely, a document issued to authorize a specific transaction to a particular destination. The applicant for a validated license was also required to submit a Shipper's Export Declaration.

For the purposes of the licensing scheme, the administration divided the potential destinations of American goods into three groups: the Western nations, Communist states, and non-Communist states outside the Western hemisphere. The validated license system linked those groups with a graded system of goods that permitted the export of some goods to any country, certain goods to certain countries, and all goods to some countries.

The Export Control Act provided the possibility of severe punishment to violators. For the wilful violation of the Act, fines up to $ 20,000 and imprisonment up to five years could be imposed.[12] In practice, however, the most severe sanction ever devised by the Office of Export Administration was the permanent denial of export privileges. For less severe infringements of the regulations such as misrepresentation concerning the nature or the utility of the goods to be exported, the Office imposed proportionately less severe penalties including the suspension of a denial order pending good behaviour or the

12 Sec.6 (b) of the *Export Control Act*. For violations, knowingly committed, a maximum fine of $ 10,000 and a maximum penalty of one year prison could be imposed, sec.6 (a) of the *Export Control Act*.

denial of the privilege of exporting under the validated license.[13]

The export of all goods to the Communist states became subject to the validated license requirements, because sec.3 (a) required the denial of authority to export "to any nation or combination of nations threatening the national security of the United States if the President shall determine that such export makes a significant contribution to the military or economic potential of such nation or nations which would prove detrimental to the national security and welfare of the United States". The strict rules and requirements for the export of any good were designed to respond to two concerns. First, it was designed to protect the "lead-time", i.e. the time gap, until the technological progress diminished. Secondly, it reflected the moral desire not to do business with "evil" people.

In the view of many, the moral rigour of the United States bordered on ridiculousness.[14] Khrustchev is said to have remarked that the United States should embargo buttons because they are used to hold up Soviet pants. In particular, the license requirement not to contribute to

13 For case references see *supra* Preface note 19 (Berman/Garson) at 850 et seq. and *id.* (Silverstone).

14 See *supra* Preface note 19 (Berman/Garson) at 813: "As long as it is forbidden to ship even chewing gum to Communist China, or Cuba, some care must be taken to see that chewing gum exported to England or Switzerland will not be diverted from these countries to Peking or Havanna."

the economic potential of the Eastern Bloc was heavily criticised.[15] "Since coumntries presumably trade because it improves their economic potential, this (provision) indeed came close to being a prescription for not selling the Soviets anything."[16] It has been argued that the Western refusal to trade came as a "God-sent aid" to the consolidation within the communist bloc. In order to survive economically, the communist states were forced to rely on each other and, above all, on the Soviet Union.[17]

In the 1950's, the need for a less time-consuming export licensing procedure became evident. New types of licenses were introduced such as the "Time Limit License", permitting the export of unlimitimed quantities of a certain product to a certain country for a period of one year; the establishment of new licensing procedures did not meet the demands of all exporters, but, at least, it facilitated and accelerated the entire bureaucratic procedure significantly.[18]

The efficacy of the American export control system was ensured by parallel controls, exercised by the United States' Western allies. In 1949, initiated by the

15 See *supra* Preface note 19 (Berman/Garson) at 882.
16 J.B.Bingham & V.C.Johnson, "A Rational Approach to Export Controls', (1979) 57 For.Aff.894 at 896 (emphasis not added).
17 See G.Adler-Karlsson, *Western Economic Warfare 1947 - 1967: A Case Study in Foreign Economic Policy*, Stockholm 1969 at XII.
18 For details see *supra* Preface note 19 (Berman/Garson) at 816 et seq.

United States, the Coordinating Committee for East-West trade (CoCom) has been established to restrict strategic exports from the member states to the Eastern Bloc more efficiently.[19] In particular, the scope of the controls should be harmonized and the transshipment of goods prevented without jeopardizing or impeding the free flow of goods between the member states. Originally, only the six major allies - the United Kingdom, France, Italy, the Netherlands, Belgium, and Luxemburg - joined the United States, but soon, on the eve of the Korean War, membership was expanded to include Norway, Denmark, Canada, and the Federal Republic of Germany. Today, all NATO-states, i.e. the above mentioned countries plus Portugal, Greece, Turkey, and Spain, with the exception of Iceland, are members of CoCom. Japan became the only country to join CoCom without, for obvious reasons, being a member of NATO at the same time. Since its birth, the headquarter of CoCom is located in Paris. CoCom has no formal treaty or charter; it is not part of any other organization though it keeps close links with NATO. The main purpose of CoCom is to provide a forum in which the participating states can agree on a uniform list of embargoed items and procedures to ensure the effective enforcement controls. Everything connected with CoCom is confidential. Apparently, secrecy is not only necessary to prevent the leakage of sensitive security information,[20] but also to avoid a public

19 For a critical study see *supra* Preface note 22.

20 Gunnar Myrdal, the well known Norwegian politician and Nobel Prize winner for peace, however, observed the disadvantage of compiling a list of sensitive items: "The embargo lists which as I came to know, were never

political discussion in some European countries with strong leftist or communist opposition.[21] Since the late 1950's CoCom maintains two lists: the embargo list and the watch list. Items are categorized according to the following criteria: (1) whether the items constitute weapons or equipment for their production, (2) whether the items incorporate unique technological know-how of military significance, and (3) whether the items represent materials in deficient supply in relation to military potential in the communist countries.[22][23]

Since CoCom is an entirely voluntary organization with no enforcement power, the unanimity rule prevails with respect to every decision as well as to every item that has been suggested by one member state for insertion. Therefore, CoCom is thus "fated to coordinate itself around a

for any length of time unknown to the Eastern intelligence services gave the planners in the Communist countries important information for deciding upon what commodities they would have to produce, or to try to buy in spite of the embargo, and stockpile in order to be safe in all emergencies." See *supra* note 17 at Xii.

21 See *supra* note 16 at 904.

22 Before 1958, CoCom has maintained four lists of controls: (1) items totally embargoed, (2) items granted quotas, (3) items under surveillance, (4) items to be denied to Communist China and North Korea. For details see *supra* Preface note 19 at 835. In 1957, at the instigation of the United Kingdom, CoCom abandoned the separate China list in spite of American resistance. See *supra* note 16 at 918.

23 See *supra* note 16 at 904.

low common denominator."[24] CoCom seems even more ill-equipped when we consider that the implementation into national law and the interpretation of its agreements are left to the discretion of each mamber state. CoCom actions are, in fact, mere recommendations to the governments of its member states. In spite of its long-time membership, Japan's understanding of controlling exports for the sake of Western security has always been viewed with suspicion which was confirmed when the investigation following the Toshiba sale of submarine equipment revealed how lenient Japanese controls on exports to the Soviet Union had become.[25]

Non-members such as Sweden and Switzerland, both of whom are considered major alternative sources, follow the CoCom-rules in an often complying, albeit unpredictable course. Again, no written agreement, only an informal understanding exists between these two countries and the CoCom-members.[26]

In addition to the CoCom-lists of embargoed items, each member state pursues its specific export control system. However, most member states are not overly zealous to extend the CoCom list by unilateral controls. This is partly because of the likely inefficiency of unilateral measures and partly because of the limited effects

24 See L.McQuade, "United States Trade with Eastern Europe: Its Prospects and Parameters", (1971) 3 L.& Pol.Int'l Bus.42.
25 See *supra* Preface note 1 and accompanying text.
26 For a historical view see *supra* note 17.

of export controls on the behaviour of the Soviet Union. They point to the "Soviet Union's long history of willingness to force its people to undergo tremendous sacrifices for the sake of preserving its internal system and foreign policy"[27] and doubt the readiness of any Soviet leader to change the system fundamentally in exchange for access to new technologies.

Among the CoCom member states, the American list of embargoed items was at all times the longest. This was based in part on the ground that technology developed faster in the United States resulting in the unilateral regulation of goods not available elsewhere. Furthermore, the United States did not share her allies' increasingly more relaxed perception of the Soviet threat. In addition to the considerable pressure that an advanced and, over decades, technologically superior economy such as the United States' vis-a-vis Western Europe could exert, the U.S.Congress adopted the *Mutual Defense Assistance Control Act* of 1951, commonly known as the *Battle Act* honoring its sponsor, Senator Laurie Battle.[28] The *Battle Act* authorized the President to cut off military, economic, or financial assistance that was highly needed by the completely devastated Western European countries to any nation that failed to prevent strategic exports to the Soviet Union. The main reason lies in the different philosophy of the Western European countries. They share the

27 *Supra* note 16 at 916.
28 For a reprint see *supra* Preface note 27 (Lowenfeld) at 370.

American concern with respect to the export of strategic goods, but they challenge the wisdom of employing trade as a tool for short-term foreign policy objectives. The United States perceive the withdrawal of trade as an effective form of punishment. After 1949 whenever the United States urged its CoCom - partners to join in the total embargo on Communist China, North Korea, North Vietnam, and Cuba, the American request for assistance was rejected each time. The unilateral measures of the American administration had an extremely limited effect on those countries, while the domestic pressure on the government to relax the existing trade restrictions grew considerably. It seemed a matter of prudence for American companies to compete and seek the benefits of trade with the Communist states to the extent that an agreement with the Western allies could not be achieved and American security was not endangered.

As a result of the increasing inefficiency of the American export control system, the *Export Control Act* of 1949 that had been renewed seven times eventually lapsed in 1969. After exhaustive debates, Congress chose even a new name to document the complete revisal of the concept: the *Export Administration Act*. The long-criticized require-

29 See e.g. S.D.Metzger, "Federal Regulation and Prohibitions of Trade with Iron Curtain Countries", (1964) 29 Law and Contemporary Problems 1000, reprinted in: *id.*, *Law of International Trade*, Washington 1966, Vol.II at 1137: see also *supra* Preface note 19 at 876.

30 Pub.L.No.91-184, 83 Stat. 841, reprinted in: (1970) 9 I.L.M. 192; for an extensive analysis of the provisions and the procedure see Note, "Export Controls - A Natio-

ment of "not enhancing the economic potential" for the grant of a license was eliminated, but the power of the United States President to curtail exports on national security grounds remained untouched. In spite of the continuing European criticim, the new Act again established the presidential power to use export controls for foreign policy objectives. The United States continued to pursue a policy "to use export controls ... to the extent necessary to further significantly the foreign policy of the United States and to fulfill its international responsibilities."[31] The insertion of the word "significantly", at least, seemed to guarantee that a minimum requirement of effectiveness had to be met before sanctions for foreign policy goals could be implemented. The *de minimis* standard of the *Export Administration Act* of 1969 proved to be no threshold for the United States governments

nal Security Standard ?", (1971) 12 Va.J.Int'l L.92; see also note 26 and *supra* Preface note 22 at 147.

31 Sec. 2 of the *Export Administration Act*. The Act also justified trade controls to protect the United States against the drain of scarce material and the inflationary impact of abnormal foreign demand. Short supply controls were used infrequently: they gained some significance in response to the Arab oil embargoes. See G.K.Bertsch, "United States Export Controls: The 1970's and Beyond", (1981) 15 J.World Trade L.67.

32 By comparison, the same sec.2 (B) of the *Export Control Act* of 1949 read: "The Congress herby declares that it is the policy of the United States to use export controls to the extent necessary... (B) to further the foreign policy of the United States and to aid in fulfilling its international responsibilities "

in the 1970's.[33] The instant success of the Arab oil boycott imposed by the OPEC cartel on states that allegedly had supported Israel in the Yom Kippur war demonstrated that even less developed countries, if united, could successfully use their scarce economic resources for policy objectives. The United States seemed thus inspired to implement economic sanctions more frequently, in support of broad foreign policy objectives including the enhancement of human rights and protection against terrorism.

The Export Administration Act was again completely revised, following heavy criticism in the Defense Science Board Task Force Report, the Bucy Report. The Bucy Report called for increased attention to be given to the intrinsic utility of the equipment, the dual-use character of a product, instead of relying on end-use statements, given by the purchaser. The Bucy Report further recommended a reduction of the list of controlled items focusing on critical products of direct military significance. Other recommendations included a legal definition of the term "critical technology" and the denial of a license in a case where the transfer of technology might have lead to a "revolutionary" advance of the Eastern

33 For a critical study of the United States practice of export controls for foreign policy controls in the 1970's see *supra* note 31.

34 Defence Science Board Task Force Report on United States Technology, An Analysis of Export Control of Unites States Technology - A Department of Defence Perspective (1976). For a critical review see *supra* Preface note 27 at 797 et seq.

Bloc economy, but the permit of a license, when only an "evolutionary" progress might have taken place.

The approach taken by the Bucy Report found its way into the new, still valid *Export Administration Act* (EAA) of 1979.[35] The EAA did not only replace its predecessor, the *Export Administration Act* of 1969, but superseded the *Battle Act*. After the Western European economies had fully recovered, the *Battle Act* had eventually lost its threatening function. The major novelty of the EAA was a separation of export controls according to their objectives in national security controls[36] or foreign policy controls[37].

35 Pub.L.No.96-72; 93 Stat.503: 50 U.S.C. App. ss.2401 - 2420, reprinted in (1979) 18 I.L.M.1508. For an analysis see e.g. *supra* note 24. See also J.T.Evrard, "The Export Administration Act of 1979: An Analysis of its Major Provisions and Potential Impact on United States Exporters", (1982) 12 Cal.W.Int'l L.J.1; Note, "The Export Administration Act of 1979: An Examination of Foreign Availability of Controlled Goods and Technologies", (1980) 2 Nw.J.Int'l L.& Bus.179: Note, "Reconciliation of Conflicting Gods in the Export Administration Act of 1979 - A Delicate Balance", (1980) 12 L.& Pol.Int'l Bus.415; Comment, "The Export Administration Act of 1979: Latest Statutory Resolution of the "Right to Export" Versus National Security and Foreign Policy Controls", (1981) 19 Colum.J.Transnat'l L.255; Note, "The Export Administration Act of 1979: Refining United States Export Control Machinery", (1981) 4 B.C.Int'l& Comp.L.Rev.77.

36 Sec.3 et seq. of the EAA.

37 Sec.6 et seq. of the EAA.

The requirements for export controls based on foreign policy objectives remained almost completely unchanged. The new Act requires the President to consider a set of criteria before imposing or extending export control measures for foreign policy reasons. These include the effects of those measures on the target nation, the likely willingness of third countries to join the embargo and the short-term and long-term effects on the economic position of the United States. The compulsory assessment of the economic impact of export controls on the United States is intended to impede the off-handed use of export controls in response to events abroad Congress favors multilateral cooperation over unilateral action, requiring the President to seek negotiations with the governments of the other CoCom member states for an agreement that includes a reduced list of items, but also contains procedures which obliges the member states to enforce the agreement more stringently.

38 Sec.6 (B) of the EAA.

39 In 1978, the Cyril Bath case caused some upheaval in the United States. The facts indicated that France had secretly decided to ignore CoCom controls on certain technologies. When the American company Cyril Bath asked CoCom for an exception request for an export to the Soviet Union, CoCom refused to grant its approval, until the competitor, a French company, finally confirmed the Russian contentions that it had delivered similar goods to the Soviet Union before - without permission Bingham & Johnson concluded bitterly: "We (the United States) simply continue to apply the CoCom controls to ourselves, and let our partners sell. The Soviets get the equipment, the French get the sale, and the United States gets left out." *supra* note 16 at 905, see also *supra* note 35 at 197.

The United States Congress responded to the multiple complaints of exporters concerned with the delay and the unpredictability of the decisions of the Office of Export Administration [4] by reducing the list of controlled items and, as suggested by the Bucy Report, by shifting the emphasis from the control of products to the control of technology. The scope of control was narrowed to "military critical goods and technology (that) would make a significant contribution to the military potential of any other country or combination of countries which would prove detrimental to the national security of the United States." [4] For that purpose, the Department of Defence was required to compile a "Military Critical Technologies List". [4] The list was to concentrate on militarily

40 The onerous validated license requirement engenders a strong incentive for foreign purchasers to seek sources outside of the United States. However, as in 1978 only 0.5% of all applications were rejected, it can be assumed that the damage deriving from transactions that were not even initiated exceed the sales losses occasioned by the relatively few actual license denials. See *supra* note 35 at 427.

41 Sec. 3 (2) (a).

42 Sec. 5 (d). The list was published in (1980) 45 Fed.Reg. 65 014. For a study of the discussions leading to the implementation of the new list see Note, "National Security Protection: The Critical Technologies Approach to United States Export Control of High-Level Technologies", (1981) 15 J Int'l L.& Econ.575. For a first critical study see Recent Developments "Export Controls: Restrictions on the Export of Critical Technologies", (1981) 22 Harv.Int'l L.J.411. For the first thorough study and inside view see *supra* note 2.

significant items, while the export of relatively low-technology items should be facilitated.[43] For the first time, the term "technology" is defined as "the information and know-how that can be used to design, produce, manufacture, utilize, or reconstruct goods, including computer software and technical data, but not the goods themselves."[44]

A new license was created to accelerate the administrative process: the general qualified license.[45] The new license authorizes multiple exports of one item regardless of whether it is destined for a communist or non-communist country. Complaints of exporters were acknowledged as the EAA continues to recognize the existence of available foreign sources as one criterion to

43 It was argued that the emphasis on control of "keystone" technology might create major impediments for the sector of the economy with the greatest potential for a substantial increase in exports. See *supra* note 34 at 417. However, this criticism fails to acknowledge the axiom of American export controls, the predominant concern of national security over economic interests.

44 Sec. 16 (4). The insertion of "information and know-how in the definition of technology caused some concern among scientists that the free exchange of scientific knowledge, for example on conferences, might be threatened. See e.g. R.L.Greenstein, 'National Security Restrictions on Research", (1983) Wis.J.Int'l L 49, C.Alexander "Preserving High Technology Secrets: National Security Controls on University Research and Teaching", (1983) 15 L & Pol.Int'l Bus 173, M M.Cheh, "Government Control of Private Ideas - Striking A Balance Between Scientific Freedom and National Security, (1982) 23 Jurimetrics J.1.

45 Sec. 4 (a) (2) of the EAA.

determine whether an item may be exported.[46] If there is "reliable evidence"[47] for the proposition that a good or technology in sufficient quantity and of sufficient quality is available from sources outside the United States, a validated license for the export may not be required, unless the United States President decides that export control is necessary to protect national security.[48] In case the President makes use of the exception clause, the Secretary of State is required to publish the decision and assess the economic impact. One writer was concerned that "the presidential veto power under the guise of national security impairs, if not nullifies, the effectiveness of foreign availability determinations required by the new Act."[49] But, as the author himself conceded, presidential flexibility may be necessary to protect national security. Credibility is an important part of a national security policy that is largely based on the deterrent effect of its military capabilities. Hence, in the case of the 1980 boycott of the Moscow Olympic Games[50], the "moral punch"[51] of

46 Sec. 5 (f) of the EAA. The unilateral control of elsewhere freely available items was frequently criticised. It was called "self-defeating" and having the effect of merely giving trade to competitors. See supra note 16 at 907. The foreign availability criterion was inserted when the *Export Administrations Act* of 1969 was amended See *Export Administrations Amendments Act* of 1977 (Pub.L No.95-52); reprinted in (1977) 16 I.L.M.909.

47 "Reliable evidence" is to be read to include "scientific or physical examination, expert opinion based upon adequate factual information, or intelligence information." Sec. 5 (f) (3).

48 Sec. 5 (f) (1)

49 See *supra* Preface note 27 at 195 (Note).

50 For details see *supra* Preface note 27 (Moyer/Mabry).

the athletes' boycott would have been undermined if the American supply for the Games with telecommunications equipment had been unaffected. All reforms of the export control system under the EAA were designed to ensure that the competitiveness of American exporters is not significantly hindered by the Administration as long as the national interest in security and foreign policy remains protected.

Although the EAA recognized the need to achieve a greater consensus within CoCom, the American list of controlled items is not linked to its CoCom equivalent to the effect that, unless a multilateral consensus on the embargo of an item can be achieved, the American exporter may go ahead with the transaction. Such a link would have resulted in the acceptance of a standard determined by the very nation that feels least threatened by the export of a particular item.

The safeguards for unimpeded trade contained in the EAA did not prove to be huge obstacles when President Reagan followed the precedent set by the Carter administration and employed export controls for broad foreign policy goals, frequently as a visible expression of moral disgust. The troublesome "highlight" of this policy became

51 *Supra* note 11 at 205.
52 For a description of the sanctions and the events that provoked its implementation see *supra* Preface note 27 (Moyer/Mabry).

the pipeline affair.[53] The pipeline dispute gave rise to another round of lengthy debates between President Reagan and Congress that concluded in the enactment of the Export Administration Amendments Act of 1985.[54] President Reagan had hoped that the Amendments struck an acceptable balance between enhancing commercial interests and protecting national security interests.[55] One of the "hot potato" issues in the dabates was contract sanctity.[56] Under the foreign policy control provisions of the EAA, the President

53 See *infra* Chapter III notes 11 et seq. and accompanying text.

54 Pub.L.No.99-64; 99 Stat.122; reprinted in (1985) 24 I.L.M.1370. The *Amendments Act* is subject of numerous articles. See e.g. D.L.Overman, "Reauthorization of the Export Administration Act: Balancing Trade with National Security", (1985) 17 L.& Pol'y Int'l Bus.325; D.C.Gonzales, "How to Increase Technology Exports Without Risking National Security - An In-Depth Look at the Export Administrations Amendments Act of 1985", (1986) 8 Loy.L.A.Int'l& Comp.L.J 399; J.R Liebman, "The Export Administrations Amendments Act of 1985", (1986) 20 Int'l Law.367; Recent Developments, "Export Controls - Export Administration Amendments Act of 1985', (1986) 27 Harv.Int'l L.J.259; Note, "The Export Administration Amendments of 1985: Continued Restrictions despite Plea for Reform", (1987) 13 Syr.J.Int'l L.& Com.549; Note, "High-Technology Warfare: The Export Adminstration Amendments Act of 1985 and the Problem of Foreign Re-export' (1986) 18 N.Y.U.Int'l L.& Pol.663. For an outside view see M.K Hentzen, "United States Export Restrictions for Foreign Policy and National Security Purposes: The 1985 Amendments to The Export Administration Act and Beyond", (1987) 26 Colum.J.Transnat'l L.103.

55 Statement of the President, July 12, 1985; reprinted in (1985) 24 I.L.M.369.

56 For the complete legislative history see *supra* note 54, describing the discussion on contract sanctity in length at 370.

was p rmitted to prohibit the export of any item to a target nation immediately, thus voiding all contracts regardless of the date of their conclusion. This effect of the Presidential power caused most of the anger abroad in the pipeline dispute. The supporters of a contract sanctity clause argued that United States exporters would be perceived as unreliable suppliers if the performance of contractual obligations depends upon the often arbitrary decisions of the President as to when to react to events abroad by imposing trade restrictions. The opponents argued that the effectiveness of foreign policy controls would be almost nullified if the controls would not have some impact on already existing contracts. Congress finally agreed on a compromise formula to the effect that existing contracts and licensing agreements may remain unaffected by export controls for foreign policy reasons "unless and until the President determines and certifies to the Congress that (a) a breach of the peace poses a serious and direct threat to the strategic interest of the United States, (b) the prohibition or curtailment of such contracts, agreements, licenses, or authorizations will be instrumental in remedying the situation posing the direct threat, (c) the export controls will continue only so long as the direct threat persists." Given the past experiences with escape clauses, the effect of the contract sanctity clause will remain limited. President Carter, for example, managed to classify the 1980 grain embargo against the Soviet Union in response to the Soviets' invasion of

57 Sec.108 (m) of the EAA Amendments.

Afghanistan as a national security matter. Thus, it is not hard to predict that the requirements for disregarding contract sanctity as drafted in the vague terms of the compromise formula pose no serious obstacle for any President who is determined to take a firm stand on a foreign policy issue.

A second important change, designed to reduce the administrative workload and remove some of the reasons causing the delay in the licensing procedure, is to be incorporated into the new Export Administration Regulations. Section 105 (b) of the Amendments requires the elimination of the validated license requirements for exports to CoCom-countries in those cases where, pursuant to CoCom-rules, the good or technology may be exported to the Eastern Bloc without CoCom-authorization, i.e. the (re-)exporter is solely required to notify his government.

The *Export Administration Amendments Act* of 1985, however, did not reflect any reconsideration with respect to the purported reach of American jurisdiction.

58 DeKieffer mentions a similar legal device. The President could simply invoke export controls under his broad authority under the *International Emergency Economic Powers Act* (December 28, 1977, Pub.L.No.95-223; reprinted in (1978) 17 I.L.M.139. See *supra* note 11 at 44.

The history of foreign protest against the extra-territorial application of American export control legislation traces back to the *Export Control Act* of 1949.[59] The first cases were mostly concerned with application of American reexport control restrictions in foreign courts. Similar to the language chosen for the *Sherman-Act*, the U.S.Congress did not limit the application of the American *Export Control Act* to nationals. The term "person", as defined by section 9, included "the singular and the plural and any individual, partnership, corporation, or other forms of association, including any government or agency thereof". It soon became evident in the 1950's to Canada and to Europe in the 1960's that the American goverrment was willing to enforce the export controls by all available means. In those early cases - as far as they have become known to the public - the United States Department of Defence regularly ordered the American parent company to prevent the foreign subsidiary from performing its contractual obligations.

In 1969, Congress developed a new, more flexible export control system, but readopted the definition of "person".[61] Obviously influenced by the numerous jurisdictional conflicts with respect to American antitrust law, the U.S.Congress decided to insert a new definition of

59 See *supra* Preface note 19 (Silverstone).
60 See J.Corcoran, "The Trading With The Enemy Act and the Controlled Canadian Corporation", (1968) 14 McGill L.J.174.
61 Then sec.11 of the *Export Administrations Act* of 1969

"United States Person" into the *Export Administration Amendments Act* of 1977.[62] Under the amended section 11 (2) of the 1969 *Export Administration Act*, a "United States Person" is defined to include "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) or any domestic concern which is controlled in fact by such domestic concern as determined under regulation of the President." In spite of massive European criticism that the scope of the American definition is not in compliance with the public international law on jurisdiction,[63] this definition of "United States Person" survived the two major revisions of the *Export Administration Act* in 1979 and 1985 and represents current United States law.

Hence, American jurisdiction on people resident and companies located abroad can still be justified with the "congressional intent" behind the EAA. Thus, disputes over American extraterritorial claims are likely to continue, as will the discussion on the most effective export control system within the United States. The business world will criticise the onerous, time-consuming procedures of licensing. According to the United States National

62 Sec. 204.
63 See e.g. the EEC Comment, *infra* Chapter III note 33.

Academy of Sciences 1987 Report on National Security Controls and Global Economic Competition,

"respondents to a panel survey of U.S. companies, reflecting on their experience during the 12 months prior to May 1986, perceived the (export) control system as frequently having significant adverse effects on their business. 52 % reported lost sales primarily as a consequence of export control; 26% had business deals turned down (in more than 212 separate instances) by free world customer because of control; 38% had existing customers actually express a preference to shift to non-U.S. sources of supply to avoid entanglement in U.S. controls; and more than half expected the number of such occurrences to increase over the next two years." [64]

Others will always be afraid that "pedestrian considerations of economic gain"[65] may defeat the paramount concern of national security and, one day, the greedy Western nations will "give away the country store"[66].

In view of this continuing battle for less restrictions, one might overlook how relatively insignificant the impact of trade with the Eastern Bloc was and, despite all alleviations, still is. However, for a number of

64 National Academy of Science Report: United States National Security Controls and Global Economic Competition (1987 Academy Report) at 11; for a critical evaluation of the results see I.Fedorowiycz, "Preventing the Transfer of Militarily Critical Technology to the Soviet Bloc: The Case for Strong National Security Export Controls", (1987) 26 Colum.J.Transnat'l L.53.

65 C.Osakwe, "Navigating the Unchartered Waters of East-West Economic Relations: A Legal Compass", (1986) 21 Tex.Int'l L.J.211 at 218.

66 See *supra* note 31 at 67.

companies and certain lines of national economies, the continuity of East-West trade is of vital importance.

The following table shows the 1986 export of goods from the "summit seven" nations to the Eastern Bloc in percentage of their total exports and in value, based on the OECD monthly report July 1987:

country	$ billion U.S.	%
U.S.A.	2.0	0.9
Canada	1.1	1.3
Germany	9.0	3.7
U.K.	1.7	1.6
France	2.8	2.3
Italy	2.9	1.8
Japan	3.9	1.8

West Germany has by far the largest interest in continuing friendly political relations with the Eastern Bloc, since its 3.7% equals an export of goods worth $ 9.0 billion U.S. compared to only $ 2.0 billion U.S. flowing from the Eastern Bloc into the United States. It remains to be seen whether East-West Trade will be stimulated again, corresponding to the improved political climate between the United States and the Soviet Union, as was the case in the past.

Chapter III: Cases of Conflict

(a) The Classic: Fruehauf (France)

Though the Fruehauf case has become "something of a *cause celèbre*"[1], it should be pointed out that similar episodes involving subsidiaries of American companies incorporated in Canada that wished to export goods to Communist China had taken place before. All these affairs could amicably be settled. The *Fruehauf* case gained so much attention, because it produced "an explicit, eyeball-to-eyeball confrontation" between France and the United States. Moreover, it was the first case concerned with the reach of jurisdiction in the area of export control that was dealt with and, eventually, decided by a court. And, above all, it clearly demonstrates the dilemma in which

1 A.F.Lowenfeld, "Public Law in International Arena: Conflicts of Law, International Law, and Some Suggestions for Their Interaction", (1979) 163 Recueil des Cours 311 at 336. For an excellent description of the case and all its legal implications see W.L.Craig, "Application of the Trading With Enemy Act to Foreign Corporations Owned By Americans: Reflections on *Fruehauf v. Massardy*", (1969) 83 Harv.L Rev.579.

2 For a description of the facts and a discussion of the legal problems involved see *supra* note 60. See also D.Leyton-Brown, "The Multinational Enterprise and Conflict in Canadian-American Relations", in A.B.Fox, A.O.Hero/J.S.Nye (ed.), *Canada and the United States: Transnational and Transgovernmental Relations*, New York and London 1976, at 140.

3 S.J.Rubin, "Multinational Enterprise and National Sovereignty: A Skeptic's Analysis", (1971) 3 L.& Pol.Int'l Bus.1.

companies and their directors doing business on an international scale can easily be placed and, hence, the necessity to develop criteria unanimously agreed upon by the trading nations that can safeguard the much desired certainty of law in the fragile world of international trade.

In December 1964 Fruehauf (France) S.A., a French company in which the Fruehauf Corporation (USA) held a two-third stock interest and controlled five of the eight seats on its board of directors, signed a contract with Berliet, S.A., France's largest manufacturer of trucks, for equipment for use in tractor-trailer units. In January 1965 the United States Treasury Department learned that the trucks were destined to the People's Republic of China. The administration issued an order compelling the American parent company Fruehauf to suspend execution of its subsidiary's contract on the ground that the execution of the contract would violate the United States *Foreign Assets Control Regulation*, providing that "any corporation which is owned or controlled by any corporation actually within the United States" is deemed "person subject to the jurisdiction of the United States". A violation of American export control legislation could subject the parent company and its senior officials, several of whom served as directors of Fruehauf (France) as well, to severe criminal penalties. The American parent company accordingly ordered Fruehauf (France) to cancel. Fruehauf (France) failed in its efforts to induce Berliet to rescind the contract amicably; on the contrary, Berliet announced that, if

Fruehauf (France) did not fulfill its contractual obligations, it would seek damages. Faced with these threats that were likely to result in the finacial ruin of the company and the unemployment of more than 600 workers, the three French directors brought suit in the Commercial Court against the Fruehauf (France) and their American directors. The Commerical Court appointed a temporary administrator to head Fruehauf(France) for three months and to execute the contract. The decison of the Commercial Court of Corbeil that was to be affirmed by the Cour d'Appel (Paris)[4] was based on the French 'abus de droit' concept. This concept serves as a "judicial safety valve' to the absolute power of management given by French law to minority shareholders. The court is permitted to overturn corporate decisions that are contrary to the corporate interest. Apparently [5], French courts are very reluctant to substitute their own business judgement for a corporate decision. But in the *Fruehauf* case, the court considered the majority decision solely motivated by the desire to avoid personal liability under the American law. The U S Treasury Department ruled that no sanction would be imposed on the parent company or the American directors of Fruehauf (France), because for the relevant period the subsidiary was not under control of the parent company or its

4 Cour d'appel de Paris (14e ch.), II Gazette du Palais 86 (1965); for the complete judgment in English translation see J.H.Barton/B.S.Fisher, *International Trade and Investment, Regulating International Business*, Boston & Toronto 1986 at 883.
5 *Supra* note 1 (Craig) at 581.
6 *id.* at 582.

directors. Though another interpretation of the regulation was possible, the United States' decision to accept the judgment and refrain from taking further steps against the parent company or its directors was welcomed everywhere. It was called "the better part of valour"[7] as well as "defeat"[8]. It should be noted that neither the Commercial Court nor the Court of Appeal took the doctrine of compulsion of a foreign sovereign into their consideration. The courts simply applied French law.

The outcome, as one writer observed, satisfied all parties.[9] China received its trucks, Fruehauf and France the benefits of the contract, and the United States had made its point. Rubin predicted that "*Fruehauf* cases of the future will be mitigated if not eliminated"[10]. His prophecy must have sounded reasonable in the early 1970's taking into account a political environment in which much emphasis and hope was laid on detente. At the end of the 1970's, however, when East-West relationships turned icy, the differences of the legal opinions and the practical approach on export controls culminated in the most bitter confrontation between the CoCom allies.

7 *Supra* note 3 at 16.
8 *Supra* note 1 (Lowenfeld) at 340.
9 *ibid.*
10 *Supra* note 3 at 18.

(b) The Modern Case: The Pipeline Affair.

Rubin's other predictions, i.e. "extra-territoriality is essentially a non-issue" and "conflicts in this area may aggravate the political problem, and annoy those who feel foreigners are intruding on what are claimed to be their own policy decisions. Of itself, it is of little more than polemic significance" [11], proved wrong for the area of export control when the pipeline affair broke out between the allied countries and resulted in almost-hostilities.[12]

On December 13, 1981, the Polish military regime under General Jaruzelski issued a martial law decree restricting civil rights and suspending the operations of the Solidarity Trade Union.[13] In the weeks following the declaration of martial law, European and North American governments expressed their outrage, but it was the United States who took action first. On December 29, 1981, President Reagan blamed the Soviet Union as directly responsible for the repression in Poland and imposed two sets of regulations under the foreign policy provisions of the EAA [14].

11 *id.* at 30.
12 For less publicized controversies over American export controls in the 1970's concerning Canada and Argentina see S.J.Marcuss & D.P Butland, "Reconciling National Interests in the Regulation of International Business", (1979) 1 Nw.J.Int'l L.& Bus.349 at 354.
13 For a complete case history see *supra* Preface note 33.
14 For an extensive description of the political background see *supra* Preface note 27 (Moyer/Mabry) at 60 et seq.
15 See e.g. the Radio Address to the Nation by President Reagan, East-West Trade Relations and the Soviet Pipe-

Goods and technology for the transportation, as well as the exploration and production, of petroleum and natural gas, which until then could be exported under general license, became subject to a validated license requirement.[17] The suspension of the proceedings of all validated license applications for export to the Soviet Union was one of the sanctions with a more significant impact on trade relations. The European Community decided not to follow the American example, but at the apparent instigation of the United States, resolved to curtail its imports from the Soviet Union

When it became obvious that neither the Soviet Union nor the Polish military regime was planning to ease of the military rule, the American President decided on June 18, 1982 to broaden the scope of the sanctions against the Soviet Union to cover now foreign subsidiaries and

line Sanctions. The amendments to the EAA announced by President Reagan are reprinted in (1982) 21 I.L.M.164.

16 47 Fed.Reg.141 (Jan.5, 1982), reprinted in: (1982) 21 I.L.M.859.

17 The rather simple political reasoning, underlying the new measures, did not appeal to European politicians. DeKieffer, well-known politician and law professor, seems exemplary: "The Russians are generally not nice people; they do unpleasant things to their neighbors like invading them; they do things like building missiles to vaporize us all, and they also deprive the citizens of Poland and elsewhere of the very rudiments of freedom." Panel: "Extraterritorial Application of United States Export Controls - The Siberian Pipeline" in (1983) American Society of International Law; Processings of the 77th Annual Meeting 241 at 243.

18 Regulation No.596/82 of March 15, 1982; (1982) 25 O.J. E.C.L 72,115

licenses as well.[1] The sanctions focused on the Euro-Siberian gas pipeline project, an ongoing controversial issue between the United States and its European allies The Pipeline in question is part of a large-capacity, long-distance network originating from the natural gas reservoirs in the Western Siberian region of Yamal, north of the Arctic Circle Western participation in the project was sought by the Soviet Union for a larger scaled version of the project than originally planned; they convinced Western banks to give them credit for the purchase of construction machinery, steel pipes, compressors, and monitoring equipment. The Soviet Union offered to pay for the goods in gas supplies. Gas companies from ten Western European countries including the Federal Republic of Germany, Italy, France, and the Netherlands finally agreed to long-time contracts obliging them to accept gas pumped through the prolonged Yamal pipeline.

The United States strongly opposed the project that was unprecedented by virtue of its size and the number of participating countries as a whole. They were afraid

19 47 Fed.Reg.27.250 (June 24, 1982), amending 15 C.F.R.pts.376, 379, 385; reprinted in (1982) 21 I.L.M.864

20 For technical details of the project see P.Merciai, "The Euro-Siberian Gas Pipeline Dispute - A Compelling Case for the Adoption of Jurisdictional Codes of Conduct", (1984) 8 Md.J.Int'l L.& Trade 1.

21 The other six nations involved in the pipeline project as gas recipients are Austria, Belgium, Finland, Greece Sweden, and Switzerland.

22 For an exhaustive discussions of all the arguments see P.J.DeSouza, "The Soviet Gas Pipeline Incident:

that Western European countries ventured into dependancy of the Soviet Union in consideration of strategic energy supplies, according to one estimation of at least 30% of Western European natural gas needs. Furthermore, the entire project would result in continued credit repayment that, if the project came to life, would have totalled to $ 10 - 15 billion U.S. over the first five years of the project. Moreover, the Soviet Union seemingly benefited significantly more from the trade than did the West Europeans. The hard currency earnings from the pipeline, it was argued, would enable the Soviet Union to obtain the equivalent value in advanced Western technology to further enhance its military capacity. Critics were also concerned that the advanced technology delivered by the West would be made available to the Soviet Union without adequate safeguards.

The European governments as advisers involved in the negotiations were aware of the American concerns, but decided that the arguments in favour of the project outweighed the political risks. In countries where energy independence could not be achieved, a sufficient standard of energy security could only be maintained if the sources of delivery were widely diversified. Since the traditional suppliers of gas for Western Europe such as North African countries (e.g.Libya) and the Middle East (e.g.Iran and Iraq) had proved to be unreliable, the additional gas

Extension of Collective Security Responsibilities to Peacetime Commercial Trade", (1984) 10 Yale J.Int'l L.92; see also *supra* note 20 at 5 et seq.

delivery from the Soviet Union would improve European energy security. The Western European countries admitted that the Soviet Union was also potentially unreliable because of its adverse ideology. It was further argued that the diversification of supply would hold down energy prices. And finally, economic interdependence with the Soviet Union would help to stabilize political relations. Despite all of the arguments the Western European governments failed to convince the United States that the pipeline project would not jeopardize Western security

Under these circumstances, the selection of the pipeline project as the prime target of American sanctions against the Soviet Union must have seemed the obvious choice. It was like killing two birds with one stone. The United States embargo on grain exports to the Soviet Union [24], implemented by the Carter Administration in the wake of the Soviet invasion of Afghanistan, was heavily criticised as being too costly [25], disproportionately burdensome on

23 For compelling arguments in favour of East-West trade in energy see G.Agnelli, "East-West Trade: A European View", (1980) 58 For.Aff.1016 at 1022.

24 For a full analysis of the Soviet grain embargo see *supra* Preface note 27 (Moyer/Mabry) at 48 et seq.

25 The relationship between costs and effects of sanctions is of particular importance to American writers. See e.g. S.D.Overly, "Regulation of Critical Technologies under the Export Adminsitration Act of 1979 and the Proposed Export Administration Amendments of 1983: American Business versus National Security", (1985) 10 N.C.J.Int'l L.& Com.Reg 423 at 456: "While critics of the grain embargo have argued that the economic costs were excessive, any costs incurred to safeguard national security should be justifiable. Such justification,

the United States agricultural community, and ineffective in influencing Soviet action. In particular, the embargoed United States grain was easily replaced by purchases from Canada, Argentina, and Australia. The United States Congress Committee on Foreign Affairs assessed the overall economic loss caused by the grain embargo at an estimated $ 11.4 billion U.S. in national output (including $ 2.3 billion U.S. in export sales, $ one billion U.S. for interest, storage, and handling arising from government ownership of the commodity for seven years, and $ 3.1 billion U.S. in personal income).

During the controversy following the pipeline controls, described as "Russian Roulette"[26], the Western European nations felt themselves to be the primary target of the American sanctions. The vigorous European reaction may also be explained by the predictable effects of the pipeline controls on the Soviet Union. Even if the sanctions had remained in place and the European companies had fully complied with the American measures, the Soviet Union would have had no difficulties in finding other suppliers. Alternatively, it could have built a smaller

however, requires that the Soviet grain embargo effectively safeguards United States national security. If this was not achieved, any costs, economic or non economic, must be deemed excessive".

26 Quoted by *id.* at 51 et seq.

27 E.B.Butler, "The Extraterritorial Reach of the United States Export Administration Act: Reflections on the Yamal Pipeline Controversy", (1983) J.Bus.L.275.

28 For a full assessment of the costs and the effects of the pipeline episode see *supra* Preface note 27 (Moyer/Mabry) at 87 et seq.

scaled version or produced the goods itself. Regardless of which of the three options the Soviet Union may have opted, the sanctions would have caused a maximum delay of two years for the completion of the project. Given the long-term importance of the project, such a delay would have been almost insignificant. A cost-benefit analysis of the pipeline controls revealed "negligible"[29] effects on the Soviet Union; taking the long-term implications such as the evolving image of American companies as unreliable suppliers by virtue of the ever changing export controls for short-term policy goals and the level of political tension created among the European allies, one writer found it "not too harsh to characterize the pipeline controls as perhaps the least effective and most costly controls in United States history."[30]

When President Reagan announced the sanctions focusing on the pipeline project, his decision seemed largely determined by two factors. Firstly, he responded to the moral outcry among the American public to "do something" with respect to the situation in Poland. Secondly, the target of the sanctions had to be more carefully selected since American farmers had become inadvertently the main and (allegedly) only victims of the then latest American attempt to influence Soviet conduct. The amendments of oil and gas controls to the Soviet Union included exports of non-U.S. origin goods and technical data by United States owned or controlled companies, i.e. foreign

29 *id.* at 88.
30 *id.* at 91.

incorporated subsidiaries as well as some foreign produced products of United States technical data. The amendments expanded the embargo on products of United States data in cases where the right to its use abroad was subject to a licensing agreement with persons subject to the jurisdiction of the United States or required the payments of royalties or other compensation to any such persons or in cases where the recipient of the technical data had agreed to abide by United States export control regulation.

Given the fact that most modern technology products are composed of different parts developped and produced by highly specialized companies around the world and given the leading position of the United States in research and development, the newly drafted amendments inevitably purported to apply to almost every Western supplier engaged in the pipeline project. The absence of a grandfather clause providing for the sanctity of already entered contracts shocked European companies, since some of them had successfully requested the American Office for Export Administration for a negative clearance before entering into the contracts with the Soviet Union. At the times when the European companies signed the contracts, all goods were not subject to American export control restrictions. Pursuant to section 6 of the EAA, violators had to face a maximum fine of $ 100,000 U.S., imprisonment up to ten years, and the cancellation of export licenses. The list of the newly concerned companies read like a European "Who's Who" of companies: Dresser (France) S.A., Creusot-Loire S.A., Nuove Pignone S.p.A., John Brown Engineering

Ltd., AEG-Kanis Turbinenfabrik GmbH, and Mannesmann Anlagenbau AG.[31] All these companies had concluded multiple agreements with the Soviet trade organisation V/O Machinimport stipulating mainly the delivery of turbines, compressors, rotor blades and the like, but also a number of inspections, quality control services, and the training of Soviet personnel. Dresser (France) was the only company directly controlled and owned by an American company. All companies, however, obtained some technical data required for the production of the contracted goods from United States sources. Without exception, the technology had been transferred under a licensing agreement, even before the December sanctions were imposed. Part of the turbines destined for the Soviet Union were rotor blades that had been designed and delivered by General Electric, a U.S. company, to AEG-Kanis, John Brown, and Nuovo Pignone before December 1981.

Western European governments and companies were completely taken by surprise, when President Reagan extended the sanctions in June 1982. However, challenged by the American regulations, the West European governments "were able to achieve unprecedented political unity"[32]. They even agreed on a joint official comment "on the United States regulations concerning trade with the U.S.S.R.", provided by the legal department of the European Community

31 For details see *supra* Preface note 33 at 31 et seq.
32 *supra* note 20 at 14.

(EEC) Commission,[33] but, pursuant to their legal regime, some governments also took unilateral action. On June 30, 1982, under the authority of section 1 of the *Protection of Trading Interests Act*, the British Secretary of Trade declared the amended regulations under the EAA, to be damaging the British trading interests insofar as they affected the reexport or export of goods from the United Kingdom.[34] A month later, on August 2, 1982, Lord Cockfield, the Secretary of Trade, ordered four British companies affected[35] to proceed with the export of the contracted goods to the Soviet Union.

The French government, under the authority of an '*ordonnance*'[36], confiscated the machinery produced for the Soviet Union and fulfilled the companies' contractual obligations. While lacking comparable legislative means as

33 Commission of the European Community on the amendments of June 22, 1982 to the Export Administration Regulations (August 10, 1982), reprinted in (1982) 21 I.L.M.891. See also P.J.Kuyper, "The European Community and the United States Pipeline Embargo: Comments on Comments", (1984) 27 G.Y.I.L.72.

34 *Protection of Trading Interests (United States Reexport Controls) Order* 1982; reprinted in (1982) 21 I.L.M.852. For an official comment see the exchange of notes between the United States and the United Kingdom, reprinted in (1982) 21 I.L.M.840 et seq. and at 847 et seq., respectively.

35 Besides John Brown Engineering Ltd, Smith International (North Sea) Ltd., Baker Oil Tools (U.K.) Ltd., and AAF Ltd. were involved.

36 *Ordonnance* no. 59/63 du 6 Janvier 1959, relative aux requisitions de biens et de services, Dalloz 1959, 212; (1959) Dalloz Bulletin Legislatif 364.

the British or French, the Italian and West German governments encouraged their companies to ignore the American export regulations and continue to honor their contractual obligations.

When the first turbines were shipped to the Soviet Union, the United States Department of Commerce escalated the conflict by issuing a number of orders temporarily denying export privileges to most of the West European companies involved.[37] The companies caught in the dilemma of being forced to abide by two conflicting jurisdictions chose, without exception, to challenge the American order. This decision has been interpreted differently. One observer pointed to the financially troubled conditions of some of the companies involved indicating the need to make an immediate profit as having dictated the directors' decisions.[38] However, it should be borne in mind that it was more than doubtful whether the Soviet Union would excuse the companies' compliance with American regulations as foreign government compulsion. Furthermore, viewed from a director's perspective, the economic detriment to the companies that could readily be assessed was likely to outweigh the American interests given the insignificant economic impact that even a full compliance with the sanctions might have accomplished.

37 See *supra* Preface note 33 at 46.
38 See *supra* note 20 at 14.

On November 13, 1982, the American President announced the lifting of the June sanctions; the orders temporarily denying export privileges to the European companies were subsequently revoked. [39] The most dramatic confrontation between the American sensitivity towards security and European willingness to trade had ended, leaving all participants with bitter feelings. President Reagan attempted to conceal the common opinion that the American sanctions had been a "fiasco"[40], declaring that a compromise with the European allies on East-West trade issues had been achieved. The Europeans agreed to consider the strengthening of enforcement measures to prevent infringement of the CoCom-rules. Nevertheless, while United States policy changed substantially with the lifting of the sanctions, European behaviour remained basically unaltered. It is also important to notice that in November 1982 the situation in Poland which had initiated the conflict had not improved. The Soviet Union had not granted any concession to the United States. No political price had to be paid because of Western disagreement [41]. All pending cases were instantly dismissed. During the pipeline affair, only the District Court at The Hague managed to render a written judicial decision in the case

39 Radio Address to the Nation, November 13, 1982, reproduced in (1983) 22 I.L.M.349. The orders lifting the sanctions are reprinted in *ibid.* at 350 - 361.

40 *Supra* Chapter II note 54 (Gonzales) at 446.

41 For an attempt to assess Soviet reactions on the pipeline affair see Note, "Soviet Reaction to the United States Pipeline Embargo: The Impact on Future Soviet Economic Relations With The West", (1984) 8 Md.J.Int'l L & Trade 144.

Compagnie Europeenne de Petroles S.A. v. Sensor Nederland B.V. [42] holding that the defendant, a wholly-owned subsidiary of a United States company, was not excused from the contractual delivery of goods under the American export control regulations.

When the June sanctions were lifted, the economic loss of the United States was estimated to amount to $ 600 million U.S., resulting from the December 1981 sanctions, and $ 850 million U.S., the equivalent of 25,000 jobs, resulting from the June 1982 sanctions.[43] As late as January 1986, the December 1981 sanctions were rescinded.[44] According to 1986 estimates, the pipeline sanctions were extremely costly for the United States; sales totalling over $ 2 billion U.S. were lost, not including the side effect that American companies may have been displaced permanently from the Soviet market.[45]

Concluding from a Western perspective, the whole affair forced the recognition that Western unity with respect to export controls and its underlying legal concept

42 Judgment of September 17, 1982. English translation of the judgment can be found in (1983) 22 I.L.M.66; German translation in (1983) 47 Rabels Z.141 with a note of Basedow.

43 See H.O.Blair, "Export Controls on Nonmilitary Goods and Technology: Are We Penalizing the Soviets or Ourselves?", (1986) 21 Tex.Int'l L.J.363, at 366, quoting government officials before Congressional hearings.

44 (1987) 52 Fed.Reg. 2,500.

45 See R.Carswell, "The Need for Planning and Coordination of Economic Sanctions", (1987) 19 N.Y.U.J.Int'l L.& Pol.857 at 858.

is a necessary prerequisite for any efficient trade embargo. It appears that consent among CoCom-member states with regard to the uniform interpretation of its own rules and the cooperation in its enforcement has drastically increased over the last years.[46]

46 See e.g. C.Hunt, then acting chief counsel for the Office of Export Administration, U.S. Department of Commerce, "The Jurisdictional Reach of Export Controls", (1987) 26 Colum.J.Transnat'l L.19. See also Recent Developments, "Trade Regulation - Export Controls - CoCom Agrees on New Multilateral Export Guidelines Allowing Eastern Bloc to Purchase Low Level Technology Legally", (1986) 16 Ga.J.Int'l & Comp.L.197.

Chapter IV: The Principles of Jurisdiction

The concept of jurisdiction has been derived from the notion of sovereignty. Though the notion of sovereignty is considered the "essential foundation of international law"[1], it seems quite surprising that the legal theory of sovereignty only dates to the late Medieval world.[2] Macchiavelli was the first to suggest the theory of a sovereign monarch who governs the (emerging) nation-state without being concomitantly responsible. The absolute and unlimited power of the sovereign, however, was limited to the territory of his state. In international relations, sovereignty necessarily corresponded to the notion of independence, i.e. the lack of outside control. But while, in many countries, the absolute monarch was replaced by a parliamentary system, following the concept of the separation of powers, the notion of sovereignty remained untouched. In fact, 'sovereignty' was merely shifted from the monarch to the state. Sovereignty was now understood as the absolute, unlimited and illimitable power of a state "over all persons and things within its territory and as full freedom of action in dealing with other States or their nationals, subject to no restraint except

1 International Court of Justice in the *Corfu Channel* Case, (1949) I.C.J.R. 4 at 25.

2 For an excellent historical view and a theoretical discussion of sovereignty see R.P.Anand, "Sovereign Equality of States in International Law", (1986) 197 Recueil des Cours 9, but see also S.Kassan, "Extra-territorial Jurisdiction in the Ancient World", (1935) 29 A.J.I.L. 237.

that interpreted by its own will".[3] Chief Justice Marshall summarized this principle in the following well-known terms: "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 ... from an external source, would imply a diminution of its sovereignty."[4] Modern public international law phrases it slightly different, but the essence of sovereignty remaines unchanged: "A State can adopt any constitution it likes, arrange its administration in anyway it thinks fit, enact such laws as it pleases, organize its forces on land and sea,... adopt any commercial policy it likes, and so on."[5]

Of course, this pure notion of sovereignty was theory at all times. In order to safeguard peaceful relations between states, sovereignty always had to be limited; public international law grew out of mutual agreements of independent states to create a restraint against the arbitrariness inherent in the notion of sovereignty.

The recognition of the territorial sovereignty of one state corresponds to the duty to abstain from any intrusion on this state's sovereignty. The United Nations is built on the premise that sovereign states are to cooperate in mutual respect to achieve common goals. The

3 *id.* at 25 (Anand).
4 *The Schooner Exchange v. McFadden*, (1812) 11 U.S.(7 Cranch) 116 at 136.
5 L.Oppenheim, *International Law*, Vol.1, London 1955, edn.8 at 287.

importance of the principles of sovereignty and non-intervention is reflected in Art.2 (1) and (7) of the Charter of the United Nations.[6] Later, the principle of non-intervention focusing on international economic relations was adopted in the United Nations Declaration on Principles of International Law concerning Friendly Relations and Cooperation among States of 1970.[7] It has been argued, however, that exceptions to the obligation of non-intervention should be permitted for the cause of universally acknowledged values as expressly laid down in the Charter of the United Nations.

Thus, general acceptance can be found for the proposition that public international law sets the limits on the jurisdiction of states. Given the rapid progress in transport, technology and communications, companies and individuals are increasingly able to change conditions in a foreign state from outside, and states feel inclined to extend their jurisdiction to events and people outside their territory in the desire to enforce their rules effectively

6 Art.2 (1) reads as follows: "The organization is based on the principle of sovereign equality of all its Members." Art.2 (7) provides: "Nothing contained in the present Charter shall authorize the United Nations to intervene in matters which are essentially within the domestic jurisdiction of any state or shall require the Members to submit such matter to settlement under the present Charter; but this principle shall not prejudice the application of enforcement measures under Chapter VII" (Action with respect to threats to the peace, breaches of the peace, and acts of aggression).

7 See *supra* Chapter I note 36 and accompanying text.

and uniformly. Inevitably, these states will interfere with what other states regard as their exclusive domain.

Justification for the extraterritorial application of domestic laws as well as for its furious rejection is sought by reference to public international law. Unfortunately, the Permanent Court of Justice gave only one judgment concerning the problem of jurisdiction. In the famous *SS Lotus* case [8], the Court handed out a split decision, permitting Turkey to institute criminal proceedings against a Frenchman who commanded a French ship as first officer. Turkey charged him responsible for the collision of the French ship with, and the subsequent sinking of a Turkish vessel causing the death of eight Turkish sailors and passengers. The Court's decision was called "Delphic" [9], since the vague terms frequently used by the court in its reasoning can seemingly be interpreted to be in support of almost any opinion concerning the extent of jurisdiction. Thus, too much emphasis should not be placed on the construction, but, nevertheless, the *Lotus* case remains the starting point for any inquiry involving the problem of extraterritoriality.

The court concluded that since "the rules of (international) law binding upon States ... emanate from their own free will as expressed in conventions or by usages generally accepted as expressing principles of law",

8 P.C.I.J., Series A, No.10.
9 J.W.Bridge, "The Law and Politics of United States Foreign Policy Export Controls", (1984) 4 Leg.St.2 at 8.

"restrictions upon the independence of States cannot therefore be presumed."[10] The court found no rule of international law prohibiting states to extend the application of their laws and the jurisdiction of their courts to persons, property and acts outside their territory.[11] Consequently, the court presumed that a state has the right to exercise jurisdiction unless another state can show that the asserted claim of jurisdiction is prohibited under a restrictive rule of international law. Thus, the onus of proof lies on the state claiming that another state's jurisdiction is illegal. The court concluded from the application of these rules of international law that since the two elements of the alleged offence - having its origin on board the Lotus, whilst its effects were felt on board the Turkish vessel - were entirely inseparable. Both countries, France and Turkey, had the right to concurrent jurisdiction.

The *Lotus* case caused much confusion because it did not address two important issues. First, it did not point to any mechanism of how to reconcile conflicting - concurrent - jurisdiction. It appears that though the court clearly recognized the inevitable differences arising from multiple concurrent jurisdictions,[12] the Permanent

10 *Supra* note 1 at 18.
11 For a draft convention on the question of jurisdiction concerning criminal law see "Research in International Law: Jurisdiction with Respect to Crime", (1935 Supplement) 29 A.J.I.L.443 also containing the results of an exhaustive investigation of state practise.
12 The court expressly states at 19: "The discretion left to States by international law explains the great

Court left it open for future consideration and, subsequently, for conventions between the States to find the proper means to settle disputes on jurisdiction. Secondly, it did not draw any express limitations on the legal capacity of states to regulate conduct outside its territory. The Permanent Court was clearly not "advocating anarchy"[13]. Moreover, it was noted that it would be "a patent absurdity to try to base a practically unlimited extraterritorial jurisdiction on a principle of territoriality."[14]

At least, it seems safe to assume that the court's majority rejected the exclusive territoriality doctrine as submitted by J.Loder in his dissenting opinion. Judge Loder deducted as "logical consequence" from the fundamental principle of independence and sovereignty of states that "no municipal law ... can apply or have binding effect outside the national territory."[15] One writer submitted that the *Lotus* judgment denies the absolute application of the territoriality principle, but he concludes from the court's statement that "the principle of the territorial character of criminal law is fundamental"[16]

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variety of rules which they have been able to adopt without objections and complaints on the part of other States, it is in order to remedy the difficulties arising from such variety that efforts have been made for many years past, both in Europe and America, to prepare conventions..."

13 *Supra* note 2 at 8.
14 *Ibid.* (emphasis added).
15 *Id.* at 35.
16 *Id.* at 20.

and that an exercise of extra-territorial jurisdiction requires a justifying principle such as nationality, the requirements of security or the objective territorial principle.[17] Logically, the requirement of a justifying principle allocates the burden of proof on the state claiming jurisdiction. The Permanent Court, however, expressly rejected this view prohibiting the exercise of extraterritorial jurisdiction only in those cases where international law places limits.

One may conclude that even in those areas of international law where no limits on the exercise of jurisdiction have been established, the outermost legitimate exercise "must stop at the point where it derogates from the sovereignty of other states."[18] This view seems consistent with the Lotus judgment since the court placed much emphasis on the sovereignty and independence of states.[19] However, the Court distinguished the territoriality of criminal law from territorial sovereignty.[20]

Conversely, it should not be assumed that every extraterritorial application of domestic law will

17 R.Y.Jennings, "General Course of Principles on International Law", (1967) 121 Recueil des Cours 323.
18 *Supra* note 2 at 8.
19 See e.g. the court's statement at 19: "Within these limits (which international law places upon its jurisdiction), its title to exercise jurisdiction rests in its sovereignty."
20 See the court's statement: "The territoriality of criminal law, therefore, is not an absolute principle of international law and by no means coincides with territorial sovereignty."

inevitably infringe the core of a foreign state's territory. The controversial United Nations Declaration on Principles of International Law Concerning Friendly Relations and Cooperation among States (1970) or the similarly contentious United Nations Charter of Economic Rights and Duties of States (1974)[21] with its emphasis on the exclusive territorial sovereignty of states can hardly be brought into accordance with the *Lotus* judgment.

The court's decision is relatively easy to explain, because it is determined by the prime objective of any judgment: to provide justice to the parties in a particular case. The Permanent Court of Justice implicitly referred to the classic case of the man standing in Windsor/Ontario who fired a gun across the border in an attempt to kill someone in Detroit (or vice versa). In this case as in the *Lotus* case, four options are conceivable: One might argue in favour of the place where the crime was initiated or the place where the crime was completed, but there is no logical reason for preferring the claim of one country over the other. Granting jurisdiction to neither state would have disastrous consequences, the only reasonable alternative left is to permit both states the exercise of concurrent jurisdiction. In a less known, rarely quoted part of the judgment, the court says: "Neither the exclusive jurisdiction of either State, nor the limitations of the jurisdiction of each to the occurrence which took place on the respective ships

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21 See *supra* Chapter I note 35.

would appear calculated to satisfy the requirements of justice and effectively to protect the interests of the two states."[22] The requirements of justice and the effective protection of the interests of both states are the standards that should be met by any suggested solution of the problem of extraterritoriality.

The *Lotus* decision of the Permanent Court of Justice unlocked the door of extraterritorial jurisdiction inviting states to assert jurisdiction on activities abroad. In 1945, the United States Court of Appeal opened the door wide and stepped on a "slippery slope"[23] into a new world of jurisdictional conflicts in the antitrust law case of *United States v. Aluminum Co. of America* (Alcoa)[24]. The foundation for the newly developed "effects" doctrine was laid, arguably unintentionally, by the Permanent Court of Justice in the following passage of the *Lotus* decision: "On the contrary, it is certain that the courts of many countries, even of countries which have given their criminal legislation a strictly territorial character, interpret criminal law in the sense that offenses, the authors of which at the moment of commission are in the territory of another State, are nevertheless to be regarded as having been committed in the national territory, if one of the constituent elements of the offence, and more especially its effects, have taken place there."[25] In

22 *Supra* note 1 at 30.
23 M.Akehurst, "Jurisdiction in International Law", (1972-73) 46 B.Y.I.L.145 at 154.
24 148 F.2d 416 (2d Cir.1945).
25 *Supra* Chapter I note 35 at 23.

Alcoa, the defendant was charged under the *Sherman Act* [26] for having entered into agreements with competitors to establish a cartel intending to fix quotas of production of aluminum ingots for the United States market. Those agreements were concluded outside the United States. Nevertheless, Judge Learned Hand ruled that the agreements "were unlawful though made abroad, if they were intended to affect imports and did affect them."[27] Without quoting any appropriate precedent, Judge Hand boldly contended: "On the other hand, it 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 reprehends; and these liabilities other states will ordinarily recognize."[28] In fact, as one writer pointed out, there had been no prior decision to that effect.[29]

The *Alcoa* case became a landmark decision. Despite the numerous references to Alcoa, one major factor for the assumption of jurisdiction, the intent of the parties to affect the American market,[30] was neglected, and

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26 15 U.S.C.A. sec.4.
27 *Supra* note 24 at 444.
28 *Id.* at 443.
29 See J.M.Raymond, "A New Look at the Jurisdiction in Alcoa", (1967) 61 A.J.I.L. 558.
30 J.Hand considered the intent of the parties crucial: "There may be agreements made beyond our borders not intended to affect imports, which do affect them, or which affect exporters ... Yet when one considers the international complications likely to arise from an effort in this country to treat such agreement as unlawful, it is safe to assume that Congress certainly

often remained unmentioned in later decisions.[31] *Alcoa* marked the first time that a court employed the rules of jurisdiction developed in the area of criminal law in a case involving economic legislation. Business laws such as antitrust laws do not fit into the traditional legal scheme of civil and criminal law. They combine elements of both, since violations of the rules embodied in economic laws may be sanctioned both by private parties seeking damages and by the administration seeking punishment. Even the private action under the *Sherman Act*, in particular the treble damage claim proceedings, in which the court may award the threefold of the actual damages to the plaintiff, serves a characteristic goal of criminal law: deterrence. By granting private parties the opportunity to profit from a competitor's infringement of the law, companies have an incentive to observe closely their competitors' conduct and, thereby, assist in governmental efforts to ensure compliance with its antitrust laws.[32] One can conclude

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did not assume the Act to cover them." *Supra* note 24 at 443.

31 For references and a discussion of the follow-up cases see R.Y.Jennings, "Extraterritorial Jurisdiction and the United States Antitrust Laws", (1957) 33 B.Y.I.L. 146 at 166 et seq.

32 This interpretation of the rationale behind the possibility of private enforcement of American antitrust law is confirmed by a note of the American ambassador to the British Secretary of State for Foreign Commonwealth Affairs. According to this note, the private treble damage action "was adopted as a complement to governmental enforcement tools, in recognition of the limited resources available in government agencies to investigate and take action against all violations of the law. It acts as a deterrent to illegal activity in the same manner as governmental enforcement, and pro-

that governments will select criminal or civil proceedings primarily based on considerations of effectiveness. If however, the choice of whether a law contains civil or criminal proceedings is part of governmental policy, it is submitted that the legitimacy of the extraterritorial application of a law should not depend on the nature of its proceedings.[33]

In accordance with the traditional terminology of principles of jurisdiction, the effects doctrine is often described as the objective territorial principle.[34] In marked contrast to the controversy over the range of the effects doctrine it is remarkable how little use has been made of the subjective territorial principle.[35] In the *Alcoa* case, Switzerland could have invoked the subjective territorial principle permitting jurisdiction over activities within the territory that have no effect on the territory on the ground that the agreements allegedly having ad-

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vides an incentive to the victims to act as private attorney-generals." Reproduced in (1979) 50 B.Y.I.L. 352 at 362 et seq.

33 *Contra* A.V.Lowe, "Public International Law and the Conflict of Laws: The European Response to the United States Export Administration Regulations", (1984) 33 I.C.L.Q.515 who finds the distinction "helpful", but he concedes that "private international law has assimilated rules of public international law. At least, it contains rules having the same effect as rules of public international law." *id.* at 525. But see also K.W.Abbott, "Collective Goods, Mobile Resources, and Extraterritorial Trade Controls", (1987) 50:3 Law and Contemporary Problems 117 at 140 and *supra* Chapter III note 1 (Lowenfeld).

34 See e.g. *supra* note 23 at 193.

35 See also *id.*

verse effects on the aluminum market in the United States were concluded on Swiss soil. Akehurst supposed that the international restraint from an application of the subjective territorial principle derives from international law "because it might constitute an attempt to impose an alien economic policy on the state where the agreement was performed." Although it cannot be ruled out that some legislator may have been influenced by considerations of international law, it appears more likely that the country in which the parties negotiate resulting in restrictive business abroad lacks interest because of the absence of any effect on the domestic market. The prime example of such state practice is the case of the export cartel. The formation of a cartel is prohibited in most western countries. The establishment of pure export cartels is, however, tolerated.[36] As long as the sole purpose for the

36 Apart from the possibility that a state itself may join a cartel for public policy reasons, a number of states permit cartels whose sole purpose is aimed at exporting under improved market conditions. See the report of C.T.Oliver, "State Export Cartels and International Justice", (1977) 72 Nw.U.L.Rev.181. See also J.R.Atwood, "Conflicts of Jurisdiction in the Antitrust Field: The Example of Export Cartels", (1987) 50:3 L.& Contemp.Problems 153. In Japan, an export cartel will easily be permitted. See A.Uesugi, "Japan's Cartel System and Its Impact on International Trade", (1986) 27 Harv.Int'l L.J.389, including a list of 64 separate cartel systems. Under section 6 of the West German Act against Restraints of Competition (*Gesetz gegen Wettbewerbsbeschränkungen*), "agreements which serve to protect and to promote exports, insofar as they are limited to regulation of competition outside the area to which this Act applies" are exempt from the scope of sec. 1 that declared any cartel agreement null and void. A similar legislation exists in the United States. The

creation of cartel lies in improving the position of domestic companies on foreign markets, countries have declined to undertake any steps in order to prevent the establishment of an export cartel.

The effects doctrine as suggested in the Alcoa case was often criticised for its purely nationalistic view, since it fails to take into account the competing interests of other nations. Moreover, taken to its logical end, a multitude of states may be entitled to regulate the same conduct because an effect, however insignificant, may occur in more than one state. The substantial effects test excludes the jurisdiction of states with de minimis contacts. To reduce jurisdictional conflicts that even a substantial effects test can not prevent, it was submitted that only the one state where the primary effect is felt should be entitled to claim jurisdiction.[37] The writer concedes that the adoption of a primary effects test would not necessarily result in the exclusive jurisdiction of one state. It is, on the other hand, suggested that concurrent

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Webb-Pomerene Act (15 U.S.C.66-64) and the *Export Trading Company Act* of 1982 (Pub.L.No.97-290; 96 Stat.1233) exempt American export cartels from the application of the *Sherman Act*, as long as the "export trade association" does not restrain competition within the United States. Considering the vigorous attempts of West Germany and the United States to battle any trade restriction on a universal scale, it can hardly surprise that the enactment of export cartel exemptions raised the criticism of "double think". See in general R.Burnett, "The United States Export Trading Company Act 1982: Its Implications for Australia", (1985) 13 Aus.Bus.L.Rev.30 at 33.

37 *Supra* note 23 at 154.

jurisdiction of two or more states be permitted in those cases in which the effects of an activity on more than one state are equally substantial. Thus, the substantial effects test does not solve the problem of extra-territoriality, but it is helpful in reducing the number of cases.

Although there is still dispute as to how broad the scope of the effects doctrine should be, it became an integral part of international law for its practical approach. The Organization for Economic Cooperation and Developmant (OECD) Report on Restrictive Business Practices of Multinational Enterprises [38] states that the effects doctrine has been recognized in the legislation of the Federal Republic of Germany [39], Austria, Denmark, Spain, France, Sweden, and Finland and may be found in the case law of Canada, Japan, Switzerland, the United States and

38 OECD Report, Restrictive Business Practices of Multinational Enterprises, para. 120. For an exhaustive survey of antitrust laws see E.Nerep, *Extraterritorial Competition under International Law*, Stockholm 1982; W.I.Fugate, *Foreign Commerce and the Antitrust Laws*, 3d ed. Boston & Toronto 1982 Vol.II at 359 et seq.

39 West Germany adopted the broad American approach in their *Act against Restraints of Competition*. Section 98 (2) specifically provides that the Act applies "to all restraints of competition which have effects within the territory in which the law applies, even if such effects are caused by actions taken outside such territory." For further commentary see D.J.Gerber, "The Extraterritorial Application of the German Antitrust Laws", (1983) 77 A.J.I.L.756; A.Riesenkampf & J.Gres, *Act Against Restraints of Competition*, Cologne 1977.

the EEC.[40] There is still resistance, especially among British scholars, to broaden the scope of the effects doctrine beyond the common ground that a state is entitled to enforce its laws in order to prevent agreements which primarily intend, and produce, illegal activities within this state's territory. They believe that it would not be proper for a state to regulate an agreement concluded in another country simply on the grounds that the agreement would have been illegal if it would have been concluded in that state's territory.[41] It is believed to be consistent with the more restricted view of the effects doctrine that states should tolerate the extraterritorial application of foreign law whenever the regulated conduct serves the sole purpose of evading the foreign law.

In 1965, the American Law Institute adopted Mann's distinction in its Restatement (Second) of the Foreign Relations Law that is designed to provide American courts with some guidance in cases involving foreign interests.[42] Mann was the first to draw a distinction

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40 The European Court of Justice just recently acknowledged the effects doctrine as part of international law justifying its jurisdiction in a case involving an American export cartel exempted from the application of the *Sherman Act* under the *Webb-Pomerene Act*. E.C.J. decision of September 27, 1988; reproduced in German translation in (1988) Neue Juristische Wochenschrift 3087. For a recent analysis of the EEC Commission policy on jurisdiction see Note, "IBM v.Commissioner: The Effects Test in the EEC", 10 B.C.Int'l & Comp.L.Rev.125.

41 See *supra* note 2 (Anand) at 9 and *supra* note 31 at 175.

42 Restatement (Second) of the Foreign Relations Law, American Law Institute 1965.

between prescriptive and enforcement jurisdiction. Prescriptive jurisdiction embraces all acts designed to taint conduct as delictual, e.g. criminal, commercial, civil codes, but also tax regulations. The legal capacity of a state to enforce the prescriptive jurisdiction is now commonly called enforcement jurisdiction. Given this distinction, jurisdiction to prescribe is a necessary prerequisite for jurisdiction to enforce, though not always sufficient. Thus, there may be cases in which jurisdiction to prescribe exists, but no corresponding enforcement jurisdiction. Of course, this distinction does not solve any of the jurisdictional problems, but it is very helpful in locating the fundamental problem of what limits international law imposes upon the enforcement of domestic legal rules. In Mann's words, "the mere exercise of prescriptive jurisdiction, without any attempt at enforcement, will not normally have to pass the test of international law, for so long as a state merely introduces a legal rule without taking to threatening steps to enforce it, foreign states and their nationals are not necessarily affected."

The Restatement (Second) purports to "state and clarify"[43] the current rules of international law. However, it is not a formal source of law. Its pervasiveness depends on the amount of consensus it reflects. The Restatement (Second) shows a strong tendency in the view of most foreign observers to establish norms of international law referring solely to American jurisdictional decisions.

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43 *Supra* note 42 at XI (Preface).

Though it is not authoritive, American judges who are generally unfamiliar with foreign or international law rely entirely on the Restatement (Second) whenever a case involves foreign contacts. This results in a vicious circle: For example, the Restatement (Second) proposes a refined effects doctrine [44] as an actual part of international law referring to the well-known passage of the *Lotus* case [45] and the American *Alcoa* case.[46]

Almost inevitably, the suggested model for reconciling conflicting jurisdictions was of particular interest for foreign states. Again, section 40 providing "limitations on the exercise of enforcement jurisdiction" failed to state current law, but promoted a new balancing-of-interests test to solve disputes as to what state should

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44 Section 18 reads: "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)...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, foreseeable result of the conduct outside the territory; and
(iv) the rule is not inconsistent with the principles of justice generally recognized by the states that have reasonably developed legal systems."

45 *Supra* note 8.

46 Section 18 of the Restatement permits jurisdiction based on substantial effects within the territory of a state as long as their effects occur as "a direct and foreseeable result of the conduct outside its territory". The requirement of "intent of the parties" which J.Hand believed crucial for the establishment of jurisdiction was eliminated. See Sec.18 comment f.

refrain from enforcing its law. Sec.40 reads:

> "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, and
> (e) the extent to which enforcement by action of either state can reasonably expected to achieve compliance with the rule prescribed by that state."

The balancing-of-interest test was followed by American courts, until again, in an antitrust action, the Ninth Circuit Court of Appeals rejected the balancing approach as suggested by the Restatement (Second) in *Timberlane Lumber Co. v. Bank of America* [47] as insufficient, establishing a new, refined balancing test based on a "jurisdictional rule of reason".[48] The effects test was considered incomplete because of its failure to pay adequate attention to the interest of other nations and "the full nature of the relationship between the actors and

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47 549 F.2d 597 (9th Cir.1976).

48 The court adopted an approach first suggested by K.Brewster, *Antitrust and American Business Abroad*, New York 1958 at 446.

this country".[49] The court suggested that once an alleged restraint substantially affecting the United States market has been found, the interest of the United States in the application of its jurisdiction should be evaluated and weighed against the relevant interests of other states as a matter of international comity and fairness. Thus, the court believed that the following factors should be considered:

> "(1) the degree of conflict with foreign law or policy,
> (2) the nationality or allegiance of the parties and the locations or principal places of business of corporations,
> (3) the extent to which enforcement by either state can be expected to achieve compliance,
> (4) the relative significance of effects in the United Staes as compared with those elsewhere,
> (5) the extent to which there is explicit purpose to harm or affect American commerce,
> (6) the foreseeability of such effect,
> (7) the relative importance to the violations charged of conduct within the United States as compared with conduct abroad."[50]

Three years later, the United States Court of Appeals for the Third Circuit found itself in "substantial agreement" with the *Timberlane* court, but extended the list of factors in *Mannington Mills, Inc. v. Congoleum Corp.*[51] to the following ten:

> "(1) degree of conflict with foreign law or policy,
> (2) nationality of the parties,

49 *Supra* Chapter III note 13 at 612.
50 *Id.* at 614.
51 595 F.2d 1287 (3d Cir. 1979).

> (3) relative importance of the alleged violation of conduct compared to that abroad,
> (4) availability of a remedy abroad and the pendency of litigation there,
> (5) existence of intent to harm or affect American commerce and its foreseeability,
> (6) possible effect upon foreign relations if the court exercises jurisdiction and grants relief,
> (7) if relief is granted, whether a party will be placed in the position of being forced to perform an act illegal in either country or be under conflicting rules by both countries;
> (8) whether the court can make its order effective;
> (9) whether an order for relief would be acceptable in this country if made by the foreign nation under similar circumstances,
> (10) whether a treaty with the affected nations has addressed the issue."[52]

The tests suggested by the *Timberlane* and *Mannington Mills* courts are viewed as the most elaborate attempts to establish the right of exercise of jurisdiction as they allow any argument to be taken into consideration which could contribute to a fair and just assessment of the interests of the parties and the states involved. In spite of its good intentions and the support given by the United States State Department [53], neither the "Timberlane" nor the "Mannington Mills" test found general acceptance.

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52 *Id.* at 1297.

53 See the legal opinion as drafted in the letter of September 27, 1979, from J.Brian Atwood, then Assistent Secretary of State for Congressional Relations, to Senator Edward M. Kennedy, then Chairman of the Senate Commission on the Judiciary, reproduced in (1980) 74 A.J.I.L.179.

When the American Law Institute revised the complete Restatement (Second) of Foreign Relations Law, they adopted a slightly modified version of the balance-of-interests test.[54] Following suggestions given by Lowenfeld, courts are no longer permitted to enforce their jurisdiction, if its exercise is "unreasonable".[55] The binding character of the operative rule was upgraded from "required by international law to consider, in good faith, moderating the exercise" to a straightforward "may not exercise". Pursuant to the reasonableness standard, courts are required to weigh an expanded list of factors including

> (a) the extent to which the activity (i) takes place within the regulating state, or (ii) has substantial, direct, and foreseeable effect upon or in the regulating state;
> (b) the links, such as nationality, residence, or economic activity between the regulating state and the persons principally responsible for the activity to be regulated, or between that state and those whom the law or regulation is designed to protect;

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54 Restatement (Revised) of the Foreign Relations Law, 1986. For a critical analysis see the study of one of the Institute's foreign advisers, K.M.Messen, "Conflicts of Jurisdiction under the New Restatement", (1987) 50:3 Law and Contemporary Problems 47.

55 See *supra* Chapter III note 1 using the term "appropriateness". The introduction of a reasonableness test was strongly supported by S.J.Marcuss & D.S.Mathias, "United States Foreign Policy Export Controls: Do They Pass Muster Under International Law?", (1984) 2 J.Int'l Tax.& Bus.L.1.

> (c) the character of the activity to be regulated, the importance of regulation to the regulating state, the extent to which other states regulate such activities, and the degree to which the desirability of such regulations is generally accepted;
> (d) the existence of justified expectations that might be protected or hurt by the regulation in question;
> (e) the importance of the regulation in question to the international political, legal or economic system;
> (f) the extent to which such regulation is consistent with the tradition of the international system;
> (g) the extent to which such regulation is of the kind adopted by other states;
> (h) the extent to which another state may have an interest to regulating the activity;
> (i) the likelihood of conflict with regulations by other states"[56]

to determine whose jurisdiction prevails. The scarcity of cases in which United States courts declined their jurisdiction [57] presumably moved the drafters of the Restatement to tighten the rules and to encourage the courts to assert jurisdiction only after a very careful

56 Sec.403 (2).

57 The list consists of four cases. It should be noted that all cases had a *de minimis* interest of the United States in common and, related, the plaintiff seeking damages was non American: *Montreal Trading Ltd. v. Amax, Inc.*, 661 F.2d 864 (10th Cir.1981), cert. denied 455 U.S.1001 (1982); *National Bank of Canada v. Interbank Card Ass'n*, 666 F.2d 6 (2d.Cir.1981); *Vespa of America Corp et al. v. Bajaj Auto Ltd.*, 550 F.Supp.224 (N.D.Cal.1982) (the court found that the "true" plaintiff was the Italian parent company); *Conservation Council of W.Australia v. Aluminum Co. of America*, 518 F.Supp.270 (W.D.Pa.1981).

analysis of the interests involved has been carried through.

Nevertheless, it need hardly to be contended that the reasonableness test, as embodied in the Restatement (Revised) reflects the current state of international law, because there is no evidence that courts outside the United States will ever be inclined to adopt any balancing approach. Expectations for the future to this effect seem bold, since some American courts refused to engage in interest balancing.[58]

The drafters of the Restatement (Revised) should hardly have been caught by surprise, when the new reasonableness test instantly became subject to scholarly criticism.[59] All the arguments originally submitted

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58 The judge in *Laker Airways v. Sabena, Belgian World Airlines*, 731 F.2d 909 (D.C.C.A.), reproduced in (1984) 23 I.L.M.519, called the interest balancing approach "unsuitable". *id.* at 948. See also *National Bank of Canada v. Interbank Card Ass'n*, 666 F.2d 6 (2d Cir.1981); *In re Uranium Antitrust Litigation*, 617 F.2d 1248 (7th Cir.1980); and most recently judge Bork: Balancing tests do not promote comity, because "in practice they tend to deemphasize foreign sovereign interests and almost never lead a court to decline jurisdiction" *Zoelsch v. Arthur Andersen & Co.*, 824 F.2d 27 (D.C.Cir.1987) at 32. See also Note, "Predictability and Comity: Toward Common Principles of Extraterritorial Jurisdiction", (1985) 98 Harv.L.Rev.1310 at 1323.

59 See e.g. H.G.Maier, "Extraterritorial Jurisdiction at a Crossroads: An Intersection between Public and Private International Law", (1982) 76 A.J.I.L.280; *id.* "Interest Balancing and Extraterritorial Jurisdiction", (1983) 31 A.J.C.L.579; D.J.Gerber, "Beyond Balancing:

against the section 40 test remained valid, since the underlying concept of balancing interests was maintained.

The list of factors as contained in sec.403 (2) is non-exhaustive, and no weight is given to each of the factors, thus leaving courts broad discretion. Consequently, it will be almost impossible to predict the outcome of cases in which some of the factors point to different directions. The factors listed are open for broad interpretation and, thus, a situation may easily be conceived in which the courts of two states, in good faith, undertake the reasonableness analysis and vindicate opposite conclusions.[60]

Gerber seems overly optimistic, arguing that courts guided by prior decisions will be capable of forming precedents.[61] The main thrust of the reasonableness test appears to be a case-by-case analysis suggesting, but not requiring courts to consider all of the factors. Furthermore, as prior decisions are not mentioned in the list of factors, judges will not feel bound by precedents. The inherent vagueness of the subjective factors and the promoted flexibility of its application will not enhance the development of a body of case law that would give clear signals to the companies concerned.

International Law Restraints on the Reach of National Law", (1984) 10 Yale J.Int'l L.185.

60 See also *supra* Chapter III note 43 at 379.

61 *Supra* note 59 (Gerber) at 207.

Courts are likely to hesitate before it denies the exercise of jurisdiction to national plaintiffs seeking damages. Conversely, United States court's practice confirms that jurisdiction will only be denied in suits brought to the court by foreign nationals.[62] Some factors such as "the extent to which another state may have an interest in regulating the activity" or "the likelihood of conflict with regulations by other states" do not suggest any solution, but represent mere prerequisites to a conflict. Further, the careful application of the reasonableness test including extensive discovery and requests for submissions by political branches inevitably requires a great deal of time and will be virtually impossible in situations where one party seeks immediate relief, e.g. an injunction.[63]

Above all, judges will lack the nessary experience and sensitivity to handle politically delicate cases and to evaluate highly complex political, economic, and social policies abroad.[64] The judge is placed in the

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62 See *supra* note 58 (Note). Needless to say, this is not the kind of predictability the business community is longing for.

63 See *supra* note 58 (*Laker* judgment) at 950.

64 The prime example can be found in the reasoning of the *In re Uranium Antitrust Legislation* (617 F.2d 1248, 7th Cir. 1980) involving the national interests of Australia, South Africa, the United Kingdom and Canada: "They (the defendants) have chosen instead to present their entire case through surrogates. Wholly-owned subsidiaries of several defaulters have challenged the appropriateness of the injunction, and shockingly to us, the governments of the defaulters have subserviently

position of a home town referee whose judgments almost inevitably will reflect a bias in favour of the forum's policy, "grounded in unsophisticated analysis, overt chauvinism, or erroneous perception of a constitutional duty to advance legislative policies described in broad language, but designed primarily for use in a domestic court."[65]

The balancing approach stresses abstract elements such as the existence of regulation, and the severeness of punishment for violations provided in the Act in question. Pursuant to the "Vacuum" theory, if a country leaves an area of economy unregulated, it is showing a lack of interest and tilting the scales in favour of a foreign nation attempting to regulate the activities in question.[66] This theory fails to take into account the possibility that a policy of *deliberate* non-regulation may represent an equally strong national political, social, or economic interest. Moreover, centrally planned economies will be less susceptible to the extraterritorial application of foreign law than laissez-faire economies. On the other hand, Lowenfeld points out that in the absence of any

presented for them their case against the exercise of jurisdiction. *id.* at 1256.

65 *Supra* note 59 (Maier, "Crossroads") at 317. See also *id. supra* note 59 ("Balancing Interest") at 590, giving convincing examples for how inadequately courts attempted to understand the importance of bank secrecy legislation for Switzerland.

66 For a discussion see *supra* Chapter III note 1 at 335 and A.V.Lowe, "The Problems of Extraterritorial Jurisdiction, Economic Sovereignty and the Search for a Solution", (1985) 34 I.C.L.Q.724.

universal principle that economic regulation must stop at the national frontier, in a situation involving more than one country, if country A wishes to regulate and country B does not, it seems equally fair to criticize B for attempting to impose its own will beyond its border as it is to criticize A for attempting to exercise its jurisdiction extraterritorially.[67]

American attitudes towards non-regulated areas of foreign law undoubtedly encouraged other countries either to formally regulate their economy or to adopt blocking legislation against what is perceived to be an encroachment by the extraterritorial application of foreign law.

With the enactment of blocking legislation designed to prevent the production of documents or the enforcement of judicial decisions abroad,[68] it became virtually impossible to juridically balance the interests of the two states when one state exercised its jurisdiction

67 A.F.Lowenfeld, Book Review, (1965) 78 Harv.L.Rev.1699 at 1703.

68 It should be further noted that, following the U.S.Supreme Court decision in *Societe Internationale Pour Participation Industrielles et Commerciales S.A. v. Rogers* (357 U.S.197, 1958) in which much emphasis was placed upon the potential legal hardship of the defendant under foreign law, a number of countries replaced traditional informal codes of conduct by official legal norms to ensure the desired respect for its legal system before United States courts. See *supra* Chapter III note 1 at 596.

and another attempted to quash the first exercise of jurisdiction in protection of its interests.[69] "There is simply no room for accommodation here if the courts of each country faithfully carry out the laws with which they are entrusted to enforce."[70]

It has been concluded that although the authors of the Restatement (Revised) aimed at a standard of administering justice in a particular case, the reasonableness test, given all the inherent flaws of domestic courts balancing different nations' interests, will work like a renvoi: "In order to delimit prescriptive jurisdiction, national law refers to international law which, under sections 403 (1) and (2) refer back to that same national law for the determination of what reasonableness means in a particular case."[71]

The Restatement (Revised) falls short of settling jurisdictional disputes. It is "a vague system, operated by inappropriate tribunals, with unpredictable results."[72] Hence, it seems very unlikely that the reasonableness test will be applied by courts outside of the United States or

69 The inefficacy of the test was recognized in the *Laker* case, when American and British courts were faced with the directly opposing provisions of the *Sherman Act* and the British *Protection of Trading Interests Act*. See *supra* note 58 (*Laker* judgment).

70 *Supra* note 58 at 948. See also *Graco v. Kremlin, Inc.*, 101 F.R.D.509 (N.D.Ill.1984), noting that it is "somewhat presumptuous, to gauge the importance of the Blocking Statute to France". *id* at 513.

71 See *supra* note 55 at 59.

72 See *supra* note 66 at 731.

be accepted by governments as an instrument in determining whether jurisdiction in favour of the forum exists.

Chapter V: The Nationality of Companies

As we have seen above [1], most of the concern with respect to the extraterritorial reach of American export controls find its roots in the definition of what is deemed to be an American company.

The attachment of nationality signs on companies is quite recent. Under the liberal economic philosophy of the beginning of the century, business had no nationality.[2] In the World War I case of *Daimler Co. v. Continental Tyre & Rubber Co.* [3] the plaintiff company was deemed to possess an "enemy character".[4] Lord Parker who wrote the judgment carefully avoided the term "nationality", but set out a control test for determining the "character" of a company according to the nationality of the shareholder. The distinction between the enemy character of a company to be determined by virtue of enemy control, and the nationality of a company, derived from the state of incorporation, was clearly put forward by McNair J. in *Kuenigl v. Donnersmarck*[5]. He expressly rejected the proposition that "the acquisition of enemy character by a corporation implies the loss of the national character of that corporation. Enemy character is not substituted for the original character,

1 See *supra* chapter III.
2 For a historic overview see e.g. H.Kronstein, "The Nationality of Enterprises", (1952) 52 Colum.L.Rev.983 at 985 et seq.; G.A.van Hecke, "Nationality of Companies Analysed", (1961) 8 Net.Int'l L.Rev.223.
3 [1916] A.C.307 (H.L.).
4 *Id.* at 345.
5 [1955] 1 All E.R.46

but is something added to it. An English company which has acquired enemy character continues to owe its very existence to English law (under which it was incorporated) and remains subject to all its obligations towards the Crown under the Companies Act as an English corporation."[6]

The United States Supreme Court rejected the control test based on the nationality of the shareholder in *Behn Meyer & Co v. Miller* [7] because of the "difficulties certain to follow disregard of corporate identity".[8] Accordingly, the Alien Property Custodian was ordered to return the property to the company. The 1941 amendments to the *Trading With The Enemy Act* [9] reflected a complete reversal of that policy. Driven by the fear that companies whose stocks were held by enemies may serve as an "innocent appearing device" which may turn out "a Trojan horse", the Supreme Court pierced the corporate veil in *Clark v. Uebersee Finanz-Kooperation A.G.* [10]. The determination of the nationality of a company according to the nationality of its shareholders was limited in the United States to wartime related matters.[11]

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6 *Id.* at 52.
7 266 U.S.457 (1925). The President was authorized to seize property of those designated as enemies under the *Trading With The Enemy Act* (October 6, 1917; 40 Stat.411).
8 *Id.* at 472.
9 *First War Powers Act* of 1941; 55 Stat.839.
10 332 U.S.480 (1947). Quotes appear at 488.
11 See *supra* note 2 (Kronstein) at 988.

The differences with respect to the determination of the nationality of a company became relevant when trade became truly international after World War II. Governments increasingly attempted to shape their national economies by regulating or deliberately deregulating the conduct of corporate entities doing business in its territory. Conflicts between the states arose quickly as it became obvious that completely opposite views existed as to what criteria determined the nationality of, and consequently the state's jurisdiction over, companies.[12] Some writers applied to companies the concepts that were originally developed for the determination of the nationality of natural persons.[13] This analogy was even more favoured after the International Court of Justice had ruled in the *Nottebohm*-case that a "genuine link" between the state and its citizen has to be established. By adopting the "genuine link" test, the court rejected the formal, traditional citizenship test in order to provide for some means to tackle the problem of evasion of jurisdiction. Hence, the traditional role of the incorporation test pro-

12 For an extensive discussion of the different concepts of that time see *supra* note 2 (Kronstein). See further Note, "The 'Nationality' of International Corporations under Civil Law and Treaty", (1961) 74 Harv.L.Rev.1429

13 See in particular D.Harris, "The Protection of Companies in International Law in the Light of the Nottebohm-Case", (1969) 18 I.C.L.Q.275 at 292: "There seems to be no reason why the requirement (genuine connection, the author) could not be applied *mutatis mutandis* to companies. Certainly it is no more artificial to regard a company as having a genuine connection with a state than it is to treat it as having a nationality in the first place."

vided to most observers only one indication of whether jurisdiction over a company existed.[14]

In 1970, the International Court of Justice addressed the issue of corporate nationality for the first and only time. It was expected [15] that, finally, the Court's ruling in the *Barcelona Traction, Light and Power Company, Limited* case [16] would settle the lasting dispute. Barcelona Traction is still regarded a landmark decision, though it is flawed by some ambiguous wording. Instead of clarifying international law, this judgement stirred even greater confusion.[17]

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14 *Cf.* e.g. S.D.Metzger, "National or Corporate Interest under Investment Guaranty Schemes - The Relevance of Barcelona Traction", (1971) 65 A.J.I.L.532, arguing for local incorporation plus 51% local ownership. See also *supra* note 2 (van Hecke) noting the problem of "corporatinon Renos", i.e. companies incorporated in the country with the least stringent rules in an attempt to avoid the more rigid legislation of the state where they are doing business.

15 See e.g. panel discussion, "Nationality of Claims - Individuals, Corporations, Stockholders", 1969 Proc.Am.Soc.Int'l L.30. See also *supra* Chapter II note 60.

16 (1970) I.C.J.R. 1, reproduced in (1970) 9 I.L.M.227.

17 See e.g. the mixed reactions and different interpretations in H.W.Briggs, "Barcelona Traction: The Ius Standi of Belgium", (1971) 65 A.J.I.L.327; R.B.Lillich, "The Rigidity of Barcelona", (1971) 65 A.J.I.L.522; R.Higgins, "Aspects of the Case Concerning the Barcelona Traction, Light and Power Company, Ltd.", (1971) 11 Va.J.Int'l L.327; Note, "Belgian Nationality of Shareholders in Canadian Corporation Held Insufficient to Give Belgium Standing to Sue on Behalf of Those Shareholders in the International Court of Justice", (1970) 3 N.Y.U.J.Int'l L.& Pol.391; Note, "Economic Internationalism versus National Parochialism: Barcelona

In 1958, Belgium instituted proceedings against Spain claiming damages on behalf of alleged national shareholders, allegedly incurred to Barcelona Traction, Ltd, as a consequence of a court order declaring the company bankrupt and permitting the seizure and liquidation of its assets. Barcelona Traction was a holding company incorporated in Canada in 1911 with a head office in Toronto. Nevertheless, it operated almost exclusively through a number of subsidiaries, some incorporated under Canadian law, most under Spanish law, in Spain. The Canadian government showed only slight interest in pursuing this case and did not take any suggested action before the International Court of Justice.

The crucial question in view of the fact that the measures complained had been taken in relation not to any Belgian national but to the company itself became whether Belgium obtained the right to exercise diplomatic potection on behalf of Belgian nationals who held shares in a company which is a legal entity incorporated in Canada.[18] The International Court of Justice finally rejected the Belgian claim of diplomatic protection, because Belgium lacked standing.

Traction", (1971) 3 L.& Pol.Int'l Bus.542; Casenote, "State of Residence of Majority of Shareholder of Expropriated Corporation Held Not to Have Standing to Sue", (1970) 38 Fordham L.Rev.809. See also *supra* note 12.

18 See *supra* note 16 at 32 and at 259, para.32 respectively.

According to the court, international law is called upon to recognize certain institutions of municipal law such as corporate entities that have an important and extensive role in the international field.[19] Although the court refused to accept the proposition that the establishment of new rules of international law necessarily depends on (multiple) references to relevant rules of municipal law, the court recognized a close link between municipal law and the development of international law. Consequently, the court confirmed as part of international law the two traditional criteria for allocating corporate entities to states. Thus, a corporate entity is regarded to be a national of the state under which it is incorporated and in whose territory it has its registered head office (*siege social*). The court explicitly rejected the genuine connection test on the basis that this concept is not generally accepted.

The court's explicit, distinct statements abstractly referring to the nationality of corporate entities were undermined when the court applied its own rules. After it had found that Barcelona Traction was incorporated under Canadian law and maintained its head office in Canada, the court went on to say, as if these findings were not sufficient evidence for the Canadian nationality of Barcelona Traction, that the company also maintained its accounts and its share registers in Canada, board meetings were regularly held there and the company

19 *Id.* at 33 and at 260, par.38 respectively.

was listed in the records of Canadian tax authorities. The Court indicated that the place of incorporation and the seat of the registered offices were only two criteria, among others, to determine the nationality of a company. One writer concluded that "as a result of this inconsistency in the Court's analysis, it is not clear whether the Court decided (a) there was no need to show a "genuine link", or (b) there was a need but Canada satisfied it."[20]

In the view of many commentators, alternative (b) has been supported by the conclusion that the court drew from the application of the rules of international law: "Thus a close and permanent connection (between Canada and Barcelona Traction) has been established."[21]

The inconsistency in the court's reasoning between its abstract statements on international law and its findings in the particular case can only be explained, if the court used those additional 'criteria' without

20 See *supra* note 17 at 562.

21 See *supra* note 16 at 268, par.71. Support for (b) can be found in Note, "Dresser Industries: The Failure of Foreign Policy Trade Controls under the Export Administration Act", (1984) 8 Md.J.Int'l L.& Trade 122 at 133: "While emphasis was placed on the State of incorporation, it was not the sole determinative factor". See also S.J.Marcuss & E.L.Richard, "Extraterritorial Jurisdiction in United States Trade Law: The Need for a Consistent Theory, (1981) 20 Colum.J.Transnat'l L.439 at 455 et seq. and R.B.Thompson, "United States Jurisdiction over Foreign Subsidiaries: Corporate and International Law Aspects", (1983) 15 L.& Pol.Int'l Bus.319.

realizing their (potentially) misleading character as justification for the decision. The logical alternative interpretation of the judgment imputes to the court two further inconsistencies in the string of arguments. First, it is difficult to understand how a court can at the same time reject a 'genuine link' test, but accept a 'close and permanent connection' test. Secondly, taking into account the context, the flow of reasoning would have been interrupted at a surprising point. The court sets out the actual international law on the nationality of a company in par.70. Starting with the words "in the present case", the court continues to apply the just found rules to the facts of the case in par.71 that ends with the 'close and permanent connection' phrase. Thus, the fist way of construing the judgment seems more coherent.

Barcelona Traction opened the gates of recognition as customary international law for new tests to be developped from municipal law. The traditional tests for the determination of the nationality of a company were increasingly criticised, particularly in the United States.[22] Admittedly the global popularity of the traditional test reflected the simplicity of its application, but a more sophisticated, less formal test reflecting aspects, such as the effective control over a company, seemed necessary to bar jurisdiction shopping and to ensure that international trade could be controlled. Kronstein suggested presumably the most elaborate test,

22 See *supra* note 2.

favouring an 'entrenchment' model.[23] According to his model, all factors that could conceivably have an influence on the fate of a company should be considered and evaluated to determine its nationality. The disadvantage of this proposal lies in the inherent difficulty in assessing all facts and evaluating them justly. As long as shares are traded freely on a global market ownership may change on a daily basis and, consequently, the nationality of a company.

The effective control theory attempts to strike a balance between the virtue of the traditional approach and the modern trade reality.[24] The extent of control is usually measured either by the voting power of the shareholder or the capital contributed by the shareholder regardless of his voting rights. The exclusive acceptance of an effective control test would lead to a situation where the sovereign right to regulate trade becomes a privilege of the capital exporting countries.

In 1977, the United States Congress explicitly adopted the effective control test in the *Export Administration Amendments Act* of 1966 by inserting a definition of "United States person" that included not only United States nationals and companies incorporated under

23 *Id.* at 999.

24 The effective control theory is developed from the "Trading with the Enemy" jurisdiction. See *supra* note 7 and accompanying text. See further M.Domke, "Piercing the Corporate Veil in the Law of Economic Warfare", (1955) Wis.L.Rev.77.

United States law, but also foreign subsidiaries and affiliates that were controlled by an American company. Since the traditional place of incorporation test remained in force, the amendments significantly widened the scope of American export control.

An increasing number of companies were caught in "catch-22" situations. They were forced to serve two masters at once: The jurisdictions of the place of incorporation and that of the place of control. The advice given by the United States Second Circuit Court in *First National City Bank of New York v. Internal Revenue Service* [25] to "surrender to one sovereign or the other the privileges therefrom" must have sounded extremely cynical, since the pipeline conflict demonstrated that even companies anxious to avoid any conflict with American export controls could be caught retroactively.

Apart from the problem of concurrent jurisdiction, the effective control test proved impractical.[26] First, the basic justification of the control test, i.e. the owner iis the decision-maker, fails almost regularly with respect to widely-held companies. For example, if one foreigner controls 49% of the shares, but 51% are held by

25 271 F.2d 616 at 620 (2nd Cir. 1959), cert. denied 361 U.S.978 (1960).

26 For detailed analysises of the different suggestions see M.Tedeschi, "The Determination of Corporate Nationality", (1976) 50 Aus.L.J.521; D.F.Vagts, "The Corporate Alien: Definitional Questions in Federal Restraints on Foreign Enterprises", (1961) 74 Harv.L.Rev.1489.

numerous locals, the company will be deemed domestic, though the effective control over the company will be exercised abroad. Secondly, the legislation of numerous countries must be substantially changed. For example, in the Federal Republic of Germany as well as in Switzerland, the ownership of shares and its transfer must not be disclosed to the public. For the purpose of an effective control test, the nationality of purchasers of shares must be disclosed. Thirdly, there is no logical way to determine the nationality whenever the shares of a company are equally held by shareholders of two or more different countries.

Fourthly, a nation's claim of jurisdiction against nationals who manage or control companies incorporated abroad ignores fundamental concepts of corporate law, the separate entity of companies and the supremacy of the corporate interest over the interests of the individual shareholder, director, or manager.[27] In France [28] as in the United States [29], decisions rendered by the board of directors in the course of management will not be substituted as long as they serve the best interests of the company.[30] This primary loyalty implies that each decision

27 See e.g. H.Henn, *Law of Corporations*, 3d ed. St.Paul 1983 at 612.
28 See *supra* Chapter III note 1 (Craig).
29 See *supra* note 27 at 661 for references.
30 Wolfsson, however, may be correct pointing at another temptation, influencing the decision-making process in publicly held companies: "The control group, i.e. the board of directors and the senior management group, respectively, may seek to maximize salaries, and the

is based on the director's independent discretionary judgment and not motivated by the fear of personal prosecution. And finally, the free trade of shares could lead to situations where the nationality of a company shifts on an almost daily basis.

The effective control test failed to obtain support outside of the United States. When the American dominance over world trade was overwhelming, a universal application of the effective control test would have largely increased the regulating authority of United States administration. In the 1980's potential repercussions of the effective control test became obvious. In 1982, the Supreme Court had to decide a case in which Sumitomo Shoji (America), Inc, the wholly-owned subsidiary of a Japanese company, relied on its defence of the reciprocal application of the effective control test. If the Supreme Court accepted the effective control test, the defendant would be considered foreign and, consequently, not subject to the American *Civil Rights Act* resulting in a situation where the uniform application of American law to all American workers in the United States was threatened. The lower court decisions in *Spiess v. C.Itoh & Co.(America), Inc.*[31]

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good and easy executive life - large executive suites, beautiful secretaries, hunting lodges, and expensive paintings on the office wall." N.Wolfsson, *The Modern Corporation: Free Trade vs. Regulation*, New York - London, 1984.

31 643 F.2d 353 (5th Cir. 1981), rev'g 469 F.Supp.1 (S.D.Tex. 1979).

and *Avagliano v. Sumitomo Shoji (America), Inc.*[32] had raised that, regardless of the validity of the effective control test, the application of American law might be abrogated in the numerous Treaties of Friendship, Commerce and Navigation the United States had concluded since the end of World War II.[33]

When the Supreme Court handed out its decision in *Avagliano v. Sumitomo Shoji (America) Inc.*[34], the significance of the judgment was immediately realized and its reasoning widely analyzed.[35]

32 638 F.2d 552 (2d Cir. 1981), aff'g in part and rev'g in part 473 F.Supp.506 (S.D.N.Y. 1979).

33 The United States concluded Treaties of Friendship, Commerce/Establishment and Navigation with 21 countries: Japan, Republic of Taiwan, Italy, Ireland, Israel, Denmark, Greece, Federal Republic of Germany, The Netherlands, Pakistan, Luxemburg, Belgium, France, Ethipia, Thailand, Togo, Vietnam, Muscat & Oman, Korea, Nicaragua, and Iran. See further reference in (1981) 20 I.L.M.565.

34 457 U.S.176 (1982); reprinted in (1982) 21 I.L.M.790.

35 B.Ritomsky & R.M.Jarvis, "Doing Business in America: The Unfinished Work of Sumitomo Shoji America v. Avagliano", (1986) 27 Harv.Int'l L.J.193; Note, "Japanese Corporation Formed under United States Law: Must Company Comply with Terms of Title VII of the Civil Rights Act of 1964", (1983) 13 Ga.J.Int'l L.& Pol.159; Note "Sumitomo Shoji America, Inc v. Avagliano: Does Title VII Trump the Treaty?", (1985) 10 N.C.J.Int'l L.& Com.Reg.515; Note, "Title VII and the FCN Treaty: The Exemption of Japanese Branch Operations from Employment Discrimination Laws", (1984) 7 B.C.Int'l & Comp.L.J.67. For a good discussion of the problem see also Note, "Commercial Treaties and the American Civil Rights Laws: The Case of Japanese Employers", (1979) 31 Stan.L.Rev.947.

The facts of Sumitomo can be summarized as follows: Several female secretarial employees of Sumitomo which is a wholly-owned subsidiary of a Japanese general trading company brought a class action against the company, claiming that the company's alleged practice of hiring only male Japanese citizens to fill executive, managerial and sales positions violated Title VII of the *Civil Rights Act* of 1964.[36] Sumitomo moved to dismiss the complaint on the ground that its enforcement practices were protected from Title VIII scrutiny by Art.VIII of the Treaty of Friendship, Commerce and Navigation between the United States and Japan [37], which provides that the "companies of either Party shall be permitted to engage, within the territories of the other Party, accountants and other technical experts, executive personnel, attorneys, agents and specialists of their choice." Art.XXII (3) defines "companies" as "corporations, partnerships, companies and other associations, whether or not with limited liability and

36 42 U.S.C.S. sec. 2000 (e) et seq. Sec. 2(a) reads: "It shall be an unlawful practice for an employer -
(1) to fail or refuse to hire or to discharge an individual, or otherwise to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's race, color, religion, sex, or national origin; or
(2) to limit, segregate, or classify his employees or applicants for employment in any way which would deprive or tend to deprive any individual of employment opportunities or otherwise adversely affect his status as an employee, because of such individual's race, color, religion, sex, or national origin."

37 April 2, 1953, 4 U.S.T.2063, T.I.A.S.2863; reproduced in S.D.Metzger, *Law of International Trade*, Washington 1966, Vol.I at 1.

whether or not for pecuniary profit. Companies constituted under the applicable laws and regulations within the territories of either Party shall be deemed companies within the territories of the other Party."

To no surprise, the judgment focused on the construction of the wording and the purpose of the treaty clauses in question. The Supreme Court held that Sumitomo is constituted under the law of the United States, because it was incorporated in New York. Under the literal language of Art.XXII (3) of the treaty, Sumitomo was barred as a U.S. company operating in the U.S. from invoking the rights provided in Art.VIII of the treaty which are only available to companies of Japan operating in the United States and companies of the United States operating in Japan. This interpretation was also considered in compliance with the purposes of the Treaty. Pursuant to the Court's interpretation, the Treaty accomplished its purpose by granting foreign companies "national treatment", i.e. equal treatment with domestic corporations. The Supreme Court accordingly remanded *Sumitomo* as well as *Spiess* [38] for further proceedings in the light of its decision.

The importance of the *Sumitomo* decision does not lie in the interpretation of the Treaty language, but in the express, though merely obiter dictum recognition of the place of incorporation test as the primary factor for the determination of the nationality of a company. The Court

38 457 U.S.1128 (1982) vacating and remanding.

did not only favour the place of incorporation test, but rejected the effective control test: "Determining the nationality of a company by its place of incorporation is consistent with prior treaty practise. The place of incorporation rule has also the advantage of making determination of nationality a simple matter. On the other hand, application of a control test would certainly make nationality a subject of dispute."[39]

The Supreme Court stressed the treaty practise and quoted its chief negotiator [40], arguably recognizing the place of incorporation test as customary law rule for the determination of the nationality of a company. A rejection of the effective control test would bring the American treatment of all companies incorporated abroad that are controlled or owned by American nationals in line with the equivalent companies incorporated in those eleven nations whose Treaties of Friendship contain an almost identical incorporation provision. Apart from Japan, the list includes some of the United States' major trading partners such as France, the Federal Republic of Germany, Belgium and the Netherlands.[41] Thompson rejects this view, arguing that the place of incorporation rules were designed to give companies substantially the same rights as individuals to do business abroad.[42] It was, however, not

39 See *supra* note 33 at 185.
40 H.Walker jr., "Provisions on Companies in United States Commercial Treaties", (1956) 50 A.J.I.L.373.
41 For the *Sensor* case see *infra* Chapter VI note 32 and accompanying text.
42 See *supra* note 20 at 377.

intended to treat companies more favourably than individuals by permitting them to separate themselves from regulation of their home state. The drafters of the treaties were primarily concerned to safeguard a status of economic competitiveness by convincing the other country to grant American companies the same legal position that domestic companies enjoyed.

The drafters of the Restatement (Revised) chose a compromise between the traditional place-of-incorporation rule and the controversial effective control theory. The exercise of jurisdiction over foreign subsidiaries is prohibited in general, but permitted under certain circumstances.[43] It remains to be seen whether the tightened rules under ss.(b) and (c) will prevent a repetition of the pipeline affair. Sec.414 (2) reads:

> "A state may not ordinarily exercise jurisdiction with respect to activities of corporations organized under the laws of a foreign state on the basis that they are owned or controlled by nationals of the state exercising jurisdiction. However, subject to sec.403 and 436, it may not be unreasonable for a state to exercise limited jurisdiction with respect to activities of foreign entities
>
> (a) by direction to the parent corporation in respect of such matters as uniform accounting, disclosure to investors, or preparation of consolidated tax returns of multinational enterprises; or

43 See also Note, "Extraterritorial Subsidiary Jurisdiction", (1987) 50:3 L.& Contemp.Problems 71.

> (b) by direction to the parent or the subsidiary in other exceptional cases, depending on all relevant factors, including: (i) whether the regulation is essential to implementation of a program to further a major, urgent national interest of the state exercising jurisdiction; (ii) whether the national program of which the regulation is a part cannot be carried out effectively unless it is applied also to foreign subsidiaries;
>
> (c) in the exceptional cases referred to in paragraph (b), the burden of establishing reasonableness is heavier when the direction is issued to the foreign subsidiary than when issued to the parent corporation."

To much regret, the United States Congress foregoing the opportunity to redefine "United States person", when it amended the EAA in 1985. It is hoped that Congress will take the next opportunity to define "United States person" in accordance with the Sumitomo judgment when the EAA expires on September 30, 1989. Otherwise, American legislation will lack coherence and, once again, be blamed for promoting a "double standard".[44]

44 See *supra* Chapter IV note 36. See also the *amicus curiae* brief of the solicitor General who implicitly recognizes the decisive importance of the place of incorporation test. Reprint in (1982) 21 I.L.M.629 at 634 FN 8.

Chapter VI: The Doctrine of Evasion and Other Suggestions

This chapter provides a discussion of some models suggested for the solution of the problem of extra-territoriality of export control. It concludes with the proposal of guidelines whose application, it is hoped, would help to reduce if not eliminate the jurisdictional problems in this area of law.

Although a consensus exists that the concept of sovereignty understood as unlimited and irresponsible power is an anachronism in today's world, no other concept has yet found acceptance.[1] In spite of the difference with respect to the size of territories, population, industrial development, financial stability or military strength, the smooth functioning of international trade still rests exclusively on the voluntary cooperation of the independent states. The respect for sovereign acts between states is traditionally ensured by the principle of comity. Presumably the most common definition was given by the United States Supreme Court in *Hilton v. Guyot*[2]: "Comity in the legal sense is neither a matter of absolute obligation on the one hand, nor of mere courtesy on the other. And it is

1 For a vigorous attack on the "root evil" territorial sovereignty and a plea for functional sovereignty see K.Sono, "Sovereignty, This Strange Thing: Its Impact on Global Economic Order", (1979) 9 Ga.Int'l & Comp.L.549. Quote "root evil" appears at 557.

2 159 U.S.113 at 164 (1894).

the recognition which one nation allows within its territory to the legislative, executive or judical acts of another nation having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons under the protection of its laws."

Thus, the principle of comity calls for mutual respect, but lacks any specific content regarding the kind of respect that is demanded. Therefore comity has been ridiculed as "an amorphous never-never land where orders are marked by fuzzy lines of politics, courtesy, and good faith."[3] Though, admittedly, the principle of comity is usually formulated in very vague terms, it will serve as a basis for any unilateral measure of restraint. In the absence of international agreements, restraint in the exercise of jurisdiction induces other states to act in the same spirit. The necessity of comity or, as some like to call it, a 'fairness approach'[4] in the complex world of modern trade becomes obvious when the consequences flowing from its general neglect are considered. Under the opposite approach, the power theory of jurisdiction, a state ignores what other states believe to be the correct conduct. Relying on its ideological, military or economic power, this country attempts to coerce individuals and companies wherever located into compliance with its regulations. No state policy officially adheres to the power theory; however, the American practice of extending

3 See *supra* Chapter IV note 54 at 281.
4 *Supra* Chapter IV note 58 (Note) at 1319.

its notion of nationality indicated to some observers an approach of power based on its economic strength.[5]

At first glance, the power theory may indeed look enticing to a mighty state such as the United States. There is ample evidence that once the foreign state has noticed that significant pressure from abroad on their nationals - companies or individuals - has been exerted[6], she will not hesitate in ordering her nationals to ignore the foreign state's orders. The powerful state will have no choice in this dispute in the absence of any effective, peaceful enforcement measure, but to give way to the territorial sovereign.[7] Thus, a principle of comity implying the equal protection of the interests of all states is needed to prevent anarchy and confusion in international relations. The United States Supreme Court recognized that "in an area of expanding world trade and commerce, we cannot have trade and commerce in world markets and international waters exclusively on our terms, governed by our law, and resolved in our courts."[8]

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5 See e.g. V.R.Grundman, "The New Imperialism: The Extraterritorial Application of United States Law", (1980) 14 Int'l Law.257: P.Widmer, "The United States Securities Laws: Banking Law of the World?", (1978) 1 J.Comp.Corp.L.& Sec.Reg.39.

6 Of course, there is room for speculation to what extent companies may "voluntarily" comply with foreign embargoes to avoid any trouble. See e.g. *supra* Chapter IV note 31.

7 See also D.F.Vagts, "The Global Corporation and International Law", (1972) 6 J.Int'l L.& Ec.247 at 256: "Recapitulating the history of past episodes, it is apparent that the host country usually wins".

8 *The Bremen v. Zapata Off-Shore Co.*, 407 U.S.1 (1972) at 9.

Comity is also the basis from which the Restatement tests of balancing interests have been developed.[9] However, as we have seen, regardless of how well-intended the drafters may have been in selecting the factors, the balancing test is doomed to rejection abroad.[10]

Therefore, many feel that in view of the present uncertainty over the proper limits on the exercise on national export controls, the question of extra-territoriality can only be answered by an international agreement, whether it be bilateral or multilateral. By definition, any agreement reflects the consensus of the parties on a particular issue and especially in international law, it is the best safeguard for a fair and just treatment of the interests of the countries involved. Thus, the signing of a treaty is always the most desirable solution. Pointing to the example of extratradition treaties, one writer suggested a series of bilateral agreements in which the parties define the terms and conditions under which the extraterritorial application of export controls will be tolerated or even enforced abroad.[11]

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9 Meessen called the reasonableness test a "twin" of comity. *Supra* Chapter IV note 54 at 56.

10 See *supra* Chapter IV note 43 and accompanying text.

11 D.Lord Hacking, "The Increasing Extraterritorial Impact of United States Laws: A Cause for Concern Amongst Friends of America", (1979) 1 Nw.J.Int'l L.& Bus.1 at 9.

Another example which is often suggested[12] is the signing of bilateral agreements similar to those concluded with respect to jurisdictional problems in antitrust law between the United States on the one hand, and the Federal Republic of Germany[13], Australia[14], and Canada[15] respectively on the other hand. All these agreements have one thing in common in that they oblige both sides to give advance notice of any antitrust proceedings touching the

12 See e.g. T.Harris, "The Extraterritorial Application of United States Export Controls: A British Perspective", (1987) 19 N.Y.U.J.Int'l L.& Pol.959.

13 Agreement Relating to Mutual Cooperation Regarding Restrictive Business Practices, June 23, 1976, 27 U.S.T.1956, T.I.A.S.No.8291.

14 Agreement Relating to Cooperation on Antitrust Matters, June 29, 1982, T.I.A.S.No.10,365. See generally Note, "A Comparative Analysis of the Efficacy of Bilateral Agreements in Resolving Disputes Between Sovereigns Arising from Extraterritorial Application of Antitrust Law: The Australian Agreement", (1983) 13 Ga.J.Int'l & Comp.L.49; W.Pengilley, "Extraterritorial Enforcement of United States Commercial and Antitrust Legislation: A View from 'Down Under'", (1983) 16 Va.J.Transnat'l L.833.

15 The first United States agreement with Canada in this troubling area of law dates back to 1969. See Joint Statement Concerning Cooperation in Antitrust Matters, November 3, 1969; reprinted in (1969) 8 I.L.M.1305. A more formal agreement was reached in 1984. See Memorandum of Understanding as to Notification, Consultation and Cooperation with respect to the Application of National Antitrust Laws, March 9, 1984; reproduced in (1984) 23 I.L.M.275. See also B.R.Campbell, "The Canada - U.S. Antitrust Negotiation and Consultation Procedure, A Study in Bilateral Conflict Resolution", (1978) 56 Can.Bar Rev.459; D.I.Baker, "Antitrust Conflicts Between Friends: Canada and the United States in the Mid-1970's", (1978) 11 Cornell Int'l L.J.165; J.J.Stanford, "The Application of the Sherman Act to Conduct Outside the United States: A View from Abroad", (1978) 11 Cornell Int'l L.J.195.

interests of the other country. Both parties are called to give "due regard" and "fullest consideration" to the sovereignty of the other state. Certainly, the application of such rules would help to reduce some of the tensions created by unilateral proceedings against foreign companies. However, it appears that the obligation to notify adds little to the duties that have already evolved from the principle of comity. Since these agreements fail to indicate whose jurisdiction will prevail, this approach alone does not abolish the uncertainty and unpredictability of international trade. The uncertainty and unpredictability of those rules will continue to deter cautious business people in engaging in apparently risky business and foregoing the benefits of trade for the company and the economy at large. Of course, the actual damage caused by the loss of business not done is unpredictable, but the effect of the uncertainty of the law on business decisions should not be underestimated.

On Canadian and British initiative, the OECD, the forum representing the governments of 25 industrialized democracies[16], agreed in May 1984 on the following "general considerations":

16 Australia, Austria, Belgium, Canada, Denmark, Finland, West Germany, Greece, Iceland, Ireland, Italy, Japan, Luxemburg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom and the United States. Yugoslavia participates with a special status. Generally, the EEC Commission also takes part in the organization's work.

> "In contemplating new legislation, action under existing legislation or other exercise of jurisdiction which may conflict with the legal requirements or established policies or another Member country and lead to conflicting requirements being imposed on multinational enterprises, the Member countries concerned should:
>
> (i) Have regard to relevant principles of international law;
>
> (ii) Endeavour to avoid or minimise such conflicts and the problems to which they give rise by following an approach of moderation and restraint, respecting and acommodating the interests of other Member countries;
>
> (iii) Take fully into account the sovereignty and legitimate economic, law enforcement and other interests of other Member countries;
>
> (iv) Bear in mind the importance of permitting the observance of contractual obligations and the possible adverse impact of measures having a retroactive effect.
>
> Member countries should endeavour to promote cooperation as an alternative to unilateral action to avoid or minimise conflicting requirements and problems arising therefrom. Member countries should on request consult one another and endeavour to arrive at mutually acceptable solutions to such problems."

Again, these provisions represent only policy commitments, not a binding treaty. States are only urged to "consider", "endeavour", "take into account" and the

like. The need for cooperation is nevertheless recognized.[17]

However, before any agreement will be signed, courts might be forced to decide issues involving the reach of export controls. Most certainly, courts will defer to a self-defined notion of comity, but the question - for the negotiators as well - remains: Is any compromise conceivable which permits the United States (or any other nation) to pursue an effective export control system without severely impinging upon other nation's sovereignty? Or, conversely, is any principle of jurisdiction implying a notion of extraterritoriality acceptable from a foreign state's view ?

Justice and the effective protection of the interests of the states involved were the two criteria to lead the majority in the *Lotus* case to the conclusion that absolute, exclusive jurisdiction will not satisfy those requirements in some cases. It is submitted that the introduction of a doctrine of evasion will meet the American desire for an effective export control system and the European insistance on territorial sovereignty.

17 For an extensive comment see e.g. K.Small, "Managing Extraterritorial Jurisdiction Problems: the United States Government Approach", (1987) 50:3 Law & Contemporary Problems 283.

The doctrine of evasion is well established in municipal law. Traces of this principle can be found in every jurisdiction. However, no uniform terminology has evolved. Not unexpectedly, the doctrine of evasion is very common in tax laws of most developed nations, generally called anti-avoidance rules.[18] Several concepts aiming at the prevention of tax avoidance have been developed.[19]

Canadian courts followed the British precedent[20] and adopted the doctrine of a sham transaction. Lord Diplock defined sham transaction as "acts done or documents executed by the parties to the "sham" which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations (if any) which the parties intend to create." Canada recently broadened the scope of their anti-avoidance rules by including new definitions granting tax authorities more discretion and by eliminating the proof of intent to evade.[21]

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18 For a complete survey of anti-avoidance rules see Report of the International Fiscal Association, Vol. LXVIIIa. Apparently, only the Japanese legislator does not feel a need for enacting any anti-avoidance rules. See G.Byran, "The Tax Implications of Japanese Multinational Corporations", (1975-76) 8 N.Y.U.J.Int'l L.& Pol.153.

19 For a comparison see B.J.Arnold, *The Taxation of Controlled Foreign Corporations. An International Comparison*, Toronto 1986.

20 *Snook v. London & West Riding Investments*, [1967] 1 All E.R.518 (C.A.).

21 Section 245 (2) of the *Income Tax Act* contains the general anti-avoidance provision: "Where a transaction is an avoidance transaction, the tax consequences to a person shall be determined as is reasonable in the circum-

American tax authorities require an independent business purpose for any transaction. If a transaction is motivated only by the avoidance of tax, it will be disregarded or, in other words, the effect will be that the tax imposed is the one which the taxpayer sought to evade. United States courts may re-characterize transactions according to the substance over form doctrine or the business purpose doctrine.

French authorities rely on the abuse of rights concept.[22] The application of this doctrine enables the tax authorities to disregard any transaction or arrangement that is intended to conceal or disguise its true nature.

The most comprehensive anti-avoidance system appears to be the West German concept. Similarly to the United States, West German courts look at the economic substance of a transaction rather than its form (sec.140 of the German Civil Code, *Bürgerliches Gesetzbuch*). In the

stances in order to deny a tax benefit that, but for this section, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction." Section 245 (3) of the *Income Tax Act* defines the term 'avoidance transaction'as a transaction that would result "in a tax benefit, unless the transaction may reasonably be considered to have been undertaken or arranged primarily for *bona fide* purposes other than to obtain the tax benefit."

22 This concept was applied to the *Fruehauf* case. See *supra* Chapter III from note 1 and accompanying text. For a detailed description see G.Tixier & G.Gest, *Droit Fiscal International*, Paris 1985.

area of tax law, potential loopholes are excluded under the broad scope of sec.42 of the Fiscal Code (*Abgabenordnung*). Pursuant to this provision, German tax authorities are entitled to disregard any transaction or arrangement without reasonable economic substance, even if this transaction is in accordance with the wording and meaning of the general laws. The German Civil Code presupposes that everyone will choose a reasonable way to carry out a transaction. If someone misuses the granted freedom of contract he will be treated for tax purposes as if he had acted in a way a reasonably prudent person in his position would have done.[23]

The doctrine of evasion has found recognition outside tax law as well, though less frequently. West Germany enacted anti-evasion rules in sec.71 (a) of its Company Act (*Aktiengesetz*) and sec.6 of the Installment Purchase Law (*Abzahlungsgesetz*) to protect shareholders and consumers, respectively. In United States case law, the American shipping laws have been enforced against an American shipowner whose ships were registered abroad for the sole purpose of evading the more stringent American rules.[24] In English case law, it is recognized that equity

23 For details of the complex German legislation and jurisprudence see K.Tipke, *Steuerrecht*, Cologne 1977.

24 *Gerrardin v. United Fruit*, 60 F.2d 927 (2nd Cir. 1932), confirmed by *Lauritzen v. Larsen*, 345 U.S.571 at 587 (1952). For further references see Note, "Fraud on the Law - The Doctrine of Evasion", (1942) 42 Colum.L.Rev. 105.

does not allow a statute to be made an instrument of fraud.[25]

The doctrine of evasion is applied as developed in other areas of law could constitute a valuable instrument to strike a balance between the interests of one government in enforcing its domestic laws most comprehensively and effectively, other governments in preserving their sovereignty unimpinged, and the interests of the business community in more predictability as to which jurisdiction will govern certain activities. This would enable companies to assess the risks and costs of doing business abroad on more reliable grounds. The exact wording of such a doctrine can be left to negotiations between the governments, but it seems clear that a broad scope of the doctrine is required to cover the countless devices ingenious, but disloyal minds may conceive.

The American legislator adopted an anti-evasion clause in the EAA Amendments of 1985. Section 108 (a) (3), adding a section 6 (a) (2) to the EAA, provides: 'Any export control imposed under this section shall apply to any transaction or activity undertaken with the intent to evade that export control, even if that export control would not otherwise apply to that transaction or activity."

25 See e.g. *Re Duke of Marlborough, Davis v. Whitehead*, [1894] 2 Ch.133.

Hein is of the view that the anti-evasion clause under the EAA may be interpreted in a way that any transaction or agreement that could somehow be linked to the United States would be covered.[26] It is believed, however, that the scope of the anti-evasion clause would not be viewed with suspicion if the United States eventually limited their (unenforceable) claims for jurisdiction on their grounds, in particular based on their extended notion of corporate nationality.

Extraterritorial export controls are often justified by the necessity to ensure compliance with a nation's control laws and to prevent evasion. The strategy most commonly used by companies to evade an embargo is the arrangement of a detour. The embargoed goods will, correctly declared, be shipped to a third country that is not participating in the embargo, from where it will be re-exported to the target nation, thus being subject to no restrictions under the laws of the third country. The only purpose of American re-export control regulations is to prevent such kind of transshipment. Such regulations have not been resisted abroad by courts.[27]

It is submitted that the rationale behind the doctrine of evasion - the prohibition of achieving indirectly what legally could not be done directly - is valid for relationships between states as well. If a rule

26 W.Hein, "Recht und Praxis der Ahndungsvorschriften des United States EAA", (1986) R.I.W.496.
27 See *infra* note 32.

of public international law limits the legal capacity of a state, the states are barred from accomplishing that goal by using devices which may otherwise be supported by international law.

The effect of a doctrine of evasion between states can be demonstrated in the *Fruehauf* case.[28] Two theories could justify American jurisdiction: The control theory and the nationality principle. The control theory was never accepted outside the United States and its validity within the United States may be doubtful given the Supreme Court decision in *Sumitomo*. In the *Fruehauf* case, its application was precluded under the United States - France Treaty of Establishment.[29] The nationality principle allows a state to regulate the activities of its nationals wherever they occur. This broad principle is limited by the rule of comity that a state cannot expect its nationals to violate foreign law. The absence of a French embargo against China does not entitle any other state to step in and apply its own regulations instead. Insistance on the establishment of positive legislation would be totally absurd. France would be forced to legislate that trade with China is not embargoed. And finally, employing the terms of the doctrine of evasion, the targets

28 For the facts see *supra* Chapter III note 1.

29 November 25, 1959, (1960) 2 U.S.T.2398, T.I.A.S. No.4625. Art.XIV (5) provides: "Companies constituted under the applicable laws and regulations within the territories of either High Contracting Party shall be deemed companies thereof and shall have their juridical status recognized within the territories of the other High Contracting Party."

of the American order were not the American directors, but the conduct of the French company which was not subject to American jurisdiction. The Treasury Department's attempt to influence the French company's behaviour via pressure on the American parent company undermined French sovereignty[30], unless the Fruehauf (U.S.A.) company was attempting to evade American jurisdiction. There was, however, no indication that Fruehauf intended to evade the United States embargo against China. Independent of any instruction given by the parent company, Fruehauf (France) entered into the negotiations and the contract with Berliet. The equipment was to be constructed in the French plant, using French techology and French goods.

The advantages of an application of a doctrine of evasion in comparison to a reasonableness test seems obvious. The laws of foreign states will neither be weighed nor evaluated, but respected by domestic courts. Companies that are suspected of evading export control laws can be expected to submit what reasons governed the business decision, for example to shift the production of certain goods to another country, and judges are in a position to assess whether the business decision "may

30 *Contra* apparently *supra* Chapter IV note 2 (Anand) at 13: "It would be entirely legitimate for the United States to try to influence foreign subsidiaries, or even foreign corporations indirectly by applying its law to United States nationals or corporations owning shares in such foreign enterprises." Undecided K.W.Abott, "Defining the Extraterritorial Reach of American Export Controls: Congress as Catalyst", (1984) 17 Cornell Int'l L.J.79 at 150.

reasonably be considered to have been undertaken primarily for *bona fide* purposes other than"[31] the evasion of stringent export controls.

It is admitted that the regulating state will sometimes find it difficult to prove evasion, in partiular in cases involving multinational enterprises that may transfer parts of their production to countries where no restrictions on the export of certain goods exist. But as long as a company continues to produce those goods abroad permanently, the corporate decision should be respected because this company's decision will usually not be determined by the intent of evasion. Rather, it takes advantage of a more favourable legal environment and the inherent advantages of a multinational enterprise facilitating the removal of production lines.

One of the criteria that should be taken into account is the degree of control on the decisions of a subsidiary generally exerted by the parent company.

The prevention of evasion has already been recognized by a court as a legitimate reason for a foreign country to extend its claim of jurisdiction beyond its borders. The District Court at The Hague found in the *Sensor* case no indication that the American parent company had transferred the production of the goods in question to the

31 Quotes appear in the definition of "avoidance transaction", embodied in sec.245 (3) of the Canadian Income Tax Act.

defendant subsidiary in order to evade the American embargo.[32] The case is also illustrative of the application of the corporate nationality principle. The defendant is a wholly-owned subsidiary of Geosource International (Nederland) B.V. which, by itself, is wholly-owned by Geosource Inc., incorporated under the law of one of the United States. On June 18, 1982, Sensor agreed to purchase 2,400 stings of geophones from the plaintiff company. When President Reagan expanded the sanctions on American subsidiaries, Sensor attempted to rescind the contract amicably, pointing out that it felt obliged to abide by the American embargo. The plaintiff company sought an injunction ordering Sensor to deliver. The District Court granted the desired injunction, compelling Sensor to pay a substantial penalty for each day after October 18, 1982 that Sensor failed to deliver the contractual goods. Sensor was held not to be excused by *force majeure* in its reliance on the United States Export Administration Regulations. The District Court ruled that the defendant company was of Netherlands nationality, "having been organized in the Netherlands under Netherlands law and both its registered office and its real center of administration being located within the Netherlands."

32 *Compagnie Europeenne de Petroles S.A. v. Sensor Nederland B.V.*, September 17, 1982, English translation in (1983) 22 I.L.M.66 at 73.

Furthermore, the court pointed to the Treaty of Friendship, Commerce and Navigation between the Netherlands and the United States[33] which provided that "companies constituted under the applicable laws and regulations within the territory of either Party shall be deemed companies thereof and shall have their juridical status recognized within the territories of the other Party."[34] The American control theory as embodied under sec.385.2 (c) (2) of the Export Administration Regulations was held "out of the question" in view of the Treaty provision.

Furthermore, it should be noted that foreign courts have refused to enforce contracts that violated foreign export control legislation. In *Regazzoni v. K.C.Sethia (1944) Ltd*[35], the House of Lords deferred to comity holding a contract void in which the parties had agreed to sell and deliver 500,000 bags of jute originating in India to South Africa. The export of goods from India to South Africa was prohibited under the India *Sea Custumer Act*. The parties intended to ship the goods to Genoa (Italy) first, before the goods were transported to South Africa. Since the Indian legislation was found not to be contrary to "essential principles of justice and morality", Viscount Simonds considered it a matter of public policy to "defer to international comity" and strike down a contract violating the laws of a foreign state.

33 March 27, 1956; 8 U.S.T.2043.
34 *id.* Art.XXIII.
35 [1958] A.C.301; [1957] 3 All E.R.288.

As long as the public law of the forum is not touched and minimum requirements of justice and morality are met, British courts will not enforce contracts violating foreign export control laws. The effect of this judgment on private parties was questioned.[36] It was argued that potential vendors may feel encouraged to contract for embargoed goods, since the economical risk has been abolished. Whenever the transaction "gets too hot"[37], they may repudiate the contract to the effect that the court will hold the contract unenforceable. The seller's financial risk in a civil litigation will be abolished, but he remains subject to the penal provision under the embargo legislation. Further, the essence of comity implies that the consequences drawn by the domestic court comply with the intentions of the foreign court's policy. And it can readily be assumed that a court in the prohibiting state would strike down the contract as well. Moreover, the award of damages to a party is not designed primarily to deter parties from breaching the contract, but to compensate the party who relied on the validity of the contract. The purchaser of embargoed goods, however, forfeits this protection of the law.

The West German Supreme Court decided a case involving American reexport regulations.[38] The defendant, an American company exporting raw material contractually

36 J.Basedow, "Private Law Effects of Foreign Export Controls - An International Case Report", (1984) 27 G.Y.I.L.109 at 121.
37 *ibid.*
38 BGH (1961) NJW 822; 34 BGHZ 169.

agreed to sell rasurit, a raw material which is used for the production of borax, to the plaintiff, a German chemical factory. The plaintiff signed another contract with a Danish company over 100 tons of borax destined "c.i.f. Rostock (East Germany)". The plaintiff obtained an export license by submitting a false "end-use statement" to American export control authorities. When the defendant refused to deliver the goods, the plaintiff sued for damages, arguing that the defendant was obliged to honor the contract, since the export of borax was not prohibited according to the West German export control rules. The Supreme Court, however, held that the intended deception to be practised on American government agencies was contrary to German public policy. Hence, the contract in question was held void under sec.138 of the German *Civil Code* and no damages were awarded. In its reasoning, the Supreme Court referred to the common interest of Western security, underlying American export control legislation.

Thereby, the Supreme Court indicated that the omission of borax in the list of controlled items can only be explained by assuming negligence on behalf of German export control authorities, not a deliberate decision of policy. Taking this rationale to its conclusion means that the more restrictive foreign provision will drive out the less restrictive domestic one.

The court could have reached this same result without assuming any governmental intention by referring to the doctrine of evasion. Rather than being determined by

comity considerations, the German Supreme Court implicitly enforced its own policy recognizing the impact of American export control regulation on German legislation.

This case served as precedent for another Supreme Court decision involving a Nigerian law that prohibited the export of cultural heritage.[39] The plaintiff, a Nigerian company, wanted to cash in the insurance policy for the loss of three African masks and figures. The defendant, a West German insurance company, argued that the insurance contract was void because of its violation of the Nigerian export prohibition. The Supreme Court held that the Nigerian interest in protecting its cultural heritage was not in conflict with German interests. It further referred to a multilateral treaty drafted by UNESCO[40] and concluded that the main principles of the treaty were already part of German public policy, although West German had not yet signed the treaty. The evasion of a law protecting cultural heritage was considered immoral.

39 BGH (1972) NJW 1575; 59 BGHZ 82. See also A.Bleckmann, "Sittenwidrigkeit wegen Verstosses gegen den ordre public international - Anmerkung zum Urteil des BGH vom 22.Juni 1972", (1974) 34 ZaöRV 112.

40 Art.3 of the UNESCO Convention Concerning Measures to be Taken to Prohibit and Prevent the Illicit Import, Export and Transfer of Ownership of Cultural Property from November 11, 1970, reprinted in (1971) 10 I.L.M.289, provided that "the import, export or transfer of cultural property effected contrary to the provisions adopted under this Convention by the States Parties thereto, shall be illicit."

In conclusion, it can be said that foreign courts defer to comity and strike down contracts providing for the evasion of foreign export control laws. Thus, foreign export control laws are respected unless the foreign law conflicts with the prevailing law of the forum.

Two other issues concerned with the reach of jurisdiction gained wide attention during the pipeline affair. The United States claimed jurisdiction based on the origin of goods and technical data. American measures were truly novel and "extraordinary"[41].

Only two precedent cases exist[42], and both deny the right to the state of origin to regulate the disparities of goods once they have been discharged in the territory of another country, applying a so-called "coming-to-rest" rule.[43] The genuine connection doctrine developed by the International Court of Justice as a shield against feeble nationality links of individuals can hardly support an expanding notion of nationality that embraces legal persons, goods, sevices and technologies. Traditionally, the nationality principle has been viewed as applying only to persons, legal or natural. However, exceptions have been

41 G.H.Perlow, "Taking Peacetime Trade Sanctions to the Limit: The Soviet Pipeline Embargo", (1983) 15 Case W.Res.J.Int'l L.253 at 272.

42 *American President Lines v. China Mutual Trading Co.*, (1953, Hong Kong S.Ct.) Am.Maritime Cases 1510; *Moens v. Ahlers North German Lloyd*, (1966) 30 R.W.360. See also *supra* Chapter III note 33 at 82.

43 See *supra* note 30 (Abbott) at 135.

made with respect to vessels, aircraft, and, arguably, cultural heritage[44].

The effects doctrine would be stretched to an "absurd length"[45]: Taking the argument that the uncontrolled transfer of goods containing American parts may threaten national security to its logical end, nothing would prevent a nation from seeking control over any activity in a foreign country on the grounds that its security is threatened.[46]

In the absence of any prior acceptance in international law, the American claim of jurisdiction over goods and technology was "enthusistically demolished"[47].

44 See *supra* note 40 and accompanying text.

45 H.H.Tittmann, "Extra-territorial Application to United States Export Control Laws on Foreign Subsidiaries of United States Corporations: An American Lawyer's View from Europe", (1982) 10 Int'l Law. 730.

46 If the export of one particular good was likely to threaten American security, access to the good would be prohibited at all, not limited to the public in allied countries. In case of high-tech strategic products based on United States technology, it is not hard to predict that reexport control will be understood and accepted by the allied host government. It should not be difficult to come to an agreement within CoCom to control the export of this particular good. See *id.* at 737.

47 *Supra* note 30 (Abbott) at 133. See also *supra* Chapter III note 20 at 32. In support apparently only D.F.Vagts, "The Pipeline Controversy: An American Viewpoint", (1984) 27 G.Y.I.L.38.

Purchasers of American goods are regularly confronted with so-called "submission clauses" in which they subject themselves to American export control regulations.[48] There is scholarly dispute as to whether this strategy is in accordance with international law. The supporters refer to the general acceptance of contractual choice-of-law provisions by courts, designed to avoid any uncertainty about the applicable law. It could be argued that the submission to American jurisdiction is part of the price that the purchaser of the goods is willing to pay.

The vigorous criticism focuses essentially on two points. First, the submission clauses are not considered to have been freely negotiated.[49] But the United States only encourage the use of submission clauses; they do not compel any foreign or domestic company to provide for such a provision in their contracts. Since the export of most high-tech products is still subject to lengthy licensing procedures, it would be naive not to suspect that the administrative procedure will be shortened whenever the purchaser had agreed to pay attention to the American regulations. The second argument is stronger. It has been argued that the United States misuse freedom of contract in

48 A common version of a submission clause can be found in G.Lebedoff & C.Raievski, "A French Perspective on the United States Ban on the Soviet Gas Pipeline Equipment", (1983) 18 Tex.Int'l L.J.483 at 487.

49 See *supra* Chapter IV note 33 at 525: Submission clauses are "the saddle for public laws to ride on the backs of private contracts."

order to circumvent the limitations imposed by international law on the reach of national jurisdictions.[50] Conversely, private parties cannot allocate the limits of jurisdiction between nations.[51] Private agreements cannot confer jurisdiction upon a state when under international law no jurisdiction prescribing legal rules exists.[52] The submission clause, however, may be interpreted differently to be consistent with the sovereign right to regulate commercial activities within a nation's borders. By suspending a foreign purchaser's ability to further participate in trade with domestic companies, the regulating state imposes conditions within the territory based on conduct wherever it occurs. The United States, for example, is certainly free to decide with whom and in what domestic companies shall have the right to trade. Instead of prohibiting trade with an entire nation, a state may choose rather to ban certain foreign companies. In conclusion, it can be said that if the scope of the sanctions is limited to the state's territority and the submission clause is

50 See e.g. the EEC Comment *supra* Chapter III note 33 at 896; A.V.Lowe, "International Law Issues Arising in the 'Pipeline' Dispute: The British Position", (1984) 27 G.Y.I.L. 54 at 65; see also *supra* Chapter IV note 55 at 27.

51 See B.G.Brunsvold & J.M.Bagarazzi, "Licensing Impact of Foreign Policy Motivated Retroactive Reexport Regulations", (1983) 15 Case W.Res.J.Int'l L.289 at 316; Note, "Extraterritorial Application of the EAA of 1979 under International and American Law", (1983) 81 Mich.L.Rev.1308 at 1326.

52 This oppinion is in accordance with the old common law rule that parties cannot give to the court a power which it would not otherwise have. See Lord Esther, M.R. *In re Aylmer; Ex parte Bischoffsheim* [1887] L.J.57, Ch.D.168.

drafted so as to provide information with respect to the potential consequences of a violation of American export controls rather than as a choice-of-law provision, the clause appears to be in line with international law.[53] Thus, United States Congress may not have acted wisely politically when it decided to impose an import ban on Toshiba[54], but it certainly acted in conformity with international law.

53 See also *supra* note 26 at 168, arguing that a submission clause is legal under international law, because it constitutes a "minus" in comparison to a complete export prohibition. See further *supra* Chapter IV note 33 (Abbott) at 139 and Chapter V note 21 (Marcuss/Richard) at 478.

54 See *supra* Preface note 1 and accompanying text.

C O N C L U S I O N

Over the last three decades, extraterritoriality of export control has become one of the most controversial issues between Europeans and Canadians on the one hand and Americans on the other. While Americans consider trade controls as a useful tool to express political disapproval, Europeans rely on the moderating influence of trade. The United States never hesitated to employ sanctions unilaterally. In order to improve the effectiveness of unilateral measures, the United States expanded their claim of jurisdiction steadily, first covering activities that had an effect within the United States, then companies incorporated abroad that were controlled by American nationals, lately goods and technical data that originated in the United States. The United States seek justification by reference to international law, in particular the *Lotus* decision. However, the Permanent Court of Justice based its ruling that states may freely assert jurisdiction unless international law prohibits it on the notion of sovereignty. Therefore, it is hardly surprising that the European countries refer to the *Lotus* case as well to demonstrate that the United States overstep the limits set by international law.

It is believed that the doctrine of evasion could strike an acceptable compromise for all parties involved: the regulating state, the foreign states concerned about their sovereignty, and the business community. Anti-evasion rules have been recognized by most states in their

internal legal practice, since 1985 even in the American *Export Administration Act*. Applied on a transnational level, the doctrine of evasion would limit the jurisdiction of states to its territory unless someone attempts to evade its jurisdiction. The foreign state tolerates the extra-territorial application of export control laws in the case of evasion; her courts may even feel inclined to defer to comity and enforce foreign export control laws (*Regazzoni v. K.C.Sethia*).

The (formal) equality of sovereign states and the uniform application of the territorial sovereign remain respected. Moreover, this approach would be consistent with the ability to enforce the laws in question. Courts would not face the problem of weighing and evaluating state interests. If one party disputes the jurisdiction of a court, the judge would apply the simple traditional rules of jurisdiction: nationality and territoriality. Under (presumably exceptional) circumstances, the judge may nevertheless assert his jurisdiction in a case where a party transferred an activity abroad for no other purpose than evasion.

The nationality of companies is the subject of scholarly dispute. In the practice of states and the judgment of the International Court of Justice (*Barcelona Traction*), the place of incorporation in common law, and the place of the registered office and central management in civil law are, respectively the decisive factors. The effective control test suggested by the United States

defines the nationality of its shareholders. This test has failed to obtain any support outside the United States, and even the United States seems to deviate from it. The Supreme Court ruled in *Sumitomo Shoji (America) Inc. v. Avagliano* that the state has jurisdiction over companies incorporated in its territory. Treaties of Friendship similar to the treaty with Japan have been concluded with the main Western allies and trading partners. Almost all of this treaties contain a clause applying the incorporation principle.

As the foreign state does not interfere with the policy of the regulating state with regard to anti-evasion attempts by choosing foreign locations, the regulating state is restrained by comity, i.e. the respect for the sovereignty of other states, from enacting legislation which attempts to reach indirectly what cannot be reached directly. Links that nationals obtain to foreign firms by having acquired shares should not be used as a tool of influence on the process of decision-making within the company by threatening the individual with personal liability. Thus, the firm incorporated abroad is not subject to the jurisdiction of the state where the shareholders reside. This prohibition is in compliance with the law of corporations. The interests of owners and management should be oriented towards the business benefits of the company. The management which founds its jurisdiction on the fear of personal liability under foreign law violates the fiduciary duty owed to the company (*Fruehauf v. Massardy*).

The nationality of goods and technology was one of the new issues advanced by the United States in the pipeline incident (1982). According to its view, nationality, and consequently jurisdiction attaches to a good and follows it wherever it is exported or transferred. In modern society, where more and more goods and technologies are the product of parts or under participation from different countries, this approach results in total confusion as to who has jurisdiction. It has been rejected by all other countries, mainly on the grounds that such a procedure is without precedent. A Coming-to-Rest rule seems to be more in compliance with state practice and the rare judical decisions (*American President Lines*). This rule provides a barrier to a claim of jurisdiction by the state of origin once the goods have arrived at their final destination - usually the purchaser who will use them for his own purposes, as part of a larger product or a tool for production or services.

If these rules had been obeyed, the conflict about the pipeline project would have been avoided. Difficulties could arise in the case of highly centralized multinational enterprises. It might be difficult to prove an intentional circumvention of the laws of the state of incorporation if its business with the target nation of sanctions is only one part of its business abroad. In these cases the options for the home state are presumably limited. It may attempt to convince other states of the benefits of restricted trade with the target nation.

This approach applying universally recognized principles such as the anti-evasion and the coming-to-rest rules offers a clear limit to the reach of national laws. The number of situations in which individuals or companies are expected to serve two masters at the same time will be drastically reduced.