

## Economic And Political Aspects Of Extraterritoriality<sup>†</sup>

Controversies over the extraterritorial application of United States law have taken on increasing importance in our foreign policy. Recall the dispute in 1982 over U.S. sanctions against the Soviet natural gas pipeline.<sup>1</sup> That problem was resolved, but the extraterritorial issue has arisen in other contexts. We have had diplomatic and courtroom clashes with Switzerland, for example, over foreign evidence production in the *Marc Rich*<sup>2</sup> case, and with Canada and a number of Caribbean jurisdictions in the *Bank of Nova Scotia*<sup>3</sup> cases. We have had disputes with other countries over application of our re-export controls to goods within their jurisdictions.<sup>4</sup> The private

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1. The Soviet pipeline sanctions consisted of two phases. In December 1981, previously existing foreign policy controls were expanded by requiring a validated license for exports to the U.S.S.R. of commodities and technical data for the transmission or refinement of petroleum or natural gas. (Validated licensing requirements previously applied only to oil and gas exploration and production equipment and related technical data.) In addition, the Department of Commerce suspended the processing of all licensing for exports to the U.S.S.R. and announced that outstanding licenses and reexport authorizations were subject to review. *See* 47 Fed. Reg. 141 (1982) (amending 15 C.F.R. §§ 379, 385, 399).

In June 1982, controls on oil and gas goods and technology were further expanded to include exports of non-U.S. origin goods and technical data by U.S. foreign subsidiaries as well as exports of commodities produced abroad under licensing agreements with U.S. firms. *See* 47 Fed. Reg. 27250 (1982) (amending 15 C.F.R. §§ 376, 379, 385). This second phase provoked the harshest criticisms from our allies.

2. *In re Marc Rich & Co., A.G.*, 739 F.2d. 834 (2d Cir. 1984).

3. *United States v. Bank of Nova Scotia*, 691 F.2d. 1384 (11th Cir. 1984), *cert. denied*, 105 S. Ct. 778 (1985).

4. The State Department has received confidential diplomatic demarches from our allies on, for example, our foreign policy controls applicable to reexports of U.S. origin aircraft and parts to Libya. *See* 15 C.F.R. § 385.7(d) (1984).

*Laker*<sup>5</sup> antitrust case and the grand jury investigation into alleged North Atlantic aviation price-fixing have seized the attention of the highest levels of the U.S. and British governments. Britain has invoked its Protection of Trading Interests Act to forbid the production in *Laker* of any documents held in that country.<sup>6</sup>

As a result of these and other experiences, the United States government and a number of other governments have dedicated themselves to a systematic effort to manage the extraterritorial application of their law more effectively. The problem naturally arises most acutely among friends and close trading partners; we therefore share a powerful interest in not letting the issue do harm to vital political relationships.

This article examines the origins of the problem, the general approach the United States has adopted to manage it, and the two areas in which it is particularly difficult—commercial and financial relations, and national security and foreign policy trade controls.

### I. Origins of the Extraterritoriality Problem

Extraterritoriality has become a bigger issue as the world economy has grown more integrated. In a sense it is one of the by-products of the West's success. People, goods, money, records, and information all move with increasing frequency, speed, and ease across national boundaries. American direct investment abroad has soared; at the end of 1983 it totaled some \$226 billion,<sup>7</sup> while foreign direct investment in the United States amounted to \$135 billion.<sup>8</sup> Business dealings are more and more often transnational, and the multinational corporation has burgeoned—a symbol of the economic interdependence of our time. International trade as a proportion of our Gross National Product has doubled since 1945.<sup>9</sup> Imports into the United States have jumped in volume, value, and variety.

Our laws, and important national interests, require us to reach many transnational activities in certain ways. For example, the legal regime of antitrust and securities and commodities market regulation could be undermined if transactions across borders were beyond the reach of our legal system. National security might be eroded if we could reach only the initial

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5. See, e.g., *Laker Airways, Ltd. v. Sabena Belgian World Airlines*, 731 F.2d. 909 (D.C. Cir. 1984); *Laker Airways, Ltd. v. Pan American World Airways*, 604 F. Supp. 280 (D.D.C. 1984).

6. E.g., Secretary of State for Trade and Industry, Protection of Trading Interests, Order 1983 (June 27, 1983) (U.S. Antitrust Measures).

7. U.S. Department of Commerce, SURVEY OF CURRENT BUSINESS, Aug. 1984, at 29.

8. U.S. Department of Commerce, SURVEY OF CURRENT BUSINESS, Oct. 1984, at 27.

9. COUNCIL OF ECONOMIC ADVISERS, ECONOMIC REPORT OF THE PRESIDENT, Table B(1), 232-3 (Transmitted to the Congress, February, 1985) (based on data from the Department of Commerce Bureau of Economic Analysis).

consignee of a sensitive export and had no right to impose foreign end-use or end-user restrictions.<sup>10</sup>

But when United States laws try to reach the activities of persons or the use of property abroad, we are bound to run up against other nations' views of their own sovereignty and national interests. Sometimes a foreign government says that sovereignty means the exclusive right to reach persons and things within its territory. The Swiss, for example, assert that only their government can order production of records held in Switzerland.<sup>11</sup> In the *Marc Rich* case, they made this claim despite extensive U.S. contacts with the case: the Swiss corporation was wholly owned by Americans, the transactions allegedly were directed from a New York office, the oil was allegedly sold to U.S. customers, and United States tax fraud was at issue.<sup>12</sup>

Perhaps the toughest problem arises when we try to exercise authority, in accordance with United States law and policy, over economic activity centered in another country. Our relationship with Canada today shows that this is more than a philosophical abstraction. Approximately 70 percent of Canada's oil and gas, 37 percent of its mining, and 47 percent of its manufacturing is owned by foreign nationals.<sup>13</sup> Americans own a controlling interest in approximately 35 percent of Canadian industry.<sup>14</sup> Components and technology originating in the United States are used extensively in products exported from Canada. Canadians fear that U.S. attempts to exercise jurisdiction over persons and activities in Canada call into question Canada's ability to govern within its own national boundaries.<sup>15</sup> The problem is

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10. In the absence of U.S. reexport licensing provisions, an initial consignee in another country could resell sensitive equipment to proscribed destinations. Controls on the reexport of U.S.-origin goods are authorized by sections 5(a) and 6(a) of the Export Administration Act of 1979, 50 U.S.C. app. §§ 2404(a), 2405(a)(1982). The Export Administration Regulations generally prohibit the reexport of goods previously exported from the United States. See 15 C.F.R. § 374.1(1984).

11. See generally, *In re Marc Rich & Co., A.G.*, 739 F.2d. 834 (2d Cir. 1984).

12. The case involved an alleged 100 million dollar tax fraud scheme, based on a fraudulent chain of oil transactions. The U.S. sought records kept at the company headquarters in Switzerland and in many other foreign locations.

13. These figures are drawn from publications issued by the Government of Canada Petroleum Monitoring Agency and Statistics Canada.

14. *Id.*

15. Ambassador Gottlieb of Canada stated Canadian concerns in this manner:

If foreign law follows foreign capital, if the flag follows the national currency, if enterprises located in a foreign country are subjected to controls which conflict with the laws and policies of that foreign country, then a stage is reached where national sovereignty itself can be at stake. Sovereignty here refers to the right and the ability of a national government to impose its laws and policies—that is, to govern—within its national boundaries without undue or unwarranted external interference.

The Ambassador went on to note, however, that

[the issue of extraterritoriality] is extremely difficult and there are no hard and fast general answers. It is clear that in our interdependent world a dogmatic and exclusively territorial approach to sovereignty—one that completely separates national jurisdictions—is not work-

particularly difficult when it involves not merely competing claims of jurisdiction but conflicting substantive policies—as in the area of antitrust.

Conflicts over extraterritoriality have the potential for serious long-term consequences. In the economic sphere, other countries are expressing resistance to U.S. companies' participation in projects thought likely to be subject to U.S. extraterritorial controls.<sup>16</sup> Some foreign manufacturers are shifting to non-U.S. sources of supply for long-term industrial projects or export-oriented manufacturing.<sup>17</sup> This is affecting U.S. companies' participation in joint ventures as well as their sales abroad. It is, of course, a particular issue in sales of high technology items where export controls may apply. The political and economic implications are so significant that they could become a bigger threat to American economic interests than the present concerns about tariffs, quotas, and exchange rates.

## II. A Framework for Managing the Problem

When I addressed the annual meeting of the American Society of International Law two years ago,<sup>18</sup> I listed a number of steps to be taken to manage the problem of extraterritoriality. They still provide a useful framework:

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able; some extraterritoriality is inevitable and, sometimes, even desirable. However, it has to be very limited. The international flow of trade and investment requires an appreciation of the differences between the legal and regulatory frameworks of different nations. We must, in the final analysis, know where one jurisdiction ends and another begins and we must respect the lines of demarcation, as ill-defined and amorphous as they may be.

Address by Allan E. Gottlieb, Ambassador of Canada to the United States, New York International Law Association (Nov. 12, 1982).

16. For example, in 1981 the United Kingdom's Monopolies and Mergers Commission refused to allow a proposed merger of a U.K. firm with Enserch, a U.S. corporation, in part because the Commission feared that the merger could subject the U.K. firm to the extraterritorial application of U.S. laws, damaging the firm's export potential. *MONOPOLIES AND MERGERS COMMISSION, ENSERCH CORPORATION AND DAVY CORPORATION LIMITED: A REPORT ON THE PROPOSED MERGER* (1981), *discussed in* 2 J. ATWOOD & K. BREWSTER, *ANTITRUST AND AMERICAN BUSINESS ABROAD* § 13.30 (Supp. 1984).

The French Aerospace Director, Michael Lagorce, also remarked, in an April 19, 1985 speech at the Aviation Club in Paris, that U.S. export policies can introduce distrust and disarray into the marketing structure for civil aircraft.

17. At least one Asian telecommunications company decided against using American technology due to licensing delays and uncertainty. *See*, Jeffrey A. Tassej, *Export Controls Can Hurt National Security*, *Journal of Commerce*, Oct. 11, 1984, at 4a col. 3. There is no reason to think this is an isolated case: U.S. aerospace manufacturers have repeatedly complained to State Department officials that U.S. export controls damage their international competitiveness and have resulted in declining market shares. Other industries where after-sale servicing and supply of spare parts are a major factor in product choice, such as computers, electronic equipment, and oil exploration and production equipment, have also reported significant declines in their overseas market shares after the imposition of controls.

18. Address by the Deputy Secretary of State Kenneth W. Dam, *Extraterritoriality, Conflicts of Jurisdiction and U.S. Foreign Policy* (April 15, 1983) (delivered at the Annual Meeting of the American Society of International Law).

- First, continue efforts to resolve the policy differences that underlie many of the conflicts;
- Second, develop appropriate guidelines for assertions of authority over conduct abroad, such as an interest-balancing or comity approach;
- Third, expand the practice, pioneered in the antitrust area, of notice, consultation and cooperation with foreign governments where contemplated actions raise a danger of conflicts;
- Fourth, expand international cooperative arrangements; and
- Fifth, increase opportunities for advance consultation by the Department of State regarding U.S. regulatory or enforcement actions that substantially involve other countries' interests.

These principles are being implemented. For example, we have strengthened the consensus with the COCOM countries on national security export controls.<sup>19</sup> In addition, we have worked out a consensus in the OECD, affirmed by the ministerial level meeting in May 1984, which reflects a good part of this practical approach.<sup>20</sup> We have also had success, for example, in working with other countries on law enforcement, where there is most likely to be basic agreement on policies and goals.<sup>21</sup> The remainder of this article focuses on two more controversial areas. The first is commercial and financial relations, and the second is national security and foreign policy trade controls.

### III. Commercial and Financial Relations

#### A. ANTITRUST

Antitrust presents vexing problems of extraterritoriality because it involves differences in national competition policies, as well as rival national economic interests. Antitrust was the area in which the practice of international notice and consultation on potential extraterritoriality conflicts received its main impetus. Arrangements for notice and consultation help us consider the interests of the various countries involved in a competition

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19. The list of commodities controlled by COCOM nations has recently been extensively updated to focus controls on areas of greater concern. *See infra* note 34.

20. COMMITTEE ON INTERNATIONAL INVESTMENT AND MULTINATIONAL ENTERPRISES, 1984 REVIEW OF THE OECD 1976 DECLARATION ON INTERNATIONAL INVESTMENT AND MULTINATIONAL ENTERPRISES (1984), reprinted in ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, INTERNATIONAL INVESTMENT AND MULTINATIONAL ENTERPRISES 23-25 (1984) (Section on Conflicting Requirements, Endorsed by Ministers on May 17, 1984).

21. Our recently concluded treaty with Canada, Mutual Legal Assistance in Criminal Matters, Mar. 18, 1985, United States—Canada, and our arrangement with the U.K. government on interdicting British flag ships engaged in drug trafficking on the high seas, Agreement on Narcotic Drugs—Interdiction of Vessels, Nov. 13, 1981, United States—United Kingdom, T.I.A.S. No. 10296, are excellent examples of the closer international cooperation we have achieved in law enforcement matters.

case. In accordance with the OECD restrictive business practices guidelines,<sup>22</sup> we have notified other countries over five hundred times of antitrust enforcement activities. These are primarily domestic actions affecting firms doing business in the United States, such as requests for information often located here. In the bilateral context, we have reached antitrust notice and assistance agreements with Canada and Australia,<sup>23</sup> and a more general antitrust agreement with West Germany.<sup>24</sup>

We have been able to reach agreement with these countries because we share a certain attitude towards competition policies and comity. But with other nations, we have had more difficulty. The British Government, for example, says we cannot legitimately impose United States competition policy on commerce that is essentially bilateral. American and British competition policies may differ over things as fundamental as the legality of secret price-fixing.<sup>25</sup> From our perspective, it is not clear why a balancing of interests or comity analysis would favor allowing secret price-fixing on goods and services in United States commerce. If, in the absence of an agreement with Great Britain, we withhold application of our laws to a case where we have jurisdiction, then the British policies will be applied unilaterally, by default. Clearly this situation is unsatisfactory and remains a serious problem in our trade relations with Great Britain.

We face other complex questions in antitrust. One is the foreign impact of private U.S. antitrust actions. American discovery practices are considerably broader than those of most other legal systems. The possibility of huge treble-damage awards can give plaintiffs in American courts valuable business leverage against foreign companies. Further, such plaintiffs have the option of retaining American lawyers on a contingency-fee basis, and they run less risk of being assessed defendants' costs than in many foreign jurisdictions.

One possible solution is a bill, S. 397, introduced by Senator DeConcini of Arizona.<sup>26</sup> It would provide a mechanism for dropping treble damages in

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22. ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, RECOMMENDATION OF THE COUNCIL CONCERNING CO-OPERATION BETWEEN MEMBER COUNTRIES ON RESTRICTIVE BUSINESS PRACTICES AFFECTING INTERNATIONAL TRADE (Adopted by the Council at its 501st Meeting on September 25, 1979), Doc. No. C(79)154 (Final) (Oct. 5, 1979).

23. Memorandum of Understanding between the Government of the United States of America and the Government of Canada as to Notification, Consultation, and Cooperation with Respect to the Application of National Antitrust Laws, March 9, 1984, United States—Canada, 23 I.L.M. 275 (1984). Agreement Relating to Cooperation on Antitrust Matters, June 29, 1982, United States—Australia, T.I.A.S. No. 10365.

24. Agreement Relating to Mutual Cooperation Regarding Restrictive Business Practices, June 23, 1976, United States—Federal Republic of Germany, 27 U.S.T. 1956, T.I.A.S. No. 8291.

25. United Kingdom laws have no direct counterpart to the Sherman Act, 15 U.S.C. § 1 (1982) which prohibits, *inter alia*, price fixing agreements.

26. S. 397, 99th Cong., 1st Sess. (1985).

certain international cases, and would also legislate comity as a jurisdictional rule in the antitrust area. The Reagan Administration has yet to formulate a position on this legislation, and the bill does raise a number of questions. Yet, it is clearly a thoughtful and serious initiative. While the DeConcini bill may or may not provide the answers, it does provide a desirable opportunity for interested legal, business and governmental parties to focus on the question and make their views known.

## B. UNITARY TAX

Another problem, but one on which significant progress has been made, is the worldwide unitary tax method, under which our state governments have adopted tax policies that differ from those of our trading partners. First, it should be noted that the U.S. government does not consider worldwide unitary taxation to be an extraterritorial application of U.S. federal or state laws; it is a system used by some U.S. states to determine what income is subject to taxation, not an attempt to regulate activities abroad.

Nevertheless, many of our trading partners have claimed that the unitary tax now used by California and a number of other states<sup>27</sup> is an extraterritorial application of U.S. laws. They claim that it results in double taxation, places other burdens on foreign commerce, and is inconsistent with the generally accepted international practice of allocating income.

A Treasury Department Working Group, which included representatives of state governments, studied the matter and recommended a "water's edge" limitation on the states' use of the worldwide unitary tax method.<sup>28</sup> American corporations, and foreign corporations with substantial business activities in this country, would still be subject to unitary taxation in some states. Following the Working Group recommendation, several states rescinded or limited their unitary taxes,<sup>29</sup> and others are considering legislation to do the same. California, however, which originated the use of worldwide unitary taxation, has not yet moved to the recommended "water's edge" approach. In sum, while the unitary tax problem is not fully resolved, it is one area where the federal government and individual state governments have acted to meet the concerns of other countries.

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27. In addition to California, Alaska, Idaho, Montana, North Dakota, New Hampshire, and Utah, all employ a worldwide unitary method of taxation. The Colorado legislature recently passed a bill, which is now before the governor, which would modify their worldwide unitary method of taxation.

28. See OFFICE OF THE SECRETARY, DEPARTMENT OF THE TREASURY, *THE FINAL REPORT OF THE WORLDWIDE UNITARY TAXATION WORKING GROUP: CHAIRMAN'S REPORT AND SUPPLEMENTAL VIEWS* (1984).

29. Florida, Indiana, and Massachusetts have modified their worldwide unitary method of taxation. Oregon has also done so, but the modification will not be effective until January 1, 1986.

#### IV. National Security and Foreign Policy Trade Controls

As in commercial relations, underlying *policy* differences play a critical role in the conflicts over national security and foreign policy trade controls. This is much more than an issue for the lawyers. It is one for the diplomats and political leaders.

Extraterritoriality has become a major issue in the context of East–West trade. It was once believed that such trade would be an incentive for the Soviet Union to moderate its international behavior. Experience, however, seems to indicate that it is the West that has been restrained more than the Soviets. In addition, there has been concern that wider trade has given the Soviet Union too much access to Western technology, both for direct military application and for upgrading the technological base that sustains the Soviet military establishment.

For these reasons, the United States has sought to limit Soviet access to advanced technology. At the end of 1981, in response to the Soviet role in the suppression of Solidarity in Poland, the United States halted Soviet access to American equipment for the construction of the natural gas pipeline from the Soviet Union to Western Europe.<sup>30</sup> In June 1982 controls were extended to exports by U.S. subsidiaries and licensees operating abroad.<sup>31</sup> The latter, of course, were foreign companies. These sanctions led, in effect, to an extraterritoriality crisis.

The rift with our allies was resolved by diplomatic efforts to harmonize policies. United States sanctions were lifted on November 13, 1982.<sup>32</sup> A consensus was reached among the major Western industrial nations on a framework for future trade relations with the Soviet Union in products having military or other strategic applications.<sup>33</sup>

We have made good progress, working through COCOM mechanisms to harmonize licensing and enforcement policies with our allies. The list of items subject to multilateral controls is reviewed and updated every few years; in the recently concluded 1982–1984 review, additional products such as robotics, telecommunications switching equipment, and computer software were included.<sup>34</sup> We are working with other governments to improve

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30. See *supra* note 1.

31. See *supra* note 1.

32. 47 Fed. Reg. 51858 (1982)(amending 15 C.F.R. §§ 379, 385, 390, 399).

33. The fact of this consensus was referred to in the Williamsburg Economic Summit Conference Declaration on Economic Recovery, May 30, 1983, *reprinted in* I PUBLIC PAPERS OF THE PRESIDENTS OF THE UNITED STATES, RONALD REAGAN, 1983 798 (1984):

East–West economic relations should be compatible with our security interests. We take note with approval of the work of the multilateral organizations which have in recent months analyzed and drawn conclusions regarding the key aspects of East–West economic relations.

We encourage continuing work by these organizations, as appropriate. *Id.*

34. See 49 Fed. Reg. 50608 (1984) (amending 15 C.F.R. §§ 379, 386, 399). Pursuant to COCOM review of strategic controls, this rule, *inter alia*, adds two new entries to the Commod-

enforcement of export controls on sensitive goods and technology. Success in these efforts should reduce the potential for conflict even further.

The issue of export controls has, of course, arisen outside the East-West context. Last year our government imposed restrictions to interdict the flow to Iraq and Iran of chemicals that could be used in the manufacture of chemical weapons.<sup>35</sup> As part of our effort to limit the role of Qaddafi's Libya in international terrorism, we have instituted stringent export controls for that country.<sup>36</sup> They cover national security items, certain oil and gas equipment, and other products. We have tried to administer these controls with due regard to the differing policies of our European allies and in regular consultation with them.

You may also be aware that Congress is likely to enact a new Export Administration Act soon.<sup>37</sup> The bill tries to strike a proper balance between commercial interests, the concerns of our allies and our own national security and foreign policy interests. Let me list some of its highlights. First, it would prevent the interruption of existing contracts or export licenses, except in special circumstances. The President would be required to make and report to the Congress certain findings before imposing controls. Second, the bill would make more difficult the imposition or extension of foreign policy and national security controls. Third, the bill would permit the President to bar imports not only from companies violating U.S. national security controls, but also those violating COCOM export controls under certain circumstances.

## V. Conclusion

Within the U.S. Government, a consensus now exists that in deciding whether or how to act, we should weigh conflicting interests, laws or policies of foreign jurisdictions. The United States has a long-term national interest in following this comity approach. There is also consensus within the government that consultation and cooperation regarding the extraterritorial application of U.S. law must take place between other agencies and the State Department.

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ity Control List, the effect of which is to control certain software for computers and equipment, as well as certain telecommunication equipment. Regulations governing robotics are to be published sometime this summer.

35. 15 C.F.R. § 385.4(e)(1984).

36. 15 C.F.R. § 385.7(1984).

37. The Export Administration Act of 1979, *as amended* by 50 U.S.C. app. §§ 2401-20 (1982), expired on March 30, 1984, and has been kept in force under the President's authorities, including his authority under the International Emergency Economic Powers Act, 50 U.S.C. §§ 1701-6 (1982). *See* E.O. No. 12470, 49 Fed. Reg. 13099 (1984); Presidential Notice of March 28, 1985, 50 Fed. Reg. 12513 (1985). Several bills to renew and amend the Export Administration Act have been introduced over the past year. The most recent incorporates agreements reached in last year's conference. While controversial provisions remain, it is expected that the bill will pass without major change. *See* S. 883, 99th Cong., 1st Sess. (1985).

Progress has been made. But we must continue working with our friends and allies for a greater convergence of underlying policies. With such a convergence, together with the informed support of the international bar, and the pooling of our collective legal, economic, and diplomatic expertise, I am confident that we will make further progress in managing the problem of extraterritoriality.