THE STILL TANGLED WEB

MALCOLM FORSTER & **GEORGIOS PETROCHILOS** OF FRESHFIELDS BRUCKHAUS DERINGER, HIGHLIGHT HOW THE LONG ARM OF ANOTHER COUNTRY'S LAW CAN REACH YOU, EVEN THOUGH YOUR CONNECTION MAY BE TENUOUS.

The essence of 'extra-territoriality' is the use of State power to affect persons or legal rights outside the boundaries of that State. Although extra-territorial jurisdiction is not new, it has recently achieved an unwonted prominence. In the commercial field, there is a perception that 'long-arm' taxation or sanctions-related provisions are increasingly common, while the extended reach of a Spanish magistrate's warrant in the Pinochet saga focused the public mind on the subject in a dramatic manner.

WHAT IS JURISDICTION? Essentially, it means the power of a State to take legitimate action to control or regulate persons or activities. This, though, is a deceptively simple approach; in reality, things are much more complicated. There are, for example, several kinds of jurisdiction, including:

- legislative jurisdiction – the power of the State to designate actions lawful or unlawful;
- judicial jurisdiction – the power of the State to hear cases and disputes in its own courts or tribunals; and
- enforcement jurisdiction – the power of the State to take physical steps, such as arresting a person, detaining a ship and the like.

TRADITIONAL BASES FOR JURISDICTION.

Territory. In simpler times, the Permanent Court of International Justice (the forerunner of the World Court) was able to pronounce that "the first and foremost restriction imposed upon a State by international law is that .... it may not exercise its power in any form in the territory of another State" – (the Case of the *SS Lotus* 1927).

Of course, this territorial principle still remains the most usual ground for a State to use to assert jurisdiction. On the face of it, it is simple, but even here there are complexities to address. One of the hoariest of international law chestnuts is the case of the person standing on Urbanian territory who shoots across the border and kills a victim in Ruritania. In that case, the territorial principle works both ways – as the State in which the crime commenced, Urbania can take action (under the 'subjective' territorial rule), while Ruritania (where the effects of the crime were felt) could base jurisdiction on the 'objective' version of the principle. In the commercial context, it is possible to think of analogous problems. Suppose Urbania's competition authorities assert jurisdiction over the proposed merger of X and Y corporations, both incorporated in third states. Suppose further that, despite clearances from their respective states of incorporation, Urbania's competition watchdog finds that the merger would hinder competition in Urbania and orders accordingly. If X and Y decide to go ahead regardless, what are the practical consequences for the branches of the new XY Corp that are established in Urbania?

Also, in commercial matters, the degree of 'presence' in the territory required to establish or legitimise the exercise of jurisdiction can be minimal, perhaps a simple brass plate outside the registered office.

Nationality. The brass plate may provide another ground for Urbanian jurisdiction. States have often asserted jurisdiction over their nationals for acts committed, not only within their territory, but elsewhere. British law, for example, has always been held to apply to serious crimes (for example, murder) committed by UK nationals anywhere in the world, the power deriving from the fact that the accused is British (the 'active nationality principle'). Note, though, that, in general, States can only enforce their own national law on this basis. The UK, therefore, would not act to punish a British national for breach of Swiss law outside the UK.

Some States operate a variation of this principle, in that they will accept jurisdiction over acts of foreigners, even if they took place overseas, if the act causes harm to a national of the State in question (the 'passive nationality principle'). This was the basis of the warrant against General Pinochet – the Spanish law grants jurisdiction over serious crimes against Spanish nationals, wherever they take place, regardless of the nationality of the perpetrator.

THE 'PROTECTIVE' PRINCIPLE. Most States assert jurisdiction over acts (even when committed by foreigners abroad) which target the security of the State in question – for instance, plotting a *coup d'état*). The limits of this principle are fairly imprecise, but it may occasionally be appealed to in the commercial field.

UNIVERSAL JURISDICTION. International law recognises that there are certain acts which are so heinous that it is the duty of any State

having custody of the perpetrators to assume jurisdiction (usually enforcement jurisdiction) over them. To the traditional examples of piracy and slave-trading are now usually added, among others, genocide, war crimes, human rights violations. It differs from the passive nationality principle in that jurisdiction can be asserted, even though the victims were foreign nationals. The recent trial in Belgium of two Rwandan nuns for participation in genocide in the latter country is a striking example of the principle in action.

EXTRA-TERRITORIAL JURISDICTION. It can be seen then, that extra-territorial jurisdiction displays elements of a number of these theories. There are limits, though, to what international law will tolerate. As international law takes the view that a State is not obliged to exercise jurisdiction in any given circumstance, if it chooses to do so, the exercise must be just and reasonable. Broadly speaking, this means there must be some link between the State and the matters with which it is seeking to control by extending its jurisdiction.

'LONG-ARM' JURISDICTION IN CONTEXT. The various federal authorities (not to mention some of the constituent States) of the US are widely thought of as the principal 'villains' in asserting extraterritorial jurisdiction. To be fair, however, other States, and notably the European Union, regularly assert jurisdiction over persons, interests *in rem*, and conduct not entirely (or not at all) undertaken within their territory.

The US Conception of Jurisdiction. The Restatement (Third) of Foreign Relations Law of the United States, a codification of the law which is relied upon by courts in the US contains two sections (ss 402 and 403) on the basis and limits of legislative jurisdiction. According to
s 403(1)(c), a state has jurisdiction to 'prescribe law' in respect of

> *"... conduct outside its territory that has or is intended to have substantial effect within its territory"*

S 402(3) goes on to allow a state to regulate

> *"... certain conduct outside its territory by persons not its nationals that is directed against the security of the State or against a limited class of other state interests"*

thus exemplifying the 'passive nationality principle' and the 'protective principle', respectively. The US, though, insists that the overriding tests of comity and reasonableness are met. S 403(1) states:

> *"Even when one of the bases for jurisdiction under s 402 is present, a State may not exercise jurisdiction to prescribe law with respect to a person or activity having connections with another state when the exercise of such jurisdiction is unreasonable".*

So, in practice, although there are significant differences between legislative, adjudicatory, and enforcement jurisdiction, the core principle of sufficient and appropriate contacts holds good for all three types of jurisdiction (although, of course, the relevant considerations for sufficiency and appropriateness will differ).

Let us consider some following examples of the US law in operation.

'JURISDICTION MEANS THE POWER OF A STATE TO TAKE LEGITIMATE ACTION TO CONTROL OR REGULATE PERSONS OR ACTIVITIES. IN REALITY, THINGS ARE MUCH MORE COMPLICATED'

Civil Jurisdiction. A number of foreign litigants have been surprised to find that, as a matter of federal law, they can validly be sued in the courts of a US State with which they have the most tenuous of contacts. For example, a recent and important English House of Lords case involved an attempt to secure an anti-suit injunction to restrain proceedings brought in Texas against the defendant Airbus Industrie, a consortium of European aerospace companies, by the relatives of victims of an aircraft crash in Bangalore, India. As the court held, jurisdiction was established over Airbus in Texas on the basis that Airbus had in the past carried out business with a Texas-based corporation.

There are ways to resist such assumptions of jurisdiction. The first is to seek anti-suit injunctions: the problem is that such injunctions are granted only by a few common law courts (they are unknown in civil law countries), are given rather sparingly, and it is a matter of conjecture how the court on the receiving end will react to them. If the court is offended, that will hardly be of help to the defendant. The second is to challenge the jurisdiction as a matter of US law, citing the 'due process' clause of the XIVth Amendment to the Constitution, which requires 'minimal connection' between the subject matter of the suit and the forum. Unhelpfully, the case law of the US Supreme Court on this point confirms that whether the requisite minimal connection can be made out in the circumstances calls for a delicate balancing exercise. Plainly, there can be little room for certainty in advance.

Competition and Antitrust. The recently aborted Honeywell/GE merger highlighted what lawyers call 'positive conflicts of jurisdiction' – in other words, situations where two States concurrently assume jurisdiction in respect of the same persons, conduct, or rights *in rem* – in this case reaching diametrically opposite results. The US Federal Trade Commission allowed the merger between those principally American companies to proceed, as a matter of US law. The European Commission, admittedly on different criteria, took the contrasting view that the merger would create a dominant position of the new entity in a number of sectors, and that this risk of the emergence of a dominant position was not sufficiently addressed by the undertakings proposed by GE.

There are two possible bases of jurisdiction in such cases. First, and this is entirely free of controversy, where two wholly foreign-held subsidiaries merge, the State of incorporation of the subsidiaries has independent jurisdiction to regulate such merger. Second, and this is the basis on which the European Commission acted on the proposed GE/Honeywell merger, the merger may have effects within the relevant jurisdiction/market so as justify the assertion of jurisdiction. As is often the case with parallel or cumulative assertions of jurisdiction, there is an element of understanding and a demonstration of comity between the two

'contending' authorities. An agreement between the Commission of the European Communities and the Government of the US provides for various way of co-operation (although not co-decision) between them, and implicitly but clearly recognises that activities in the territory of each party that 'adversely affect the interests of the other' are a legitimate target for regulation by the affected party.

A good example is offered by the UK Protection of Trading Interest Act 1980, which was designed to counterbalance treble damages imposed by virtue of US anti-trust legislation. That Act was not aimed at the US assertion of jurisdiction *per se* but the penalties imposed, which were regarded as excessive. As a matter of fact, the prosecution of anti-trust violations by the US Department of Justice regularly include foreign-based entities, on the basis of effects of such violations in the US.

Tax Jurisdiction. While the principles of US federal tax jurisdiction are fairly well known, State taxation over foreign companies is an area that has been accurately described as 'murky'. The parameters within which US States can exercise tax jurisdiction are prescribed by the US Constitution (the due process and interstate commerce clauses) and Public Law No 86-272 (prohibiting income tax on corporations whose sole contact with the taxing State is the solicitation and shipment of orders for tangible personal property). The Supreme Court has also accepted that 'trivial' connections with the State are too tenuous to justify the imposition of income tax.

Unfortunately, the practical application of those principles is problematic. The test of 'triviality', or *de minimis* connection, calls for careful examination and is thought to be misapplied, if not altogether ignored. Further, the legally relevant nexus differ widely from State to State, calling for careful assessment of the tax position of each business venture. (For example, the State of California includes the foreign parent company's income in the taxable income of the Californian subsidiary, unless the parent company makes a so-called 'water's edge selection'.) Finally, in addition to income tax, sales, franchise, property and various others special forms of tax may be applicable, based on a range of contacts with the relevant State.

Essential interests. This category is a residual, and not wholly defined, one. No one has come up with a satisfactory and generally applicable definition of what 'essential interests' are and, furthermore, States will often be tempted to assert jurisdiction on the basis of very tenuous or remote connecting factors, invoking 'essential interests' as a fig leaf.

A particularly good example is the so-called Helms-Burton Act, which is aimed at isolating the Cuban government. Among other provisions, s 302(1)(A) creates liability on the part of any person who 'traffics' in property confiscated from a US citizen by the Cuban State. (The same provision further includes a rebuttable presumption on the value of such property.) Although s 301 has not been brought into force, s 401, which is in force, does have extraterritorial application in that it denies entry to the US to any person who, among others, is a corporate officer of an entity 'which has been involved in the trafficking' in confiscated property.

The EU has taken the view that such measures are contrary to US undertakings under various World Trade Organisation agreements and has adopted Regulation 2271/96 to counter the extraterritorial effects of the Act. Other States, including those of the Organization of American States, have adopted similar blocking legislation. Eventually, a so-called Understanding on Disciplines to resolve the dispute was agreed upon by the US and the EU at a summit meeting in London in May 1998.

A similar dispute between the US and the EU has arisen in relation to the US sanctions on Iran and Libya. Under the relevant US legislation, there are mandatory sanctions against foreign companies that make investments of more than $20m, which contribute directly to the development of petroleum or natural gas in those two States. In addition, Federal Regulations provide that 'banks subject to US jurisdiction' must not operate accounts, even for foreign citizens, if those accounts are used for transactions connected with Libyan projects or commercial activities.

Again, the May 1998 Understanding has gone some way towards resolving the dispute, but the tendency of States (as well as the UN and EU) to impose economic sanctions on 'pariah States' (there are about 20 of them at present) means that these issues are likely to arise more frequently.

GET THE RIGHT ADVICE. Extraterritorial jurisdiction is here to stay and is likely to occur more and more frequently. Challenging the assertion of jurisdiction is likely to be difficult and the outcome uncertain. Treasurers would be wise to insist on taking specialist international law advice on potential exposure to foreign jurisdictions as part of the structuring of a transaction.

STATES SUBJECT TO UNITED NATIONS SANCTIONS

- Afghanistan
- Angola (UNITA forces and controlled area)
- Eritrea
- Ethiopia
- Former Republic of Yugoslavia
- Iraq
- Liberia
- Libyan Arab Jamahiriya
- Rwanda
- Sierra Leone
- Somalia

Most of these States are subject to arms embargoes and, in some cases, more far-reaching sanctions.

STATES SUBJECT TO UNITED STATES SANCTIONS

- Afghanistan
- Angola (UNITA forces and controlled area)
- Burma (Myanmar)
- Cuba
- Federal Republic of Yugoslavia
- Iran
- Iraq
- Liberia
- Libyan Arab Jamahiriya
- North Korea
- Sierra Leone
- Sudan
- Syria

The US also imposes sanctions on a number of people and groups in the Balkans and on a significant number of designated terrorists and terrorist organisations, narcotics traffickers, etc.

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