EXTRATERRITORIAL OPERATION OF LAWS

Comment by

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One very interesting area in this field of extraterritorial jurisdiction which occurs to me from reading the papers, and particularly the exposition in Philip Wood's paper, concerns the parent-subsidiary relationship. It has been mentioned that this has been the subject of much debate, I think you will find that the speakers have focussed on the reach of state laws in getting at subsidiaries through parents control. I think what Barry Metzger talked about - the US regulation of US banks, reaching right through to the subsidiaries outside the USA - will be directly relevant to the establishment of foreign banks in Australia.

What I find very intriguing about this whole issue of piercing the corporate veil is that it leads more and more to the blurring of the separate entities of parent and subsidiary companies and one wonders where this will end.

I think Philip had referred to the Freuhaf case which does deal with one aspect of this. But I find that it is going to be more and more of a problem when the laws of one state try to reach through parent companies to get at subsidiaries, without recognizing that other interests in the subsidiary should not be brought under such laws. I would be very interested to learn how this is going to work, how would banks established here as subsidiaries of US corporations but with substantial Australian investment accept the subjugation to regulations?

The other area of this parent-subsidiary relationship relates to the inherent inconsistency between parental control to enforce foreign regulations and the consequences of this control. To illustrate that point we could refer to the tax effect in such cases. I think you are well aware of the position of subsidiaries, whether wholly owned or partially owned, which have parents located in other countries. If the foreign subsidiary is managed or controlled by the parent company in another country one could end with the subsidiary becoming a resident of the parent company's country, and brought into the taxation system of that country. Many companies, because of this, take elaborate

precautions to ensure that this management or control nexus does not arise.

On the other side, we find a spate of legislation in foreign countries, and some of these Barry Metzger touched on, which in effect provide that if you are the parent company, you have to ensure that your subsidiary gives effect to the laws of the foreign country. The question I ask is, how can you do that unless you accept that the parent company is in effect conceding it does manage or control the business affairs of the subsidiary? I certainly welcome comments on that problem.

Again, just persisting with the parent-subsidiary situation in relation to extraterritorial jurisdictional aspects, a lot of emphasis goes to the Westinghouse case (I would like to make a couple of comments on that later on).

But I think one of the most intriguing legal cases taking place right now is the Union Carbide case (or the Bhopal case, as it is sometimes called). I think all of you have read a lot about it in the media. I don't profess to know the details or the complexities of the legal issues involved, but from what one has read in the media we have a situation here of Union Carbide in the USA being sued for billions of dollars over the consequences of alleged defaults by the Indian company in which it is a shareholder. I am not sure that it is a subsidiary of Union Carbide as I think it is a 50-50 joint venture with the Indian Government. Litigation is proposed in the United States under laws which permit and encourage this type of litigation. The whole thrust of success in that litigation is against the US "parent company" rather than the Indian company. If the claimants win in these proceedings and recover damages, I would have thought that this raises interesting concerns over the extent to which extraterritoriality jurisdiction can reach.

I think another similar case, though I am not sure what the extent of the exposure would have been had it gone against the company, was one that took place a few years ago. Certain interested groups active in environmental issues took legal action against Alcoa Australia in the United States, on the basis of their activities which, if I recall correctly, were perfectly legitimate in Australia. However, the plaintiffs were trying to use the wider scope of US legislation to claim damages or restraints on Alcoa Australia. If anybody is interested in knowing more about this, Jeffrey Browne who is here and was involved in that case would be able to comment.

Just a couple of random comments reflecting what has been said on the choice of law and forum. I thought a rather interesting development was the New York amendments last year to the General Obligations Act. These provide that parties to a private contract can choose New York law or the New York courts, irrespective of whether there is any nexus between the parties, the substance of the contract, or the performance of the contract.

I would suggest this voluntary choice of law opens up possibilities about the defensive measures that companies could

take, where they want to get out of exposure to, or perhaps less attractive effects of the laws of particular countries.

Another quick illustration that occurred to me about the extent to which "extraterritoriality" can be a problem relates to the American depository receipt system. Recently I had some experience of being exposed to these regulations. I still can't get over the absurdity of the extent to which the application of US laws can reach into a company's business outside the USA.

A good illustration of this is the case of an Australian company in which a small number of shares is held by US residents and who "convert" them into depository receipts in the States.

If this happens even without the knowledge or consent of the Australian company, and it crosses certain threshold limits, there are compliance requirements which the Australian company is obliged to observe. These include the provision of information and reports that are made by the company. My understanding is, that if the law was adhered to strictly, this would require filing of every public document of the company. Presently, in practice, the SEC accepts those documents which the company is obliged to provide to our Corporate Affairs Commission and stock exchanges.

There are many Australian companies which have accepted this situation and complied with the US requirements because it is relatively easy to do. But I still think it raises an important point of principle. We have in this example an Australian company with absolutely no control on what happens in the United States over its securities, even of a minor nature, and is obliged at some cost to comply with these US regulations. The risk is that if they don't do so, it could have some adverse effects if they operate in the US at any subsequent stage or get involved in a US financing.

Can I just jump to a few quick comments on the Westinghouse case? I think by now everyone has heard about the Westinghouse uranium litigation in which some Australian companies were involved. I don't propose to talk about the details. I think it really is in some ways pertinent to reiterate the comment which Philip made, earlier, that the issue of the extraterritorial reach of a foreign country's laws has been around a long time, and it wasn't really "invented" in the Westinghouse case.

A couple of days ago in The Australian Financial Review the journalist, in commenting on the Bell Resources matter, referred to the embargo or restrictions that were placed on the CRA directors, in going to the United States while the Westinghouse litigation was on. This was not due to any embargo as such but the companies involved with CRA had taken the position that they would not submit to the jurisdiction of the US courts.

It was possible to take this precautionary action because at the time the CRA group did not have any investments in the United States. I suggest that if any Australian company is placed in a similar situation and it did have assets of substance in the United States, it would not be able to overcome as readily the

consequences of non-submission to jurisdiction, and there would be significant commercial and other problems. The reality also was that even in the Westinghouse case the directors and senior management of CRA and other companies were handicapped in running their businesses during the period when they could not go into the United States.

Listening to our three speakers there emerge a number of important principles. One stated very clearly is that the problems caused by the extraterritorial reach of the courts of the United States is not something that is recent. It has been around for a long time and Philip has rightly commented that it is only that the pace has hotted up and we are thereby a lot more conscious about this problem.

The other factor that comes through is the problem inherent in the conflict between the needs of different countries as expressed through their national laws and regulations. I think to some degree efforts have been made to come to terms with these conflicts. We have seen it in different forms, for example by double tax claim treaties. I think Barry refers to another in commenting on the treaties of friendship in commerce. I wonder whether in looking forward, and recognizing we live in a very different commercial world today than twenty years or more years ago, whether legal systems, whether domestic or international, have come to terms with recognizing that the free flow of international trade and commerce must not be hamstrung by ever increasing laws which are over protective of their domestic interests. There are needs that have to be addressed and the answers don't always lie in looking to blocking legislation, or using effective and clever legal devices. Again, I think some of the papers touch on these matters in a very helpful way.

I would like to leave you with a question. Should more efforts be exerted, not just by groups such as this, but by governments and others, to move towards international treaties or conventions that can deal with those areas where uniformity of regulation or approach could enhance the effectiveness of business, banking and other activities to the international scene?