CHAPTER VII
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LEGAL EFFECTS

Extra-Territorial Reach of Local Legislations

An important aspect or consequence of the working of the transnational corporations relates to the extra-territorial reach of the legislative and administrative controls of one country into another as a result of the regulations applied to these companies where they are incorporated or states where they operate. An act or administrative action is said to have extra-territoriality if it seeks to regulate, punish, or deal with any act beyond its territorial limits or seeks to impose a liability on property situated outside its jurisdiction or on a person resident outside. In this connection it is usual to refer to the anti-trust legislation of the United States as a prominent irritant to host States where transnational corporations are directed to obey the directions issued under that legislation. However, certain host countries also lay down regulations controlling the activities of the branch or subsidiary of the transnational corporation operating within their jurisdiction which may have an effect
beyond its territories. For example, when the Arab States issued directions in 1973 to the oil companies not to ship any oil to the Netherlands or United States it was clearly intended to affect the economy of the United States and the Netherlands possibly with a view to bringing political pressure to stop aid to Israel. Similarly, instances of a host Government's extra-territorial reach have been seen in many legislations relating to corporate taxation, where under a deeming clause income not earned within their territory is deemed to have been earned in the territory.\(^1\) It is, therefore, proposed to examine some aspects of these legal conflicts in the international arena involving national jurisdictions.

**Anti-Trust Laws: US**

Taking the conventional anti-trust policies of the United States these policies have witnessed a growth in which the reach of the anti-trust acts through judicial interpretation cover activities and even parties outside the territory of the United States. This development has prompted the US Congress to assume and exercise jurisdiction even over corporations domiciled overseas.\(^2\)

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A package of 4 statutes has enabled the US Government to have this reach of extra-territoriality which has caused great resentment among many countries. These statutes are: (i) The Sherman Anti-Trust Act (1890); (ii) The Clayton Act (1914); (iii) The Federal Trade Commission Act (1914), and (iv) The Webb-Pomerene Act (1913). Of these four, the Sherman and the Clayton Acts have generated the greatest amount of litigation and controversy. In the early stages of interpretation of the provisions of the Sherman Act, the US courts applied the test of "the rule of reason", under which only unreasonable restraints of trade were held illegal, and "of per se test" under which some acts, such as price fixing, were held automatically illegal. The "rule of reason" was formulated by the courts to temper down the explicit extra-territorial language of Section I of the Sherman Act which is as follows:

Every contract, combination in the form of trust or otherwise, or conspiracy in respect of trade or commerce among several States or with foreign nations, is hereby declared to be illegal....

Section 2 of the Act makes it a crime -

...to monopolise or attempt to monopolise or combine or conspire with any other person or persons, to monopolise any part of the trade or commerce among the several States, or with foreign nations....
In interpreting the above section of the Sherman Act, the US Supreme Court had held initially, while delivering its judgment in the *Standard Oil Case of New Jersey (1911)*, the section 1 of the Sherman Act should not be construed literally but had to be interpreted by way of rule of reason, i.e. that the congressional intent was to make this statute applicable where circumstances required but not to prohibit agreements and mergers that did not involve undue restraint "because the prohibition of all restraints of trade would make it impossible for any business to be carried on". This interpretation was more pointedly brought out in the case of *American Tobacco Company (1911)*. The facts of this case, in brief, are that the 'Anti-Trust' authorities brought a charge of violation of both sections 1 and 2 of the Sherman Act against a holding company constituted in 1890 by the five biggest cigarette manufacturers in the USA. American Tobacco, by resorting to a number of unfair trade practices, had come to control 96 per cent of the country's total cigarette production. In its petition the US Government also pointed out that in the years since the formation of the trust, American Tobacco had attained an important position in

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3 *Standard Oil Co. (New Jersey), 221 U.S.1, 31 Supreme Court 562.*

4 *U.S. vs. American Tobacco Company, 221 U.S. 106 (1911).*
fields of tobacco manufacture as well, often by employing similar methods. The Supreme Court in the course of its judgment held:

> It was held not that acts which the statute prohibited could be removed from the control of its prohibition by a finding that they were reasonable, but that the duty to interpret which inevitably arose from the general character of the term 'restraint of trade', required that the words 'restraint of trade' should be given a meaning which would not destroy the individual right to contract and render difficult, if not impossible, any movement of trade in the channels of interstate commerce.... (5)

However, there was a shift in the jurisdictional approach of the Court after the Second World War when the doctrine of "effects" on US domestic commerce was formulated. This doctrine was first laid down in the case of U.S. vs. National Lead Co., in which the majority held that the Sherman Act could reach even foreign corporations if it affected American commerce. Effects on US commerce, rather than acts, found to be within the physical confines of US borders came to be the test of the anti-trust enactment. The extreme form of application of this doctrine is to be found in the case of U.S. vs. Aluminium Co. of America, in which the court held that the State may impose its

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5 Ibid., pp. 179-81.
7 143 F.2(d)416(1945).
laws upon persons not within its boundaries for conduct outside its borders which had a consequence within its boundaries. 8

The Aluminium Co. of America, familiarly known as ALCOA, was the sole manufacturer of aluminium. It had succeeded in popularizing the new metal and managed to gain control of various deposits of bauxite - the raw material of aluminium. It had almost monopolized the production of aluminium and in 1937 the Government filed a suit against ALCOA for monopolizing the manufacture of aluminium ingot and for having abused its monopoly power under the Sherman Act. The District Court ruled in favour of the Company and an appeal to the Supreme Court ruled that it was not essential for a firm to have acted unfairly towards its competitors in order to be judged guilty of violating Section 2 of the Sherman Act. The fact that a firm enjoys monopoly position and has demonstrated its intention to use it is sufficient to show an infringement of Section 2. It is in that connection that the Court handed down a new theory known as the "Effects Doctrine", which helped to

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establish the extra-territorial reach of the American Anti
Trust laws. Judge Hand in his decision held that "any
State may impose liabilities even upon persons not within
its allegiance for conduct outside its borders that has
consequences within its borders that the State reprehends".

An actual conflict between two jurisdictions
arose in the anti-trust arena in the case of U.S. vs.
Imperial Chemical Industries Ltd. In this case the Federal
Court (US) in the southern district of New York ordered
Imperial Chemical Co. to retransfer British patents to
Du Pont for licensing. The British Court refused to carry
out the order. Thus an American court ordered an act on
British soil which conflicted with the British law and the
British court accordingly refused to extend compliance to
the American decree.

The enforcement of anti-trust legislation is
entrusted in US to the Federal Trade Commission, an autonomous
body set up under the Federal Trade Commission Act, 1914.
The Supreme Court of USA ruled in FTC v. Cement Institute
and FTC v. Motion Picture Advertising Company that the

9 100 F. Supp. 504 (SNDY 1951).
10 Ibid., p. 216.
11 333 US 683 (1948).
conduct which violated the Sherman Act might also be an unfair practice under the Clayton Act and would fall under the jurisdiction of the Federal Trade Commission. Thus investigation by this agency of firms reached extra territorially and was permitted. However, a beneficial fall-out of the extra-territorial reach has been to give right to any person (including a foreign government) injured anywhere in the world in this business or property by reason of anything forbidden in the anti-trust laws to sue in New York courts for recovery of triple damages even for acts done outside US.

The Trading With the Enemy Act (1917) is another area which had the most pointed and spectacular cases of extra-territorial application. In *National Interest and the Multinational Enterprise*, Professor Jack Behrman gives general instances where the United States authorities, acting under this legislation, issued directions to

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15 Ibid. (\cite{Vagts1973} vide n. 19 therein)
corporations outside the United States regulating the manufacturing and trading activities. Refusal in 1974 to permit American subsidiaries incorporated in Canada and Argentina to export to Cuba raised such a strong protest that the United States had to relax provisions imposed under this Act. Application of the provisions of this Act combined with those of the Export Administration Act, under which license could be refused for exports of commodities manufactured abroad with American technology and components to third countries, have more prominently than the anti-trust clauses brought other nations into conflict with the United States. The case of Fruehauf-France, a French subsidiary of an American company has been cited as a prominent example in this connection by Rubin. This company signed a contract with another French company, Berliet, to sell its components and parts for manufacture of trucks, which the latter company was to export to China. The US Treasury, under the Trading With the Enemy Act, directed the American parent to issue orders to its French subsidiary to break the Berliet contract. The Berliet, asserting its right as a separate entity,


17 Ibid., p. 52.
threatened to sue them and the French Directors went to Court arguing that as directors they would be personally liable for breach of contract and also any damages paid by the Company would affect the French stock-holders. The French Court resolved the issue by appointing a Receiver to see that the contract was fulfilled. This case illustrates in the same way as the case of Imperial Chemical Industry, referred to earlier, that unless it is possible to enforce legislation beyond the territories, retaliatory action by the host country through legislation or legal processes could make the extra-territorial application of law ineffective. However, the potentials of conflict remain and the embarrassment to the corporations would continue with probably a trace of bitterness.

The third area of extra-territorial reach is the Security and Exchange Commission Act, 1934, adopted with an amendment in 1964. These regulations apply to persons within the jurisdiction of the United States, i.e. to persons in the United States, to American citizens and to corporations organized in one of the United States and corporations not organized in the United States so long as they are subject to the controls of such American citizens or corporations. (ii) Germany

It is not America alone that has sinned in this respect. The German Anti-Trust legislation is applicable to every enterprise doing business within Germany irrespective
of the ownership of the enterprise. The question as to how far the provisions of the Anti-Trust Legislation would affect foreign transactions or activities outside Germany of transnational corporations whose branches are in Germany, or whose affiliates are in Germany, has arisen, and the German Law takes the position that such external activities would be a point to be considered by Germany's courts or administrative agencies "provided the contracts or monopolies have effects on the German domestic market". The second point that has been noticed is, that Section 23 of the German Anti-Trust Act, 1957, imposes a duty on corporations wishing to merge to send intimation to the State administration regarding the share of the market the merging companies have attained and other relevant particulars. Here, in determining the question of merger, the law permits the administrative agency not only to take the market share of the affiliated company operating in Germany but also the share reached by the parent organization and other firms affiliated to it provided of course the parent corporation or other companies or other company affiliated have a market share in German domestic

(iii) India

In India, the Indian Monopolies and Restrictive Trade Practices Act, 1969, has in some respects an extra-territorial reach. Section 35 of the Act deals with the registration of agreements relating to production, supply and distribution or control of goods or the performance of any service in India. Under Explanation 1 to this Section, the provisions of registration would apply to any agreement

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Note: The German anti-trust legislation is applicable to every enterprise doing business within Germany. It does not matter who owns the enterprise in question - no distinction is made between national and foreign owned companies. Thus the foreign company has only to submit to the general legislation existing in Germany. The fact that a company operating in Germany is affiliated with a foreign corporation does not place it in a more difficult situation than any German company operating on the German Market. In determining whether such a duty as that of informing the state administration of the intended merger - under section 23 of the German Anti-trust Act - exists, two kinds of criteria are specified by the Act: On the one hand, the share of the market the merging companies have attained; and on the other, certain other data, such as the number of employees, the balance sheet total and the turnover. As regards the last mentioned data, in the case of an affiliated company of a foreign corporation, only those regarding the German affiliated company are considered, thus, it does not matter what the number of employees or the turnover of the parent company may be. It is different with the market share.
of which one party carries on business in India. Even if the other party (or parties) does not carry on business in India, the provisions of the India Act will apply compelling registration under it. Referring to this provisions it has been observed:

Our Parliament as other sovereign legislatures elsewhere, has extraterritorial powers of legislation and therefore the UNO should take steps to draft a general Treaty which gives general powers to the legislatures of the High contracting parties to pass extra-territorial legislation to make its territorial legislation effective which will be recognised and given effect to by all the high contracting parties, not only as regards particular branches of law ad hoc, but under a general treaty embracing several branches of law. (20)

**Taxation**

Taxation is yet another area where the extraterritoriality is often alleged. Owing to differences in the tests of "residence" for corporations, in the definition of "taxable income", and in the basis of liability (accrual or receipt) the same corporation would suffer taxation in more than one jurisdiction on the same income.


21 Note: For 'residence' - in some countries the test of 'incorporation' is adopted and in some others like UK the 'control and management of affairs' test is applied.
The double, or multiple, taxation of inter-corporate dividend in particular where it is assessed in one country on the basis of accrual and in the other on the basis of receipt has been a matter of considerable concern to corporations and stockholders. Under the United States Internal Revenue Code, tax on the profits of an affiliate operating abroad are not imposed till they are brought into the United States (tax deferral). This benefit will be useful only if the foreign country's taxation is lower than US tax. Otherwise, there will be a tendency to repatriate profits without retaining them in the foreign jurisdiction where they may be needed. Many of the host countries offer tax incentives for establishment of new industries in priority areas. These incentives can be rendered a nullity if the home country were to impose its taxes on the entirety of the foreign income without giving credit to the relief and rebate available to them under the local laws. Thus, a crop of difficulties have risen on account of each country reaching out to tax the incomes arising in other jurisdictions.

In India the question of extra-territoriality of the application of the tax laws arose in the case of Wallace Brothers v. CIT Bombay 1948; 22 Governor-General in Council v. Raleigh Investments; 23 and Caltex v. CIT. 24 The

22 (1948) 16 ITR 240 (P.C.)
23 (1948), 16 ITR 140 (P.C.)
Privy Council in the *Wallace Brothers* case decided that, though Parliament had power to legislate extra-territorially there was in law no extra-territorial operation of the Income Tax Act, because so long as a connection could be established between the individual and the state it would be held to have sufficient territorial connection to legislate in regard to such persons or things. There is no general rule of international comity which renders taxation incompetent when there is sufficient territorial connection. 25 One of the prominent sections of extra-territorial reach in the Indian Income Tax Act 1961, is Section 9, which would bring to assessment income arising from any business connection in India - a term not defined in the Act, but held judicially to include not only a branch or a subsidiary, 26 but also an agency, a close financial association or the grant of a continuous license. It may be noted that what is taxable here is not only the profits of the subsidiary or the branch or agency, as the case may be, but profits arising to the non-resident foreign company through the aforesaid activities.

25 (1942) 16 ITR 240 (P.C.)

Other Regulations

Certain other regulations on the local activities of a transnational corporation or its affiliate may have effects on other affiliates. For example, if the parent company decides on a production and investment plan for investment in a needed sector in host country, a directive issued under the Foreign Exchange Act (or a foreign Investment Act), prohibiting investment either for reasons of conservation of foreign exchange resources, or regulation of local industrial capacity, would have the effect of depriving the host country of its industrial development needs. Restrictions on use of trade mark regulations may also have extra-territorial effects. Cases have arisen in the United States where the US Trade Mark Regulations were held to apply to transactions outside its territory if the offender could be found within its limits.27

Assertion of Right to Diplomatic Protection

Lastly, legal conflicts are always inherent in a State trying to assert its right to protect any diplomatic action injuries to its enterprises that go abroad. In public international law states claim competence to protect

corporations who are their nationals by espousing claims of such corporations against the host state.

There are a number of cases arising in international law relating to protection of a corporate interest by nations. The leading case on the subject is the *Barcelona Traction Light and Power Company Ltd.* - first phase and second phase. 28 The question of actual or threatened nationalisation, rights of the country nationalising it, the home country of the company, or the country of the shareholders of the company, have been debated so long in international forums that a separate treatise can be written on the subject of nationalisation of corporate assets. The sovereign right of a state to nationalize enterprises in public interest of that state is well recognized in international law and is no longer in dispute. This rule is carried out in a number of local national laws and constitutions. However, the conditions of nationalization, in particular the final authority to determine the question of jurisdiction, and the rules relating to compensation, have remained controversial issues. 29 That

28 Note: P.C.I.J. series, the facts and issues of the case are discussed in the next chapter.

Only the tribunals of the nationalising state should have jurisdiction over controversies arising out of nationalization, and the appropriate law for determining the legality of nationalization and the amount and mode of compensation offered, should be the national law is one view taken generally by the developing countries. Another view, which is canvassed by the western industrial nations, is that such questions must be decided on the basis of international law which imposes certain constraints on the state's power to nationalize and prescribes both the standards of compensation and the mode of international settlement of disputes. The OECD draft convention on the Protection of Foreign Property asserts this in Article 3 by laying down the conditions that (i) the measures are taken in public interest, (ii) are not discriminating, and (iii) are accompanied by payment of compensation, representing the genuine value of the property and that the payment should be effective and paid without undue delay.

However, the General Assembly Resolution30 on permanent sovereignty over natural resources declared unequivocally that the compensation should be appropriate compensation in accordance with the rules in force in the

30 General Assembly Resolution 1803 (XVII), Sec. I, para 4.
state which seeks to nationalize and in accordance with international law. It further said that its disputes should first be settled in local courts. The Charter of Economic Rights and Duties also insisted on the applicability of domestic law as decided by the domestic tribunals. The matter, however, is still in the realm of controversy. Even at the time of the discussion of the draft article 2 of the Charter of Economic Rights and Duties, some of the developed nations considered that international law should determine the question of compensation or at least just compensation, in the light of all relevant circumstances. The developing countries denied the existence of any such principle in international law. The present trend is to seek a way out by incorporating in bilateral agreements, specified lump sum as payable in the event of expropriation. Further, emergence of insurance guarantee schemes under which the home countries agree to cover the risk of expropriation without adequate compensation has also somewhat mitigated the problem.

31 General Assembly Resolution 3221 (XXIX), Chap. II, article 2.
32 UN Doc. A/ C. 2/ SR. 1638, pp. 5-6.
33 See for further discussion Herbert Salzman, "How to Reduce and Manage the Political Risks of Investment in Less Developed Countries", Global Companies, n. 16, pp. 85-110.