Extraterritorial Application of U.S. Law [New Chapter]

EXTRATERRITORIAL APPLICATION OF U.S. LAW [NEW CHAPTER]*

INTRODUCTION**

One of the most significant and complex issues that arises in dealing with transnational business activities—including labor and employment matters—is determining which nation’s laws will govern the activities and relationships of the involved parties. The problem has become even more difficult in the era of globalization. Business dealings in the globalized marketplace, and their accompanying labor-management relationships, have become so complex and have evolved so rapidly that they have blurred concepts of nationality and citizenship, which historically provided at least some principles to use in determining the applicable law.

This chapter reviews some of the significant jurisdictional issues, roughly broken down by the major topic headings in the U.S. and other country chapters found in the Main Edition of the book. Additional topic headings may be added in the future. Emerging problems that spring from globalization are noted as appropriate, particularly in this Introduction, which contains information on U.S. statutes that does not fit within other topic headings in individual country chapters.

Section I discusses extraterritorial issues that have arisen under individual employment law—specifically, state wrongful termination law.

Section II, Collective Bargaining, addresses jurisdictional issues by focusing primarily on issues of concern arising not only under the U.S. National Labor Relations Act, but also under the U.S. Railway Labor Act (RLA).1 The RLA, which governs labor-management matters in the airline and railroad industries, was not discussed in the U.S. chapter in the Main Edition because it affects a relatively small sector of the U.S. work force. However, because the business activities of airlines have long involved transnational activities, they have given rise to some of the most significant consideration of international jurisdictional issues and thus are extensively reviewed in the following discussion. Recent changes in business practices, noted in the analysis that follows, have created even more jurisdictional issues. While the discussion extends beyond “collective bargaining” to some degree, that heading has been used to conform with the structure of the chapters in the Main Edition.

A discussion of issues arising under U.S. employment discrimination law is included in this chapter in Section VI, Antidiscrimination. The discussion addresses both the extraterritorial application of U.S. employment discrimination laws and the application of U.S. civil rights laws to foreign employers operating in the United States.

Issues that arise under state workers’ compensation laws and state safe workplace laws are included in Section VII.

Individual work contracts, particularly those of corporate executives, may trigger complex issues

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1For a discussion of the RLA, see ABA SECTION OF LABOR AND EMPLOYMENT LAW, THE RAILWAY LABOR ACT (Douglas L. Leslie ed., 1995).
involving employee benefit matters. Section VIII analyzes the structuring of compensation and benefits arrangements to minimize the tax liability of the corporation and the employee.

A subsequent chapter, entitled Corporate Codes of Conduct on Labor Standards, is devoted to a discussion of selected private sector activities of corporations that may have a significant impact on labor and employment practices around the world.

### A. Extraterritoriality of Federal and State Labor-Related Laws, Generally

Congress has the authority to enforce its laws beyond the boundaries of the United States. Whether Congress has actually exercised such authority is a matter of legislative intent. The Supreme Court reiterated in *E.E.O.C. v. Arabian American Oil Co.* the “longstanding principle of American law ‘that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.’” This presumption against extraterritorial effect is based on the common sense notion that Congress is “primarily concerned with domestic conditions” when it legislates. It is assumed that Congress acts with knowledge of this presumption; hence, unless there is “the affirmative intention of the Congress clearly expressed,” courts hold that a federal statute does not apply outside the United States.

Although the “presumption against extraterritoriality” requires a “clear expression” from Congress that a statute is intended to reach nondomestic conduct, the Second Circuit has declined to read *Arabian American Oil* as requiring a “clear statement” in the strictest sense. Rather, the Second Circuit has indicated that courts should consider all evidence of legislative intent, including legislative history, to ascertain whether Congress intended a particular statute to apply outside the United States. When a plaintiff brings a claim under a statute and the claim is based on events that occurred abroad, the burden is on the plaintiff to overcome the presumption. Under this rubric, courts have held that the Federal Tort Claims Act does not apply to tortious conduct occurring in Antarctica, the Federal Employers’ Liability Act does not apply to common carrier activities conducted in foreign countries, and the Federal Fair Labor Standards Act does not apply to works performed by United States employees in foreign countries. Congress has explicitly exercised its extraterritorial authority in the International Parents of Inmates Act, the Selective Service Act, and other statutes. Congressional intent is also important to the extraterritorial application of state law.

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2This section was written by Jack A. Raisner, Associate Professor of Law, St. John’s University, College of Business, Jamaica, New York, Of Counsel, Outten & Golden LLP, New York, New York.
4*Id.*
5*Id.* (quoting *Foley Bros., Inc. v. Filardo*, 336 U.S. 281, 285, 93 L. Ed. 680, 69 S. Ct. 575 (1949)).
6*Foley Bros.*, 336 U.S. at 285.
7*Arabian Am. Oil Co.*, 499 U.S. at 248 (quoting *Benz v. Compania Naviera Hildalgo*, 333 U.S. 138, 147, 1 L. Ed. 2d 709, 77 S. Ct. 699 (1957)).
9*Id.*
10See *Labor Union of Pico Korea, Ltd. v. Pico Prods., Inc.*, 968 F.2d 191, 194 (2d Cir. 1992).
Act did not apply to an accident occurring in Canada,\(^{13}\) and the Labor Management Relations Act did not apply to a labor agreement dispute arising in Korea.\(^{14}\)

There is an exception to the presumption against extraterritorial intent for criminal statutes. According to the Supreme Court, criminal laws are, “as a class, not logically dependent on their locality for the government’s jurisdiction, but are enacted because of the right of the government to defend itself against obstruction, or fraud wherever perpetrated, especially if committed by its own citizens, officers, or agents.”\(^{15}\) The Ninth Circuit has concluded that this exception survives Arabian American Oil and permits the application of certain statutes beyond U.S. boundaries even in the absence of an affirmative statement of congressional intent for these statutes to apply extraterritorially.\(^{16}\) This extraterritorial extension can be relevant in the employment context. First, U.S. employers may be subject to criminal sanctions abroad. Second, they may be subject to whistleblower liability for retaliating against employees abroad who report or refuse to engage in conduct made illegal by the extraterritorial application of U.S. criminal laws to those foreign venues.\(^{17}\)

State courts interpreting their own state’s antidiscrimination laws have been inclined to apply the same presumption against extraterritoriality that the U.S. Supreme Court recognized in Arabian American Oil.\(^ {18}\) At least one state, however, has provided for the extraterritorial application of its Human Rights Law, but only to the conduct of domestic (New York) employers who venture out of state, not to foreign employers.\(^ {19}\) Therefore, when a New York employee claimed discrimination in Tokyo against his French employer, he was denied relief under New York’s Human Rights Law.\(^ {20}\) In a hybrid situation, a domestic New York employer argued that it was immune from the application of New York law when its employee was harassed in Canada by an individual who was not himself a New York employer. The court held, however, that it was foreseeable that the effects of such harassment would impact the employee’s job conditions even after her return to New York, making it harder to perform. Thus, the court refused to dismiss the employee’s claim on summary judgment.\(^ {21}\)


\(^{16}\)United States v. Vasquez-Velasco, 15 F.3d 833, 839 n.4 (9th Cir. 1994).

\(^{17}\)See discussion of Foreign Corrupt Practices Act, 15 U.S.C. §78dd et seq., in the Introduction to the U.S. chapter in this Supplement and particularly as it relates to wrongful discharge in I.D. of this chapter.

\(^{18}\)E.E.O.C. v. Arabian Am. Oil Co., 499 U.S. 244, 248, 113 L. Ed. 2d 274, 111 S. Ct. 1227 (1991); see, e.g., Hammell v. Banque Paribas, 780 F. Supp. 196, 200 (S.D.N.Y. 1991) (“it would be incongruous if Congress, which clearly has the power to legislate extraterritorially, was more restricted in drafting [Title VII] than the New York legislature”).

\(^{19}\)N.Y. EXEC. LAW §290 et seq.


B. Statutes Not Covered in Other Sections of This Chapter That Have Extraterritorial Effect

1. The Foreign Corrupt Practices Act and the OECD Antibribery Convention

U.S. companies and their employees are barred by the Foreign Corrupt Practices Act (FCPA),\(^22\) passed in 1977 and amended in 1988, from bribing foreign officials to obtain or keep business.

The FCPA makes it unlawful for a firm (as well as any officer, director, employee, or agent of a firm, or any stockholder acting on behalf of the firm) to offer, pay, promise to pay—or even to authorize the payment of money or anything of value or to authorize any such promise—to any foreign official for the purpose of obtaining or retaining business for or with, or directing business to, any person. A similar prohibition applies with respect to payments to a foreign political party or official thereof or candidate for foreign political office. It is also unlawful to make a payment to any person while knowing that all or a portion of the payment will be offered, given, or promised, directly or indirectly, to any foreign official or foreign political party, candidate, or official for the purposes of assisting the firm in obtaining or retaining business. “Knowing” includes the concepts of “conscious disregard” or “willful blindness.”\(^23\) The business to be obtained or retained is not limited to business with a foreign government or foreign government instrumentality.

A 1988 amendment to the FCPA\(^24\) provides an explicit exception to the bribery prohibition for facilitating payments for routine governmental action and provides for certain affirmative defenses (i.e., that the payment was lawful under the written laws of the foreign country or that the money was spent as part of demonstrating a product or performing a contractual obligation).

The provisions of the FCPA apply not only to certain issuers of registered securities and issuers required to file periodic reports with the SEC (issuers), but also to “domestic concerns,” defined as any individual who is a citizen, national, or resident of the United States, or any corporation, partnership, association, joint stock company, business trust, unincorporated organization, or sole proprietorship that has its principal place of business in the United States, or organized under the laws of a state in the United States, or the laws of a territory, possession, or commonwealth of the United States.

Criminal penalties are as follows:

- for a firm, a fine of up to $2 million;
- for officers, directors, stockholders, employees, and agents, a fine of up to $100,000 and imprisonment for up to five years. Fines imposed on individuals may not be paid by firms.

Civil penalties in the form of fines also are provided for, and persons or firms found in violation of the FCPA may be

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\(^{22}\) 15 U.S.C. §§78m, 78dd-1, 78dd-2, 78ff.
• barred from doing business with the U.S. government,
• ruled ineligible to receive export licenses,
• suspended or barred from the securities business, and/or
• suspended or barred from agency programs for the Overseas Private Investment Corporation and Commodity Futures Trading Commission.

In addition, a cause of action for treble damages can be brought against violators by private parties under the Racketeer Influenced and Corrupt Organizations (RICO) Act\(^\text{25}\) or other federal or state laws.

The Department of Justice is responsible for all criminal enforcement and for civil enforcement of the antibribery provisions with respect to domestic concerns. The SEC is responsible for civil enforcement of the antibribery provisions with respect to issuers. The 1988 Trade Act directed the U.S. Attorney General to provide guidance concerning the Department of Justice’s enforcement policy with respect to the FCPA to potential exporters and small businesses that are unable to obtain specialized counsel on issues related to the Act.\(^\text{26}\) This is done through the Department’s Foreign Corrupt Practices Opinion Procedure.\(^\text{27}\) The Office of General Counsel of the Department of Commerce also answers general questions by U.S. exporters concerning the FCPA’s basic requirements and constraints.

In the past, businesses in countries other than the United States have not been bound by legislation corresponding to the FCPA, and in some countries bribes have even been tax deductible. However, in December 1997, under the Organization for Economic Cooperation and Development (OECD),\(^\text{28}\) 34 countries signed the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.\(^\text{29}\) The Convention was the end result of U.S. efforts to “level the playing field,” by having its trading partners follow U.S. anticorruption standards. The Convention entered into force in February 1999.

The Convention requires signatories to

• make bribery of foreign officials outside the signatory country a criminal offense within the applicable country,
• eliminate tax deductibility of bribes, and
• require broader financial disclosure on the part of companies operating within the country concerned.

Payments to facilitate the performance of official duties will not be criminalized, however.

On July 31, 1998, the U.S. Senate ratified the Convention and approved a bill to implement it by amending the FCPA to bring the FCPA into conformity with the Convention. The House of Representatives also had a bill to amend the FCPA to implement the Convention under consideration,\(^\text{30}\) but ultimately

\(^{27}\)28 C.F.R. pt. 77.
\(^{28}\)See the chapter on the OECD in Part 4 of this Supplement for further information on that organization.
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passed the Senate version after amending it to contain the language of the bill as passed by the House. The final bill was signed into law by the President on November 10, 1998. The law requires the Secretary of Commerce to provide Congress with a report each year concerning international implementation of the Convention.

The changes to the FCPA that were needed to implement the Convention were as follows:

• although payments to foreign officials to obtain or keep business have been criminalized under the FCPA, implementing legislation adopts OECD language, banning payments made to gain “any improper advantage”;
• the FCPA previously covered only issuers with securities registered under the 1934 Securities Exchange Act and “domestic concerns,” while the implementing legislation expands coverage to include all foreign persons who commit an act in furtherance of a foreign bribe while in the United States;
• implementing legislation expands the definition of public officials to include officials of public international organizations;
• implementing legislation gives the United States jurisdiction over the acts of U.S. firms and nationals in furtherance of unlawful payments that occur outside the United States;
• the FCPA originally made U.S. nationals employed by or acting as agents of U.S. firms liable for both civil and criminal penalties, but made non-U.S. nationals liable only for civil penalties, while the implementing legislation subjects both groups to both civil and criminal penalties.

All of these changes were made in the bill that was signed in 1998.

In May 1997, the OECD issued a Recommendation calling upon member states to ban tax deductibility of bribes and take other measures to eliminate the practice of bribery. The Convention itself does not provide for elimination of the tax deductibility of bribes in countries where this is accepted practice. See II.A. in the chapter on the OECD in Part 4 of this Supplement for additional information.


2. The Alien Tort Claims Act

   a. The Unocal Case

   In *John Doe v. Unocal*, a federal district court allowed a suit by citizens of Myanmar (formerly known as Burma) for injunctive, declaratory, and compensatory relief to proceed against the oil company Unocal Corp. and its president and chairman/chief executive officer for crimes against humanity and a variety of other torts. The suit alleged that the company knew or should have known of its Burmese government partners’ human rights violations (such as forced labor, forced relocation, and rape) when the company agreed to invest in the pipeline project and that, despite this knowledge, it agreed that one of those partners would provide labor for the joint venture. The suit also alleged that Unocal and its officers were aware of and benefited from the use of forced labor that took place in the course of work on the Yadana gas pipeline in furtherance of a joint venture by entities of the government (former Burma) and Unocal. The plaintiffs alleged that numerous decisions in furtherance of the joint venture were taken in California, including decision making regarding labor relations on the project. Among the torts alleged by the plaintiffs were negligent hiring and negligent supervision.

   The Burmese government entities included in the suit were found entitled to sovereign immunity pursuant to the U.S. Foreign Sovereign Immunities Act. However, those entities were found not to be indispensable parties to the suit since the plaintiffs could obtain complete relief from the remaining defendants. The court held that it had subject matter jurisdiction under the Alien Tort Claims Act and 28 U.S.C. Section 1367. It also held that the plaintiffs’ claims survived Unocal’s motion to dismiss for failure to state a claim. The court did not reach jurisdictional issues concerning alleged violations of the Torture Victim Protection Act and the Racketeer Influenced and Corrupt Organizations Act. A summary judgment motion was filed by the defendant early in 2000.

   See also the discussion of U.S. government sanctions against Myanmar/Burma in the Introduction to the U.S. chapter update in this Supplement.

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36*Unocal*, 963 F. Supp. at 885.
3728 U.S.C. §§1603(d), 1605(2).
38*The district courts shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States.” 28 U.S.C §1350.
39*The provision concerning supplemental jurisdiction of district courts, in this case as regards various tort claims under California state law and a claim for violation of the California Business & Professions Code.
40Also codified at 28 U.S.C. §1350.
b. The Chevron Case

A suit filed against Chevron claiming violations of the Alien Tort Claims Act through alleged human rights abuses in Nigeria was allowed to go forward in April 2000 when a U.S. district court denied Chevron’s motion to dismiss for lack of jurisdiction, failure to state a claim, and on grounds of *forum non conveniens*, and refused to dismiss a concurrent state action. Additional motions to dismiss were denied in May. The suit claimed that Chevron was liable for human rights abuses allegedly committed against Nigerian citizens by Nigerian forces in Nigeria, because a Chevron subsidiary allegedly assisted the Nigerian government in quelling political unrest.

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43THE RECORDER (Apr. 10, 2000).
44THE RECORDER (May 17, 2000).
I. INDIVIDUAL EMPLOYMENT*

A. Individual Contract of Employment

[Reserved]

B. Statutory Regulation of Employment

[Reserved]

C. Substance of the Individual Contract of Employment

[Reserved]

D. Wrongful Discharge

Wrongful discharge has become an increasingly important source of employee protection. This protection generally resides in state law. Some states have wrongful discharge statutes, but the majority list wrongful discharge among their common law tort or contract-based claims. In addition, one branch of the doctrine creates a public policy exception to the employment-at-will rule.

The question of whether the state’s wrongful discharge protection travels along with employees working abroad may depend on the scope of the state’s underlying public policies. Few, if any, state statutes specifically refer to coverage abroad; it is left for the courts to resolve the geographic scope of these laws, along with the substantive issues. In fact, the two may be closely related.

At the outset, one can argue that the public policies of a state are not meant to protect the public of another sovereignty. For example, one the one hand, it is problematic to say that a state has, as its mandate, the protection of a foreign country’s general public. On the other hand, for a state to simply close its eyes to avertable disasters that its domestic businesses may cause abroad could be difficult to justify.

To date, few courts have faced these issues; thus, decisional law provides little or no guidance. The first high court ever asked to apply state law wrongful discharge principles to overseas conduct, however, found that they do apply. The New Jersey Supreme Court’s 1993 decision in D’Agostino v. Johnson & Johnson, Inc., discussed under 2., below, provides the first road map for courts and employers to look at and use.

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1. Breach of Contract

[Reserved]

2. Implied Covenant of Good Faith and Fair Dealing

As discussed in the U.S. chapter in Section I, another branch of the wrongful discharge doctrine involves claims sounding in contract, not tort, law. In *Crossen v. Foremost-McKesson, Inc.*, the plaintiff worked in Thailand for Foremost Dairies (Bangkok) Ltd. The plaintiff alleged an implied-in-law covenant of good faith and fair dealing in the employment contract and wrongful termination because he had sought to correct violations of Thailand, California, and U.S. law. The plaintiff stated that he observed and sought to correct the following violations of law: (1) making false statements to the Thai government on factory license applications; (2) violating certain sanitary laws controlling the manner of transporting milk and ice cream to various customers; (3) bribing Thai government officials and police to terminate criminal investigations and to obtain special treatment in the processing of certain government licenses; (4) misrepresenting the financial condition and projected income of ice cream parlors to prospective Thai franchisees; (5) violating Thai exchange control regulations; and (6) submitting falsified tax returns to the Thai government. He further asserted that, if he had continued in some or all of these activities, he would have been personally exposed to criminal penalties, including imprisonment, under the laws of Thailand. He argued that he was discharged for refusing to personally violate Thai law, and thereby subject himself to the risk of imprisonment, thus establishing a cause of action for breach of the implied-in-law covenant of good faith and fair dealing, which, if proven, would entitle him to relief in both contract and tort. The defendants asserted in their motion for summary judgment that, as a factual matter, plaintiff was discharged not because he refused to engage in violations of Thai law, but because of the disrespectful and disruptive letters plaintiff sent to various superiors.

The court treated the claims as if they had arisen in California and applied California law, apparently without objection. It rejected the wrongful discharge claim because it was duplicative and California’s public policy doctrine was, at the time, untested in the state courts. Given the questions of fact on the implied covenant of good faith and fair dealing, the court denied summary judgment.

3. Wrongful Termination in Violation of Public Policy

There is no precise definition of what constitutes public policy for purposes of the wrongful discharge doctrine. In general, it can be said that public policy “concerns what is right and just and what affects the citizens of the State collectively. It is to be found in the State's constitution and statutes and, when they are silent, in its judicial decisions.” Many wrongful discharge laws limit the type of public policy violations that can give rise to wrongful discharge claims. As one court noted, public policy cannot be found

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3537 F. Supp. 1076 (N.D. Cal. 1982).
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7. Id. at 521, 628 A.2d at 308.

8. N.J. STAT. ANN. §§34:19-1–34:19-8 (protecting employee from retaliatory discharge, including when employee refuses to participate in activity that violates law, regulation, or rule; is criminal or is against clear mandate of public policy concerning public health, safety, welfare, or environment).


Wrongful discharge laws usually recognize discharge claims founded on violations of clear policy mandates, such as those found in laws protecting public health, safety, welfare, or the environment.

As discussed in Section I of the chapter on U.S. law, employers typically incur this kind of wrongful discharge liability when they fire employees for refusing to perform an act that is a violation of a clear mandate of public policy, for exercising a protected right, or for blowing the whistle on conduct that violates such a mandate. Litigation often centers around the question of whether the type of public policy allegedly offended by the discharge is among those the state seeks to guard through its wrongful discharge law.

a. Discharge for Refusing to Perform an Illegal Act

Cases that have arisen under this theory are discussed individually below.

i. Cases upholding overseas application of the public policy doctrine for refusing to perform an illegal act

In D’Agostino v. Johnson & Johnson, Inc., a U.S. citizen and long-time resident of Switzerland was hired in Switzerland by Johnson & Johnson’s (J & J) wholly owned subsidiary there, Cilag. At no point did he reside in New Jersey. Plaintiff signed an employment contract in Switzerland providing that Swiss law would govern any disputes under the contract. J & J International, a New Jersey company, announced the hiring on its letterhead. J & J in New Jersey maintained a written policy against the use of corporate funds for unlawful purposes, including bribes, illegal political contributions, or payoffs.

After Swiss authorities had rejected the registration of a J & J drug, D’Agostino was asked to approve a payment for “consulting fees” to the head of the advisory committee that controls the registration of new drugs in Switzerland. When he refused to make the payment, he was allegedly told that “you have to pay, you have to go along. . . . [I]t has been going on for a long time. Be happy that it wasn’t more.”

After refusing to sign the voucher for payment again, the plaintiff was discharged. D’Agostino brought suit in New Jersey, asserting wrongful discharge claims under New Jersey’s tort law and Conscientious Employee Protection Act, and claiming that he was retaliatorily fired for refusing to violate a law, specifically the Foreign Corrupt Practices Act (FCPA), which sets forth a domestic policy against bribing a foreign regulatory official. The complaint also asserted claims of intentional causation of injury to
another, conspiracy, libel, and slander. Swiss authorities, meanwhile, cleared the company of any criminal wrongdoing.

The major issue before the court on summary judgment was whether the New Jersey court was the appropriate forum to hear a claim that essentially involved a foreign employment relationship and, if so, whether New Jersey’s wrongful discharge law should trump Switzerland’s employment-at-will rule. The court held that the determinative law is “that of the state with the greatest interest in governing the particular issue,” and that it is the “qualitative, not the quantitative, nature of a state’s contacts” that is important. The company argued that New Jersey has no cognizable interest in regulating Swiss employment relationships and that the employment relationship at issue was indisputably a Swiss employment relationship. The court held, however, that the operative issue was the tort liability of a domestic corporation for ordering and directing the discharge of a subsidiary’s employee for refusing to participate in corrupt practices. That issue was not encapsulated within a Swiss employment doctrine. This raised the question, however, of whether the FCPA constituted a state policy, which in turn hinged on whether the FCPA itself was intended to apply extraterritorially.

The court held that New Jersey’s interests in resolving the dispute under its laws outweighed the Swiss interest in the at-will employment relationship. The underlying controversy involved an alleged violation in New Jersey of the FCPA. The court found that federal law and policy can constitute New Jersey’s clear mandate of public policy, a holding consistent with decisions of state courts elsewhere, such as Illinois, Texas, and Minnesota. In particular, the court held that the FCPA expresses a policy that New Jersey seeks to advance. It found three courts that had addressed whether to adopt the FCPA policies as state policies. Washington and Maryland had opted to integrate FCPA into their wrongful discharge public policies; Illinois declined to do so.

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10D’Agostino, 133 N.J. at 523, 628 A.2d at 309.
11In Adler v. American Standard Corp., 538 F. Supp. 789, 797 (D. Md. 1982), aff’d and rev’d on appeal on other grounds, 830 F.2d 1303 (4th Cir. 1987), the plaintiff, who worked in the United States, claimed abusive discharge resulting from, among other things, his discovery of alleged bribes of Mexican officials in violation of the FCPA. The district court rejected the defendant’s arguments that federal law cannot be a source of Maryland public policy contravened by the wrongful discharge. Suggesting, however, that such a claim would not extend extraterritorially, the Court explained its reasoning as follows:

The civil law remedy in Maryland for an abusive discharge does not seek to enforce federal law nor to regulate activities thereunder; it does seek to foster and promote the policy of that law. This does not offend federal sovereignty, nor the Federal Constitution, no does it have extraterritorial effect. . . . If defendant’s arguments were to be adopted, this Court would accept the proposition that the State of Maryland, as a matter of public policy of its own, should not be concerned with serious violations of federal law resulting from acts of bribery. . . . This Court cannot agree that the State of Maryland should close its eyes and, as a matter of policy, not be concerned with violations of federal law.

In Thompson v. St. Regis Paper Co., 102 Wash.2d 219, 685 P.2d 1089, the plaintiff was a Washington resident working for a Washington company. He alleged, among other things, that he had been “fired for instituting an accurate accounting program in compliance with the” FCPA. The Washington Supreme Court found that the FCPA “is a clear expression of public policy that bribery of foreign officials is contrary to the public interest” and
The New Jersey court next evaluated whether the strong public interest against the bribing of foreign officials by domestic companies expressed in the FCPA was sufficiently beneficial to the New Jersey public to serve as a foundation for a state wrongful discharge claim. The court reasoned that violations of that federal policy have an impact on the health and welfare of New Jersey’s citizens. The record contained evidence that members of the review boards, who were allegedly bribed, were compiling documents to be used in the United States for the registration of the drug by the Food and Drug Administration. Thus, the effect of commercial bribery abroad was found to have a potential effect on New Jersey and the health and welfare of its citizens.

On the other side of the balance, the court considered the doctrine of “comity,” which might militate against the extraterritorial application of the FCPA in a wrongful discharge case. First, it held that New Jersey’s common law employment law would apply extraterritorially only when the underlying clear mandate of public policy is intended to have an extraterritorial effect. The court found that the FCPA expressly applied extraterritorially to U.S. citizens working for foreign subsidiaries of domestic companies. Thus, it held that the FCPA is intended to govern U.S. citizens abroad, and applying the policies of the FCPA to D’Agostino’s claim was an intended and permissible extraterritorial effect.

The court made clear, however, that it was “not exporting New Jersey employment law so much as applying New Jersey domestic policy, drawn from federal sources, to a domestic company.” That is, the question is not whether New Jersey’s wrongful discharge law “follows a New Jerseyan everywhere,” but whether a New Jersey policy has “an intended and permissible extraterritorial effect.” To illustrate the difference, it provided an instructive illustration of a “researcher forbidden by federal law to conduct fetal research in the United States who, as an employee of a foreign subsidiary of a New Jersey company, is ordered to do fetal research in Canada. The employee would not have a retaliatory-discharge claim.

Considering both the supremacy clause of the United States Constitution and the plenary authority of the federal government in matters of foreign affairs it is difficult to conceive of a United State[s] foreign policy which is not also the policy of this State and intended for the protection of its citizens. . . . If the Foreign Corrupt Practices Act and the Export Control Act do not represent policies adopted by the citizens of the fifty States, then whose policies are they?
based on the forum law because, unlike the FCPA, such a law would not seek to regulate conduct outside of the United States. A parent company in New Jersey that requires a Canadian employee of a subsidiary to do such research would not thereby violate a clear mandate of public policy. The issue is always the policymaker's intent to affect extraterritorial events."16

The court further noted that, under the FCPA, D'Agostino, as a U.S. citizen, faced a potential five-year imprisonment for bribing a foreign official.17 "[A]n employee should not be put to an election whether to risk criminal sanction or to jeopardize his continued employment."18

Finally, the court averred that this was an “unusual” and complex case that did not fit easily within any of the conventional rubrics for choice of law. Given the lack of guidance, it advised that forum courts should consider several factors relevant to the choice of the applicable rule of law, including: “the needs of the interstate and international systems”; “the relevant policies of the forum”; “the protection of justified expectations”; and “certainty, predictability and uniformity of result.”19 It found these factors supported liability in the case before it. In sum, it ruled that “as between Switzerland and this forum New Jersey has the greatest interest.”20 Citing the Restatement of Conflicts of Law, the court wrote that “we do not see how a domestic corporation could have any ‘justified expectations,’ that it was free to put at jeopardy overseas employees who refuse to participate in commercial bribery.”21

ii. Cases rejecting overseas application of the public policy doctrine for refusing to perform an illegal act

In Pratt v. Caterpillar Tractor Co.,22 the plaintiff was employed by a subsidiary of Caterpillar Tractor Company, Caterpillar Overseas, S.A., in Geneva, Switzerland. The plaintiff’s position involved him in the sale and distribution of Caterpillar products to the Soviet Union, Eastern Block, and Middle Eastern countries. During his employment he alleged that he was asked by his superiors to engage in conduct in violation of the Foreign Corrupt Practices Act23 and the Export Administration Act.24 He further alleged that he refused to sign statements denying any knowledge that any other person or officer of Caterpillar Tractor Company engaged in activities or was required to engage in activities that violated these statutes and, as a consequence of his refusal to sign these statements, he was returned to the United States in 1983 and subsequently discharged.

The plaintiff filed a complaint alleging retaliatory discharge and intentional infliction of emotional distress. Upon Caterpillar Tractor Company’s motion, the circuit court dismissed the complaint, concluding,

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16Id. at 540–41, 628 A.2d 318.
19D’Agostino, 133 N.J. at 544, 628 A.2d at 320.
20Id. at 545, 628 A.2d at 321.
21Id.
2315 U.S.C. §78dd et seq.
2450 U.S.C.App. §2401 et seq.
inter alia, that no state policy was alleged to support the claim of retaliatory discharge. On appeal, the court held that the Foreign Corrupt Practices Act and the Export Administration Act did not establish a public policy of the state of Illinois sufficient to create a basis for a state tort of retaliatory discharge in that the federal laws did not express a clearly mandated public policy of Illinois. The court reasoned that the plaintiff’s suit “reflect[ed] a private concern between himself and his former employer and [could not] be held to impact on the general welfare of Illinois citizens . . . . The common theme of our courts’ decisions sustaining a plaintiff’s cause of action for retaliatory discharge is there must be a State public policy at issue. We find no such public policy involved in the instant case and conclude that exclusively Federal concerns cannot support a State common law remedy as alleged in this case.\textsuperscript{25}

Dissenting from the denial of leave to appeal, however, Justice Simon stated:

\begin{quote}
Considering both the supremacy clause of the United States Constitution and the plenary authority of the federal government in matters of foreign affairs it is difficult to conceive of a United States foreign policy which is not also the policy of this State and intended for the protection of its citizens. . . . If the Foreign Corrupt Practices Act and the Export Control Act do not represent policies adopted by the citizens of the fifty States, then whose policies are they?\textsuperscript{26}
\end{quote}

As for the intentional infliction of emotional distress claim, the court treated it as if the claim had arisen in the state, but dismissed it. The court held that, under Illinois law, an employer's exercise of the right to dismiss at will cannot constitute the extreme and outrageous conduct required to maintain a cause of action for intentional infliction of emotional distress.

\paragraph*{b. Termination in Retaliation for Exercising a Vested or Statutory Right}

In \textit{Parsons v. United Technologies},\textsuperscript{27} the Connecticut Supreme Court considered a complaint by a helicopter maintenance instructor who alleged that he was discharged for refusing an assignment in Bahrain during Operation Desert Shield to teach maintenance of nonmilitary helicopters to the Bahrain Defense Force. The plaintiff alleged a violation of Connecticut public policy requiring Connecticut employers to provide employees with reasonably safe workplaces. The plaintiff alleged that the locale of the Gulf War was not a safe workplace. The lower court had found that this claim did not constitute a cause of action sufficient to allow the case to be tried. The Connecticut Supreme Court allowed the case to go forward, holding that such a statutory mandate gives the employee a valid cause of action if the employee is discharged for refusing to work under conditions that pose a substantial risk of death or serious physical harm and are not contemplated within the scope of the employee’s duties. In its decision, the Connecticut Supreme Court noted:

\begin{quote}
\textsuperscript{25}Pratt, 149 Ill. App. 3d at 591, 500 N.E.2d at 1003 102 Ill. Dec. at 902.
\textsuperscript{26}Pratt, 114 Ill. 2d at 556–57, 506 N.E.2d at 959, 107 Ill. Dec. at 68 (citations omitted).
\textsuperscript{27}243 Conn. 66, 700 A.2d 655, 13 IER Cases 462 (1997).
\end{quote}
We do not find support for the trial court’s conclusion that, even if the relevant statutes do establish a public policy requiring employers to provide a safe workplace, the policy only applies to a workplace that is: (1) located in Connecticut; and (2) controlled, maintained, or owned by the employer. Such a narrow conception of a safe workplace ignores both the underlying purposes of the statutes upon which the public policy of workplace safety is predicated as well as the modern day realities of our global economy and increasingly mobile society. . . 

[Am employer in the state who sends one of its employees in the state to an unsafe work site fails to comply with the mandate of that statute. Finally, we have held that “the remedial purpose of [the Connecticut] Workers’ Compensation Act supports application of its provisions in cases where an injured employee seeks an award of benefits and Connecticut is the place of injury, the place of employment contract, or the place of the employment relation.” [Emphasis in original. Citations omitted.]

. . . A Connecticut employer is not relieved of the obligation to provide a safe workplace to its employees because that employer decides to send an employee to a work site outside Connecticut over which the employer has no control. The only relevant inquiry is whether the employer directed the employee to work in a place or condition that poses an objectively substantial risk of death, disease or serious bodily injury to the employee.  

c. Discharge for “Whistleblowing”

The New Jersey Supreme Court heard a second overseas wrongful discharge scenario. The claims in D’Agostino v. Johnson & Johnson,” discussed previously in Section I.D.3.a.i., were brought prior to the effective date of the state’s Conscientious Employee Protection Act (CEPA).  However, the CEPA claim was central to the complaint in Mehlman v. Mobil Oil, Inc. Dr. Mehlman had been Mobil Oil’s chief of toxicology. After a meeting in Japan at which he criticized Mobil executives there for selling gasoline with dangerously high levels of benzene, he was terminated. He brought his CEPA claim in New Jersey, arguing that he was terminated for refusing to perform an act incompatible with a clear mandate of New Jersey public policy. Since Mehlman was a New Jersey employee terminated in that state, application of the CEPA was not in dispute. Consequently, the Act’s extraterritorial effect was not discussed. At trial, the jury awarded Mehlman almost $7 million. The company appealed, arguing that Mehlman had not proved the existence of a clear mandate of public policy that he reasonably believed Mobil had violated as required by CEPA.

After reviewing the various sources of policy, the court held that “[t]he core value embodied in CEPA is that employees courageous enough to object to illegal, fraudulent or harmful activity . . . be
shielded from retaliation by their employers.”\textsuperscript{32} As to the charge that New Jersey’s public policy does not extend to protecting the entire world from harm, the court stated, “[w]e would not impute to the Legislature so parochial an objective as to protect New Jersey employees retaliated against for taking risks to protect only New Jersey citizens.”\textsuperscript{33} In affirming the verdict, the court reasoned that, “[u]nder CEPA, the wrongful conduct is the employer’s retaliatory action, and we decline to impose artificial geographical limits on the harm or illegality that the objecting employee sought to avoid.”\textsuperscript{34}

\textsuperscript{32}Id. at 195, 707 A.2d at 1016.
\textsuperscript{33}Id. at 195–96, 707 A.2d at 1016.
\textsuperscript{34}Id. at 196, 707 A.2d at 1017.
II. COLLECTIVE BARGAINING*

A. Jurisdictional Considerations: Determining Which Nation’s Laws Apply

The international airline industry presents a graphic example of an industry in which changes in international operating practices are occurring with such great speed and magnitude that they may well necessitate significant modification of legal principles of individual countries regarding labor and employment law matters to enable the airlines and their employees to effectively function in a transnational arena. It is hardly surprising that such important issues should arise in the airline industry. International activities have long been an important component of the airline industry. More than any form of transportation before, aircraft have enabled people and businesses to leap across national and other boundaries, overcoming natural and artificial barriers to movement that result from distance, terrain, remoteness of location, and even infrastructure constraints. The ability of aircraft to transcend such limitations has been exponentially enhanced by technological breakthroughs, including electronic ticketing and satellite communications, which have further reduced reliance on centralized, single-nation-based airline systems and spurred a move to an era of “open skies.”

Examples of such recent developments in the airline industry are the following:

- Many U.S.-certificated air carriers have entered into relationships or alliances with foreign carriers through which the carriers (in many instances previously competitors) have coordinated significant aspects of their businesses, including pricing, scheduling, marketing, maintenance, and frequent flyer programs. In certain circumstances, carriers have even acquired ownership interests in one another.
- International flights, through code-sharing agreements, are marketed as the flights of several carriers of different nations (e.g., a flight between the United States and Germany may have both a United Airlines and a Lufthansa Airlines flight number and may be marketed as a flight of both carriers).
- Increasingly, flight operations by a particular air carrier are no longer confined to one nation or continent; the notion of “wholly foreign” or “wholly domestic” flights has largely disappeared.
- Many tasks that are performed largely by computer, such as reservation services, also are no longer confined to one nation or continent. The location of such work can easily be switched from one nation to another with the mere transmittal of information among computers.

As a result of these developments, neither carriers nor their employee representatives can realistically continue to function by taking into account only airline activities confined to a single nation. Quite

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clearly, actions taken in the “airline workplace” in one nation can substantially impact the conduct of work in other nations. Legal precepts built on an assumed single-nation workplace can no longer be squared with economic or business reality. At the same time, determination of what legal rules are applicable in a specific situation may well impact fundamental decisions such as where to locate employees and operations and the terms and conditions that will be applicable in the workplace.¹

Predictably, labor-management disputes will arise in the context of these transnational activities.

- For example, there may be disagreements over whether the employees of one nation or another should perform certain work and under what terms and conditions. Such issues may be particularly difficult and contentious if they arise in the context of an attempted relocation of work within a transnational enterprise from one nation to another, especially where the work is shifted from a higher-cost to a lower-cost work force or to a nation that mandates or permits fewer social and economic benefits to employees than the nation in which the work previously was located.
- In addition, strikes by employees of one employer may impact the employees of the same employer or of other parties to the transaction who are based in a different country.
- Just as airlines have joined forces across international boundaries to expand beyond their domestic systems, so too have labor organizations formed alliances in an effort to coordinate and protect their mutual interests and to defend against perceived threats posed by the joint activities of their employers. This too adds another layer of complexity to transnational airline operations.

The increasing blurring of geographical lines in the conduct of business and employment relationships makes even the determination of which nation’s laws apply particularly difficult. Moreover, the ground rules for determining applicable law may well differ from country to country. The following discussion will focus on the principles applied under U.S. laws in addressing these issues. However, it should be recognized that disposition of the legal issues presented by the expanded international activities of U.S. companies may not be solely dependent on determination of rights under U.S. law. As a threshold matter, foreign countries may impose rules that limit the ability of U.S. companies to

¹While the current discussion focuses principally upon the determination of applicable law as it pertains to U.S. employers and employees, many of the issues discussed are also of significance to foreign entities. See, e.g., Michael Skapinker, Aerospace Correspondent, Sabena may move pilots’ contracts to Switzerland, FIN. TIMES, Apr. 3, 1998, at 17 (consideration is given by Sabena Airlines, the national airlines of Belgium, to a shift of its pilots’ employment contract to Switzerland in an attempt to avoid higher social security charges and taxes in Belgium; similar concerns may be behind possible relocation by Virgin Express, a Brussels-based carrier, to the United Kingdom or Ireland). Indeed, in recognition of the difficulties that may be presented by the application of different national laws to transnational airline operations and relationships, the Association of European Airlines (which includes most of the major European carriers) has proposed the adoption of a “Transatlantic Common Aviation Area” with the objective of substituting for the bilateral relationships between nations a common regulatory framework within which European and U.S. carriers will operate. See, Towards a Transatlantic Common Aviation Area AEA Policy Statement, Sept. 1999 (Association of European Airlines).
operate within their borders. For example, in the airline industry, these may take the form of restrictions on the number of foreign carriers that are authorized to fly into or out of particular airports within the country.\(^2\) Restrictions may also be imposed that affect the ability of U.S. citizens to be employed or to remain employed within the foreign country.

Foreign countries in which employees of U.S. companies or of multinational enterprises are based also may interpose their own concepts of labor law that may affect those employees and may substantially differ from concepts under U.S. law. While international collective bargaining agreements among employers and unions in several nations could provide a means for establishing operative rules,\(^3\) there would still remain questions as to which country’s laws would apply in the event of disagreements, particularly since, at least under U.S. law, subject matter jurisdiction is not something that the parties, by agreement, can dictate. In the absence of solutions officially negotiated by the involved nations themselves, it may well be that employers and employees who are involved in transnational activities may find themselves subjected to different and possibly inconsistent requirements imposed by the different nations whose interests are implicated by the particular activities.

B. Standards for Determining Whether U.S. Law Applies to Extraterritorial Activities

A frequently applied starting point for determining which laws apply to the relations of U.S. employers and employees involved in activities outside the United States is the so-called “non-extraterritorial” presumption. This presumption recognizes that (1) while U.S. statutes can be enforced beyond the territorial boundaries of the United States, (2) they will not be presumed to apply outside the U.S. in the absence of some indication that Congress so intended. This presumption was articulated by the U.S. Supreme Court in *EEOC v. Arabian American Oil Co.*\(^4\)

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\(^2\) The U.S. government frequently has responded with restrictions of its own to actions by foreign governments to restrict the ability of U.S. employers and employees to operate in foreign countries. For example, consideration by the U.S. Department of Transportation of a proposed alliance of British Airways and American Airlines was linked to U.S. efforts to secure the agreement of the United Kingdom to an “open skies” arrangement that would permit broad access by U.S. carriers to London’s Heathrow Airport.

\(^3\) The feasibility of resolving these difficult international labor law issues through negotiated agreements among employers and unions in more than one country may appear somewhat remote. However, it may be pertinent to recall the experience provided by the formation of the RLA. The statute was actually drafted by labor and management, rather than by third parties (e.g., regulators or congressional staff and legislators). The statute thus contained a set of rules that the interested parties themselves judged would be appropriate to govern their relationship and provide a framework for resolution of future disputes. See *The Railway Labor Act*, *supra* note 1, at 43–46.

A different analytical approach is found in numerous decisions addressing the extraterritorial reach of U.S. legislation other than labor law, in which the courts have focused on (a) the “effects” of the extraterritorial conduct within the United States (the “effects test”) or on (b) the extent to which the conduct in question took place within the United States as well as extraterritorially (the “conduct test”).

Since these latter tests have begun to be applied in a labor law context, and their reasoning arguably has applicability in a labor context, this chapter will address these tests as well as the non-extraterritorial presumption.

1. Applying the Non-Extraterritorial Presumption in a Labor Law Setting

Long before the Supreme Court’s decision in Arabian American, courts applied the non-extraterritorial presumption to find that activities abroad of employees of U.S. companies are not governed by the National Labor Relations Act (NLRA), the Labor Management Relations Acts (LMRA), or the Eight Hour Law.

Courts have applied the same reasoning in cases involving the RLA. Shortly after the Arabian American decision, the Railway Labor Act was found inapplicable on the basis of the non-extraterritorial presumption, to a dispute between a U.S. air carrier and the union representing its flight attendants involved in flying outside the United States. The case, Independent Union of Flight Attendants v. Pan Am World Airways, Inc., is referred to hereafter as the Berlin Express case.

In Berlin Express, the collective bargaining agreement required Pan American World Airways (Pan Am) to use flight attendants on its flight attendants’ system seniority list for all present and future flying. This obligation also was binding on Pan Am Corp., the parent of Pan Am.

Despite these agreements and the long-established practice of using seniority list flight attendants on intra-European flights, Pan Am suddenly shifted flights within Europe to Pan Am Express, another
subsidiary of Pan Am Corp., using the name “Berlin Express,” and staffed them with foreign national flight attendants represented by a German union rather than with Pan Am seniority list flight attendants. The union for the Pan Am flight attendants (IUFA) challenged this action through a grievance, but Pan Am refused to arbitrate, claiming that the dispute raised issues beyond the jurisdiction of the arbitration board under the collective bargaining agreement. The union’s action to compel arbitration was dismissed for lack of subject matter jurisdiction on the ground that the RLA does not apply extraterritorially, and the Ninth Circuit affirmed, by a 2–1 vote. Because the majority and dissenting opinions extensively review the competing considerations in determining applicable jurisdiction, both opinions are reviewed in the following discussion.

The Ninth Circuit majority found no clear expression of congressional intent to apply the RLA or the Interstate Commerce Act (ICA) to “purely foreign flying.” Accordingly, the court majority concluded that “the presumption against extraterritoriality, in conjunction with Congress’ careful and thorough definitions of commerce, compels the conclusion that the RLA does not prescribe substantive law with respect to flights which are not within its definitions of commerce.” The majority considered this result required even though, as it recognized, RLA contracts are governed and enforceable by federal law and the RLA mandates precisely the arbitral resolution of contractual disputes that IUFA was seeking through its lawsuit.

The dissenting judge believed that the court should never have reached the extraterritoriality issue, as what was at issue was simply an action to compel arbitration over a “domestic agreement”—a “routine agreement between a union and a carrier”—which explicitly covered intra-European flying and thus provided a “domestic ‘hook’ on which to hang the controversy that neither party could unilaterally modify by virtue of the RLA.” As the dissent further explained, “it is not the RLA that must be stretched beyond our boundaries; it is the agreement that brings us there. . . . The RLA may have no operation in another country; that does not mean, however, that the agreements which the RLA purports to guarantee are limited in any way by territorial or national boundaries.

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10 923 F.2d at 683, 136 LRRM at 2221.
11 Id. at 683, 136 LRRM at 2221. The majority opinion noted that “virtually every court to consider the question has concluded that Congress did not intend the RLA to govern labor disputes in other countries,” id. at 682, but all the prior decisions involved employees based outside the United States, who worked exclusively outside the United States, and who, in virtually all instances, were “foreign nationals.” See Air Line Steward Ass’n v. Northwest Air Lines, Inc., 267 F.2d 170, 172–73, 44 LRRM 2189, 2190–91 (8th Cir.), cert. denied, 361 U.S. 901 (1959); Air Line Stewards Ass’n v. Trans World Airlines, 273 F.2d 69, 71, 45 LRRM 2282, 2282 (2d Cir.), cert. denied, 362 U.S. 988 (1960); Air Line Dispatchers Ass’n v. National Mediation Bd., 189 F.2d 685, 690, 28 LRRM 2048, 2051–52 (D.C. Cir.), cert. denied, 342 U.S. 849 (1951). See also Allen v. CSX Corp., 22 F.3d 1180, 146 LRRM 2566 (D.C. Cir. 1994) (Canadian employees who worked exclusively outside the United States not covered by RLA); cf. Van Blaricom v. Burlington N. R.R., 17 F.3d 1224, 145 LRRM 2696 (9th Cir. 1994) (labor protective benefits awarded by Interstate Commerce Commission inapplicable because applicant was a Canadian citizen who had worked solely in Canada and the ICA does not apply extraterritorially). The Berlin Express majority did not purport to treat any of the prior “extraterritorial” decisions as dispositive, as in none of the cases had courts been called upon to consider the enforceability of an existing contract. 923 F.2d at 682, 136 LRRM at 2219–20.
12 923 F.2d at 683–84, 136 LRRM at 2221.
13 Id. at 685, 136 LRRM at 2223 (Nelson, J., dissenting).
14 Id.
The dissent also found that an exercise of jurisdiction was warranted because this dispute would have a “substantial, direct, and foreseeable effect upon or in the territory” of the United States, by depriving U.S. citizens of employment opportunities. In the view of the dissent, “[t]he court has a responsibility to act in the face of an alleged breach that might cause serious injury, for ‘collective bargaining agreements are central to American labor law and are the essential threads of its fabric.”

2. The “Effects Test” and the “Conduct Test”

a. Non-Labor Law Cases

Precedents established in court decisions outside of the labor arena have avoided the consequences of a rigid application of the non-extraterritoriality presumption by finding U.S. laws applicable to activities occurring outside the United States through use of the “effects” and “conduct” tests.

Under the effects test, a U.S. law will be considered applicable to “foreign” conduct (i.e., to conduct occurring outside the United States) where that conduct has a “substantial, direct, and foreseeable effect upon or in the territory” of the United States. This standard has long been applied in determining whether U.S. laws regulating commercial activities are applicable in particular circumstances involving foreign conduct.

For example, in an antitrust context, courts have held that where anticompetitive activity occurring outside the United States has substantial and intended consequences within the United States, it may form the basis for a viable claim under the U.S. antitrust laws. The effects test has also been applied to extend the jurisdiction of U.S. courts to reach conduct occurring outside the United States under the Commodity Exchange Act, the Securities and Exchange Act, the Lanham Act, and RICO.

The conduct test focuses on whether conduct within the United States played a part in the accomplishment of illegal activities occurring outside the United States. For example, in Tamari v. Bache & Co., U.S. jurisdiction was found to extend to a dispute between foreign parties over a commodity futures contract entered into outside the United States that was subsequently traded on United States
commodity exchanges. The fact that all contacts between the parties to the contract took place outside the United States was held insufficient to negate the reach of U.S. law. The activity on the commodity exchanges, the court reasoned, while not itself illegal, furthered the illegal activity committed abroad.26

Steele v. Bulova Watch Co.27 presents another instance in which the Supreme Court determined to apply U.S. law because the illegal scheme included certain conduct within the United States (although the conduct test was not specifically mentioned in the decision). There, a U.S. citizen manufactured watches in Mexico and then applied the “Bulova” name to the watches without permission. The only United States nexus, besides the American citizenship of the parties, was the fact that certain parts used in manufacturing the watches came from the United States and certain individuals who purchased the watches in Mexico thereafter brought the watches with them when they returned to the United States. The Court held that this U.S. activity, even though perfectly lawful in and of itself, was sufficient to permit the extension of U.S. law because it formed part of the foreign trademark infringement scheme.28

In virtually all of the non-labor settings in which the courts have found U.S. law applicable through the effects or conduct tests, the courts found little or no evidence in the language and legislative history of the statutes of congressional intent to apply the statutes to conduct outside the United States.29 Thus, the linchpins for application of the non-extraterritoriality presumption—the language of the statute and surrounding congressional intent—have played no role in the determination of whether these non-labor U.S. laws are applicable in situations involving foreign conduct.

b. Labor Law Cases

In a number of cases arising in a labor law context, courts have also focused on the extent to which conduct at issue had an impact or occurred within the United States. These decisions have, in substance if not by name, applied the effects and conduct tests. One such example is found in a series of decisions

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26Id. at 1106–09.
28Id. at 287. See also Alfadda v. Fenn, 935 F.2d 475 (2d Cir.) (Securities and Exchange Act and RICO applicable to claim by foreign investor-purchasers of interests in a foreign corporation where the investors’ stake was fraudulently diluted by sales to others in the United States, even though the U.S. sales, in and of themselves, may not have been illegal), cert. denied, 502 U.S. 1005 (1991); Grunenthal GmbH v. Hotz, 712 F.2d 421 (9th Cir. 1983) (federal securities laws applicable to transaction in foreign securities between foreign corporations and citizens of foreign states where certain limited conduct in fraudulent scheme took place in the United States); SEC v. Kasser, 548 F.2d 109 (3d Cir.) (federal securities laws applicable in action based on alleged scheme to defraud foreign corporation, where certain conduct in furtherance of scheme took place in the United States, even though the scheme had no effect in the United States), cert. denied sub nom. Churchill Forest Indus. (Manitoba), Ltd. v. SEC, 431 U.S. 938 (1977).
29See Hartford Fire Ins. v. California, 509 U.S. 764, 814 (1993) (Scalia, J., dissenting in part) (noting the absence of legislative history evincing congressional intent to apply the antitrust laws to conduct outside the United States). See also Nieman v. Dryclean U.S.A. Franchise Co., 178 F.3d 1126 (11th Cir. 1999) (applying non-extraterritorial presumption to find that Franchise Rule of Federal Trade Commission Act inapplicable to foreign franchisee with regard to a foreign franchise deal with a U.S. company, noting the absence of evidence of congressional intent that Rule apply extraterritorially).
under the NLRA that addressed actions committed in Japan that were related to a labor dispute in the United States in connection with an international dispute in which the union was prohibited from taking action abroad.

In Dowd v. International Longshoremen’s Ass’n, the International Longshoremen’s Association (ILA) sought to require the exclusive use of union dockworkers to load goods intended for export on ships docked in Florida. The ILA requested its counterpart in Japan to pressure Japanese importers not to import goods from the United States that arrived on ships that had been loaded in the United States by nonunion labor. As a result of the actions of Japanese unions, Japanese importers restricted their imports to goods that had been boarded in the United States by union workers. The affected American exporters filed charges with the NLRB claiming that the ILA had engaged in unlawful secondary activity.

While the NLRB and the courts differed on the merits of the underlying issues in this dispute involving conduct in Japan, all tribunals that addressed the issue concluded that NLRA jurisdiction properly extended to the action in question because the conduct, notwithstanding its foreign locale, was intended to and in fact had substantial effects within the United States and pertained to other conduct within the United States—namely, the ongoing labor dispute between the U.S. unions and employers that lay at the center of the controversy.

U.S. labor law has also been held applicable to a secondary boycott by U.S. labor unions motivated by actions taken by foreign governments where the activity in question occurred in the United States and was directed against U.S. companies.

In the RLA context, certain courts have also focused on the interrelationship between conduct occurring outside the United States with conduct or effects occurring within or at least touching the United States—rather than on the non-extraterritorial presumption—to determine whether U.S. labor law is applicable.

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30 975 F.2d 779, 789–91, 141 LRRM 2489, 2496–98 (11th Cir. 1992) (on NLRB application for injunction), International Longshoremen’s Ass’n, 313 NLRB 412, 416–18, 144 LRRM 1273, 1277–79 (1993) (decision on merits), enforcement denied on other grounds, 56 F.3d 205, 149 LRRM 2449 (D.C. Cir. 1995) (not addressing jurisdictional issue), cert. denied sub nom. Canaveral Port Auth. v. International Longshoremen’s Ass’n, 116 S. Ct. 1040, 151 LRRM 2672 (1995). On remand from the D.C. Circuit, the NLRB dismissed the case. International Longshoremen’s Ass’n, 323 NLRB 1029, 155 LRRM 1161 (1997). While the NLRB majority did not address the jurisdictional issue, Chairman Gould, in his dissent, agreed with the Board’s 1993 determination that the foreign conduct in question properly fell within the NLRB’s jurisdiction. Id. at 1166–68 (Gould, dissenting).

31 E.g., International Longshoremen’s Ass’n v. Allied Inl’l, Inc., 456 U.S. 212, 104 LRRM 2001 (1982) (NLRA extends to a refusal by U.S. union to unload ships within the United States that were engaged in trade with the Soviet Union, which action was taken in protest of the Soviet invasion of Afghanistan); International Longshoremen’s Ass’n v. NLRB, 723 F.2d 963, 965, 115 LRRM 2093, 2094–95 (D.C. Cir. 1983). For a further discussion of international jurisdictional issues as addressed in cases arising under the NLRA, see the discussion in ABA SECTION OF LABOR & EMPLOYMENT LAW, II THE DEVELOPING LABOR LAW ch. 28, at II.B. (Patrick Hardin et al., ed. 1992 & Supp. 1996).
One example is *Local 553, Transport Workers Union v. Eastern Air Lines.* Eastern Airlines (Eastern) purchased the South American routes of Braniff Airlines (Braniff). Eastern’s collective bargaining agreement required that all Eastern flying be assigned to flight attendants on the Eastern seniority list. However, Eastern claimed that it would lose its right to operate in various South American countries unless it used the “foreign nationals” whom Braniff had employed on such routes, and it therefore refused to assign the flying to the Eastern flight attendants. Eastern further claimed that the RLA did not apply outside the United States and thus was inapplicable to the dispute.

The district court in *Local 553, Transport Workers Union*, held that the RLA was applicable because, unlike prior extraterritorial cases, the flying did not involve foreign-based employees, and was primarily “between foreign points and points within the United States.” In language seemingly conflicting with the previously noted view of the majority in the *Berlin Express* case, the court concluded that injunctive relief was appropriate even if the RLA did not apply, because “parties to an agreement made pursuant to the RLA may, by agreement, place conditions on the company’s hiring of employees that may not be required by the RLA itself.”

Similar issues were presented and yielded similar results in litigation in the United Kingdom. In the case of *Gately v. United*, United Air Lines (United) had entered into an agreement to purchase Pan Am’s London routes. As part of the transaction, United agreed to hire a “reasonable number” of Pan Am pilots and flight attendants, subject to terms agreed upon by United’s pilot and flight attendant unions, ALPA and the Association of Flight Attendants (AFA), respectively.

United offered employment to some but not all of the individuals who had been employed as flight attendants at Pan Am’s London domicile. United informed those to whom it extended employment offers that they could be credited for seniority purposes at United for their service at Pan Am only if the union that represented the United flight attendants, AFA, concurred.

Both those who were hired and those who were not sued United in London, claiming that under the British Transfer of Undertakings Act, United was obligated to hire all the former Pan Am flight attendants based in London and to grant them terms and conditions, including seniority, no less favorable than those they had enjoyed at Pan Am.

United and AFA contended (a) that the RLA rather than British law was applicable because the bulk of the flying was not purely foreign but instead flying between the United Kingdom and the United

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32544 F. Supp. 1315, 111 LRRM 2402 (E.D.N.Y.), aff’d as modified, 695 F.2d 668, 112 LRRM 2482 (2d Cir. 1982).

33See the discussion of the “foreign compulsion” defense at II.B.3., below.

34*Id.* at 1322 n.1, 111 LRRM at 2408 n.1.

35*Id.* at 1326, 111 LRRM at 2411–12.

36*Gately v. United*, CH 1991 G No. 2740 (High Court of Justice, Chancery Div.). A discussion of this unreported decision is included here because the principal issue in the case was whether U.S. labor law or British labor law should govern the dispute. Interestingly, as discussed in the text, the British court decided the case on the basis of its assessment of what U.S. law required (in that case, the RLA), after having first determined that there were overriding reasons why U.S. law rather than British law should govern.

37See the discussion of this Act in the chapter on the United Kingdom in the Main Edition, at IV.B., 7–45 through 7–48.
States, and (b) that United would violate the RLA if it unilaterally changed terms and conditions of employment mandated by the United-AFA collective bargaining agreement.

The British Court denied the plaintiffs’ request for the equivalent of a preliminary injunction, concluding that the plaintiffs had not demonstrated that they were likely to establish that the British statute applied and that the balance of hardships tipped in defendants’ favor. The latter conclusion was based upon the British Court’s assessment that United was likely to be enjoined in the United States if, in response to the British Court’s issuance of an injunction, United were to provide the terms and conditions sought by plaintiffs. The Court considered this result compelled by Local 553, Transport Workers Union, the only case the Court considered to be directly on point.

As is often the case in litigation in the United States involving labor law issues in which a party seeks injunctive relief at the outset of the case, the British lawsuit was discontinued shortly after the Court denied the injunction.38

Another employment context in which the focus has been on conduct within the United States rather than on the non-extraterritorial presumption is found in the Employee Polygraph Protection Act (EPPA).39 This statute forbids the use by employers of polygraph examinations. The statute does not, by its terms, explicitly apply extraterritorially. Nevertheless, the regulations that the Department of Labor has promulgated for the administration of the statute provide that the Act extends “to any actions relating to the administration of lie detector . . . tests which occur within the territorial jurisdiction of the United States. . . .”40 According to the regulations, this would include, for example, a situation in which a foreign corporation prepares paperwork in a Miami office related to a polygraph test, even if that test is administered in a foreign rather than a U.S. location.41

38These labor decisions illustrate that labor and management, when confronted with international labor issues, may well urge inconsistent positions from controversy to controversy depending on their assessments of how they will be affected by particular legal results. For example, in Independent Union of Flight Attendants v. Pan Am, [[[para]]](see B.1., above), the union for the Pan Am flight attendants argued that its collective bargaining agreement was enforceable and the RLA was applicable with regard to flight attendants based in Europe, notwithstanding the non-extraterritorial presumption. In contrast, in Gately v. United Airlines, the same union argued that the non-extraterritorial presumption precluded applicability of United’s collective bargaining agreement and of the RLA to flight attendants based in London. Similarly, United Airlines, in Gately, argued that the RLA and its collective bargaining agreement applied to London-based flight attendants, while in Association of Flight Attendants v. United Airlines, 797 F. Supp. 1115, 140 LRRM 2894 (E.D.N.Y.), rev’d, 976 F.2d 102, 141 LRRM 2353 (2d Cir. 1992) (discussed below), United argued that requirements of French law relieved it from compliance with certain requirements of the collective bargaining agreement in dealing with its flight attendants based in France, even though it also acknowledged that the RLA was applicable to the foreign-based employees.

4029 C.F.R. §801.3(b).
41Id.
3. The Foreign Compulsion and Act of State Doctrines

a. The Local 553, Transport Workers Union Case

The previously discussed decision in Local 553, Transport Workers Union,\(^{42}\) also addressed consideration of what is commonly referred to as the “foreign compulsion defense”—a claim that a defendant’s allegedly unlawful conduct is “involuntary” in the sense that it is “compelled” by the foreign law of the country in which the defendant is operating.

In deciding whether to permit a “foreign compulsion” defense, a court is to balance the following factors:

- (a) vital national interests of each of the states,
- (b) the extent and 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 either state can reasonably be expected to achieve compliance with the rule prescribed by that state.\(^{43}\)

The court in Local 553, Transport Workers Union, did not specifically review these factors, but nevertheless rejected the “foreign compulsion” defense advanced by Eastern Airlines for its refusal to assign the flying to Eastern flight attendants, because “[e]ven assuming that . . . the laws and political reactions of these [South American] countries to any change in the employment status of the [foreign] Braniff flight attendants” were as Eastern contended, Eastern was bound to follow the terms of the Transport Workers Union collective bargaining agreement, for it was Eastern, not the Union, that “voluntarily decided to take over” the foreign routes.\(^{44}\) In the court’s view, “a carrier should not be able to avoid its RLA obligations based upon foreign law where it has voluntarily put itself in a situation where it knew those laws would be applicable.”\(^{45}\)

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\(^{42}\)Local 553, Transport Workers Union v. Eastern Airlines, 544 F. Supp. 1315, 111 LRRM 2402 (E.D.N.Y.), aff’d as modified, 695 F.2d 668, 112 LRRM 2482 (2d Cir. 1982).

\(^{43}\)Air Line Pilots Ass’n v. TACA Int’l Airlines, S.A., 748 F.2d at 971–72, 118 LRRM at 2132–33 (quoting RESTATEMENT (SECOND), THE FOREIGN RELATIONS LAW OF THE UNITED STATES §40). See RESTATEMENT (THIRD), THE FOREIGN RELATIONS LAW OF THE UNITED STATES §§403, 441.

\(^{44}\)544 F. Supp. at 1335, 111 LRRM at 2419.

\(^{45}\)Id. at 1336, 111 LRRM at 2419. The decision of the Second Circuit in Local 553, Transport Workers Union, did not specifically address either the extraterritorial or foreign compulsion issues. See Steele v. Bulova Watch, 344 U.S. 280, 288 (1952) (defendant that, by its own acts, brought about forbidden results, cannot avoid liability for Lanham Act violation based on foreign government’s registration of trademark); cf. W.R. Grace & Co. v. Local Union 759, Int’l Union of Rubber Workers, 461 U.S. 757, 767–70, 113 LRRM 2641, 2645–47 (1983) (company cannot excuse compliance with collective bargaining agreement by entering into conflicting conciliation agreement with EEOC; dilemma was of company’s own making).
b. The ALPA v. TACA Case

A more explicit discussion of the foreign compulsion defense, as well as of a doctrine known as the “act of state,” is found in *Air Line Pilots Ass’n v. TACA International Airlines, S.A.* TACA was the national airline of El Salvador. While a majority of its pilots were Salvadoran nationals, they were all based in New Orleans and represented by the Air Line Pilots Association (ALPA), a U.S. union.

In the midst of negotiations between TACA and ALPA for a new collective bargaining agreement, the constitution of El Salvador was amended to require all public service companies to have their work center and base of operations in El Salvador, which prompted the Salvadoran government to order TACA to relocate its pilot base to El Salvador. TACA announced that it would immediately comply, and would abrogate the TACA-ALPA collective bargaining agreement and withdraw recognition from ALPA. ALPA challenged TACA’s announced course of action in court as a unilateral change prohibited by the RLA. In response, TACA claimed that, as a Salvadoran company, it had to comply with the constitutional directive and that, if it did not, it faced the loss of its operating certificate; that its actions were authorized by an Air Transportation Agreement between the United States and El Salvador; and that under the act of state doctrine, the United States courts should defer to the requirements of Salvadoran law and not grant injunctive relief. TACA’s position was supported by the government of El Salvador, which appeared as an amicus in proceedings before the Court of Appeals for the Fifth Circuit.

Under the act of state doctrine, U.S. courts will not question the validity or motivations of actions of foreign governments within their own borders, the purpose being to avoid conflicts between governments and judicial interference with the role of the U.S. executive branch in international affairs. Among the factors to be considered in determining whether the doctrine applies are:

- the degree of involvement of the foreign state;
- the effect a judicial decision would have on foreign relations; and
- whether the decision will involve the adjudication of the laws, conduct, or motivation of a foreign government.

A critical factor is the location of the interest (or *res*) to which the attempted action in question would apply; where “the *res* is outside the control or territory of the foreign state, the doctrine need not apply.”

The court rejected TACA’s reliance on the Air Transportation Agreement, holding that it was not intended to replace relevant domestic labor law. Next, the court held that the act of state doctrine was

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46 748 F.2d 965, 118 LRRM 2128.
47 A similar effort by TACA to leave the United States in 1969 had been enjoined. Ruby v. TACA Int’l Airlines, S.A., 439 F.2d 1359, 77 LRRM 2089 (5th Cir. 1969). In that instance, the alleged Salvadoran government directive to TACA was less clear than the constitutional amendment in 1983.
49 Air Line Pilots Ass’n v. TACA Int’l Airlines, S.A., 748 F.2d 965, 970, 118 LRRM 2128, 2131 (5th Cir. 1984).
50 Id.
inapplicable because: (1) the court was not adjudicating the validity of Salvador’s Constitution, but rather the legality of TACA’s response to the Salvadoran governmental directive, which, “[i]nsofar as the relationship between TACA and ALPA . . . must be made in a manner consistent with controlling provisions of United States law, specifically and primarily the Railway Labor Act”;51 (2) the TACA-ALPA dispute did not involve sensitive areas of international relations; and (3) “the res or interest in this case, whether we deem it the pilot base or the collective bargaining agreement, is clearly located in the United States.”52 Thus, the court concluded:

[W]e cannot give effect to El Salvador’s directive to TACA to extinguish ex parte the collective bargaining agreement and relocate the pilot base. Those acts directly affect interests located within the United States and contravene fundamental principles of American labor policy.53

One such “fundamental principle” was that “collective bargaining agreements are a cornerstone of our national labor policy.”54 Like the court in Local 553, Transport Workers Union, the court placed heavy emphasis on the fact that TACA had voluntarily chosen to conduct business in the United States. By doing so, the court reasoned, TACA became “subject to all relevant domestic [U.S.] laws.”55

Similar considerations led the court to reject TACA’s attempt to justify its actions on “foreign compulsion” grounds.56 The court held that TACA could relocate its base only by following the procedures of the RLA.57

51Id. at 971, 118 LRRM at 2132.
52Id.
53Id.
54Id. at 972, 118 LRRM at 2133. Cf. W.R. Grace & Co., 461 U.S. at 771, 113 LRRM at 2647 (permitting company to alter collective bargaining agreement through conciliation agreement with EEOC without union consent “would undermine the federal labor policy that parties to a collective bargaining agreement must have a reasonable assurance that their contract will be honored”).
55Id.
56Id. at 971–72, 118 LRRM at 2132–33.
57See id. As previously noted, Congress in 1991 amended Title VII of the Civil Rights Act to provide for extraterritorial application of the statute. The amendment specifically incorporates a foreign compulsion defense, applicable where statutory compliance with respect to an employee in a foreign workplace would “cause” the employer to “violate the law of the foreign country in which such workplace is located.” Section 702(b), 42 U.S.C. 2000e-1(b)(1991). The EEOC’s guidelines on the new amendments confirm that the burden is on the employer to demonstrate all elements of the defense, including, inter alia, a showing that there is an “inevitable” conflict between statutory compliance and foreign law. (The guidelines further emphasize that foreign court decisions do not constitute “foreign law” for purposes of the foreign compulsion defense.) EEOC Enforcement of Application of Title VII and the Americans with Disabilities Act to Conduct Overseas and to Foreign Employers Discriminating in the United States., EEOC Notice 915.002 (Oct. 20, 1993), 8 FEP Manual (BNA) 405:6663, at 405:6668–69 and n.10 (1993). See also VI.B.2., below.
c. The Flight Attendants v. United Airlines Case

An attempted use of the foreign compulsion defense was also rejected in Association of Flight Attendants v. United Airlines.\(^58\) That case arose after United had announced the opening of a flight attendant domicile in Paris, France. The applicable U.S. collective bargaining agreement required that vacancies in new domiciles be filled through a bidding process by seniority, and precluded the use of new hires unless there were insufficient bids from incumbent flight attendants.

Flight attendants who were not citizens of the European Economic Community purportedly needed visas to be able to work at the Paris base. Although the domicile was slated to open with 225 flight attendants, United made arrangements with the French government for only 75 visas. Many more incumbents bid for the vacancies than there were openings, but United permitted only the 75 most senior non-EEC citizens to transfer, on the grounds that these were the only ones for whom visas were available. United filled the remainder of the positions either with incumbents who held EEC citizenship (almost all of whom would not have been awarded the positions had seniority prevailed), or with new hires who were EEC citizens. United claimed that incumbents without visas were “not qualified” for the Paris positions. The flight attendants’ union claimed that the insufficiency of visas could not excuse United’s filling of vacancies in out-of-seniority order and that the collective bargaining agreement obligated United to arrange for the necessary number of visas.\(^59\)

As part of its legal defense, United asserted the equivalent of a foreign compulsion defense, arguing that any noncompliance with the collective bargaining agreement could be excused under the agreement’s “savings clause” because United’s actions were required by French immigration law. The district court rejected the company’s position, finding no factual basis for the contention that United’s actions were required by French immigration law.\(^60\) Additionally, the court considered United’s argument to be flawed as a matter of law because any alleged conflict had resulted from United’s own chosen course of action: “[l]ike the common law of coming to a nuisance, this rule prevents the instigator of trouble from calling itself the victim.”\(^61\)

\(^{58}\) 797 F. Supp. 1115, 140 LRRM 2894 (E.D.N.Y.), rev’d on other grounds, 976 F.2d 102, 141 LRRM 2353 (2d Cir. 1992), unreported decision following trial, CV-92–2919 (E.D.N.Y. Nov. 19, 1993).

\(^{59}\) The district court initially granted a preliminary injunction and barred United from opening the Paris domicile until visas could be obtained for senior incumbents desiring to fill the openings. 797 F. Supp. 1115, 140 LRRM 2894 (E.D.N.Y. 1992). The appellate court reversed, not on the merits, but because it concluded that United’s contractual position was “arguably justified” by the collective bargaining agreement and therefore presented a “minor dispute” under the RLA within the exclusive jurisdiction of the arbitration board. 976 F.2d 102, 141 LRRM 2353 (2d Cir. 1992). On remand, following trial, the district court found that the case presented a minor dispute to be determined on the merits by the system board. CV-92–2919 (E.D.N.Y. Nov. 19, 1993) (unreported).

\(^{60}\) 797 F. Supp. at 1123, 140 LRRM at 2900.

\(^{61}\) Id. at 1123–24, 140 LRRM at 2900. It is doubtful that United’s “foreign compulsion” argument would have satisfied the standards required to establish a foreign compulsion defense under the amended Civil Rights Act (see notes accompanying discussion of Local 533, Transport Workers Union and TACA, above), had those standards been applicable.
4. Application of U.S. Labor Laws to Foreign Employers in the United States

U.S. labor law has been held applicable to the activities of foreign employers within the United States. For example, in *State Bank of India v. NLRB*,[62] the Second Circuit held that because the employees of a New York branch of the State Bank of India “live and work in the United States and are subject to the obligations and responsibilities of American citizens, they are at the same time entitled to the protections and benefits our nation provides through its laws.”[63] The court relied on the fact that the State Bank planned to expand its business in the United States and that its employees were either American citizens or American residents awaiting naturalization.[64]

Similarly, the RLA has been held applicable to the U.S. activities of foreign air carriers.[65]

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[63] *Id.* at 533, 124 LRRM at 2007.


[65] *E.g.*, Air Line Pilots Ass’n v. TACA Int’l Airlines, 748 F.2d 965, 118 LRRM 2128 (5th Cir. 1984), *cert. denied*, 417 U.S. 1100 (1985); Ruby v. TACA Int’l Airlines, 439 F.2d 1359, 77 LRRM 2089 (5th Cir. 1971); Aerovias de Mexico, 20 NMB 584 (1993); Egypt Air, 19 NMB 166 (1992).
Extraterritorial Application of U.S. Law [New Chapter]

III. REPRESENTATION BY ENTITIES OTHER THAN UNIONS
[Reserved]

IV. REDUNDANCY AND TRANSFERS OF UNDERTAKINGS
[Reserved]
V. WAGES, HOURS, AND LEAVE

A. Wages and Hours

1. The Fair Labor Standards Act

See the discussion of the FLSA and the Foreign Sovereign Immunities Act under VI.A.4.d. in this chapter.

2. Other Wage and Hour Statutes

Illinois’s wage and hour law was held inapplicable to employment in Spain. In dismissing the statutory claim, the Seventh Circuit held that the law “applies to all employers and employees in this State.” The plaintiff was not at the time a resident of Illinois, nor did he perform any work in Illinois; he performed work for the defendants in Spain. “Although the employer defendants have their principal places of business in Illinois, and are therefore ‘employers . . . in this State,’” the court held that the statute did not have an extraterritorial reach. Its evident purpose, it found, “is to protect employees in Illinois from being stiffed by their employers.” It found it “inconceivable that the framers of the statute meant to extend its protection to employees abroad, who would usually not even be U.S. citizens, let alone residents of Illinois.” Further, the Seventh Circuit found it “highly unlikely” that the law would protect a resident of another state who is working in a foreign country, “especially since a state’s attempt to regulate a transaction wholly in foreign commerce would violate the ‘negative’ commerce clause. ‘A state cannot regulate sales that take place wholly outside it.’”

B. Leave

[Reserved]
VI. ANTIDISCRIMINATION

As graphically illustrated by Chrysler Corporation’s merger into a new German corporation called DaimlerChrysler Aktiengesellschaft—followed weeks later by the even larger merger of Amoco into British Petroleum (the biggest industrial mergers up to that time)—today’s transnational mergers are increasing the number of domestic employees who work for foreign entities, either in their own countries or abroad. Such arrangements raise issues about when domestic law applies. A number of legal principles in this regard have been set out under U.S. law in the area of antidiscrimination statutes, as discussed below.

A. Application of U.S. Civil Rights Laws to Foreign Employers in the United States

1. Title VII

In mergers such as Chrysler’s into DaimlerChrysler, A.G., it is inevitable that at some point German expatriates will be placed in executive or managerial positions on U.S. soil that Americans now fill. To protect their rights, the displaced U.S. employees may well turn to Title VII of the Civil Rights Act of 1964, as amended (Title VII). Whether Title VII would offer relief for such claims, however, is questionable. Title VII prohibits employers from discriminating because of a person’s race, color, religion, sex, or national origin. National origin means the country in which a person was born or from which his or her ancestors came.

Although an employer discriminates intentionally (engages in disparate treatment) when it favors employees because of their national origin, it may have a bona fide occupational qualification defense or BFOQ. The Equal Employment Opportunity Commission’s (EEOC) Guidelines state that the BFOQ for national origin discrimination “shall be strictly construed,” and most courts follow a restrictive construction. To have its preference upheld as a BFOQ, an employer generally must show it to be a “business necessity, not a business convenience.”

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1Labor Holds Key to Fate of a Daimler-Chrysler Merger, WALL ST. J., May 7, 1998, at B18.
242 U.S.C. §2000e et seq. See also the antidiscrimination section of the U.S. chapter in Part 2 of the Main Edition for a more detailed discussion of Title VII and other U.S. civil rights laws and agencies.
442 U.S.C. §2000e-2(e) (“[i]t shall not be an unlawful practice for an employer to hire . . . on the basis of . . . national origin in those certain instances where . . . national origin is a bona fide occupational qualification reasonably necessary to the normal operation of that particular business or enterprise”).
7Id. (quoting Diaz v. Pan American World Airways, Inc., 408 F.2d 228 (5th Cir. 1971)).
Under Title VII, an employer may not adopt practices that appear neutral on their face but have the effect of creating significant statistical disparities between members of a protected group and those of nonprotected groups. Neutral policies or practices that have such a disparate impact on protected groups can be legal if the employer can show that the policy or practice is “consistent with business necessity.”

a. The FCN Treaty Defense

Foreign employers charged with national origin discrimination have raised another defense: that they are wholly or partially immune from Title VII liability based on one of the 20 or so post–World War II friendship, commerce, and navigation (FCN) treaties between the United States and its foreign trading partners.9

i. FCN treaties

After World War II, the United States entered into reciprocal treaties with Japan and other countries under which the foreign investor has the right to control and manage enterprises in the host country. A key provision of these treaties is the right of foreign companies to engage managerial, professional, and other specialized personnel “of their choice” in the host country. Thus, for example, the much-litigated Article VIII(1) of the U.S.-Japan FCN Treaty10 provides that


nationals and companies of either Party [Japan or the United States] shall be permitted to engage, within the territories of the other Party, accountants and other technical experts, executive personnel, attorneys, agents and other specialists of their choice.

**ii. Purpose of the “of their choice” provision**

After World War II, the laws of some countries restricted the employment of noncitizens (e.g., American investors) by limiting their numbers to certain “percentiles.” As several federal circuit courts have noted, Article VIII(1)’s “of their choice” (or “employer choice”) language was intended primarily to exempt foreign companies from local legislation restricting the employment of noncitizens, and more generally, to facilitate a company’s employment of its own nationals to the extent necessary to ensure its operational success in the host country. It should be noted that the U.S.-Korea FCN Treaty contains an employer-choice clause identical to the U.S.-Japan Treaty Article VIII(1), as does the U.S.-West Germany FCN Treaty, which could govern claims raised by U.S. employees of companies such as DaimlerChrysler.

*b. Reconciling the Clash Between Title VII and FCN Treaties*

There is no legislative discussion, or even recognition, of the apparent conflict between Title VII’s ban on discrimination and the FCN treaties’ apparent conferral of a license to foreign companies to discriminate in favor of their own nationals. Courts have had to resolve the conflict based on their interpretations of these treaties in conjunction with Title VII. Possible resolutions are noted below.

**i. Possible approaches: Immunity for hiring executives based on their citizenship (majority view)**

This approach attempts to eliminate the conflict between FCN treaties and Title VII by viewing preferences through the lens of citizenship, given that (1) FCN treaties protect the right of foreign

11Avigliano v. Sumitomo Shoji Am., Inc. 638 F.2d 552, 554 (2d Cir. 1981), vacated on other grounds, 457 U.S. 176 (1982); see also MacNamara v. Korean Airlines, 863 F.2d 1135, 1144 (3d Cir. 1988) (“the target of Article VIII(1) was domestic legislation that discriminated on the basis of citizenship”).

companies to utilize their own “nationals” (i.e., citizens), and (2) Title VII does not protect against
The Third, Fifth, Sixth, and Seventh Circuits espouse this view.

- \textit{Third Circuit}. Employers who favor their own nationals, who are executives or other
  enumerated essential personnel, based on their citizenship, are not subject to intentional
- \textit{Fifth Circuit}. Preference for employees who speak the home country’s language is
  considered citizenship-based, not national-origin-based, discrimination, and foreign
  businesses operating in the United States have the right to discriminate in favor of citizens
  of their home countries because of their citizenship.\footnote{Bennett v. Total Minatome Corp., 138 F.3d 1053, 1059 (5th Cir. 1998); Papaila v. Uniden Am. Corp., 51 F.3d 54, 55, 67 FEP Cases 993 (5th Cir. 1995).}
- \textit{Sixth Circuit}. A treaty offers an employer only a narrow privilege to give preference to
  Greek citizens in the hiring of essential personnel.\footnote{Wickes v. Olympic Airways, 745 F.2d 363 (6th Cir. 1984); \textit{see also} Papaila v. Uniden Am. Corp., 51 F.3d 54, 55 (5th Cir. 1995).}
- \textit{Seventh Circuit}. “Foreign businesses have the right to choose citizens of their own nation
  as executives because they are such citizens,” and the exercise of that treaty right “may not
  be made the basis for inferring a violation of Title VII.”\footnote{Weeks v. Samsung Heavy Indus., 126 F.3d 926, 935 (7th Cir. 1997) (quoting Fortino v. Quasar Co., 950 F.2d 389 (7th Cir. 1991)); MacNamara v. Korean Airlines, 863 F.2d 1135 (3d Cir. 1988).}

The majority approach has its critics. Professor Michael H. Gottesman contends that the Third,
Sixth, and Seventh (and certainly the Fifth) Circuits have erred. His argument, in essence, is that FCN
 treaties were meant to sweep away discriminatory quotas imposed by host countries, not to confer on
eliminates virtually all conflicts between the treaties and Title VII. Among his key points are:

- \textit{The treaties eliminate discriminatory quotas}. The purpose of FCN treaties was simply
to void local rules that required foreign employers to hire local employees by percentile,
regardless of their qualifications. By placing percentile restrictions on domestic
employment, these local hiring laws had blocked Americans from jobs in their own
overseas operations. Professor Gottesman argues that it is ironic that the same foreigners,
whose “xenophobic laws” were used to discriminate against Americans in the pre-FCN
treaty days, now can do so on American soil, as their companies use FCN treaties to
block Americans from prime executive jobs in their U.S. operations.
The citizenship preference is dubious. The Supreme Court in Espinoza v. Farah Manufacturing Co.\textsuperscript{19} did not create a blanket license to discriminate on the basis of citizenship. That case involved a citizenship distinction within members of one national origin group—Mexicans—not between members of two national origin groups (e.g., Japanese and Americans). “Citizenship” rationales for hiring can be pretextual and mask a stereotypical bias against the host country’s employees. If citizenship-based hiring policies are not consistent with business necessity, national origin protected employees should have a Title VII cause of action.

Foreigners are put on an equal footing. Congress intended in Title VII that employees be chosen on the basis of qualifications. In that spirit, Professor Gottesman questions the purpose of giving foreign companies a blanket exemption from the prohibition on national origin discrimination.

\textit{ii. Possible approaches: Title VII applies, but employer’s BFOQ burden lightened (minority view)}

The Second Circuit has held that Article VIII(1) does not exempt Japanese companies operating in the United States from U.S. laws prohibiting discrimination in employment. Such a company “can only hire according to national origin if the company can show that national origin is a bona fide occupational qualification.”\textsuperscript{20} Citing the circuit court case, a district court held:

Although this exception is generally read in a narrow fashion for domestic Title VII defendants, the Second Circuit has determined that “as applied to a Japanese company enjoying rights under Article VIII of the [FCN] Treaty,” [this exception to Title VII] must be construed in a manner that will give due weight to the Treaty rights. . . .\textsuperscript{21}

To show that the employment of Japanese nationals is “reasonably necessary to the successful operation of the business” (i.e., a BFOQ),

the employer should assert the “unique requirements of a Japanese company doing business in the United States” including such factors as a person’s (1) Japanese linguistic and cultural skills, (2) knowledge of Japanese products, (3) familiarity with the personnel and workings of the principal or parent enterprise in Japan, and (4) acceptability to those persons with whom the company or branch does business.\textsuperscript{22}

\textsuperscript{19}141 U.S. 86 (1973).
\textsuperscript{22}Id.
iii. Possible approaches: Full immunity for executive hiring (minority view)

The Fifth Circuit has held that Article VIII(1)’s language fully insulates a foreign company from the host’s antidiscrimination law with respect to the hiring of executives or those others specified in the treaty. Faced with a claim of citizenship, race, and age discrimination, the Fifth Circuit concluded that French companies operating in the United States had the right to discriminate in favor of French citizens due to their citizenship when replacing non-French managers, but declined to decide whether Article VI of the Convention between the United States and France (which contains a similar “at their choice” clause) immunizes French companies from ADEA as well as Title VII liability, finding insufficient evidence of age bias to support a verdict. Subsequent district court decisions suggest that the Fifth Circuit would join the majority view that the “of their choice” language contained in the FNC treaties immunizes employers for employment decisions based on citizenship only, and does not shield against claims of sex, race, age, or other categories of discrimination or retaliation.

iv. Absolute bar

Some employers have argued that the literal meaning of the employer-choice clause makes them immune from U.S. antidiscrimination laws with respect to all hiring. No court has agreed with this position.

c. Immunity From Disparate Impact Claims

The majority view, discussed in A.1.b.i., above, attempts to harmonize Article VIII(1) and Title VII by pointing out that Title VII, on its face, does not prohibit citizenship-based intentional (disparate treatment) discrimination, and then characterizing the claim as one based on citizenship, not national origin. This reconciliation does not work well, however, in the disparate impact context. A lawful Japanese-citizen-only policy still is likely to have a disparate impact on those of non-Japanese national origin. The two circuit courts that have considered this clash have ruled that Article VIII(1) takes precedence over Title VII in such cases.

The Third Circuit has reasoned that Korean citizens are virtually all of Korean origin; thus, when a Korean company in the United States hires on the basis of Korean citizenship, there will always be a statistical disparity created between the national origin of the Korean citizens hired and the non-Korean

24Bennett v. Total Minatome Corp., 138 F.3d 1053, 1059 (5th Cir. 1998) (“[w]e need not decide whether [the Convention] immunizes French companies to the extent urged [by the defendant] because the record contains no evidence that [the plaintiff] was discriminated against on any basis other than his citizenship”).
26See Wickes v. Olympic Airways, 745 F.2d 363, 367 (6th Cir. 1984) (rejecting the employer’s argument that the U.S.-Greek FCN Treaty offered complete insulation from Michigan’s antidiscrimination law).
citizens rejected. The company would likely face “substantial” disparate impact liability for exercising its Article VIII(1) “right.” The court concluded, therefore, that disparate impact liability cannot be imposed.\textsuperscript{27}

The Seventh Circuit, following the reasoning of the Third Circuit, has held that “using the correlation between citizenship and national origin to infer national-origin discrimination from treaty-sanctioned preferences for Japanese citizens would nullify the Treaty.”\textsuperscript{28}

de. Branch Versus Subsidiary

While the courts were struggling over the scope of the FCN treaty-based defense to Title VII, they were also concerned with the question of who was entitled to raise the defense. The U.S. Supreme Court, in \textit{Sumitomo Shoji America v. Avagliano},\textsuperscript{29} faced the question of whether the FCN treaty defense was available to a foreign corporation’s wholly owned subsidiary that was incorporated in the United States. The following distinctions flow from its decision. (The Supreme Court avoided any discussion of the substantive scope of the immunity conferred by FCN treaties.\textsuperscript{30})

\begin{enumerate}
\item \textit{FCN treaties protect only foreign corporations and their U.S. branches}

The \textit{Sumitomo} Court held that the employer provision of Article VIII(1) was applicable only to “companies of either party,” which, according to the Court’s interpretation of the definitional section, did not apply to domestic corporations. A branch office of a foreign-incorporated entity, under the Court’s holding, would be entitled to claim FCN treaty immunity; but since the \textit{Sumitomo} corporate party was incorporated in the United States, it did not enjoy any direct protection under the FCN treaty.\textsuperscript{31}

\item \textit{U.S.-incorporated subsidiaries’ invocation of their foreign parents’ FCN treaty rights}

The \textit{Sumitomo} Court, in a footnote,\textsuperscript{32} left open the possibility that a domestic (U.S.) subsidiary of a foreign corporation might still assert FCN treaty-based defenses.

Answering the question posed in \textit{Sumitomo} 10 years earlier, the Seventh Circuit, in \textit{Fortino v. Quasar},\textsuperscript{33} determined that much of the employment decision making in Quasar was directly controlled by its parent corporation. Accordingly, the court decided that “Quasar must be allowed to invoke the treaty rights of its parent ‘to prevent the [T]reaty from being set at naught.’”\textsuperscript{34} This approach has its critics. The EEOC, in its Enforcement Guidance, expressly rejected \textit{Fortino’s} conclusion and accepts the \textit{Fortino} rule

\begin{footnotes}
\item 27MacNamara v. Korean Airlines, 863 F.2d 1135, 1148, 48 FEP Cases 980 (3d Cir. 1988).
\item 28Fortino v. Quasar Co., 950 F.2d 389, 392–93, 57 FEP Cases 712 (7th Cir. 1991); Weeks v. Samsung Heavy Indus., 126 F.3d 926, 937 (7th Cir. 1997).
\item 29457 U.S. 176, 28 FEP Cases 1753 (1982).
\item 30See discussion at A.1.b., above.
\item 31\textit{Sumitomo}, 457 U.S. at 182.
\item 325457 U.S. at 189 n.19.
\item 33950 F.2d 389, 393–94, 57 FEP Cases 712 (7th Cir. 1991).
\item 34\textit{Id.}
\end{footnotes}
only in states in the Seventh Circuit’s jurisdiction. A comprehensive and forceful judicial repudiation of *Fortino* was issued by the California Court of Appeals in *Kirmse v. Hotel Nikko of San Francisco, Inc.*

In the Fifth Circuit’s decision in *Papaila v. Uniden America Corp.*, as in *Fortino*, it was alleged that the parent, Uniden Japan, not the domestic subsidiary, Uniden America Corp. (UAC), made all of the discriminatory decisions. The court applied *Fortino*’s logic that

[a] judgment that forbids [UAC] to give preferential treatment to the expatriate executives that its parent sends would have the same effect on the parent as it would have if it ran directly against the parent; it would prevent [Uniden Japan] from sending its own executives to manage [UAC] in preference to employing American citizens in these posts.

Likewise, in *Bennett v. Total Minatome Corp.*, a U.S.-incorporated, wholly owned French subsidiary was permitted to assert its parent rights under Article VI of the U.S.-French Convention, in that the parent had dictated replacement of the plaintiff, an American, by a French expatriate.

Although an Italian company was the majority shareholder of a domestic subsidiary, however, the court held the subsidiary could not use the FNC treaty to shield itself from a discrimination claim because the subsidiary failed to present evidence that the parent required it to take the disputed actions.

### iii. The “single employer integrated enterprise” test

This widely adopted test determines whether parent companies can be found liable for their subsidiaries’ Title VII discrimination, or, conversely, whether subsidiaries can be shielded by their parents’ FCN treaty defense. The factors used under this test to measure the common identity of separately incorporated companies are:

- interrelated operations;
- common management;
- centralized control of labor relations; and

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3751 F.3d 54 (5th Cir. 1996).
38Id. at 56 (citing *Fortino*, 950 F.2d at 393).
39138 F.3d 1053 (5th Cir. 1998).
• common ownership or financial control.42

Typically, Japanese or other foreign corporations that are charged with staffing their U.S. operations with their own executives assert the business justification of “rotating” to defeat discrimination claims. Under a rotation system, employers assign employees to tours of duty overseas to gain familiarity with the company’s foreign operations. Such a system, however, appears to be a double-edged, if not a triple-edged, sword. On the one hand, the parent consents to defendant status when it admits to controlling the subsidiary’s employment functions in this manner under the integrated-enterprise rule. On the other hand, the parent can extend its FCN treaty defense to the subsidiary and, if that line of defense fails, the rotation system itself may provide the employer with a business-oriented defense that rises to a BFOQ.

iv. The “affecting access to employment” test

Even if the parent’s control over the subsidiary is insufficient to create a single or integrated enterprise for the purpose of attaching Title VII liability to the parent (and, conversely, the FCN treaty defense to the subsidiary), the plaintiff may try an alternative theory to bring the parent within Title VII’s coverage. Third-party entities have been held to be “employers” for Title VII purposes when they significantly affect or interfere with the claimant’s access to employment with the defendant employer.43 For example, Dentsu, Inc., a Japanese corporation, acquired an American corporation and named it DCA Advertising, Inc. (DCA). DCA’s clientele were the U.S. subsidiaries of Dentsu’s clients. Dentsu directed DCA to hire a group of 10 Japanese executives, set the terms of their employment, and supplemented their compensation. When DCA laid off 15 percent of its work force, it was explicitly ordered by Dentsu not to fire any of the Dentsu executives. Under the interference with access test, the court held that “[a]lthough Dentsu maintained that it had no specific involvement with the plaintiffs’ terminations, the expatriate policy that Dentsu dictated had an impact on all DCA employees because it affected who was to be fired in the downsizing of DCA.”44 Dentsu’s control created an adequate “nexus” by which it could be held to be an employer under Title VII.

42See Robins v. Max Mara, U.S.A., 914 F. Supp. 1006, 1008–09 (S.D.N.Y. 1996) (foreign parent of a U.S.-incorporated subsidiary could be held liable under ADEA if the parent and subsidiary were an “integrated enterprise” and the total of the subsidiary’s employees and the parent’s employees located in the United States were 20 or more); Armbruster v. Quin, 711 F.2d 1332, 1337 (6th Cir. 1983).


v. Statutory minimum number of employees

Another issue that turns on whether the parent and subsidiary are integrated is whether the employer meets the statutory minimum number of employees to be subject to Title VII (15 employees) or the Age Discrimination in Employment Act (ADEA) (20 employees). For example, if a domestic subsidiary of a foreign corporation has only 14 employees (for 20 or more weeks per year), it is not subject to Title VII. But if it also employs at the same location 10 expatriates of the parent company, does the domestic corporation satisfy the statutory minimum number of employees?

This issue was addressed in Robins v. Max Mara, U.S.A. First, the court noted that neither Title VII nor the Americans with Disabilities Act (ADA) “apply with respect to the foreign operations of an employer that is a foreign person not controlled by an American employer.” Similarly, the ADEA does not apply “where the employer is a foreign person not controlled by an American employer.” The court thus excluded from the count any employees of the international parent who did not work in the United States. It took the view, however, that the U.S.-incorporated subsidiary, if not the parent, could be held liable if the two companies were an “integrated enterprise” and the aggregate total of the subsidiary’s and the parent’s employees located in the United States met the 15- or 20-employee minimum.

The Second Circuit Court of Appeals has obviated much of this analysis by holding that a foreign employer’s overseas employees are to be included in the U.S. location’s “nose count.” In Morelli v. Cedel, the plaintiff was fired from the U.S. branch of a Luxembourg-based bank, and sued under the ADEA, ERISA, and New York’s Human Rights Law. After reviewing the relevant provisions of the ADEA, Title VII, and ADA, the court concluded that the ADEA applies to the domestic operations of foreign employers. (“We therefore agree with the E.E.O.C. . . . that the law generally applies ‘to foreign firms operating on U.S. soil.’”). With respect to the “nose count” of employees, the Morelli court rejected the notion that only ADEA-protected employees be included. The court concluded that the purpose of the 20+ employee rule was to spare small employers liability; thus, Congress did not intend for the cut-off to exempt large foreign employers. Although the overseas employees of the foreign employer may be outside ADEA’s ambit, so too, reasoned the court, are domestic employees under 40 years of age who are in the nose count. Thus, in “determining . . . the 20-employee threshold, employees cannot be ignored merely because they work overseas.” Courts outside the Second Circuit have adopted the Morelli court’s reasoning in finding that the exemption for overseas operations of foreign companies does not preclude counting employees of these foreign entities for purposes of determining whether Title VII’s minimum-employee threshold is met.
2. ADEA

Although similar to Title VII in many respects, the Age Discrimination in Employment Act of 1967 is codified with the Fair Labor Standards Act, which accounts for the difference in its coverage of foreign employers. At the outset, it is clear that a U.S.-incorporated subsidiary of a foreign corporation is subject to both Title VII and ADEA liability. As the Supreme Court held in *Sumitomo Shoji America, Inc. v. Avagliano*, U.S.-incorporated companies are domestic corporations and “subject to the responsibilities of other domestic corporations.” Under the ADEA, such a subsidiary cannot take advantage of its parent’s FCN treaty rights (except perhaps in the Fifth Circuit) because the courts have restricted the protection offered by those employer-choice treaties to employment decisions based on citizenship, not on age. The questions that remain are whether foreign employers are liable under the ADEA when they operate in the United States directly (e.g., through branches) or when they closely control their U.S.-incorporated subsidiaries.

Several courts have held that American employees may sue a foreign employer for age discrimination in the United States. Two federal courts have held, however, that foreign employers in the United States are not subject to the ADEA. The reason for the split is that before 1984, courts universally held that the ADEA covered foreign employers operating in the United States, but not U.S. companies employing Americans abroad. This prompted Congress to enact the Older Americans Act Amendments of 1984 (OAAA), which extended the ADEA’s protection to Americans working abroad for U.S. companies. At the same time, Congress sought to make clear that the OAAA did not affect foreign companies employing Americans abroad. To do so, it added the following clause: “The prohibitions of [ADEA] shall not apply where the employer is a foreign person not controlled by an American employer.” Taken literally, this language might indicate that foreign employers are immune from ADEA liability in the United States, and two courts have so ruled. The legislative intent of the passage, however, as well as several other policy considerations (including the EEOC’s Guidance), indicates that it refers merely to overseas employment sites, not domestic ones.

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55See *Bennett v. Total Minatome Corp.*, 138 F.3d 1053 (5th Cir. 1998) (also discussed at A.1.b.ii., above).
3. Civil Rights Act of 1866

Foreign employers in the United States may also be held liable for national origin/race discrimination, and possibly citizenship-based discrimination, under the Civil Rights Act of 1866 (Section 1981).\footnote{42 U.S.C. §1981; see Anderson v. Conboy, 156 F.3d 167 (2d Cir. 1998).}

\paragraph{a. National Origin/Race}

The extent of that statute’s protection against national origin discrimination, however, is a subject of debate. According to some courts, Section 1981 does cover national origin discrimination. In \textit{Adames v. Mitsubishi Bank, Ltd.}\footnote{751 F. Supp. 1548 (E.D.N.Y. 1990).}, the bank, a Japanese corporation, was sued by four employees of American/Hispanic origin under Section 1981. They alleged denial of promotions, which they blamed, in part, on the rotating staff system. Their claims were grounded in their non-Asian ancestry and national origin, not race. The bank sought summary judgment by characterizing their charges as based on nonprotected citizenship or origin. Noting that the U.S. Supreme Court, in \textit{Saint Francis College v. Al-Khazrahi}\footnote{481 U.S. 604, 613 (1987).}, had defined the scope of Section 1981 as including “race, ethnic characteristics or ancestry,” the court concluded that Section 1981 permits claims by non-Japanese persons against a Japanese employer. In support of its position, the \textit{Adames} court cited two courts’ earlier decisions in which similar conclusions were reached: \textit{Spiess v. C. Itoh & Co.}\footnote{408 F. Supp. 916 (S.D. Tex. 1976).}, recognizing that racial and national origin discrimination were “indistinguishable,” and \textit{Bullard v. Omi Georgia, Inc.}\footnote{640 F.2d 632 (5th Cir. 1981).}

Other courts, however, have held that Section 1981 does not cover national origin discrimination. On appeal from the underlying district court decision in \textit{Avagliano v. Sumitomo Shoji America, Inc.}\footnote{473 F. Supp. 506 (S.D.N.Y. 1979), vacated and remanded on other grounds, 638 F.2d 552 (2d Cir. 1981), rev’d and remanded on other grounds, 457 U.S. 176, 28 FEP Cases 1753 (1982).}, the Second Circuit dismissed the Section 1981 claim. It held that the plaintiffs’ claims of discrimination by Japanese managers were essentially based on citizenship and could not be equated with race-based claims. Note, however, that the \textit{Avagliano} decision preceded the Supreme Court’s decision in \textit{Al-Khazrahi}.

\paragraph{b. Citizenship}

The Second and Fourth Circuits have held that Section 1981 prohibits discrimination based on citizenship or alienage.\footnote{See Anderson v. Conboy, 156 F.3d 167 (2d Cir. 1998); Duane v. Geico, 37 F.3d 1036 (4th Cir. 1994).} While courts have questioned whether this prohibition applies to both private and public employers, the U.S. Court of Appeals for the Second Circuit, in \textit{Anderson v. Conboy}, found that Congress extended the prohibition to both sectors in 1991 when it amended the Civil Rights Act of 1866.
Citizenship-based discrimination under Section 1981 closes a possible safe harbor for employers who have favored their own citizens. As described earlier (see A.1.a. and b., above), foreign employers in the United States have argued that the law allows them to prefer their own nationals over U.S. citizens in higher level jobs, inasmuch as Title VII does not expressly cover citizenship discrimination and FCN treaties appear to protect such choices. An employer’s assertion of this defense, however, could result in a violation of Section 1981, given the overt alienage-based reasoning. Courts that confront these claims will have to sort out whether Section 1981 in fact covers such “reverse” alienage claims by U.S. citizens and, if so, whether Section 1981 trumps the FCN treaties’ “of their own choice” provisions.

4. Employer Defenses Based on Sovereignty

When agencies or other branches of foreign governments employ Americans in the United States, they may claim employment law immunity under the Foreign Sovereign Immunities Act (FSIA). A number of factors affect whether these laws can be enforced against such entities.

a. Scope of the FSIA’s Immunity

The FSIA “provides the sole basis for obtaining jurisdiction over a foreign state in the courts of this country.” Otherwise, “a foreign state shall be immune from the jurisdiction of the courts of the United States and of the States except as provided in sections 1605 and 1607 [of title 28].”

For FSIA immunity purposes, a foreign state includes “a political subdivision of a foreign state or an agency or instrumentality.” A state’s immunity may extend to its agency or instrumentality. Under Section 1603(b), “agency or instrumentality” of a “foreign state” means any entity:

(1) which is a separate legal person, corporate or otherwise, and (2) which is an organ of a foreign state or political subdivision thereof, or a majority of whose shares or other ownership interest is owned by a foreign state or political subdivision thereof, and (3) which is neither a citizen of a State of the United States . . . nor created under the laws of any third country.

For example, the British Tourist Agency (BTA) argued that it was an “agency or instrumentality of a foreign state” under Section 1603(b). The ADEA plaintiff countered that the BTA, a corporation, was a citizen of the State of New York. The court found that the BTA was not incorporated in New York and its principal place of business was in London and concluded therefore that the BTA was an agency or instrumentality of a foreign state and was presumed immune.

71 Elliot v. British Tourist Auth., 75 FEP Cases 873, 1997 WL 726009 at *3 (S.D.N.Y. Nov. 17, 1997), aff’d, 172 F.3d 37 (2d Cir. 1999).
b. Exceptions to Immunity Under the FSIA

Once a defendant is deemed a foreign state or agency/instrumentality, the burden of showing that an exception applies shifts to the plaintiff. Most heavily relied on is the “commercial activity” exception. When the action arises from the state’s or agency’s commercial activity, no immunity applies.

i. Commercial activity

The nature of the activity, not its purpose, renders the activity commercial or noncommercial. The issue is not whether the foreign government is acting with a profit motive, but whether the conduct resembles what a private party does when engaged in “trade and traffic in commerce.”

ii. “Employment” as a commercial activity

Whether employment qualifies as a “commercial activity” depends on the nature of the work and, perhaps, on the citizenship of the employee. The House Report on the FSIA discusses the distinction as follows:

Also public or government and not commercial in nature, would be the employment of diplomatic, civil service, or military personnel, but not the employment of American citizens or third country nationals by the foreign state in the United States. . . . Activities such as a foreign government’s employment or engagement of laborers, clerical staff or public relations or marketing agents . . . would be among those included within the definition [of commercial activity].

Courts will have jurisdiction when governmental employers injure employees by means of commercial activity, but not when they inflict harm through more traditional means. The Supreme Court clarified this distinction when it decided whether Saudi Arabia acted as a private party engaged in “‘trade and traffic or commerce’” when it subjected an American employee of its national hospital to detention, alleged beatings, and torture as retaliation for his persistence in reporting hospital safety violations. To overcome the Saudi government’s FSIA immunity, the employee argued that his mistreatment was an extension of his on-the-job commercial activity and that his employer’s failure to warn him of possible torture when he was hired added to the private, commercial nature of the tort. The Supreme Court
concluded, however, that since the basis of the claim was the alleged tortious—perhaps criminal—actions of the Saudi police (not the arguably commercial activity in recruiting Nelson), and private parties cannot exercise that “sort” of power while engaging in commerce, the activity could not be thought “commercial.” Thus, although the punishment might have been a consequence of commercial activity, it boiled down to abuse of power by the police and prison officials, whose conduct has long been understood to be peculiarly sovereign in nature.

c. Holdings of the Circuits

In the Second Circuit, a marketing executive with the title “Manager of Industry Relations” was deemed to have occupied a commercial activity position. In another case, the employment of a secretary, who brought a sexual harassment claim against the Brazilian National Superintendency of Merchant Marine, was determined to be commercial activity.

The Seventh Circuit held, in Segni v. Commercial Office of Spain, that the hiring of an Argentinean national as a marketing agent for Spanish wines was found to be an activity “in which a private person could engage,” and thus commercial.

In the Ninth Circuit, the hiring and firing of a “Commercial Officer” was held not immune under the reasoning applied in Segni.

In the District of Columbia Circuit, the only employment relationships of a foreign state that are governmental in nature are relationships with diplomatic, civil service, or military employees “who are neither U.S. citizens nor third country nationals employed in the United States . . . [t]he hiring of all other employees is commercial.” Thus, the court allowed a breach of contract action to proceed against the United Arab Emirates because its employment of an Egyptian citizen in its Washington D.C. embassy was held to “fit squarely into the type of employment relationships” that have been recognized in the D.C. Circuit as being commercial activity.

d. FSIA and the Fair Labor Standards Act (FLSA)

In a case of first impression, a foreign diplomat was sued by his domestic servant for, among other things, minimum/overtime wage violations under the FLSA. The court held that, while a diplomat’s contracts for goods and services are incidental to the foreign state’s concerns, the servant’s employment

78Elliot v. British Tourist Auth., 75 FEP Cases 873, 1997 WL 726009 at *3 (S.D.N.Y. Nov. 17, 1997), aff’d, 172 F.3d 37 (2d Cir. 1999).
80835 F.2d 160 (1987); see also State Bank of India v. NLRB, 808 F.2d 526 (7th Cir. 1986), cert. denied, 97 L. Ed. 2d 735 (1987) (agency’s commercial activity precluded immunity from NLRB jurisdiction).
83Id.
was personal to the diplomat, thus not a commercial activity of the foreign state. Finding no exception to the FSIA, the court held the diplomat immune from the suit.84

e. Civil Service

In all of the “commercial activity” holdings above, the plaintiffs were not citizens of the foreign state. When the plaintiff is a citizen of the foreign state, there is a greater likelihood that the courts will view the employment as “civil service” (as mentioned in the House Report) and not apply the commercial activity exception to pierce the immunity veil.


Mexico, as a foreign nation, lacked standing to represent Mexican migrant workers in their United States district court discrimination action against their private employer in the state of Maine.85 The court refused to expand to foreign nations the doctrine of parens patriae, which has been used to confer standing on domestic states in employment litigation. It held that, absent a treaty, to allow a foreign nation to litigate on behalf of its citizens would involve the courts in foreign policy matters usually reserved to the foreign relations functions of the polical branches of government.

B. Extraterritorial Application of U.S. Employment Discrimination Laws

1. ADEA

The Age Discrimination in Employment Act was amended in 1984 to extend coverage to Americans working for U.S. employers in foreign locales. Three key provisions were added, as set forth below. Before 1984, the ADEA’s coverage was considered coterminous with that of the Fair Labor Standards Act (FLSA), which specifically does not apply with respect to an employee whose services are “performed in a workplace within a foreign country.”86 Thus, the FLSA’s coverage is still only domestic.

a. Definition of Employee

An employee includes “any individual who is a citizen of the United States employed by an employer in a workplace in a foreign country.”87 The courts have used the citizenship requirement to deny
ADEA protection to foreign nationals who perform work for American employers abroad, even when they are U.S. resident aliens and the interviewing and decisionmaking process takes place in the United States.  

b. Issue of “Control”

The question of whether the U.S. employer is liable for conduct abroad turns on the concept of control. ADEA provides that

(1) If an employer controls a corporation whose place of incorporation is in a foreign country, any practice by such corporation prohibited under this section shall be presumed to be such practice by such employer.
(2) The prohibitions of this section shall not apply where the employer is a foreign person not controlled by an American employer.

The ADEA sets forth four criteria for determining whether an employer controls a corporation:

1. Interrelationship of operations, i.e., whether the parent is directly involved in the subsidiary’s daily decisionmaking with regard to production, distribution, and marketing; whether the two entities share employees, records, services, and equipment; whether their accounts, inventories, and credit sources are commingled; whether the parent issues paychecks for the subsidiary; and whether the parent files the subsidiaries’ tax returns.

2. Common management, i.e., whether the management structures of the two entities are separate and distinct. Ordinary parent-subsidiary relationships usually will not support a finding that the parent is the employer or joint employer of the subsidiary’s employees.

3. Centralized control of labor relations, i.e., whether the subsidiary has a separate human resources staff; whether it independently sets policies and makes hiring, discipline, and termination decisions; whether it seeks approval from the parent for significant personnel decisions; whether employees rotate between the two entities; and whether employees apply to the parent for jobs with the subsidiary.

4. Common ownership or financial controls. Typical management, ownership, and financial control by the parent of the subsidiary generally will not turn the parent into an employer. The dispositive factors,
then, are 1. and 3. When added, these factors can make a foreign parent liable as an employer or joint employer of the domestic subsidiary’s employees in an ADEA or Title VII case brought in the U.S.\textsuperscript{92}

Applying these rules, the court in \textit{Denty v. SmithKline Beecham Corp.},\textsuperscript{93} was faced with an American who worked domestically for a U.S. corporation that was controlled by a British one. He was denied overseas jobs by the British parent, he alleged, because of his age. He argued that the ADEA’s coverage extended to the British parent because it was highly integrated with the U.S. subsidiary. Focusing, instead, on the issue of “control,” as set forth in the ADEA,\textsuperscript{94} the court found that the defendant British parent was not controlled by its American subsidiary; it was the other way around. Accordingly, the ADEA did not to apply to decisions of the British parent.

EEOC Policy Guidance is also instructive on the ADEA’s extraterritoriality.\textsuperscript{95}

c. The “Foreign Law Conflict” Defense

The ADEA states:

\begin{quote}
It shall not be unlawful for an employer . . .

(1) to take any action otherwise prohibited under . . . this section . . . where such practices involve an employee in a workplace in a foreign country, and compliance with such subsections would cause such employer, or a corporation controlled by such employer, to violate the laws of the country in which such workplace is located.\textsuperscript{96}
\end{quote}

Illustrating this rule is \textit{Mahoney v. RFE/RL, Inc.}\textsuperscript{97} There, Radio Free Europe (RFE), a U.S. corporation, dismissed three U.S. citizen employees working in Germany pursuant to a German collective bargaining agreement that set a mandatory retirement age of 65. The three Americans filed ADEA claims and persuaded the district court that, while the RFE might be contractually bound to retire Germans at age 65, no German law prohibited the employment of the 65-year-old Americans. RFE argued that its Works Council, which enforces its collective bargaining agreement, had rejected its prior attempts to carve out separate, nonconforming employment arrangements for American employees. The Third Circuit reversed, finding that the German law of contracts, which stood behind the collective bargaining agreement, was a

\textsuperscript{92}See id.
\textsuperscript{94}29 U.S.C. \textsection623(h)(3).
\textsuperscript{96}29 U.S.C. \textsection623(f)(1).
conflicting “law” that RFE would be violating if it retained the Americans past age 65. Due to that conflict, the court held the ADEA inapplicable to the claims.

Further analysis of the “foreign law conflict” defense can be found in the EEOC Compliance Manual.\^98

2. Title VII

\textit{a. Civil Rights Act of 1991}

In 1991, Congress overruled the U.S. Supreme Court’s domestic-only interpretation of Title VII in \textit{EEOC v. Arabian American Oil Co.}^{99} Congress adopted the ADEA’s extraterritorial language, which it had used the year before in the Americans with Disabilities Act of 1990 (ADA).

Title VII now applies “[w]ith respect to employment in a foreign country . . . [to] an individual who is a citizen of the United States.”\^100 Title VII covers discrimination against U.S. citizens abroad if engaged in by a U.S. employer or by a foreign corporation controlled by a U.S. employer.\^101 Courts hold that with respect to foreign employment, Title VII applies only to American citizens employed abroad by American companies or their foreign subsidiaries.\^102 This exclusion of aliens has been applied to resident aliens when their U.S. employers send them overseas. For example, a Title VII discriminatory termination claim was brought by a Japanese citizen who lived as a legal resident alien in United States until he was hired by a U.S. corporation to serve as president of its subsidiary in Japan. After returning from Japan and resuming his residency in the United States, the resident alien filed suit based on alleged discrimination that occurred in Japan. Dismissing his suit for lack of subject matter jurisdiction, the court held that because the plaintiff lived and carried out his duties in Japan and was at no time a citizen of the United States, he was not an employee protected by Title VII.\^103 Although the courts have noted that Congress “was careful not to impose its labor standards on another country,” and thus did not extend Title VII’s or the ADEA’s protections to foreign nationals working abroad for American companies or their subsidiaries, the courts have not pointed to where Congress actually considered whether U.S. legal resident aliens are more like citizens or noncitizens with regard to assignments abroad, nor have they explained what burden would be imposed on the host country if the American laws, applicable to workers from the United States working at a U.S. company’s foreign site, were to cover both U.S. citizens and U.S. resident aliens.\^104

As for the important issue of control, Title VII uses the four-part ADEA test noted at 1.b., above.\^105


\textsuperscript{100}42 U.S.C. §2000e(f) (Title VII); 42 U.S.C. §12111(4) (ADA).

\textsuperscript{101}42 U.S.C. §2000e(c)(1)(Title VII); 42 U.S.C. §12112(c) (ADA).


\textsuperscript{103}Twata v. Stryker Corp., 59 F. Supp. 2d 600 (N.D. Tex. 1999).

\textsuperscript{104}See Denty v. SmithKline Beecham Corp., 109 F.3d 147, 150 (3d Cir. 1997).

\textsuperscript{105}42 U.S.C. §2000e(c)(1) (Title VII); 42 U.S.C. §12112(c) (ADA).
Title VII also borrows the ADEA’s conflict-with-local-law exemption noted above at note 152.  

b. EEOC Guidance

The EEOC issued its “Enforcement Guidance on Application of Title VII and the Americans with Disabilities Act to Conduct Overseas and to Foreign Employers Discriminating in the United States” on October 20, 1993. According to the EEOC, a U.S. corporation is one that “has numerous contacts here,” even if it is incorporated elsewhere. Such contacts include its principal place of business, dominant shareholders, officers, and directors.

According to the Guidance, a foreign corporation would be controlled by a U.S. corporation, and thus be covered under Title VII, if it satisfies the same four-part standard used under the ADEA (discussed above). Thus, in the EEOC’s view, the following hypothetical foreign corporation would be controlled by a U.S. corporation:

- U.S. corporation owns 25 percent of the foreign corporation’s stock;
- board memberships of the two corporations overlap;
- U.S. corporation sets human resources policies for the foreign corporation;
- U.S. corporation’s representatives visit and inspect the foreign corporation’s operations; and
- U.S. corporation dictates changes in marketing and sales strategy.

The EEOC also acknowledges a “foreign law conflict” defense. A foreign law for the purposes of this defense is one that is codified. Thus, the EEOC shares the view of the reversed district court in Mahoney. Given that many foreign cultures observe strict employment requirements that are part of their customs or religion, but that are not codified as law, the EEOC’s position could leave employers with no exemption when an American expatriate employee’s rights collide with the mores and practices of a foreign country.

c. State Antidiscrimination Laws

State antidiscrimination laws are generally subjected to the presumption against extraterritoriality set forth by the U.S. Supreme Court in E.E.O.C. v. Arabian American Oil Co. For a more detailed discussion of this issue, please see section A. in the Introduction to this chapter.

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106 42 U.S.C. §2000e-1(b) (Title VII); 42 U.S.C. §12112(c)(1) (ADA).
VII. OCCUPATIONAL SAFETY AND HEALTH AND WORKERS’ COMPENSATION

A. Occupational Safety and Health

[Reserved]

B. State Safe Workplace Laws

In addition to insurance-based statutes that compensate injured workers, some state laws impose special sanctions on employers who maintain unsafe workplaces. Whether these statutes extend to workplaces abroad will depend on whether the statute makes a provision for extraterritorial effect and, if not, on the state’s conflict-of-laws principles. For example, faced with a scaffolding accident that occurred in a Massachusetts workplace, New York’s highest court was asked, in Padula v. Lilarn Properties Corp.,¹ whether New York’s labor law regulating job safety extended to the site. After finding no statutory provision for extraterritorial application, the court of appeals looked through the conflict-of-law prism. It noted a distinction between statutes that “regulate conduct” (e.g., the labor law) and those that allocate loss (e.g., wrongful death statutes). It held that if a conduct-regulating law is at issue, the law of the jurisdiction where the tort occurred will generally apply, because that jurisdiction has the greatest interest in regulating behavior within its borders. If, however, a loss-allocating law will apply, and the parties to the lawsuit share a common domicile, the loss allocation rule of the common domicile will take precedence. Accordingly, Massachusetts’ safe workplace law was found to apply.

See also the discussion of Parsons v. United Technologies² in Section I.A.3.b. in this chapter.

C. Workers’ Compensation

The New York’s Workers’ Compensation Law (WCL) was held to apply to an injury that occurred in Canada, but in the same case, Rogers v. Consolidated Rail Corp.,³ the Second Circuit held that the Federal Employer’s Liability Act (FELA)⁴ did not have extraterritorial reach.

The plaintiff, a New York resident, worked as a freight railroad conductor out of a New York facility. He fell off the train in Quebec, Canada, and claimed that the fall was caused by the employer’s failure to maintain safe working conditions and by its negligent supervision of its train master. The court held that FELA does not have extraterritorial effect and therefore did not preempt state law remedies for injuries sustained beyond U.S. borders.

¹Jack A. Raisner, Associate Professor of Law, St. John’s University, College of Business, Jamaica, New York, Of Counsel, Outten & Golden LLP, New York, New York.
³243 Conn. 66, 700 A.2d 655, 13 IER Cases 462 (1997).
⁴948 F.2d 858 (2d Cir. 1991).
The court then rejected the employer’s contention that, since the injury occurred in Canada, the workers’ compensation law of Canada, not that of New York, should apply. The Second Circuit found that New York courts apply the law of the jurisdiction having the most significant contacts with the action. In particular, the WCL applies if employment is located in New York, even though the accident occurred in Canada. In this case, the plaintiff resided in New York, worked out of a facility in New York, and, except for his initial hospitalization, has been treated for his injuries in New York. Thus, New York had the dominant interest in the controversy and its law was held to apply. This reasoning was consistent with prior cases noted by the court in which a WCL award was made to the widow of a New York employee killed in Israel\(^5\) and an award was made to the widow of a pilot working out of Hamburg who was killed in Brazil.\(^6\)


A. Introduction

When transferring employees from one country to another, multinationals face choices concerning the structuring of compensation and benefit arrangements that can have a significant impact on the corporation’s tax liabilities in each country involved. How the arrangement is structured also can have a significant impact on the tax liability of the employee involved, and on the employee’s benefit package. Two of the primary concerns are ensuring the deductibility of compensation and benefits for the employer and minimizing taxability of these for the employee. Issues can arise both from transferring U.S. citizens and permanent residents out of the United States and from transferring citizens and residents of other countries into the United States. This article concentrates on the former, although the latter will be covered. Some of the issues in this regard are:

For government-sponsored social security systems

- **Social Security Coverage.** Can the executive stay in the home country system? Must the executive move into the host country system? May or must the executive participate in both? What is the effect of a “totalization” agreement?

For private (employer-sponsored) pension plans

- **Deductibility by the Employer.** Which business entity may take the deduction for compensation and benefits? Are there special limitations for compensation and benefits provided from outside the United States? What is the role of secondment and payroll? (These concepts are explained further below.) How does choice of entity affect deductibility? Do treaties cover this issue? How do the deductibility issues change when compensation is deferred?
- **Benefits-Plan Coverage.** Can the executive stay in the home country plan? Must the executive move into the host country plan? May the executive participate in both? What problems result from the coverages? What planning opportunities arise? In addition to retirement benefits, what are the problems of medical plan benefits?
- **Grantor Trusts.** What are they (in an international context)? How can funding executive deferred compensation give the U.S. entity U.S. tax problems? Is this an issue that affects executives only? What effect does the U.S. Employee Retirement Income Security Act of 1974 (ERISA) have?
These issues are covered below. The discussion provides only a basic overview.\(^1\)

**B. Government-sponsored Social Security Systems**

Coverage under the Social Security system is based on employment within the United States without regard to nationality of employee or employer,\(^2\) or work performed outside the United States if both the employer and the employee are U.S. persons (i.e., a U.S. corporation, a U.S. citizen, or a U.S. resident).\(^3\) There is a special exception allowing expanded coverage: a U.S. employer can execute a "3121(l) agreement"\(^4\) to include its foreign subsidiaries (but not affiliates) in the Social Security system. This arrangement treats the foreign subsidiary as a U.S. employer, and sweeps into the Social Security system, irrevocably, all U.S. citizens and U.S. (as defined for tax status purposes) residents.\(^5\) In general, nonresidents will only be covered by Social Security for services rendered inside the United States. (Medicare eligibility generally follows Social Security principles, although, unlike Social Security retirement payments, which can be made to an individual residing anywhere in the world, Medicare usually covers only the delivery of medical services inside the United States.)

Some examples of typical situations follow.

1. **Facts:** Mr. Akasaka, a Japanese citizen, works for a Japanese trading company in Los Angeles, California.  
   **Result:** The U.S. Social Security system covers that employment. The coverage is based on Mr. Akasaka’s working inside the United States. It doesn’t matter that Mr. Akasaka does not have a “green card” (i.e., is not a permanent resident of the United States) and instead has a temporary work visa.

2. **Facts:** Joe, a U.S. citizen, is transferred from the Widget Company’s New York headquarters to the Rome office of its Italian subsidiary. No “3121(l) agreement” applies.  
   **Result:** Joe is no longer covered by the U.S. Social Security system during his employment in Rome.

3. **Initial Fact:** The Widget Company executes a “3121(l) agreement” covering its French subsidiary Oeuvre S.A.  
   - **Situation A Facts:** Ron, a U.S. citizen, is transferred from the Widget Company’s New York headquarters to the Paris, France, office of Oeuvre.  
     **Result:** Ron stays in the U.S. Social Security system.

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\(^1\)For a more detailed discussion of this and other issues, see Woyke, Hall, & Klein, INTERNATIONAL PENSION PLANNING, Tax Management Portfolio No. 320 (1998).  
\(^2\)U.S. Internal Revenue Code (hereinafter I.R.C.) §3121. For further information on the Social Security system, see the discussion under VIII.A.1 in the chapter on the United States in the Main Edition. For further information on the social security systems of other countries covered in Volume I, see the discussion under Section VIII in the chapter on the country concerned.  
\(^3\)I.R.C. §3121.  
\(^4\)I.R.C. §3121(l).  
\(^5\)I.R.C. §3121(l)(3).
Situation B Facts: Harry, a long-time resident of France, gets hired by the Paris office of Oeuvre.
Result: Harry begins coverage under the U.S. Social Security system.

Situation C Facts: Ian, a Canadian citizen with a U.S. green card, transfers from the Toronto subsidiary of the Widget Company to the Paris office of Oeuvre. Ian was not in the U.S. Social Security system in Canada, because he worked for a foreign corporation not covered by a 3121(l) agreement.
Result: Ian begins U.S. Social Security coverage when he starts working for Oeuvre. He’s covered because Oeuvre is covered by the 3121(l) agreement.

There is an important exception to the above rules. The United States has entered into a number of “totalization” agreements with other nations. These agreements are all essentially the same, and do the following:

1. They prevent duplicative coverage by allowing an individual in two systems at the same time to get a certificate of coverage from one system and use that certificate and the totalization agreement to avoid coverage in the other system. In general, they specify (a) that if an assignment will not exceed 5 years, the home country’s social security system will prevail over the local system and (b) that if the assignment will exceed five years, host country coverage will apply. Note that the totalization agreements only avoid duplicative coverage; they do not grant coverage where it does not exist by statute.

2. They adjust the amounts paid from both the United States and the treaty partner’s social security system. The reason for this is that individuals may in some circumstances have participation in both systems. For example, an individual could be in the U.S. system for 15 years, then go into the German system for 8 years, and then return to the U.S. system for 3 years. The separate pieces may not give the participant the equivalent of a full benefit in either system, so the treaty will adjust or “totalize” each system’s benefits in order to better approximate a full benefit.

(The term “coverage” under the U.S. Social Security system is used to indicate that wages are taxable for Social Security purposes, not that workers are eligible for benefits. Eligibility for benefits depends on workers’ having completed minimum periods of time worked.6)

C. Private Pension Plans

Retirement income plans of employers—private pension plans—usually have a goal of providing at least a part of the income needed in retirement. In virtually all developed countries, the concept of a pension as a “gratuity” has long since disappeared, replaced by the concept of retirement income being

6See the discussion under VIII.A. in the chapter on the United States in the Main Edition.
“deferred compensation” for services (while an active employee). For the concept of deferred compensation to have any meaning on an individual basis, the deferral must be nonforfeitable, or “vested,” after some reasonable period of service.

Having established that the compensation is vested and attributable to active service, most private retirement plans in developed countries provide for an orderly accrual of benefits during active service. A typical formula might be that for each year of service, 1.66 percent of final pay will be continued for life after retirement at age 65. In such a plan, the value of each year’s accrual can be ascertained at the time of rendering the services. The calculation of the value of the total accrual prior to retirement may require some estimations and projections, but some minimum value can at least be determined at any given time.

Once the amount has vested, given this fact that a minimum value can be determined, an income-based tax system could begin to tax the accrual at that point. One can quickly observe, however, that a national policy to encourage private retirement plans would be seriously frustrated by a practice of taxing noncash property accumulated for the purpose of providing income support during retirement. (The vested accrual generally is characterized in developed countries as a property right of the employee.) Accordingly, virtually all major developed countries’ private pension regulatory systems allow for the deferral of taxation until the point at which the property right is converted into cash. As an aside, it should be noted, however, that under most regulatory systems, the purchase of a commercial annuity contract would, in the jargon of the tax attorney, “attract” income tax immediately regardless of when the purchase occurred, and notwithstanding the fact that cash may not be paid to the employee until some date far in the future. This would be consistent with the position taken in most tax systems that compensatory property transfers (and such a purchase is considered a “transfer”) are to be taxed just like compensatory cash payments.

However, few systems allow for this tax deferral to continue until the time the property right is converted into cash—a deferral that is often referred to as a “tax advantage” or “tax expenditure” (that is, a loss to the Treasury of amounts that would be taxed)—without a significant commitment on the part of the employer to maintain the plan according to some national standards. Plans that meet such standards are variously referred to as “qualified” (in the United States), “registered,” “approved,” etc., plans. The problem arises when retirement benefits accrue outside the approved national system of regulation for private plans. Within a given country this problem can arise when a plan is “funded” in some unapproved way, or is in excess of statutory limits, or is readily converted into current cash (although this last category is more properly an issue of tax accounting, sometimes referred to as an issue of “constructive receipt”). This purely domestic problem often arises for highly paid executives. In many situations involving multinationals, this problem can arise simply because the benefits are accruing in a private plan approved by and operating in one country when the individual in the plan is a national or resident of another country, and no attempt has been made to have the private plan approved in the other country. The reason no attempt is made is often simply that the standards and requirements vary from one country to another and it is difficult, if not impossible, at this stage in international business and pension law, to secure approval on the part of multiple countries.

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7See the discussion of “qualified” and “nonqualified” plans in the chapter on the United States in the Main Edition, at VIII.B.2.
Focusing on the topic of interest in this discussion, a peculiar policy problem develops when pensions are earned in an international framework, as illustrated by the following.

- **Facts:** Employee A works in his home country, X, and is a participant in a private pension plan approved under the regulatory requirements of his home country. **Result:** Mr. A will not be taxed on the accruals, though he will be taxed on benefits as he receives them after retirement.

- **Facts:** Employee B is working in his home country, Y, and is a participant in a private pension plan approved under the regulatory requirements of his home country. Employee B then is transferred to X, A’s home country. Mr. B then begins to have accruals to the pension plan in effect in X. **Result:** Mr. B may well find that he will be taxed by country Y, to whom he continues paying taxes, on the accruals to this plan in X while he is working in X, while A is not taxed on his accruals to this plan in X.

- **Facts:** Before A has a chance to take much satisfaction in this fact, A is transferred to country Y, and joins the Y country plan. **Result:** Mr. A may well find that he is taxed by his home country X on the pension accruals to the country Y plan.

Assuming a reasonably supportive attitude on the part of countries X and Y toward international business activities in general and toward the needs of multinationals in particular, some balancing of interests on this issue should occur, and both countries should accommodate the needs of their own employees and the corporations involved, and recognize each others’ national private pension regulatory systems to the point of granting tax deferral. However, most countries do not have such a provision—though some do—and many in addition fail to enforce the technical requirements of their national tax laws in this area. The problem with failure to enforce (or failure to enforce consistently) is that it does not reward the careful tax adviser but does reward ignorance of the law. Nonetheless, few countries seem willing to alter this result through their domestic tax systems by adding a provision extending such deferral to plans of other countries and enforcing their own technical requirements. Instead they rely on the treaty network to resolve the issue, on a treaty-partner-by-treaty-partner basis.

1. **Deductibility of Compensation and Benefits by the Employer**

This section addresses some of the planning issues that must be considered in advance of any employment-related action in order to avoid unintended consequences. It is written, perhaps unavoidably, from the perspective of a U.S.-based multinational.
a. Taxation of U.S.-Based Trusts

Plans that are “qualified” under ERISA\(^8\)—i.e., those that meet I.R.C. conditions, allowing them to be deductible by employers—are usually funded with assets held in trust. The trust must be “created or organized in the United States.”\(^9\) Qualified plans can only cover employees of the sponsoring employer.\(^10\) Under common law principles of employment, one corporation is generally the employer of an employee. However, under the rules established by ERISA in 1974, both tax and labor law have a technical alternative definition that states that the “employer” sponsoring a qualified plan is not one corporation, but rather the entire affiliate group.\(^11\)

The basic rule in the United States as regards the question of deductibility of compensation and benefits by employers is that “salaries or other compensation for personal services actually rendered” may be deducted by the employer from its taxable income.\(^12\) The rule for the deductibility of deferred compensation (often particularly important for executives) had at one time been explicitly linked to a threshold requirement that the deferred compensation pass a test established by I.R.C. Section 162, which generally denied a deduction for compensation paid by a parent corporation for the compensation expense of employees of a subsidiary of that corporation. (This explicit cross-reference was dropped by the Tax Reform Act of 1986, although the substance of the test remains the same.)

Generally, if the compensation paid (as well as benefits and deferred compensation) for services of an employee is to be deductible, such amounts must be for services of an employee of the employer claiming the deduction. This rule has its clearest statutory underpinning in the area of deferred compensation, particularly compensation deferred under qualified plans. Qualified plans are those that meet certain conditions set forth in the Internal Revenue Code, thus allowing employers to deduct from their taxes the contributions they make to a plan on behalf of their employees and allowing participants to exclude from their income the contributions made to a plan on their behalf, and the earnings on those contributions, until participants actually receive benefits from a plan.\(^13\) For some other benefits, such as corporate medical plans, there can be a deduction even though the amounts are never included in income. For nonqualified deferred compensation, the deduction is linked to the point in time when the amount is included in income.

Note: It is important to understand the basic concept that the “controlled group” rules of Section 414 (treating all affiliated companies as one employer) are not applicable to the corporate

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\(^8\)See the discussion of “qualified” and “nonqualified” plans in the chapter on the United States in the Main Edition, at VIII.B.2.

\(^9\)I.R.C. §401(a).

\(^10\)Id.

\(^11\)Id.\(^\text{ }\)I.R.C. §414(b) and ERISA §1060(c), 29 U.S.C. §210(c).

\(^12\)I.R.C. §62; Treas. Reg. §1.162–7.

\(^13\)See the discussion of “qualified” and “nonqualified” plans in the chapter on the United States in the Main Edition, at VIII.B.2.
retirement plan deduction rules. This is generally understood to permit plan participation on a controlled-group basis, although deductibility will still hinge on actual common law employment.

There are some interesting exceptions to this common law employment requirement that the employee must be providing services to the employer claiming deductibility of compensation and benefits.

- Long-standing rules under the reorganization provisions of the Code permitted surviving entities to deduct deferred compensation for employees of predecessor entities.\footnote{\text{14}{Treas. Reg. §1.381(c)(11)-1.}}
- More intriguing are the rules relating to nondiscrimination requirements for qualified plans.\footnote{\text{15}{I.R.C. §401(a)(4).}} (Nondiscrimination requirements specify that certain highly compensated individuals may not receive more than a certain proportion of benefits when their benefits are compared to those received by other employees.)

\footnote{\text{14}{Treas. Reg. §1.401(a)(4)-11(d)(3).}}

As a practical matter, when testing discrimination, etc., overseas locations are ignored.\footnote{\text{16}{I.R.C. §410(b)(3)(C).}} However, as a technical matter, only nonresident aliens\footnote{\text{17}{See discussion under C.2.b., below.}} with no U.S.-sourced income\footnote{\text{18}{See discussion of “sourced” income under C.2.b., below.}} can be excluded from consideration. That does not mean nonresident aliens have to be covered under the plan; it simply means that if they are, they can be excluded from consideration when testing nondiscrimination. Conversely, nonresident aliens, while ignored for testing, can still be covered, even if they work for non-U.S. subsidiaries.

\footnote{\text{15}{I.R.C. §401(a)(4).}}

\footnote{\text{16}{I.R.C. §410(b)(3)(C).}}

\footnote{\text{17}{See discussion under C.2.b., below.}}

\footnote{\text{18}{See discussion of “sourced” income under C.2.b., below.}}

\footnote{\text{19}{Treas. Reg. §1.401(a)(4)-11(d)(3).}}

One of the most significant choices faced by an employer transferring an executive overseas is the decision as to what entity will be the employer. Although the word “seconded” is often used in connection with this issue, it is a word that adds more confusion to the situation. The Webster’s New World College Dictionary (Third Edition) definition of “seconded” is “chiefly Brit: to release (as a military officer) from a regularly assigned position for temporary duty with another unit or organization.” This appears to have no particular meaning under U.S. tax, Social Security, withholding, and ERISA rules, all of which refer to common law employment. The word “second” (as a verb with the accent on the second syllable) has little if any meaning in U.S. jurisprudence; issues of taxation, Social Security coverage, “doing business,” and maintaining a permanent establishment will be much more focused on the fact of common law employer. The two options are discussed below:
Extraterritorial Application of U.S. Law [New Chapter]

• If a U.S. corporation chooses to keep an executive as an employee of that U.S. corporation when the executive is sent abroad, then the U.S. corporation will be able to keep the executive in U.S. plans and in the U.S. Social Security system and will be able to take a deduction against the corporation’s U.S. taxes for all compensation and benefits payments made for the individual. However, that U.S. corporation (1) will then be the entity with the requirement to file information returns for the compensation paid, (2) will probably be considered to be doing business in the location the employee is working in, and (3) may well have to allocate U.S. taxable income and deductions outside the United States. Although many businesses choose to operate in this fashion overseas—as “branches” of the U.S. entity—this can be disastrous if it is an unplanned result of compensation and benefit practices.

• By contrast, if a non-U.S. subsidiary is the employer, then the executive may well fall outside the boundary for eligibility under U.S. law for U.S. benefits and for coverage under the U.S. Social Security system, and deductions from U.S. taxes will not be allowed for compensation and benefit expense (absent taking actions noted below). (This tax deductibility is one of the primary incentives provided to employers under U.S. law to encourage employers to engage in more hiring.)

The technical reason that contributions to qualified plans attributable to coverage of employees of overseas affiliates are not deductible in the United States is that I.R.C. Section 414(b) (relating to controlled groups of corporations being treated as one employer) by its own statutory words does not apply to the deduction rules of Section 404.

As part of this discussion, it should be noted that saying on tax forms that an executive is on this or that “payroll” does not give a substantively different result. Payroll is an administrative function, and saying that an executive is on this or that payroll does not answer the crucial question of what entity employs this executive. Confusion over the concepts of payroll and “employer” are common, but U.S. tax and labor law generally will ignore payroll and look to the common law definition of employer and employee.

Some alternative approaches to this issue that allow at least partial deductibility from U.S. taxes involve using split pay/dual employment or establishing U.S. corporations as regional management companies for non-U.S. activities.

• Under the former, each entity is a common law employer of the employee, and each entity pays an appropriate amount of compensation for the services actually rendered to itself.

• In the latter approach, a U.S. corporation is established with all its operations outside the U.S. This entity then hires executives to guide the business activities in that country, allowing a full U.S. deduction for the compensation paid, and often permitting improved benefit plan and Social Security coverage.
Partnerships can also be used for international business ventures, and these partnerships may or may not be able to take deductions for salary and benefit payments. Partnerships can each have employees of their own, in which case deductions may be taken. But if each partner retains its own employees, then payments for individuals other than the partner’s own employees are not allowed. Harder to analyze are “joint ventures,” which do not rise to the level of a partnership and are not a corporate form. Often they are only contractual agreements between or among various corporations, and can have no employees of their own.

b. Taxation of Foreign-Based Trusts

The section above discussed taxation of U.S.-based trusts. This section discusses taxation of foreign-based trusts. U.S. companies set up foreign-based trusts because they can often achieve local tax advantages only through the use of a local trust.

The discussion below assumes that the U.S. employer is operating overseas directly, i.e., through a “branch” rather than through a foreign subsidiary corporation. As discussed in C.1.b.vi, below (on subsidiaries), different rules apply to foreign subsidiary corporations.

The general tax rule is that the United States will tax the earnings of a non-U.S. trust of any type only to the extent the earnings have a U.S. source. The tax is usually a flat 30 percent, or such lesser treaty rate as may apply. However, under some circumstances, the entire earnings can be subject to U.S. tax, i.e., for foreign trusts of U.S. taxpayers established after May 21, 1974, if the trust has as a beneficiary a U.S. citizen or U.S. resident (or, for that matter, a domestic partnership, corporation or trust). The purpose of this provision is to keep U.S. taxpayers from avoiding U.S. tax by transferring assets to trusts located in “tax haven” countries.20

It was, however, recognized that the law should not tax a U.S. taxpayer/employer for a foreign-based trust that is used in connection with a foreign pension plan. Historically, the exception (from “grantor trust”21 status) for foreign pension plan trusts was only applicable to qualified plan trusts (i.e., qualified under I.R.C. Section 401(a) or qualified under Section 401(a) in all respects except that it does not have a trust created or organized in the United States).

When general rules on the taxation of foreign pension plans were passed in 1980 as the new Code Section 404A, the special rules on the taxation of foreign trusts were amended only to except (along with qualified pension plans) plans that elect special tax treatment under I.R.C. Section 404A. In 1997, this exception was expanded to include all trusts that relate to deferred compensation. This evolution is discussed in greater detail below.

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20I.R.C. §679.
21See discussion of this term under iii., below.
i. Historical background

To understand the interrelationship of foreign grantor trusts and deferred compensation, the role of Section 404A and why it is of current interest, the reader may find some history helpful.

Prior to 1976, when the complex tax provisions of ERISA became applicable for any plans seeking to be “qualified” in order to qualify for tax deductibility, U.S. multinationals routinely deducted contributions to foreign plans (particularly in the United Kingdom and Canada), often under the protection of a determination letter from IRS. For foreign subsidiaries of U.S. companies, these pension payments did not have to be deductible in the United States. Rather, these payments had a U.S. tax effect through the “charge to earnings” mechanism, which would affect the amount of indirect foreign tax credit. These charges to earnings for pension costs that were locally tax-deductible were rarely, if ever, challenged. Generally, these payments would be deductible under U.S. law only if the U.S. corporation had a direct presence overseas, i.e., was operating as a foreign branch.

In 1976, however, the tax provisions for qualification of plans under ERISA became effective. As a consequence, proving that overseas plans were tax-qualified (that is, met all qualification rules except the U.S. situs trust requirement, thereby allowing tax deductions for contributions) became more difficult.

In 1978 and 1979, IRS made clear that nonqualified defined benefit plans abroad would neither generate deductions (unless separate accounts were maintained) nor, where amounts were reserved but not funded, be allowable offsets as charges against earnings. This was important because in those days almost all foreign retirement plans were defined benefit plans, and defined benefit plans almost by definition do not have separate accounts. Such charges are important to U.S. shareholders, for they directly affect the determination of foreign tax credits applicable to repatriated earnings. This led a number of U.S. multinationals to seek a legislative solution, and in 1980, I.R.C. Section 404A was enacted, “the first exemption” permitting U.S. companies to take charges against earnings for the deferred compensation costs of foreign subsidiaries.

A second exemption exists under I.R.C. Section 678. If Section 404A is not elected, and the plan is not qualified, the problem of taxing a U.S. employer on foreign trust earnings can still be avoided if the foreign trust is amended to provide that no benefits will be paid (and no assets will revert) to a U.S. citizen or resident. This solution is not foolproof because a beneficiary receiving benefits could become a U.S. citizen or resident during this period. Further problems could develop if joint and survivor annuities are offered (because the status of the spouse will then be important) or if residency status is ambiguous.

These two exemptions are discussed in greater detail below.

ii. Section 404A exemption

Section 404A permits deductions for contributions and reserve accruals related to deferred compensation. In addition, as noted above, Section 404A permits charges to earnings for the deferred compensation costs of foreign subsidiaries.

In 1981, IRS issued several procedural releases concerning Section 404A, including one permitting protective Section 404A elections by companies to be perfected within the period ending 90 days after
issuance of final regulations (subsequently lengthened as noted below). In April 1985, proposed regulations under Section 404A were issued. Subsequently, after extensive comment and review, the regulations were reissued in 1993 and as of this date (1999) are still in proposed form.

The 1993 proposals differ from the 1985 proposals in a number of significant ways. These changes may help or hurt a company’s tax result, and only a detailed analysis can say what their result is in a given situation. The major changes include the following:

- The IRS is explicit in saying that I.R.C. Section 404A is the only way for U.S. companies to take a charge against earnings for funded plans of subsidiaries. This will have a major impact, for example, on plans in Canada and the United Kingdom, where the typical plan is a funded defined benefit plan.
- The local foreign tax deduction limits will cut back on Section 404A only on a cumulative basis, meaning that the level of local deduction for any given year will not reduce the U.S. deduction (as it did before 1987), and instead the aggregate local deduction for all years elected will be the limit.
- The U.S. full-funding pension deduction limit will apply to plans around the world (for the purpose of determining U.S. deductions and charges against earnings).
- Companies will have a full year after final regulations to perfect or revoke elections, up from the 90 days permitted in the 1985 proposals.
- Special “change in accounting method” rules under I.R.C. Section 481 have been re-proposed. However, the rules still seem to miss the mark in properly avoiding duplication or omission of deductions and charges because the rules do not take into account the overall tax limit based on foreign law that continues to apply after a Section 404A election. For example, if foreign law had permitted a reserve in excess of the permissible Section 404A reserve as of the year of election (and the foreign law amounts had actually been taken), the shift to Section 404A would not result in duplication (because the foreign law precludes the duplication of reserve additions). Admittedly, the opening foreign law reserve would have been “erroneous,” but this is not a Section 481 issue, and should be addressed for prior years only, or under a mitigation of the statute of limitations for such years.
- Termination indemnity plans (plans common in Italy and some Latin American countries—these plans provide benefits on termination of employment, even before retirement age) are specifically permitted to elect use of Section 404A.
- Highly detailed rules on currency translation and amortization of experience gains have been added.
- In what the author considers the strangest aspect of the regulations, U.S. “prohibited transaction” principles are to be applied to overseas plans. If there were a U.S.-defined prohibited transaction in a foreign plan, it would be evidence that the plan was not

22See VIII.B.4. in the chapter on the United States in the Main Edition.
operating for the “exclusive benefit” of employees, and a 404A election as a funded plan might be voided.

iii. The foreign grantor trust rule

The 1993 proposed foreign pension expense regulations included a new rule on foreign grantor trusts under I.R.C. Section 671. These rules are part of the general U.S. tax policy to tax earnings on funds “parked” abroad. The new rule specified that, under some circumstances, the entire earnings of a foreign pension trust can be subject to U.S. tax. This is because the trust could be deemed to be a “grantor trust,” a type of trust in which all of the trust’s income would be deemed to be the income of the grantor. Employers have always been concerned that a pension trust would someday be classified as a grantor trust and, hence, made subject to taxation, simply because a pension trust is invariably established to satisfy the obligation of the grantor to provide promised employee benefits, and therefore exists, in a sense, for the benefit of the grantor.

In proposed regulations, however, the IRS has stated that domestic (U.S.) employee benefit trusts will not be considered grantor trusts, even though they are established to satisfy the obligations of the grantor.23 However, the IRS made this exemption specifically inapplicable to foreign trusts, crafting a more limited exemption for those trusts. Under the more limited exemption, those trust funds would also be exempt, except for the amount by which the fair market value of plan assets exceeds the plan’s accrued liability.24 That portion is considered to be a grantor trust. In such a situation, the amount of trust earnings that would be attributable to the grantor (and thus not exempted) would be determined by multiplying the entire trust earnings by a factor, the numerator of which is the excess of assets over accrued liability, as described above, and the denominator of which is the fair market value of the assets of the trust.25

• **Facts:** A foreign trust has earnings of $10 million. The excess of assets over accrued liability is $2 million. The fair market value is $9 million.
  
  **Result:** The grantor trust amount is:
  
  \[
  \frac{\$2\text{ million}}{\$9\text{ million}} \times \$10\text{ million} = \$2.22\text{ million}
  \]

  Thus, $2.22 million is the amount of the grantor trust earnings taxable to the grantor.

  This rule effectively taxes a U.S. employer on the portion of its foreign pension trust that consists of “surplus” under U.S. principles. It would be especially harsh if the surplus resulted from actions over which the employer had no control, such as appreciation in investments over the rate assumed in funding calculations, rather than from overfunding by an employer to shelter income. To ameliorate this unfairness, there is an exception to the exception. The proposed regulations allow the employer to deduct from the surplus (in the example above, $2 million—the numerator in the fraction of the trust income that will be

23Prop. Treas. Reg. §1.671-1(g).
taxable) for any amounts that (a) the employer can demonstrate is attributable to amounts contributed under a reasonable funding method or (b) that arose from experience that is more favorable than the actuarial assumptions that the employer followed, provided the IRS determines that those actuarial assumptions were reasonable.\textsuperscript{26} The proposed regulations define a reasonable funding method as one that would be allowed under I.R.C. Section 412. Furthermore, a funding method is considered reasonable only if the method provides for any initial unfunded liability to be amortized over at least 6 years, and any net change in liability resulting from a change in funding method is also amortized over 6 years.

The regulations were proposed to be effective for tax years ending after September 27, 1996. However, as of 1999 they are still proposed. A special transition rule in the proposed regulations exempted the amount of surplus existing in the plan as of the measurement date immediately preceding the proposed 1996 effective date. (The measurement date is a valuation date consistently applied by the plan. In most cases, the measurement date will be the close of the prior plan year.) The transition rule exempts 100 percent of that fixed amount of surplus as determined under the measurement date prior to September 27, 1996, until the regulations are published in final form. The exemption is phased out in stages of 10 percent for each year thereafter.\textsuperscript{27} However, the transition rule does not exempt any surplus that arises after the proposed 1996 effective date, so the regulations, when finalized, may have a significant retroactive effect if the original proposed effective date is not moved forward.

iv. Section 679 provisions

If Section 404A is not elected, and the plan is not qualified, as noted at the beginning of this section, the problem of taxing a U.S. employer on foreign trust earnings can still be avoided if the foreign trust is amended to provide that no benefits will be paid (and no assets will revert) to a U.S. citizen or resident.

Thus, another way a foreign trust to which a U.S. person has transferred funds may run afoul of the grantor trust rules is if it has a U.S. citizen or U.S. resident (or, for that matter, a domestic partnership, corporation, or trust) as a beneficiary, as specified in I.R.C. Section 679. The purpose of this provision is to keep U.S. taxpayers from avoiding U.S. taxes by transferring assets to trusts located in “tax haven” countries.

The rationale for the exemption is the recognition that the law should not tax a U.S. taxpayer/employer for a foreign pension trust. This means that, technically, a U.S. corporation that establishes a foreign-funded pension plan for a foreign branch may be taxable in the United States on the trust fund’s earnings if there is even one U.S. beneficiary, unless the foreign plan meets all of ERISA’s rules and I.R.C. Section 401(a)’s qualification standards (except the U.S. situs trust requirement), or the trust is covered by Section 404A. The technical explanation for this development is that the exception from “grantor trust” status discussed above for foreign pension plan trusts is only applicable to qualified plan trusts (i.e., either qualified under Section 401(a) or qualified under Section 401(a) in all respects except that it does not have a U.S. situs trust), or to trusts qualified under Section 404A.

\textsuperscript{26}Prop. Treas. Reg. §1.671-1(h)(3)(iii).
\textsuperscript{27}Prop. Treas. Reg. §1.671-1(h)(5).
v. Summary

To sum up, what this means is that, technically, a U.S. corporation that establishes a foreign-funded pension plan for a foreign branch may be taxable in the U.S. on the trust fund’s earnings if there is even one U.S. beneficiary unless (a) the foreign plan meets all of ERISA’s rules and the I.R.C.’s qualification standards of Section 401(a) (excepting, of course, the U.S. situs trust requirement) or (b) the U.S. corporation elects to follow I.R.C. Section 404A discussed above.

vi. Subsidiaries

The above discussion regarding the deductions for foreign pension expense assumes that the U.S. employer is operating overseas directly, i.e., through a “branch” rather than through a foreign subsidiary corporation. (The distinction between a branch and a subsidiary is discussed in more detail at C.1.a., above). If the U.S. employer is operating through a subsidiary, it will generally be the subsidiary that will be considered the grantor. Subsidiaries that are not “controlled foreign corporations” (CFCs)—generally those that are less than 50 percent owned by the U.S. parent—will be exempt from the grantor trust rules under the proposed regulations, even if they sponsor plans with a surplus.

Foreign corporations owned by U.S. entities (i.e., subsidiaries) generally do not pay U.S. tax on their earnings until the earnings are repatriated. An exception is made for CFCs, which are deemed to repatriate certain types of income, called “Subpart F Income,” each year. Subpart F income includes passive investment income, such as dividends and interest. Because most of the trust earnings imputed to the grantor will be of this type, application of the proposed regulations will have the effect of subjecting the U.S. corporate parent to tax on the earnings of its CFC foreign subsidiaries’ pension funds. Furthermore, because the pension fund is exempt from foreign tax under the foreign tax rules, there may be no foreign tax credits to offset the U.S. tax.

Note: Because Section 679 covers “direct or indirect” transfers of property, it could, in some situations, apply if a U.S. corporation’s controlled subsidiary established a foreign trust, such as where the U.S. parent must contribute to the subsidiary in order for the subsidiary to fund its pension obligations. In the case of a funded pension plan of a foreign subsidiary of a U.S. corporation, where the plan has been funded by the subsidiary, the statute is not clear as to whether the requirements discussed above apply. Because “direct or indirect” transfers are covered by the rules, it is arguable that a transfer to the fund by an entity controlled by the U.S. corporation is an “indirect” transfer. However, some language in the legislative history of the statute indicates that this will not apply if the transfer by the subsidiary to its pension fund is “unrelated to the U.S. person’s
transfer of property to the foreign (subsidiary).”

This language suggests that whether a U.S. parent could be taxed on a funded subsidiary’s plan may be determined by reference to the specific facts of the situation. This statement is made only in legislative history, however, and how much weight it has is therefore uncertain.

Moreover, while application of U.S. requirements to foreign pension plans was almost certainly not the real intent of the rules making a foreign trust with a U.S. beneficiary a “grantor” trust, the specific amendment excluding from “grantor trusts” those treatment plans covered by Section 404A carries a negative inference for foreign-funded plans for which a Section 404A election is not made.

2. Taxation of Employees

a. U.S. Citizens and U.S. Residents

U.S. citizens and U.S. residents are taxed on their worldwide income without regard to source. A statutory exception for services rendered outside the United States permits U.S. citizens an annual exclusion (hereinafter the “expatriate exclusion”) of up to $72,000 (in 1998) of income derived from such services outside the United States.

This exclusion does not apply to amounts U.S. citizens and U.S. residents receive as a pension or annuity. Nonetheless, the exclusion is an important consideration in pension planning because of the way the U.S. tax laws treat deferred-compensation arrangements. The reason it is important is that the time when the tax is due differs depending on whether the deferred compensation is unfunded or funded. An unfunded arrangement is one that does not segregate assets from the claims of creditors and keeps the employees at the level of general creditors. If assets are segregated from creditors, the plan is considered funded.

When deferred-compensation arrangements are unfunded, the “tax event” (the time when the funds become taxable) is generally postponed until the deferred compensation is paid, regardless of where the employee’s services were rendered or where the employee resides (provided the election to defer was irrevocable and made before the compensation to be deferred was earned).

In the case of funded pensions, tax is due from the employee as soon as he or she has a vested right to the amounts accrued under the plan, unless the plan is qualified under the notoriously complex U.S. tax rules. Accordingly, a U.S. citizen participating in a foreign-funded plan that is not qualified in the United States is (at least as a technical matter) taxable on the value of his or her vested interest in the plan.

One solution to the problem that employees may be taxed as soon as benefits vest if the plan is not a qualified one, is to keep U.S. citizens in U.S. qualified plans. Another is to take advantage of the expatriate exclusion. If an expatriate earns less than $72,000, or is in a low tax bracket, having taxable nonqualified funded benefits might be advantageous. Consider a 55-year-old U.S. citizen who earns $60,000 abroad and is a participant in a qualified pension plan with a current accrual worth $10,000. That

amount might generate a fully taxable benefit of $2,000 a year, beginning at age 65. However, if the employee were to use the $10,000 now to purchase a single premium annuity that will pay the same benefit at age 65 or if the employee were to contribute it to a funded nonqualified plan now, the amount would still be taxable to the employee now (i.e., upon vesting) but the amount would fall within the $72,000 exclusion limit; thus, the $10,000 in pension payments received by the employee would be exempt from U.S. tax to the extent of this $10,000 basis.

Congress at one time had mandated that expatriates should always get a tax basis (that is, an amount that would be recovered by the employee tax-free when the pension went into pay status) in pension payments when pensions were earned outside the United States, including payments earned under a plan that was qualified under ERISA. A fading vestige of this rule survives for U.S. citizens: contributions for pre-1963 service that could have been excluded under what was at that time an unlimited “expatriate exclusion,” are considered to generate basis in the annuity. A more important vestige is the exclusion for amounts earned outside the U.S. in a funded pension plan of a nonresident alien who receives the pension while a U.S. resident.

Requirements for aliens who have rendered services both inside and outside the United States, including individuals who have become resident aliens by the time they receive pension payments, are discussed below (see c., below).

b. Nonresident Aliens

There is much confusion on coverage of nonresident aliens. Most of the confusion can be traced to a misunderstanding of the role of I.R.C. Sections 406 and 407. Prior to ERISA, these sections were viewed as the exclusive authorization for coverage of employees of overseas affiliates. Those sections require an I.R.C. Section 3121(l) agreement (see discussion under B., above), which can be burdensome and expensive, and would not apply in any event to nonresident aliens. This “problem” of covering nonresident aliens because they fall outside a 3121(l) agreement does not apply to the use of the “controlled group” concept under I.R.C. Section 414. Any nonresident alien employed by an affiliate of the U.S. plan sponsor could become a participant under the controlled group rules.

As noted under a., above, aliens who reside in the U.S. (resident aliens) are taxable on worldwide income without regard to source. Nonresident aliens (that is, non-U.S. citizens resident outside the United States) are taxable on income that is “effectively connected” to a U.S. trade or business and on income that has the United States as its source.

For any taxable year in which they render personal services inside the United States, nonresident aliens are considered to have a U.S. “trade or business.” Income derived from those services is considered U.S.-source income that is “effectively connected” to the nonresident alien’s U.S. trade or business (termed “effectively connected income” (ECI)) if the nonresident alien receives the income in the same taxable year in which he or she renders the services.

All nonresident alien ECI is taxed at progressive rates, whereas U.S. income “sourced to” the United States but not classified as “effectively connected” (hereinafter U.S.-sourced non-ECI) is taxed at
a flat rate of 30 percent.\textsuperscript{33} Deductions are available with respect to ECI, but not with respect to U.S. non-ECI. Interest and dividends paid by U.S. residents (including U.S. corporations and U.S.-based multinationals) are “sourced to” the United States and thus are classified as U.S.-sourced non-ECI. Thus, an alien who has never resided in the United States or never rendered any services there but receives a pension that is funded in the United States, or is funded through U.S. investments, owes the 30 percent tax on the earnings on employer pension contributions, except as noted below. Note the use of the term “earnings.” In the situation under discussion, the employer contributions are considered compensatory payments “sourced” outside the United States and as such are not taxable in the United States, but earnings on those contributions (such as interest and dividends), which are indirectly received by the employee as a beneficiary of a U.S. trust because the earnings are used to pay pension benefits to the nonresident alien, are considered U.S.-source income and hence are taxable at the 30 percent rate.\textsuperscript{34}

There is, however, an important exception to the 30 percent tax on the earnings element of the deferred compensation. If the nonresident alien receives an annuity from a U.S. “qualified” plan, no part of the pension is taxable, provided: (1) all the services giving rise to the pension were performed outside the U.S. and (2) 90 percent of the plan participants are U.S. citizens or residents.\textsuperscript{35} The logic here is that a plan that is essentially a U.S. plan should not be burdened with this complicated calculation for a small group of non-U.S. participants. This provision is referred to hereinafter as “the annuity rule.”

Although pension and profit sharing benefits are usually considered “compensation,” there is an element of them that, for tax purposes, is considered investment income and is “sourced” not to the place where the services of the participant were rendered, but rather to the place of the investment. Thus, in general, the interest or earnings element (even for defined benefit plans) will be subject to U.S. tax even if paid to a nonresident alien who never worked in the United States.\textsuperscript{36}

Requirements concerning aliens who have rendered services both inside and outside the United States are discussed immediately below (see c., below)

c. Aliens Who Have Rendered Services Both Inside and Outside the United States

For an alien who has rendered services both inside and outside the United States, whether the alien’s payments from a pension are taxed depends upon the alien’s residence at the time of receipt of the payments. In general, if an alien renders service in the United States, compensation for such service is considered ECI and taxable at the progressive rates.\textsuperscript{37} For many years, if compensation was deferred and the alien continued to be a nonresident at the time of receipt, the deferred compensation payments were not considered “effectively connected” and were not subject to progressive tax rates. Instead, such payments attributable to U.S. service were taxed as U.S.-sourced non-ECI, as were any pension plan earnings resulting from U.S. investments. This rule was considered to be something of a loophole, because,

\textsuperscript{33}I.R.C. §871(a).
\textsuperscript{34}Rev. Rul. 79-388, 1979-2 C.B. 271.
\textsuperscript{35}I.R.C. §871(f) (requirement (2) is waived for certain developing countries and certain treaty partners).
\textsuperscript{36}See I.R.C. §871(f).
\textsuperscript{37}I.R.C. §871(b)(1).
under prior law, the tax rate could have dropped from as high as 50 percent (the maximum progressive rate) to 30 percent (the flat rate). Under 1986 legislation, however, income that is “effectively connected” in the year it is earned would retain that characteristic forever, even if the payments are made for many years in the future, even if the recipient had no U.S. trade or business in the year it was received.\textsuperscript{38} Ironically, the 1986 law also changed the tax rates, so that at that time ECI was taxed at only 28 percent, while U.S.-sourced non-ECI remained taxable at the higher 30 percent rate. As the U.S. has increased the overall tax rate, the differential has regained importance.

An alien who is a U.S. resident when he or she receives payments faces a peculiar dilemma. Even if some or all of the alien’s pension was earned outside the United States, the fact that he or she is a U.S. resident at the time of receipt would appear to require full taxability at the time receipt of payments begins. This might be so even if the pension was funded outside the United States. It would seem to be better (although some might dispute this conclusion) to treat non-U.S.-source contributions and earnings as capital amounts not subject to U.S. tax, on the theory that the interest in the plan funds that vested in prior years became property that had already been transferred at the point of vesting.\textsuperscript{39} The cash transfers made in retirement pursuant to the previously earned interest in the pension fund could then be characterized as amounts already reduced to income (albeit not U.S. taxable income) in years prior to the years of U.S. residency. Accordingly, these amounts would not then be taxable in the United States when paid to the retiree. Statutory support for this position can be found in the annuity rule (discussed in C.2.b., above), under which contributed amounts that would have been nontaxable if they had been paid directly to the employee are considered nontaxable when finally paid as benefits (through the mechanism of treating the amounts paid as “premiums” that can be recovered tax-free). The IRS seems to have accepted this view.

IX. IMMIGRATION
[Reserved]