

Restricting Flow of Technology

The Siberian Pipeline Capers and the extraterritorial application of U.S. technology export controls

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When I addressed the LES Conference in Helsinki in September 1980 on the subject of "The Effect of Government Sanction on International Technology Transfers" I had no idea that two years later I would be privileged to speak once again on essentially the same subject.

The first time around, we had just experienced the embargo of a major sporting event, the Moscow Summer Olympics. This time the target of the embargo has been a major engineering project, the Siberian Gas Pipeline. Both of course concern Russia and were brought about by the Soviet invasion of Afghanistan for the first one, and by the institution of martial law in Poland for the second.

Both were declared by American presidents, the first by President Carter, a Democrat, and the second one by President Reagan, a Republican.

If one wished to look for some differentiation between them, it could be said, perhaps, that the Moscow Olympics Games boycott was basically motivated by humanitarian concerns, whereas the Siberian Pipeline embargo is principally motivated by economic concerns.

It is also interesting to note that the Olympic Games and pipeline sanctions were directed at individual projects of some notoriety but of a nonmilitary nature, as opposed to trading in general, or the trading in military equipment and armaments, as was the case in the earlier embargoes of Rhodesia, South Africa, and Iran, or the more recent embargo of Argentina with respect to the Falkland Islands.

One might quite naturally assume that by scaling down the scope of an embargo to the blocking of a single project, one could expect such an embargo to have significantly improved chances of succeeding. However, we saw that the Olympics Games of 1980 took place on schedule, and that, according to present indications, the Siberian Pipeline to Western Europe will be completed in due course. Already one-fourth of it is finished.

Furthermore, the Siberian Pipeline has by now earned the somewhat embarrassing distinction of having

caused more harm to the relations between the United States and Western Europe than to Russia, the intended target.

Major Controversy

The Siberian Pipeline embargo is also unique for having generated a major controversy between the members of the Atlantic Alliance over a legalistic issue—namely, the extraterritorial application of export control legislation by the United States.

Also significant is the fact that the Siberian Pipeline embargo, more than any other embargo that preceded it, was predominantly concerned with high technology and with the attempt of the United States to block its transfer in any form or by any direct or indirect means in spite of the existence of prior contractual obligations. The Reagan Administration went all out to enforce its embargo of high technology by applying the sanctions of American export control laws at home and abroad.

As I pointed out in Helsinki, trade embargoes are becoming more and more common occurrences in our era of nuclear deterrence. Since nuclear war is unthinkable, and conventional wars have become too unpopular and carry too many political risks, we find major powers or groups of nations more readily and more frequently reaching for the expediency of trade embargoes to exert pressure on their foes. As of late, America appears to be initiating most of them.

Let's retrace the steps that brought us to this state of affairs.

THE SIBERIAN PIPELINE PROJECT

The pipeline is intended to bring natural gas from the huge gas fields of Siberia to Western Europe over nearly 4,000 miles of extremely varying terrain influenced by a great disparity of climatic conditions. To travel all that way the gas will have to be propelled and compressed repeatedly by means of some 41 compressor stations where huge turbines will be at work relentlessly. At several stages the gas will also have to be cooled, contained, controlled, metered, and so on. All of this will require highly sophisticated and reliable equipment and techniques, much of which is based on hardware and technology originating from the United States, or supplied by the European subsidiaries or independent licensees of American companies. These include General Electric, Dresser Industries, Rockwell International, Cooper Industries, and many others.

There is also a number of European and Japanese suppliers such as Mannesmann, AEG-Telefunken,

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Creusot-Loire, Alsthom-Atlantique, Thomassen Holland, John Brown Engineering, Nuovo Pignone, Japan Steel Works, Mitsubishi, Hitachi and Kawasaki, and others. Many of these firms make equipment under license from U.S. firms, as well as based on their own research and development.

The Russians do not have the required hard currency to purchase all the western equipment and know-how, reportedly valued at about \$20 billion, which they need to complete and operate the gas pipeline. Consequently, many of these purchases are being financed by loans from West-European banks, and supported by government export incentives at highly preferential interest rates.

When the magnitude of the Siberian Pipeline project and the corresponding western equipment and technology purchases are considered against the background of western economic recession and mass unemployment, it is not surprising that the contracts involved were considered by all participants as constituting the "deal of the century." Nor is it surprising that the reaction to the Pipeline Capex has become a major multinational diplomatic imbroglio.

The original contract for the supply of Siberian Gas was signed in November 1981 between Soyouz-Gas Export and Ruhrgas A.G. with the financial support of a consortium of West German banks. This was closely followed by contracts with major state enterprises in France and Italy.

Under these contractual arrangements the Soviets expected to be selling by 1988 some 40 billion cubic meters of gas per year to Western Europe, generating annual revenues in hard currencies worth around \$10 billion. However, since then, due in some part to the pressure exerted on the allies by the U.S. embargo, as well as by falling oil prices, the purchases are no longer expected to attain those levels. They are estimated to reach only 26 billion cubic meters per year, for a total of about \$5 billion per year. These figures still uphold the strategic importance of this project.

Extends Reach

Shortly after the signing of those contracts the Polish Government imposed martial law in Poland under pressure from Moscow. President Reagan retaliated by announcing in December 1981 the imposition of a total embargo on the export of oil and gas equipment from the United States destined to be used for the Siberian gas pipeline. However, this did not prove to be an effective order for controlling the sale of such equipment made outside of the United States and which thus escaped the U.S. export licensing controls. Consequently, President Reagan issued a second order in June 1982 to have the oil and gas equipment embargo extended to cover foreign subsidiaries of U.S. companies, as well as the independent foreign enterprises which utilized U.S.-origin technology under license.

Thus we see the linkage of technology transfer being utilized as both the motivating factor and the implementing lever for extending the U.S. export controls beyond the territorial limits of the United States.

The consequences of that chain of events not only produced immediate and strenuous political and

economic reactions. It also raised many complex legal issues and controversies which focused particularly on the attempted extraterritorial exercise of jurisdiction by the U.S. Government.

As an international lawyer I must admit that the legal questions raised, and their significance to the future conduct of major technology-transfer negotiations and contracts are most baffling and ambiguous.

But before getting to some of those questions, it is necessary to first understand the U.S. legislation that served as the launching pad for President Reagan's pipeline petard.

U.S. EXPORT CONTROLS APPLICABLE TO TECHNOLOGY TRANSFERS

The Export Administration Act of 1979, as amended in 1981, which is due to expire on September 30 of this year, is the source for President Reagan's Executive Orders of December 1981 and June 1982, which imposed a freeze on the granting of export licenses for oil and gas equipment destined for the Siberian pipeline.

Although it is set to expire on September 30, the act will most certainly be extended.

The act first seeks to establish some guiding principles and policies, which are expressed at the beginning of the act in a statement of Congressional Findings and a declaration of Congressional Intent.

In those findings and declaration it is stated that the ability of United States citizens to engage in international commerce is a fundamental concern of United States policy. It is recognized that exports of goods and of technology contribute significantly to the economic well-being of the United States and to the stability of the world economy. On the other hand, it is considered that the indiscriminate exporting of goods and technology which does not take into account whether they make a significant contribution to the military potential of any country or combination of countries, could adversely affect the national security of the United States.

It is also considered justifiable to impose controls on the export of goods and technology if this is considered necessary by the president to further significantly the foreign policy of the United States or to fulfill its declared international obligations.

Particularly relevant to the Siberian Pipeline controversy is the provision that it is the policy of the United States to apply any necessary controls to the maximum extent possible in cooperation with all nations, and to encourage observance of a uniform export control policy by all nations with which the U.S. has defense treaty commitments.

Another significant provision states that as a matter of U.S. policy the desirability of subjecting or continuing to subject particular goods or technology to U.S. export controls should be subjected to review by and consultation with representatives of private industry.

It is generally considered that in establishing and expanding the Siberian pipeline embargo the Reagan Administration largely ignored these provisions or applied them too little and too late.

It is also interesting to note that the act specifically includes a provision for the minimization of restrictions on exports of agricultural commodities and

products which are considered to be of critical importance to the stabilization of the United States economy and balance of payments, and to the reduction of federally-funded agricultural support levels. The fact that the agricultural sector is specifically highlighted in the act may well help to explain why the Reagan Administration was particularly intent on lifting the grain embargo both for economic as well as political reasons. America's farming community represents a most important sector of the United States electorate.

Finally, and in an effort to summarize all of the foregoing principles, the Congress affirms that:

"It is the policy of the United States that export trade by United States citizens be given a high priority and not be controlled except when such controls (A) are necessary to further fundamental national security, foreign policy or short supply objectives, (B) will clearly further such objectives, and (C) are administered consistent with basic standards of due process."

Thus we see that the Export Administration Act justifies the implementation of export controls for essentially three main purposes only:

1. To protect significant U.S. national security interests.
2. To further U.S. foreign policy.
3. To protect the domestic economy from the excessive and inflationary drain of scarce materials.

As to this last-stated purpose, and in spite of the claims of an increasing number of persons that the United States leadership in technology and innovation is rapidly declining and in danger of being overtaken by Japan and Europe, it is obvious that U.S. technology is not about to become scarce material.

Thus the pipeline sanctions had to be justified on either of the first two grounds. The Reagan Administration in its past pronouncements has been somewhat ambivalent between claiming that the measures were either for national security purposes to prevent the Soviets from using oil and gas technology or revenues for their military needs, or were for foreign policy purposes to put pressure on the Soviets to relax their strangleholds on Afghanistan and Poland, or to avoid having Western Europe become too dependent on Russian gas supplies.

A major difficulty that the Reagan Administration has faced in trying to convince its Atlantic Alliance partners to cooperate with the embargo, was the lack of consensus on the relationship between oil and gas equipment technology and the Russian military potential. To the Europeans the embargo meant only a serious deterioration of their own national economies and an ill-timed and undesirable escalation of tensions with neighboring Russia. The embargo was perceived as more of a punishment to America's economic partners than an embarrassment to Russia. Consequently, instead of fostering cooperation, it generated mass rejection and retaliation.

What is particularly noteworthy about this, is that this strong reaction was not so much in terms of diplomacy as it was in terms of law:

1. The economic sanctions were considered to be applications of U.S. law in blatant disregard of local laws and in violation of the principles of international law and comity.

2. The sanctions violated the sanctity of contracts by retroactively enjoining foreign companies from fulfilling their obligations under contracts concluded before the sanctions were announced.

3. The sanctions had been applied without due process. Namely without proper notice and consultation and in an arbitrary manner.

The legal issues which have been raised are most pertinent to our concerns with the ability to freely engage in international transfers of technology. The main problem was the extraterritorial exercise of jurisdiction by the United States over transfers of technology.

THE ISSUE OF EXTRATERRITORIALITY

The Export Administration Act grants the president, with respect to national security controls and foreign policy controls, the right to:

"Prohibit or curtail the export of any goods or technical subject to the jurisdiction of the United States or exported by any person subject to the jurisdiction of the United States."

This grant of authority to the president does not appear to raise any particular problem if "subject to the jurisdiction of the United States" is intended to cover only goods, technology, and persons located within the United States territory. But the intent of Congress when it passed the act was not so limited.

As defined in the act and further clarified by the regulations issued by the Department of Commerce, a "person subject to the jurisdiction of the United States" includes (1) any citizen or resident of the United States wherever located, (2) any person while present in the United States, (3) any corporation organized under the laws of the United States or any state thereof, and (4) any corporation or other business entity *outside* the United States which is owned or controlled by any of the preceding persons.

Thus the act clearly was intended to cover foreign subsidiaries of American corporations and transfers of technology taking place entirely outside the territorial limits of the United States. This extraterritorial exercise of jurisdiction has run into an avalanche of criticism, the intensity of which seems to surpass that which has been building up in past years over the extraterritorial excursions of U.S. antitrust laws and procedures.

When it is considered that many high-technology companies in the United States operate in a number of countries through subsidiaries and controlled affiliates, it is not surprising that both the act passed by Congress and the supporting regulations issued by the Secretary of Commerce would contain provisions aimed at avoiding the circumvention of the export controls by U.S. companies shifting research and production to overseas affiliates.

Furthermore, such shifting would not occur if the U.S. companies involved did not refrain effective control over such overseas companies owned by them. It is this aspect of "ownership and control" in the hands of persons who clearly are found within the territorial limits of the United States and therefore clearly falling under its sovereign jurisdiction which is looked to for justifying the extraterritorial extension of the act's reach.

Other Laws

The same sort of extraterritorial extension of jurisdiction is found also in other United States laws and regulations, such as those applicable to competition and taxation. This phenomenon is not just limited to United States laws and regulations. We find it also in the laws of many other countries. Even the EEC has included extraterritorial measures in a number of cases of existing regulations or proposed legislation. For instance, its latest proposal in the area of social legislation, known as the "Vredeling Proposal," would impose, if it is adopted by the member states, compulsory disclosure of data on foreign concerns which have subsidiaries in Europe.

Yet, when President Reagan extended the embargo to the European subsidiaries of U.S. companies in order to stop them from exporting oil and gas equipment to Russia, regardless of whether that equipment was based on U.S.-supplied technology, the reaction of the European governments concerned and of the EEC officials was immediate to condemn such action. But it did not stop there.

These European governments, led by France, promptly ordered these same subsidiaries, incorporated under their own laws, to respect their contracts and deliver the goods on schedule. This was done essentially through the application of local government requisition laws, such as the French "Ordonnance" of 6 January 1959. That law empowered the government to requisition from private enterprises goods or services needed in the national interest. Another approach is through local so-called "blocking-laws," such as the British Protection of Trading Interests Act of 1980. That law authorized the Secretary of State to prohibit compliance by any person in the United Kingdom with any order of a foreign government or foreign court which the Secretary considers to be against the trading interest of the United Kingdom.

The result of this forceful clash of opposing exercises of sovereign power was the imposition of sanctions by the U.S. Department of Commerce on those companies who in defiance of the embargo but in compliance with the orders issued by their own host-country governments, shipped the restricted goods and technology with ultimate destination to Russia. The managers of these subsidiaries were literally caught in a vicious cross-fire with nowhere to duck for safety.

Though the sanctions imposed by the U.S. Commerce Department, consisting mostly of the denial or revocation of export license privileges through "blacklisting," were challenged in a number of legal actions brought before U.S. courts, no final decisions were reached by the time President Reagan suspended the embargo and lifted the sanctions in November 1982.

It is interesting to recall at this point that a similar situation occurred in the Iranian Hostage Crisis, when the U.S. Treasury Department issued its Iranian Assets Control Regulations of November 1979. Those regulations blocked the Iranian Government funds held on deposit in foreign branches and subsidiaries of U.S. commercial banks. These regulations contained an identically-worded definition of "persons subject to United States jurisdiction" which the Iranian Central

Bank sought to challenge by filing legal actions in London and Paris in 1980. The settlement of the hostage crisis mooted those actions before any of the courts could render decisions.

However, in connection with the Siberian Pipeline embargo the legal issues were considered and a decision was rendered in a relatively unnoticed private suit brought before a Dutch court in The Hague. The case involved the *Compagnie Europeenne des Petroles S.A.* of France against *Sensor Nederlands B.V.* of the Netherlands.

Specific Performance

The suit was brought by the French company for obtaining specific performance by the Dutch company under a subcontract calling for the delivery of high-technology precision instruments to monitor gas flow along the Siberian pipeline. The purchase order was established shortly before President Reagan issued his June 22 order extending the embargo to American-owned foreign subsidiaries. Sensor being a subsidiary of a Houston-based American company, Geosource, Inc. notified CEP promptly that it would not be able to deliver the ordered instruments on time.

Unlike France, the Netherlands did not have a requisition law on its books. Thus, it was not possible for CEP to appeal to the Dutch Government to intervene on its behalf, but instead it filed a lawsuit which under an accelerated procedure was decided on September 17, 1982, just a few weeks before deliveries were due to begin.

The Dutch court held that the application of the embargo to Sensor constituted the exercise of extraterritorial jurisdiction in violation of the law of nations, and consequently ordered Sensor to deliver the instruments on time, under penalty of being fined for each day of delay. Let us consider how that decision was reached.

First, the court noted that although the contract involved different countries, it did not stipulate a choice of law. Applying international law principles as embodied in an International Convention on the Choice of Law in Matters of Contractual Obligations, which was signed in 1980 though not yet ratified by the Netherlands, the court determined that Dutch law applied as the law of the place where performance was called for under the contract.

In accordance with Dutch law and in conformity with international law it then determined that Sensor was of Dutch nationality, it having been incorporated under the laws of Holland and having its registered office and principal place of business there. Furthermore, by reference to Article 23 of the United States-Netherlands Treaty of Friendship, Commerce and Navigation, the court held that the United States was bound under that treaty to recognize the Dutch nationality of the Geosource subsidiary.

Having thus determined that a recognition of the export embargo would result in the application of U.S. law to a contract executed outside the United States and governed by Dutch law, between a Dutch company and another non-American company, the court questioned whether it was appropriate under the principles of public international law to have U.S. law prevail

over Dutch law in this case. It noted the general rule that no nation is allowed to exercise jurisdiction over transactions that take place outside its borders. It also observed, however, that this rule is subject to two pertinent exceptions: one based on the nationality principle, and the other on the principle of protecting national interests.

Regarding the nationality principle, the court recognized that the criterium of "ownership and control" by an American corporation of a Dutch subsidiary could in certain rare circumstances give some basis for that subsidiary to be considered as having U.S. nationality. It seemed to the court, however, that this concept was of questionable validity under international law, and furthermore that it was clearly preempted in this case by the U.S.-Netherlands Treaty of Friendship, Commerce and Navigation which called for the recognition of the Dutch nationality.

Protection Principle

As for the protection principle, the court recognized that a nation may exercise jurisdiction over acts, wherever and by whomever perpetrated which would be injurious to that state's security or would threaten other important national interests. However, it concluded that *national security interests did not encompass the foreign policy interests which had prompted the Siberian pipeline embargo*. (I believe that the Reagan Administration would have some difficulty with this conclusion in the context of its pronouncements that the Siberian pipeline would contribute to the Soviet's military might.)

The court also considered whether the embargoed export activities, to the extent they were carried on outside the United States, would have any direct and forbidden effects within the territory of the United States. The court no doubt was concerned here with the injurious effect doctrine applied in the area of antitrust law. It admitted that if such injurious effect could be found in this case, the forbidden export activities involved could be considered as having taken place also within the United States, thereby justifying under principles of international law the imposition of U.S. sanctions.

The court, however, concluded that this argument had to be rejected because *it could not see how an export to Russia of goods which did not originate in the United States, by an exporter who was not American could have any direct and prohibited effect within the United States*.

At this point you may ask yourself, as I did, whether the court did not overlook an important link to the United States—namely, the origin of the technology which enabled Sensor to produce these instruments in Holland.

The court was silent on this point, but I understand that the instruments involved (strings of geophones) did not contain components, nor were they produced with the use of any technology obtained from the United States under license from Geosource. This would certainly explain why the court makes at no time any mention of a license agreement or any reference to U.S. technology. Had such a link existed, however, I believe that the decision could have gone

the other way.

The court made two further interesting observations. The first one was that a national court is not always bound to reject extraterritoriality just because it is at odds with the law of nations. Such would be the case, it said, if the exercise of extraterritorial jurisdiction by the United States had been directed at American citizens who would be seeking to escape the U.S. embargo by setting up for that purpose a company outside the United States. It did not find this to be the case with Sensor.

The second observation was to the effect that in the case of international contracts a Dutch court has discretion, under application of the Dutch conflict of laws rule to give priority under compelling circumstances to the law of a foreign country over Dutch law. For this, however, it must first be demonstrated that the international contract in question has significant contacts with that foreign country, which condition appeared to the court in this case to be totally unsatisfied.

One could take issue with a number of the court's conclusions. For instance, with regard to the "ownership and control" question, it seems to me that the court may have brushed it aside too quickly.

The United States-Netherlands Treaty of 1956, which the court cited for settling the issue of the nationality of Sensor, does also provide in its Article 7 for nondiscrimination in matters of U.S. parent corporations exercising control over Dutch subsidiary corporations. This point was apparently not raised or considered. Yet the court's decision would have the effect of denying Geosource's executives and directors from exercising management control over their subsidiary in the matter of the U.S. embargo.

It was in the interest of Geosource as the owner of Sensor to insure that valuable export licenses allowing it to transfer technology and high-technology products to its Dutch subsidiary would be maintained. The refusal of Sensor to comply would mean running the risk of such licenses being revoked and of the parent company being fined. If this in turn would have had the result of drastically reducing Geosource production and sales, it could have further resulted in employees being laid off for lack of work.

This kind of scenario is not too far-fetched because it actually happened to a number of U.S. companies with subsidiaries that became blacklisted. It does raise questions about the court's conclusion that for Sensor's performance under its contract with CEP could not have had effects within the United States.

I believe that this case illustrates the difficulty of ensuring effective enforcement of export controls in the context of multinational enterprises. This problem is not limited to export controls, nor the American multinationals. It is a problem very much inherent to all relations between multinationals, their home countries and their host countries, which as we know have come increasingly under criticism from all sides. As one international law commentator put it:

"Controversies will abound between home country and host country states over who has the right to control multinationals stretched between them."

SOME LESSONS FROM THE SIBERIAN PIPELINE EMBARGO

What will be the likely effect of the Siberian Pipeline embargo on future transfers of technology?

The answer to this will no doubt greatly depend on what Congress will do next September when the Export Administration Act comes up for renewal. The Reagan Administration has asked Congress to make a number of changes in the act to particularly strengthen enforcement capability. One proposed amendment would give the President the power to deny imports of foreign blacklisted companies, a much more effective way to put pressure on companies abroad that would not involve the problem of extraterritoriality.

Here are some thoughts that I would like to leave with you:

- Contractual provisions dealing with Force Majeure, Choice of Law, Performance Guarantees, Insurance and Arbitration, can no longer be ignored or relegated to the back pages of the license agreement among the other standard "boilerplate." They will need to be meticulously drafted and carefully negotiated to minimize the harmful effects which are bound to follow from the imposition of future embargoes.

- It will be difficult to convince foreign licensees to accept the choice of U.S. law to govern the license agreements. The choice of another country's law, or even no choice at all, may be more comforting, and—let's face it—sometimes more predictable.

- Foreign subsidiaries of American companies may find it more difficult from now on to land important high-technology supply contracts as foreign buyers may increasingly look for sources that are not exposed to the U.S. export control regulations.

- The reputation of American manufacturers for being reliable suppliers has become questioned. This means that efforts will have to be expended by the U.S. Government as well as by the private sector, to restore the confidence of foreign business partners dependent on American technology. A large part of that task will fall on the shoulders of American licensors and their lawyers.

- The United States Government will have to be more selective as to the type of technology subject to export controls, and what measures should be taken to

enforce them. Foreign courts and governments will be more cooperative when it can be demonstrated that the controls are to protect national security interests, which are perceived as vital to all participants.

- We have seen that East-West trade interests and policies are not the same on both sides of the Atlantic. There are signs however of a willingness toward mutual accommodation, particularly with respect to setting up more realistic trading conditions that will put East-West trade more on a par with trade in other parts of the world.

- The recently concluded meeting of the OECD ministers held in Paris shows positive signs of reconciliation between the industrial nations on the hot issues of economic interdependence, the limitation of dependence on the Siberian pipeline as a single source of energy, East-West trading, and North-South development assistance. As members of the international licensing community, we must let it be known that we want to see this trend continue.

- There are indications of closer cooperation also between the western powers with respect to the control of "sensitive technology" as reflected by the recently revived activity of COCOM, the Consultative Committee on Trade with Communist Countries, headquartered in Paris. The United States recently proposed that COCOM's budget be drastically increased so that it can become more influential and efficient in advising the individual member governments on the adoption of effective means to control and reduce the surreptitious drain of technology toward unfriendly military uses. We should encourage that trend also because a more effective and more responsible COCOM will mean a better chance for consensus cooperation and pragmatism in matters of technology vital to the safety of our western democracies.

Looking at it from the positive side, the "Siberian Pipeline Caper" may have served as a long-needed catalyst for getting the industrial nations motivated again to better manage their technologies and other resources for finding solutions to the many crises that bedevil us.

As the Siberian Pipeline crisis begins to show signs of petering out, let us hope that East-West relations will become less wearing on our collective nerves, so that we can better concentrate on the momentous challenge to western technology for resolving the pressing problems of the North-South.