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Review of the Supreme Court's 1988-89 Term and Preview of the 1989-90 Term for the Transnational Practitioner

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The Supreme Court of the United States did not make much news during its 1988-89 Term, at least insofar as the transnational practitioner is concerned. The only purely transnational decision, Chan v. Korean Air Lines, Ltd., involved the Court's interpretation of one of the limitation on liability provisions of the Warsaw Convention. The decision, although very important to the airline industry, did not exactly make headlines in the United States or around the world.

The Court set the stage for next year's term by granting review in three cases raising important issues for the transnational practitioner. This Article will preview those cases.

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1. Although the term "transnational law" is of course not susceptible to precise definition, for purposes of this series of articles on the Supreme Court, a decision has special implications for the transnational practitioner only if it involves legal transactions between the nationals of two or more states. See Doland, Book Review, 1 TRANSNAT'L LAW. 499, 500 n.2 (1988).
I. LIMITATION OF LIABILITY UNDER THEWarsaw Convention

A. History of the Warsaw Convention

United States courts now have over fifty-five years of experience in deciding cases involving international air travel under the Warsaw Convention. Although various provisions of the Convention have been under nearly constant attack, particularly those provisions limiting the liability of air carriers, the Convention continues to serve the useful function of unifying the rules regarding international air travel. In

Chan v. Korean Air Lines, Ltd., the Supreme Court of the United States attempted to further this unification by giving the Convention’s rules on liability limitation a literal interpretation despite what may have been a drafting error by the Convention’s drafters.

By interpreting the Convention according to its literal terms and resisting the temptation to rewrite the Convention in light of an American sense of “fairness” or “justice,” a temptation to which many lower courts in the United States had succumbed, the Supreme Court maximizes the likelihood that the Convention will be uniformly interpreted. The decision reached by the Supreme Court is consistent with an earlier decision from Canada’s highest court. Fairness and justice vary with the length of the chancellor’s foot and with a particular country’s relative world view. By contrast, words in a treaty, if they have an unambiguous meaning, are less likely to vary from nation to nation. If the result which the Supreme Court reached, limiting the recovery by the plaintiff for wrongful death to $75,000, is unjust or unfair, the proper recourse is found by turning to the drafters who are responsible for amending the treaty, not to the courts which are responsible for interpreting the treaty.

The Convention for the Unification of Certain Rules Relating to International Transportation by Air, more commonly known as the Warsaw Convention, is a multilateral treaty which sets forth certain uniform norms regarding litigation arising out of damages suffered in the course of international air travel. The United States Senate ratified the treaty in 1934 without having held any hearings or debates.

The Convention contains regulations dealing with three separate types of international air transactions: (1) transportation of people;
(2) transportation of baggage; and (3) transportation of freight. For each of these transactions, the Convention sets forth specific ticket or document requirements. For example, Article 3 of the Warsaw Convention provides as follows:

(1). For the transportation of passengers the carriers must deliver a passenger ticket which shall contain the following particulars:

(a) The place and date of issue;
(b) The place of departure and of destination;
(c) The agreed stopping places, provided that the carrier may reserve the right to alter the stopping places in case of necessity, and that if he exercises that right, the alteration shall not have the effect of depriving the transportation of its international character;
(d) The name and address of the carrier or carriers;
(e) A statement that the transportation is subject to the rules relating to liability established by this convention.8

Similar provisions exist in articles 4 and 8 with regard to baggage checks and air waybills, respectively.9

8. Warsaw Convention, supra note 6, at art. 3.
9. Id. at art. 4. Article 4 provides in pertinent part as follows:

(3) The baggage check shall contain the following particulars:

(a) The place and date of issue;
(b) The place of departure and of destination;
(c) The name and address of the carrier or carriers;
(d) The number of the passenger ticket;
(e) A statement that delivery of the baggage will be made to the bearer of the baggage check;
(f) The number and weight of the packages;
(g) The amount of the value declared in accordance with article 22(2);
(h) A statement that the transportation is subject to the rules relating to liability established by this convention.

Id.

Article 8 of the Warsaw Convention provides in pertinent part as follows:

The air waybill shall contain the following particulars:

(a) The place and date of its execution;
(b) The place of departure and of destination;
(c) The agreed stopping places, provided that the carrier may reserve the right to alter the stopping places in case of necessity, and that if he exercises that right the alteration shall not have the effect of depriving the transportation of its international character;
(d) The name and address of the consignor;
(e) The name and address of the first carrier;
(f) The name and address of the consignee, if the case so requires;
(g) The nature of the goods;
(h) The number of packages, the method of packing, and the particular marks or numbers upon them;
(i) The weight, the quantity, the volume, or dimensions of the goods;
(j) The apparent condition of the goods and of the packing;
Passenger tickets, baggage checks, and air waybills are all supposed to contain "[a] statement that the transportation is subject to the rules relating to liability established by this convention."\textsuperscript{10} The "rules relating to liability" are found elsewhere in the Convention.\textsuperscript{11} In 1934, when the United States ratified the Convention, recovery for personal injuries or death was limited to approximately $8,300, recovery for damage or loss to checked baggage or freight was limited to approximately $17 per kilogram, and recovery for damage or loss to unchecked baggage and objects was limited to approximately $332 per passenger, absent an agreement to the contrary between the carrier and customer.\textsuperscript{12}

It is relatively clear why the drafters of the Convention agreed upon these liability limitation provisions and why the United States agreed to be bound by these provisions. A letter from Secretary of State Cordell Hull to the Senate in 1934 explains part of the rationale for the limitation provisions:

\begin{itemize}
  \item [(k)] The freight, if it has been agreed upon, the date and place of payment, and the person who is to pay it;
  \item [(l)] If the goods are sent for payment on delivery, the price of the goods, and, if the case so requires, the amount of the expenses incurred;
  \item [(m)] The amount of the value declared in accordance with article 22(2);
  \item [(n)] The number of parts of the air waybill;
  \item [(o)] The documents handed to the carrier to accompany the air waybill;
  \item [(p)] The time fixed for the completion of the transportation and a brief note of the route to be followed, if these matters have been agreed upon;
  \item [(q)] A statement that the transportation is subject to the rules relating to liability established by this convention.
\end{itemize}

\textit{Id.} at art. 8.
\textsuperscript{10} \textit{Id.} at arts. 3(1), (3); 4(3)(h); 8(q).
\textsuperscript{11} Limitation of liability is provided for in Article 22 of the Warsaw Convention.
\textsuperscript{12} Warsaw Convention, \textit{supra} note 6, at art. 22. Article 22 provides as follows:

\begin{enumerate}
  \item (1) In the transportation of passengers the liability of the carrier for each passenger is limited to the sum of 125,000 francs. Where, in accordance with the law of the court to which the case is submitted, damages may be awarded in the form of periodic payments, the equivalent capital value of the said payments shall not exceed 125,000 francs. Nevertheless, by special contract, the carrier and the passenger may agree to a higher limit of liability.
  \item (2) In the transportation of checked baggage and of goods, the liability of the carrier is limited to a sum of 250 francs per kilogram, unless the consignor has made, at the time when the package was handed over to the carrier, a special declaration of the value at delivery and has paid a supplementary sum if the case so requires. In that case the carrier will be liable to pay a sum not exceeding the declared sum, unless he proves that sum is greater than the actual value to the consignor at delivery.
  \item (3) As regards objects of which the passenger takes charge himself the liability of the carrier is limited to 4,000 francs per passenger.
  \item (4) The sums mentioned above are deemed to refer to the French franc consisting of 65 milligrams of gold at the standard fineness of nine hundred thousandths. These sums may be converted into any national currency in round figures.
\end{enumerate}

\textit{Id.}
It is believed that the principle of limitation of liability will not only be beneficial to passengers and shippers as affording a more definite basis of recovery and as tending to lessen litigation, but that it will prove to be an aid in the development of international air transportation, as such limitation will afford the carrier a more definite basis on which to obtain insurance rates, with the probable result that there would eventually be a reduction of operating expenses for the carrier and advantages to travelers and shippers in the way of reduced transportation charges.\(^\text{13}\)

Although some portions of this explanation are certainly subject to challenge as political smoke-blowing or over-simplistic analysis,\(^\text{14}\) it surely takes no great powers of perception to recognize that one purpose of Article 22’s limitation of liability was to help protect and subsidize the fledgling airline industry.

The limitation of liability provisions protect not only private industry, of course, but also those countries which operate their own air carriers. In the absence of the limitation provisions, countries which operate their own carriers would have left themselves open to possibly crippling damage judgments. Indeed, as Professors Lowenfeld and Mendelsohn noted in their much-cited 1967 article in the Harvard Law Review, “‘[s]ome [countries] even contended that the limit was too high, thus discouraging a number of countries . . . from adhering to the Convention.’”\(^\text{15}\) The absence of any limits on liability would surely have doomed the Convention to a quick obscurity.

Not all nations agreed with the limitation on liability provisions, however. Even though the United States Senate ratified the treaty in 1934, there almost immediately appeared in the United States and elsewhere strong opposition to Article 22’s limits.\(^\text{16}\) After a series of false starts, a conference convened at the Hague in 1955 agreed to amend the Warsaw Convention by increasing the amounts which could be recovered.\(^\text{17}\) The limit for personal injury or death, for example, was doubled to around $16,600.\(^\text{18}\)

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14. \textit{See Comment, Constitutional Issues, supra note 3, at 904-06.}
16. \textit{See id. at 502; Comment, Judicial Hostility, supra note 3, at 810; Casenote, supra note 3, at 846-47.}
18. \textit{Id. at art. XI.}
The United States had asked the Hague conference for the limit to be set at $25,000. Resistance in the United States to the limitation provision prevented the Hague Protocol from being ratified by the Senate. Professor Lowenfeld explained the United States position as follows:

Our quarrel rather is with the other compromise contained in the Warsaw Convention: the compromise between the interests of the airlines and the interests of the traveling public. . . . [T]he overriding issue in the Warsaw Convention, as we see it, is that is was entered into in the late 1920's, when international aviation was hardly over the experimental stage and when the primary need was a means to prevent the growth of international aviation being choked off by one or more catastrophic accidents. Today, in contrast, international aviation is big business. We are over the experimental stage. We are over the infant industry stage. . . . [T]he hazards of flying have been very much reduced and are actuarially predictable.

For these reasons the United States believes that there is no longer justification for a convention which tips the balance heavily in favor of the industry and against the consumer.

Dissatisfaction with continuing negotiations led the United States in 1965 to notify the contracting parties that the United States intended to denounce the Warsaw Convention, a denunciation which, according to article 39, would become effective six months after notification.

With the stick of denunciation by the largest contracting state firmly in one hand, the United States held a carrot in the other: The United States would retract its denunciation if all international air carriers agreed to certain changes in the Warsaw Convention. Most pertinently, the United States demanded that air carriers waive the limits in the Hague Protocol with respect to passenger injuries and substitute in their place a limitation of $75,000 for passenger injuries.

The crisis created by the threatened withdrawal of the United States from the Warsaw Convention was averted when the interna-

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22. *Id.* Article 22 itself provided that the limits could be changed by special agreement between the carrier and passenger.
tional air carriers capitulated to the United States demand. In the Montreal Agreement, the air carriers agreed to the United States demand with respect to any flight which included the United States as a point of origin, point of destination, or agreed stopping place.23

It is useful at this point to summarize the present state of affairs under the Warsaw Convention with respect to limitations of liability for personal injury or death. The carrier must deliver to all passengers a ticket which contains a statement that the transportation is subject to the limitations of the Warsaw Convention except that, pursuant to the Montreal Agreement, the dollar amount of the limitation shall be $75,000 rather than the dollar amount set forth in the Warsaw Convention as amended by the Hague Protocol. It is fair to say that the United States, including most lower federal courts, remained openly hostile even to the $75,000 limitation of liability.24

B. Chan v. Korean Air Lines, Ltd.

This brings us now to consider the facts facing the Supreme Court in Chan v. Korean Air Lines, Ltd. The case involves the death of passengers on the ill-fated Korean Air Lines (KAL) flight #007 which was shot down by a Soviet fighter on September 1, 1983, over the Sea of Japan. Survivors filed wrongful death actions against KAL in a number of federal district courts, and the actions were consolidated for pretrial proceedings in the District Court for the District of Columbia.


24. See, e.g., Westerns v. Flying Tiger Line, 341 F.2d 851 (2d Cir. 1965) (loss of Warsaw Convention limits unless airline delivers passenger ticket sufficiently in advance so passenger may take additional precautions); Warren v. Flying Tiger Line, 352 F.2d 494 (9th Cir. 1965) (Warsaw Convention liability limitations lost because passenger ticket not delivered sufficiently in advance so passenger could purchase insurance); Lisi v. Alitalia-Ziner Aeree Italiane, S.P.A., 370 F.2d 1508 (2d Cir. 1966) (airline not entitled to Warsaw Convention liability limitations since passenger ticket printed in 4 point type size). Cf. Ross v. Pan American Airways, 299 N.Y. 88, 85 N.E.2d 880 (1949) (Warsaw Convention liability limitations applied even though passenger ticket delivered only moments before departure). See also Comment, Judicial Hostility, supra note 3, at 824-28 (commenting on history of judicial hostility to Warsaw Convention); Note, supra note 3, at 860-63 (commenting on history of judicial hostility to Warsaw Convention); Comment, Warsaw Convention Limitations, supra note 3, at 590-91 (commenting on history of judicial hostility to Warsaw Convention).
All parties to the lawsuit agreed that the Warsaw Convention applied. Pursuant to Article 22 and the Montreal Agreement, each plaintiff’s recovery would be limited to $75,000. The plaintiffs argued, however, that the limits imposed by these agreements did not apply. The tickets which KAL delivered to the passengers contained a notice of limitation of liability that did not comply with the specific requirements of the Montreal Agreement. The Montreal Agreement provided that each ticket delivered to a passenger should contain a notice of the limitation of liability in at least 10-point type. The tickets delivered to the passengers on KAL Flight #007 contained the limitation notice in only 8-point type.

The plaintiffs sought by a motion for partial summary judgment a declaration that the too-small type on the tickets deprived KAL of the Warsaw Convention’s liability limitation. The district court disagreed with the plaintiffs and denied the motion. Recognizing the importance of the issue for possible settlement purposes and for the subsequent proceedings in the case, the district court certified for interlocutory appeal its otherwise unappealable order. The court of appeals affirmed, adopting the district court’s opinion in full. The Supreme Court granted a petition for a writ of certiorari to consider the case.

Article 3(2) of the Convention specifically deals with the effect of failing to deliver tickets to passengers or delivering non-conforming tickets:

The absence, irregularity, or loss of the passenger ticket shall not affect the existence or the validity of the contract of transportation, which shall none the less be subject to the rules of this convention. Nevertheless, if the carrier accepts a passenger without a passenger ticket having been delivered he shall not be entitled to avail himself of those provisions of this convention which exclude or limit his liability.

25. Here is the difference between 10-point and 8-point type: This is printed in 10-point type. This is printed in 8-point type.


29. Warsaw Convention, supra note 6, at art. 3(2).
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The first sentence of Article 3(2) clearly provides that the "irregularity . . . of the passenger ticket" does not affect the validity of the contract of transportation. More importantly, that contract "shall none the less be subject to the rules of this convention," including the rules on liability limitation. Relying upon the definition of "irregularity" in the Webster’s Second International Dictionary, the Court concluded that, because of the first sentence in Article 3(2), "a delivered document does not fail to qualify as a ‘passenger ticket,’ and does not cause forfeiture of the damages limitation, merely because it contains a defective notice." This does not end the analysis, of course, since the second sentence of Article 3(2) specifically deals with whether the carrier may "avail himself of those provisions of the convention which exclude or limit his liability." The second sentence is significantly different from the first sentence. Whereas the first sentence deals with the "absence, irregularity, or loss of the passenger ticket," the second sentence covers only non-delivery of tickets. Courts which were generally critical of liability limitation provisions could easily overcome the words in the second sentence. If the second sentence requires non-delivery, then, as the Supreme Court noted, courts could "equate[] non-delivery of a ticket, for purposes of [Article 3(2)], with the delivery of a ticket in a form that fails to provide adequate notice of the Warsaw limitation." Since 10-point type was required by the Montreal Agreement, it would be rational to hold as a matter of law that any type smaller than 10-point type failed to provide adequate notice, and the inadequate notice would trigger Article 3(2), thereby depriving the carrier of the limitation of liability provision of the Convention.

There is some reason to believe that the drafters of the Convention intended Article 3(2) to have this meaning, and that the language in Article 3(2), which is, at best, ambiguous, was the result of a monumental drafting error. In an initial draft of the Convention, Article (3)(2) read as follows:

30. Id.
31. Id.
32. Chan, 109 S. Ct. at 1680-81.
33. Id.
34. Id.
35. Id. at 1680.
36. As discussed below, Justice Brennan in his concurring opinion in Chan, disagreed with the majority's interpretation of Article 3(2) of the Warsaw Convention, but he ultimately rejected the notion that the 10-point type requirement in the Montreal Agreement established a legal minimum under the Warsaw Convention.
If, for international transportation, the carrier accepts a passenger without a passenger ticket having been made out, or if the ticket does not contain the above-mentioned particulars, the contract is still subject to the rules of this Convention, but the carrier shall not be entitled to avail himself of those provisions of this convention which totally or partially exclude his direct liability or liability derived from the negligence of his agents.37

Recall that the Convention contains separate but similar provisions for international documentation regarding passengers, checked baggage, and freight.38 In its initial drafts, the convention contained provisions for checked baggage and freight similar to the provision just quoted. That is, the Convention treated documentation for passengers, checked baggage, and freight similarly, and provided a similar sanction for a carrier's failure to conform the documentation to the Convention's requirements.39

The Greek delegation objected to the sanctions contained in the Convention. The delegation claimed that the sanctions were too harsh, especially where the failure to include within a document all of the particulars was a result of simple omission by an employee of the carrier. The delegation proposed at the Warsaw meeting to delete the words "or if the document does not contain the above particulars" from the sanction clause dealing with passenger tickets.40 The drafting commission agreed to this change.41

The sanctions provided for non-conforming documents with regard to baggage and freight were not amended. The end result is that the explicit sanction for non-conforming baggage and freight documents is loss of the protections of the Convention, yet there is no sanction

37. Chan, 109 S. Ct. at 1686-87 (Brennan, J., concurring) (emphasis added).
38. See supra note 9.
39. The reporter for the drafts made it clear that this parallel treatment was specifically intended. The reporter for the Convention opened the Warsaw session in 1929 with the following explanation:
   In chapter 2, we examined the matter of documents of transportation: passenger ticket, baggage check, air waybill for goods. All these documents contain a minimum of particulars. [1] The essential thing, with regard to this, is the sanction, sanction provided for the three documents and which consists in withdrawing from the carrier who would transport passengers or goods without documents, or with documents not in conformity with the convention, the benefit of the advantages provided by the convention.
   ICAO, Second International Conference on Private Air Law, Oct. 4-12, 1929, at 19-20 (emphasis added). See also Chan, 109 S. Ct. at 1687 (Brennan, J., concurring).
40. Chan, 109 S. Ct. at 1689 (Brennan, J., concurring).
41. Id.
for delivery of non-conforming passenger tickets. The majority of the Court used the difference between Article 3 dealing with passenger tickets, and Articles 4 and 9, dealing with baggage and freight, as supporting the majority's conclusion that there was no sanction for delivering a passenger ticket which did not contain the minimum requirements imposed by the Convention. The majority also proposed several possible reasons for treating passengers different from baggage and freight, thus suggesting that the difference was more than "an obvious drafting error."

42. Article 4(4) of the Warsaw Convention, dealing with the baggage check, provides as follows:

The absence, irregularity, or loss of the baggage check shall not affect the existence or the validity of the contract of transportation which shall none the less be subject to the rules of this convention. Nevertheless, if the carrier accepts baggage without a baggage check having been delivered, or if the baggage check does not contain the particulars set out at (d), (f), and (h) above [section (h) contains the adequate notice provision], the carrier shall not be entitled to avail himself of those provisions of the convention which exclude or limit his liability.

Warsaw Convention, supra note 6, at art. 4(4) (emphasis added).

Article 9, dealing with air waybills, provides as follows:

If the carrier accepts goods without an air waybill having been made out, or if the air waybill does not contain all the particulars set out in article 8(a) to (i), inclusive, and (q) [which contains the adequate notice provision], the carrier shall not be entitled to avail himself of the provisions of this convention which exclude or limit his liability.

Id. at art. 9.

43. Chan, 109 S. Ct. at 1682-83.

44. Id. at 1683. Speaking for the Court, Justice Scalia explained:

Petitioners and the Solicitor General seek to explain the variance between Section I and Sections II and III (as well as the clear text of Article 3) as a drafting error, and lead us through the labyrinth of the Convention's drafting history in an effort to establish this point. It would be absurd, they urge, for defective notice to eliminate liability limits on baggage and air freight but not on personal injury and death. Perhaps not. It might have been thought, by the representatives from diverse countries who drafted the Convention in 1925 and 1929 (an era when even many States of this country had relatively low limits on wrongful death recovery) that the $8,300 maximum liability established for personal injury or death was a "fair" recovery in any event, so that even if the defective notice caused the passenger to forgo the purchase of additional insurance, he or his heirs would be treated with rough equity in any event. Cf. C. McCormick, Law of Damages § 104 (1935) ("In about one-third of the states, a fixed limit upon the recovery under the Death Act is imposed in the statute. The usual limit is $10,000, but in some instances the maximum is $7,500 or $5,000"). Quite obviously, however, the limitation of liability for baggage and freight (about $16.50 per kilogram, see Article 22(2)) was not set with an eye to fair value (the very notion of a "fair" average value of goods per kilogram is absurd), but perhaps with an eye to fair level of liability in relation to profit on the carriage—so that the shipper of lost goods misled by the inadequate notice would not be compensated equitably. Another possible explanation for the difference in treatment is that the limitations on liability prescribed for baggage and freight are much more substantial and thus notice of them is much more important. They include not just a virtually nominal monetary limit, but also total exclusion of liability for "an error in piloting, in the handling of the aircraft, or in navigation."
In his concurring opinion, Justice Brennan interpreted Article 3 in light of the purpose of the Greek amendment. Justice Brennan concluded that the no-sanction amendment should be given effect only in those cases involving "clerical errors in selling in the ticket forms." In cases where the non-conformity is not the result of clerical error, Justice Brennan would sanction the carrier by depriving the carrier of the Convention's limitations of liability.

A majority of the Court rejected Justice Brennan's use of the legislative history surrounding the Convention. Utilizing a "plain-meaning" approach to interpretation, the Court gave Article 3(2) its literal meaning:

We must thus be governed by the text solemnly adopted by the governments of many separate nations whatever conclusions might be drawn from the intricate drafting history that petitioners and the Solicitor General have brought to our attention. The latter may of course be consulted to elucidate a text that is ambiguous, see, e.g., Air France v. Saks, 470 U.S. 392 (1985). But where the text is clear, as it is here, we have no power to insert an amendment.

The Court then closed its analysis with a quote from Justice Story in 1821:

[T]o alter, amend, or add to any treaty, by inserting any clause, whether small or great, important or trivial, would be on our part an usurpation of power, and not an exercise of judicial functions. It would be to make, and not to construe a treaty. Neither can this Court supply a casus omissus in a treaty, any more than in a law. We are to find out the intention of the parties by just rules of interpretation applied to the subject matter; and having found that, our duty is to follow it as far as it goes, and to stop where that stops whatever may be the imperfections or difficulties which it leaves behind.
The Court's decision in *Chan* would appear to end most of the controversy surrounding the enforceability of the Warsaw Convention's limitation on liability provisions.\(^4\) So long as the carrier delivers a ticket to a passenger, the limitation provisions will apply. The Court left open only the smallest room for argument in the following passage:

When Article 3(2), after making this much clear, continues (in the second sentence) 'Nevertheless, if a carrier accepts a passenger without a passenger ticket having been delivered, etc.,’ it can only be referring to the carrier's failure to deliver any document whatever, or its delivery of a document whose shortcomings are so extensive that it cannot reasonably be described as a 'ticket' (for example, a mistakenly delivered blank form, with no data filled in).\(^5\)

This appears, however, to be a very small crack, and practitioners can be sure that the Supreme Court will try to keep its finger firmly planted in that crack to prevent Article 3(2) from crumbling.

### II. Preview of the 1989-90 Term

**A. Alcan Aluminum Ltd. v. Franchise Tax Board of California—Standing of a Foreign Parent to Challenge a State’s Unitary Tax System**

One of the more serious commercial and trade disputes between the United States and foreign nations concerns the tax laws of several states which utilize a "unitary" tax approach in computing corporate tax.\(^5\) A unitary tax approach generally involves ignoring formal corporate structure in determining corporate earnings. Instead the approach favors an analysis based upon the "unitary business" which a corporation engages in, whether by itself or through affiliated companies. In *Alcan Aluminum Ltd. v. Franchise Tax Board of*...

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49. An issue that remains undecided in the United States is whether the limitation provisions are contrary to the United States Constitution. See *supra* note 5 and accompanying text.


51. England, for example, has authorized its treasury department to retaliate against the United States by denying a United Kingdom tax credit to United States companies with substantial operations in unitary tax states. See United Kingdom Finance Act of 1985, New Clause 27. An amicus brief filed on behalf of the Member States of the European Communities and the Governments of Australia, Japan and Switzerland characterizes the resolution of the issue as one of "vital importance to the fifteen countries and to their future economic and commercial relations with the U.S." See *Alcan Aluminum v. Franchise Tax Bd.*, 860 F.2d 688, 698 n.11 (7th Cir. 1988), cert. granted, 109 S. Ct. 1741 (1989).
California,\textsuperscript{52} for example, a foreign corporation had a wholly owned California subsidiary. In determining the taxable earnings of the California subsidiary, the California Franchise Tax Board used the following procedure:

[The Franchise Tax Board] first determines the scope of the ‘unitary business’ in which a California corporation participates with affiliated companies and calculates the total earnings of this unitary enterprise. It then computes an allocation fraction for each affected taxpayer. This fraction is an unweighted average of three ratios, the ratios of California payroll to total payroll, California property value to total property value and California sales to total sales. Multiplying a corporation’s allocation fraction by the total income of the unitary business in which it participates yields that corporation’s taxable income for purposes of the franchise tax.\textsuperscript{53}

A unitary taxing scheme of this sort risks overstating the income attributable to operations within the taxing state. Since a systematic overstatement of domestic income imposes a burden on interstate commerce (by imposing a special burden on out-of-state affiliated companies), unitary taxing schemes are to be subject to constitutional scrutiny under the commerce clause and foreign commerce clause. The Supreme Court has held that the threat of overstatement by itself does not cause unitary taxing schemes to be in violation of the commerce clause.\textsuperscript{54} The Court has left open, however, whether the application of a unitary taxing scheme to a domestic subsidiary of a foreign parent violates the foreign commerce clause’s proscription against multiple taxation and impairment of federal uniformity.\textsuperscript{55}

This constitutional challenge could conceivably arise in either state or federal court since a federal constitutional question is involved. The Tax Injunction Act usually makes this choice illusory, however, forcing the challenge to be raised initially in state court. The Tax Injunction Act provides as follows:

\[\text{[t]he district courts shall not enjoin, suspend or restrain the assessment, levy or collection of any tax under State law where a plain, speedy and efficient remedy may be had in the courts of such State.}\textsuperscript{56}\]

\textsuperscript{52} 860 F.2d 688 (7th Cir. 1988), cert. granted, 109 S. Ct. 1741 (1989).

\textsuperscript{53} Id. at 690.


\textsuperscript{55} See Container Corp., 463 U.S. at 189 n.26, 195 n.32. See also Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979) (discussing inquiry court must make when considering multiple taxation question).

Thus, so long as a state provides a "plain, speedy and efficient remedy," a federal court has no power to "enjoin, suspend or restrain" the assessment or collection of state taxes. Because of the Tax Injunction Act, the domestic subsidiary in Alcan Aluminum, a California corporation, has been pursuing its remedy before California state administrative officials and courts, which are fully competent to hear and decide the constitutional issue raised.\(^{57}\)

Apparently sensing that the constitutional claim might be more fairly or quickly resolved in federal court, the foreign parent brought an action for a declaratory judgment in the District Court for the Northern District of Illinois. The foreign parent's action is not barred by the Tax Injunction Act because it is clear that the foreign parent has no remedy under state law; the California procedures may be utilized only by the taxpayer.\(^{58}\)

The inapplicability of the Tax Injunction Act does not end the pre-trial squabbles. First, it is far from clear that the foreign parent has standing in federal court to complain about the way California computes the taxes of the foreign parent's California subsidiary. Second, even if the foreign parent would have standing in federal court to raise this complaint, fundamental principles of comity—principles which underlie the Tax Injunction Act—strongly militate against having a federal court action running concurrently with state court proceedings when the sole issue to be raised in the federal proceeding will surely be resolved in the state proceeding, and the federal action is brought by the corporate parent of the corporation litigating in the state courts.

The district court dismissed the federal action, holding that the corporate parent did not have standing to sue because the parent was injured only in its capacity as shareholder. Under well-established standing rules, a shareholder ordinarily cannot bring suit on behalf of the corporation in the absence of a direct and independent injury to the shareholder.\(^{59}\) The Court of Appeals for the Seventh Circuit reversed, holding that the corporate parent had standing and that there was no basis for abstaining.\(^{60}\) The court of appeals' standing holding created a conflict between the circuit courts,\(^{61}\) and the Su-

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57. Alcan Aluminum, 860 F.2d at 691.
58. Id. at 698.
59. Id. at 689.
60. Id. at 700.
Supreme Court granted a petition for a writ of certiorari to resolve the following important questions:

1. Does foreign company that is sole stockholder of American subsidiary have standing to challenge in federal court accounting method by which California determines locally taxable income of that subsidiary? (2) Assuming that requisite standing exists in such instance, is federal action for injunctive and declaratory relief nevertheless barred by Tax Injunction Act (28 USC 1341) or principle of comity that underlies act?62

As a practical matter, it seems apparent that the corporate parent was engaging in nation-wide forum shopping. The corporate subsidiary was a California corporation subject to a California tax. The corporate parent did not file suit in a California federal court because the Ninth Circuit Court of Appeals, whose jurisdiction includes California, had already determined that a corporate parent had no standing in the circumstances presented.63 This factor by itself may influence the Supreme Court's decision.64

More to the point, so long as the state forum remains open to consider the constitutionality of its unitary tax scheme, there seems little reason to open the federal courts to a suit by the state corporation's foreign parent. Since the federal suit would of necessity duplicate the efforts of the state courts, it seems likely that the Supreme Court will decide to reverse the decision of the Court of Appeals for the Seventh Circuit. The Supreme Court will have a choice of rationales. It could easily apply the shareholder standing rule and find that the foreign parent's injury flows entirely from its shareholder status. Alternatively, the Court could easily find that the federal court should abstain. The Court's many abstention doctrines are surely flexible enough to prevent the corporate parent's attempt to do an end-run around the available state procedures.65


Commercial bribery is an unfortunate reality of certain transnational commercial transactions. In order to secure contracts with a

63. Shell Petroleum, 709 F.2d at 595-96.
64. See Pennzoil Co. v. Texaco Inc., 407 U.S. 1, 14 (1987) (Marshall, J., concurring). Justice Marshall took critical note of Texaco's choice of a forum "more than halfway across the country from the locale in which the case was tried." Id.
foreign government, a hungry contractor may make payments or kickbacks to high government officials—often labelled "commissions"—in return for receiving the government's business. In reaction to these practices, the Congress enacted and the President signed the Foreign Corrupt Practices Act, which prohibits such activity by United States companies.\(^6\)

*Kirkpatrick, Inc. v. Environmental Tectonics* is a civil suit brought by the losing bidder against a contractor who was awarded a military contract by a foreign government as a result of bribes paid to foreign officials. After the successful bidder, W.S. Kirkpatrick & Co., was awarded a military contract by the government of Nigeria, the losing bidder, Environmental Tectonics Corporation ("ETC"), learned that its bid had been lower than Kirkpatrick’s, and ETC decided to investigate the circumstances under which the contract had been awarded. It discovered Kirkpatrick’s bribery scheme, and reported its findings to the United States Embassy in Lagos, Nigeria. Following an investigation by the United States Justice Department, Kirkpatrick and Carpenter, high company officials in Kirkpatrick & Co., were charged with violating the Foreign Corrupt Practices Act. They each pleaded guilty to one violation of the Act.\(^6\)

Not satisfied with having exposed Kirkpatrick’s illegal practices, ETC shortly thereafter filed an action for damages against Kirkpatrick & Co. under the Racketeering Influenced Corrupt Organizations Acts,\(^6\) the New Jersey Anti-Racketeering Act,\(^6\) and the Robinson-Patman Act.\(^7\) Among other pre-trial challenges to the lawsuit, Kirkpatrick & Co. asserted that the act of state doctrine barred consideration of the claims by the federal court. The district court agreed, and dismissed the action.\(^1\) The court of appeals reversed.

The act of state doctrine is a judicially-created limitation on the exercise of federal court jurisdiction. The doctrine finds its modern inspiration in the separation of powers between the branches of the United States government.\(^7\) In particular, since the conduct of foreign

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affairs has been vested primarily in the Executive Branch, both by
tradition and by explicit Constitutional delegation,\textsuperscript{73} federal courts
must exercise care and caution in adjudicating claims that involve
judgments being rendered about the legality of foreign government
practices. Such judgments may tread upon the Executive Branch’s
constitutional powers. The act of state doctrine must not be cavalierly
applied, however, since its application results in an individual litigant
being forced to “forgo decisions on the merits of their claims.”\textsuperscript{74}

The Supreme Court’s decisions on the act of state doctrine have
generally involved state expropriations of private property.\textsuperscript{75}\textit{Kirk-
patrick}, by contrast, involves the award of a government military
contract. A preliminary question then is whether the act of state
document should apply when the foreign government practice being
examined involves the award of military contracts. Both the district
court and the court of appeals held that the award of a major
military contract (as opposed, for example, to the granting of a
patent or award of a contract for paper) involved national security
considerations that could potentially have far-reaching international
and political repercussions.\textsuperscript{76} Both courts also agreed that the “com-
mercial act” exception to the act of state doctrine—an exception
never approved by a majority of the Supreme Court\textsuperscript{77}—did not apply
since, again, a military procurement decision “is by its very nature
governmental.”\textsuperscript{78}

The district court and court of appeals disagreed, however, with
whether the act of state doctrine ultimately barred federal court
consideration of the plaintiff’s claims. The district court held that
the doctrine applied “if the inquiry presented for judicial determi-
nation includes the motivation of a sovereign act which would result
in embarrassment to the sovereign or constitute interference in the
conduct of the foreign policy of the United States.”\textsuperscript{79} Under this
formulation, the federal action was barred since an inquiry into
whether Nigerian officials had accepted bribes (I) involved an inquiry

\textsuperscript{73} U.S. CONST. art II, § 2.
\textsuperscript{74} First National City Bank v. Banco Nacional de Cuba, 406 U.S. 759, 769 (1972)
(Rehnquist, J., concurring).
\textsuperscript{75} See \textit{Sabbatino}, 376 U.S. at 398; First National City Bank, 406 U.S. at 759.
\textsuperscript{76} Environmental Tectonics Corp. v. W.S. Kirkpatrick, Inc., 847 F.2d 1052, 1058-59 (3d
\textsuperscript{78} Environmental Tectonics, 847 F.2d at 1059.
\textsuperscript{79} Environmental Tectonics Corp. Intl. v. W.S. Kirkpatrick, Inc., 659 F. Supp. 1381,
into the "motivation" of the government's decision to award the contract to Kirkpatrick & Co. and (2) would result in "embarrassment" to Nigeria.

The district court's holding was contrary to the position expressed by the Department of State in a letter to the district court from Abraham D. Sofaer, the Department of State's legal counsel. The Department of State took the position that "if the adjudication of this suit were to involve a judicial inquiry into the motivations of the Government of Nigeria's decision to award the contract, the Department does not believe the act of state doctrine would bar the Court from adjudicating this dispute." According to the Department of State, the act of state doctrine would bar a federal court action only if there would be a judicial determination of or inquiry into "the validity or legality of foreign government actions." The court of appeals largely adopted the Department of State's view of the act of state doctrine. According to the court of appeals, the doctrine bars a federal court action only if (1) the federal court would necessarily render a judgment concerning the "legal validity" of a foreign government's practices or (2) the defendant shows "a demonstrable, not a speculative, threat to the conduct of foreign relations by the political branches of the United States government." An inquiry into the Nigerian government's motivation for awarding the defense contract would not involve a judicial determination that the award was illegal or void, and the defendant had made no demonstrative showing that the civil suit would pose a real threat to the conduct of United States foreign relations. The court of appeals held that the suit was not barred by the act of state doctrine.

It seems likely that the Supreme Court will affirm the court of appeals. The court of appeals' decision is consonant with the position expressed by the Executive Branch in its letter to the trial court. To the extent that the act of state doctrine is based upon a separation of powers rationale, the letter from the Department of State suggests that separation of powers would not be offended by federal court adjudication of ETC's claims against Kirkpatrick & Co. The Department of State's position is of course not determinative, since the Court must make its own evaluation of the appropriateness of

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80. The letter is reprinted in full in Environmental Tectonics, 847 F.2d at 1068-69.
81. Id. at 1068.
82. Id. (emphasis in original).
83. Id. at 1061.
exercising its jurisdiction. Nevertheless, it would be somewhat surprising for the Court as presently constituted to reject the Executive Branch's formal declaration that ETC's lawsuit does not trigger the act of state doctrine.

C. Verdugo-Urquidez v. United States—The Applicability of the Fourth Amendment's Protection Against Unreasonable Search and Seizure to the Search of a Foreign Citizen's Home in a Foreign Country

In a decision that is almost sure to be reversed, the Ninth Circuit Court of Appeals held in United States v. Verdugo-Urquidez that Drug Enforcement Agency ("DEA") officers must seek a search warrant from a United States magistrate before conducting the search of a foreign citizen's home as a joint venture with foreign law enforcement officers. The case involved the joint search by DEA agents and Mexican law enforcement officials of two homes in Mexico, both owned by Verdugo-Urquidez, a Mexican national. The district court held that the Fourth Amendment had been violated by the search and that the evidence obtained in the search should be suppressed. The Court of Appeals affirmed in an opinion authored by Judge Thompson, joined by Judge Norris, over a dissent by Judge Wallace. The Supreme Court granted a writ of certiorari to consider the following question:

Must evidence seized from foreign national's residence in foreign country be suppressed under Fourth Amendment because U.S. law enforcement officers who conducted seizure, in conjunction with foreign officials and with their approval, did not have search warrant?

In reaching its conclusion, the Ninth Circuit made three critical holdings. First, it held that the defendant could raise a Fourth Amendment challenge even though the defendant was a Mexican

85. Id. In First National Bank, Justice Rehnquist argued that the courts should generally defer in individual cases to the Executive Branch's determination regarding the applicability of the act of state doctrine. Rehnquist was joined in this view by Chief Justice Burger and Justice White. A majority of the Court at the time (Douglas, Powell, Brennan, Stewart, Marshall, and Blackmun) rejected Rehnquist's position. It seems very likely, however, that the three Reagan appointees, O'Connor, Scalia, and Kennedy, will join Rehnquist and White in deferring to the institutional expertise of the Department of State in foreign affairs.
national. Second, it held that the search was a "joint venture" between the United States and Mexican officials, and was thus subject to Fourth Amendment scrutiny. Third, it held the DEA agents were not entitled to rely upon the statements by Mexican officials that the search had been properly authorized, and the DEA agents were instead required to obtain a search warrant from a United States court.

Resolution of the first issue, whether a foreign national could claim the protections of the Fourth Amendment, involves a consideration of the fundamental relationship between government and the people subject to the government's control, and the purpose of the Fourth Amendment. According to the dissenting opinion, the Constitution represents a "compact" between the people and government. Because the relationship between government and the people is essentially contractual in nature,

[n]o one can seriously doubt that the compact applies only to the people who empowered the government of the United States for the benefit of themselves and their posterity, not to other peoples of the world who neither ceded authority to it in exchange for certain guarantees of liberty nor otherwise consented to its rule.

According to the dissent, since the defendant, a Mexican national, had not taken upon himself the obligations of U.S. citizenship or residency, the defendant had no right to claim the protections contained in the Fourth Amendment.

The majority rejected this interpretation of the Constitution. It found the historical record much less clear than the dissent with respect to the relation of government to the people. In particular, the majority noted that the Bill of Rights and the Declaration of Independence, among other documents, were based upon a theory of "natural rights," rights which no government could encroach upon. The majority also found in Supreme Court precedent support for the idea that the Constitution may be invoked by foreign nationals who are subject to the control of the United States government.

The discussion by the majority and dissent is of course of great academic interest. Strong arguments can be made both in favor of

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89. *Id*. at 1224-28.
90. *Id*. at 1228-30.
91. *Id*. at 1233 (Wallace, J., dissenting).
92. *Id*.
94. *Id*. at 1221-24.
a compact theory of government and in favor of a natural rights theory. It seems likely that the Supreme Court will not choose to rest its decision upon any one view of the purpose of government or the fundamental nature of the Constitution, especially when that issue can be relatively easily avoided.

The Supreme Court is also likely to give the second issue, whether the search was a "joint venture" of American and Mexican law enforcement officials, scant attention. Both searches were requested by United States Drug Enforcement Agency officers; DEA officers were present during the first search and actually conducted the second search. A more active involvement of United States law enforcement officials could hardly be imagined. Although the Supreme Court has not itself formally enforced the "joint venture" doctrine, it has received widespread acceptance in the courts of appeals, although there is some disagreement as to the exact formulation of the doctrine. The Supreme Court is likely to recognize the "joint venture" doctrine and hold that the United States government can be charged with responsibility for the search of the two homes.

The issue most likely to be dispositive is whether the DEA agents were entitled to rely in good faith upon the statements by Mexican officials that the search was legal under Mexican law. The Ninth Circuit held that no good faith exception to the Fourth Amendment applied because the circumstances did not prevent the DEA agents from securing a search warrant from a United States magistrate.

The court's holding is strange because, as the court itself recognizes, "a warrant issued by an American magistrate would be a dead letter in Mexico" and "it would be an affront to a foreign country's sovereignty if the DEA presented an American warrant and suggested that it gave the American agents all the authority they needed to search a foreign residence." Although not mentioned by the Ninth Circuit, requesting a United States court to issue a warrant that is nowhere enforceable might also be an "affront" to the United States court, which might refuse to exercise its jurisdiction in circumstances when the judgment requested would have no legal effect.

The Supreme Court is almost certain to reverse the Ninth Circuit's decision. In recent years, the Supreme Court has looked more fa-

95. The cases are cited and discussed in Verdugo-Urquidez, 856 F.2d at 1225.
96. Id. at 1230.
97. Id. at 1229-30.
98. Ordinarily, federal courts refuse to issue advisory opinions or judgments which have no legal force. Hayburn's Case, 2 U.S. (2 Dall.) 409 (1796).
Inexplicably, the Ninth Circuit failed to cite any of these decisions in its opinion. The court’s discussion of good faith exceptions was limited to a discussion of *United States v. Peterson*, a Ninth Circuit opinion which, contrary to the decision in *Verdugo-Urquidez*, held that United States law enforcement officials were entitled to rely in good faith upon the assurances of high ranking foreign law enforcement authorities that a search conducted within that foreign jurisdiction was proper under foreign law.

In *United States v. Peterson*, DEA agents relied upon the representations of high ranking law enforcement authorities in the Philippines that a planned phone tap was legal under Philippine law. The information gained through the phone tap was used to locate a ship loaded with marijuana. In an opinion written by then Judge, and now Justice Kennedy, the Ninth Circuit held that, because of the DEA agents’ good faith reliance upon the representations of legality made by Philippine officials, evidence obtained as a result of the phone tap should not have been suppressed in the subsequent criminal trial.

The Ninth Circuit in *Verdugo-Urquidez* purported to distinguish *Peterson* on the ground that “[t]he warrantless search of the vessel in *Peterson* was permissible due to exigent circumstances inherent in a high seas search.” Since the search of two Mexican homes did not involve similar exigent circumstances, the court felt free to ignore the holding in *Peterson*.

The decision in *Peterson* was not based upon exigent circumstances, however. Judge Kennedy explained in *Peterson* the rationale of permitting a good faith exception in the context of searches in foreign jurisdictions:

American law enforcement officers were not in an advantageous position to judge whether the search was lawful, as would have been the case in a domestic setting. Holding them to a strict liability

100. 812 F.2d 486 (9th Cir. 1987).
101. Id. at 492.
102. Id. at 488.
standard for failings of their foreign associates would be even more incongruous than holding law enforcement officials to a strict liability standard as to the adequacy of domestic warrants.\textsuperscript{104}

We should expect the Supreme Court to adopt this rationale and to reverse the Ninth Circuit's decision in \textit{Verdugo-Urquidez}.

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104. \textit{Peterson}, 812 F.2d at 492.
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