

EXTRATERRITORIAL COURTS FOR CORPORATE LAW

Jens Dammann and Henry Hansmann¹

March 2006

Jens Dammann
University of Texas School of Law
727 East Dean Keeton Street
Austin, Texas 78705
JDammann@law.utexas.edu

Henry Hansmann
Yale Law School
P.O. Box 208215
New Haven, CT 06520-8215
henry.hansmann@yale.edu

¹ Dammann is Assistant Professor at the University of Texas School of Law. Hansmann is Augustus E. Lines Professor of Law at the Yale Law School.

This essay was first presented at the Conference on EU Corporate Law-Making in Cambridge, Massachusetts, October 29-30, 2004. For valuable discussions and comments the authors are grateful to the participants in that conference, to Akhil Amar, John Armour, Kevin Clermont, Owen Fiss, Judith Resnik, Gary Simson, and Richard Squire, and to workshop participants at Columbia Law School and Yale Law School.

Abstract

A central goal in devising a system of courts is to make judicial services easily accessible. As a result, justice is usually administered in a geographically decentralized fashion: trial courts are distributed across the territory in which the jurisdiction's law is applied. Corporate law, however, does not fit this pattern: courts are often located far away from the companies subject to their jurisdiction. This is a consequence of choice of law rules providing that a corporation's internal affairs are governed by the laws of its state of incorporation, and that a corporation need not be incorporated in a jurisdiction where it does business. The result is that Delaware law governs most publicly-traded firms in the U.S., and is now extending its reach to encompass corporations headquartered around the globe. But Delaware courts are located only in Delaware. Consequently, there is a large and growing disparity between the geographic area where Delaware law is applied and the location of Delaware courts. This disparity is all the more striking because the quality of the Delaware judiciary is a prime reason why firms incorporate under Delaware law. This situation provokes a simple question: would it not be both desirable and feasible to have Delaware, and other jurisdictions whose law has substantial extraterritorial reach, hold hearings and trials out of state? The creation of such extraterritorial courts might well yield significant benefits: litigation costs could be lowered, and regulatory competition between jurisdictions could be increased with regard to both substantive law and judicial services.

This paper explores the issues involved in such a regime of extraterritorial courts. We consider those issues as they arise within the U.S., within the EU, and globally. We largely limit our analysis to courts whose jurisdiction is confined to corporate law. We note, however, that much of what we say applies as well to other areas of commercial law. Moreover, in exploring their promise we gain important perspective on the basic relationships among substantive law, adjudication, territoriality, and sovereignty, and on the differences between private arbitration and public adjudication.

EXTRATERRITORIAL COURTS FOR CORPORATE LAW

Jens Dammann and Henry Hansmann

I.	Are Extraterritorial Courts in the Public Interest?	6
A.	<i>Advantages of Extraterritorial Courts</i>	6
1.	Lowering the Costs of Litigation	6
2.	Invigorating Regulatory Competition	10
a.	<i>Within the United States</i>	11
b.	Between Nations	11
3.	Creating Competition in the Area of Judicial Services	13
B.	<i>The Potential Drawbacks</i>	15
1.	The Lack of a Uniform Environment	15
2.	Would There Be Enough Business?	16
3.	Abusive Litigation?	16
4.	Forum Shopping	17
C.	<i>Extraterritorial Courts versus Arbitration</i>	19
2.	The Parties' Perspective	19
a.	The Benefits of Arbitration	20
b.	The Drawbacks of International Commercial Arbitration	23
2.	Society as a Whole	24
D.	<i>Should Access to Extraterritorial Courts be Restricted?</i>	24
1.	Protecting Litigants	25
2.	Protecting the Interests of the Host State	25
II.	Are Extraterritorial Courts in the Interest of Popular States of Incorporation?	26
A.	<i>The Costs</i>	26
B.	<i>The Benefits</i>	26
III.	Other Obstacles to Extraterritorial Courts	27
A.	<i>Traditional Concerns about Sovereignty</i>	27
B.	<i>Opposition from Delaware Law Firms</i>	28
C.	<i>Lack of Demand</i>	29
IV.	Extraterritorial Courts outside Corporate Law	30
A.	<i>Extraterritorial Application of a Jurisdiction's Law</i>	30
B.	<i>Uniform Law</i>	31
C.	<i>Other</i>	31
V.	Legal Obstacles to Extraterritorial Courts	31
A.	<i>Between Unrelated Sovereigns</i>	32
B.	<i>Within the United States</i>	34
VI.	Implications for the Understanding of Sovereignty	36

VII. CONCLUSION..... 38

A central goal in devising a state, national, or supranational court system is to make judicial services easily accessible. To reach that goal, justice is usually administered in a geographically decentralized fashion: lower level courts tend to be distributed across the territory of the jurisdiction to which they belong, and that territory is typically identical with the area where the relevant law is applied.² From an economic perspective, this tendency towards a geographically decentralized court system is easy to explain: It will generally be cheaper to locate courts near potential litigants than to force litigants and witnesses to attend hearings in far-away courts.

The judicial administration of corporate law, however, does not fit this pattern. At least where publicly traded corporations are concerned, courts are often located far away from the companies subject to their jurisdiction. This is the result of the state of incorporation doctrine, which is applied in all U.S. states and in many other jurisdictions around the world.³ Under that doctrine, corporations are free to choose the state whose law will govern their internal affairs.⁴ Particularly in the United States, but also in other parts of the world, corporations make use of that doctrine to opt for corporate law from a jurisdiction other than the one where their primary place of business is located. A striking

² It is easy to see, for example, that the structure of the federal court system in the United States follows this pattern: The district courts and even the courts of appeal are spread across the United States. Similarly, the European Community Treaty, while using a different technique, also makes sure that the relevant conditions are met: To the extent that Community law is applied in litigation between private parties, the courts of the Member States, which are distributed across the United States, have jurisdiction.

³ Denmark, Ireland, the Netherlands, and the United Kingdom have traditionally applied the state of incorporation doctrine. See, e.g., Karsten Engsig Sørensen & Mette Neville, *Corporate Migration in the European Union: An Analysis of the Proposed 14th EC Company Law Directive on the Transfer of the Registered Office of a Company from One Member State to Another with a Change of Applicable Law*, 6 COLUM. J. EUR. L. 181, 185 (2000); Jens C. Dammann, *Freedom of Choice in European Corporate Law*, 29 YALE J. INT'L L. 477, 479 n.9 (2004) [hereinafter Dammann, *Freedom*]. Finland and Sweden also appear to fall into this category. See Paul Krüger Andersen & Karsten Engsig Sørensen, *Free Movement of Companies from a Nordic Perspective*, 6 MAASTRICHT J. EUR. & COMP. L. 47, 54-56 (1999). A number of other Member States have traditionally applied the so-called real seat doctrine under which the law of the headquarters state governs a corporation's internal affairs. However, the Court of Justice of the European Communities has recently made it clear that this latter approach generally violates the Freedom of Establishment granted by the Treaty Establishing the European Community provided that the corporation has been validly formed in another Member State. For a description of the relevant case law see Dammann, *Freedom*, at 483-486.

⁴ See FRANKLIN A. GEWURTZ, *CORPORATION LAW* 36 (2000).

consequence is that Delaware law governs most publicly-traded firms in the U.S.⁵, and is now extending its reach to encompass corporations headquartered around the globe.

But Delaware courts are located only in Delaware. Consequently, there is a large and growing disparity between the geographic area where Delaware law is applied and the location of Delaware courts. To be sure, courts in other jurisdictions can hear disputes arising under Delaware law. But their judgments do not constitute binding precedents with respect to Delaware law. And, even if one focuses solely on the parties' perspective, courts from other jurisdictions will find it hard to be seen as an attractive alternative to Delaware. It is precisely because of Delaware's unusually competent and efficient judiciary that many firms choose to incorporate in that state.⁶ Moreover, quite apart from the particular strengths of Delaware courts, when the courts of other states apply Delaware corporate law, they are faced with the law of a foreign jurisdiction.

These observations suggest a simple question: would it not be both desirable and feasible to have Delaware hold hearings and trials out of state? Why, for example, does not Delaware set up courts in San Francisco, or Frankfurt, or Singapore? Why, for that matter, does it not set up a court in New York City, which would be much more convenient than Wilmington, Delaware, even for most of the publicly traded U.S. firms that already incorporate in Delaware? In the remainder of this essay, we explore why this has not been done, whether it should be done, and how it might be done.

Although we use Delaware as an example, there is no reason why other important – or wish-to-be important – states or countries that welcome incorporation by out-of-state firms might not also create extraterritorial courts. The United Kingdom, for example, might choose to facilitate access to their own corporation law by the same means, holding hearings and trials elsewhere in Europe, in the U.S., or in the world at large.⁷ Singapore might seek to play the same role in East Asia and the Pacific. Nor is there any reason why extraterritorial courts need be confined to corporate law. The same approach could be applied to other aspects of commercial law, such as contract law, where actors commonly choose to be governed by the law of a foreign jurisdiction.

Moreover, whatever the merits of extraterritorial courts as a practical proposal, in exploring their promise we gain helpful perspective on the basic

⁵ Cf. DELAWARE DIVISION OF CORPORATIONS, *Why Choose Delaware As Your Corporate Home?*, available at <http://www.state.de.us/corp/default.shtml> (last visited July 20, 2005) (claiming that “[m]ore than half a million business entities have their legal home in Delaware including more than 50% of all U.S. publicly-traded companies and 58% of the Fortune 500”).

⁶ See Black, *supra* note 12, at 586-89 (1990) (citing the expertise of Delaware judges as the primary reason for Delaware's success in the charter market).

⁷ As pointed out above, the United Kingdom adheres to the state of incorporation doctrine. See Sørensen & Neville, *supra* note 3, at 185.

relationships among substantive law, adjudication, and territoriality, and on the differences between private arbitration and public adjudication.

Part I argues that the creation of extra-territorial courts by Delaware and other would-be-contenders in the market for corporate charters lies in the interest of society as a whole. Part II then suggests that it also lies in the interest of popular states of incorporation, especially Delaware, to establish such courts. Part III examines possible reasons why, despite their desirability, extraterritorial courts have not been established already and why the relevant obstacles are unlikely to prevent their creation in the future. Part IV briefly explores the potential for extraterritorial courts outside corporate law. Part V then examines the current legal framework and suggests that neither federal nor international law stand in the way of extraterritorial courts provided that the host state grants its permission. Part VI ties together our analysis of the merits of Extraterritorial courts, the value of exporting judicial services in general, and the nature of state sovereignty. Part VII concludes.

I. Are Extraterritorial Courts in the Public Interest?

The most central question with regard to extraterritorial courts is, of course, whether their creation would be in the interest of society as a whole. There is much reason to believe that the answer is yes.

A. Advantages of Extraterritorial Courts

The creation of extraterritorial courts by popular states of incorporation such as Delaware could have a number of significant benefits.

1. Lowering the Costs of Litigation

The most obvious advantage is that establishing courts in the geographic vicinity of potential litigants should, in many cases, be cheaper than forcing potential litigants to litigate in the state of incorporation itself. Thus, the establishment of extraterritorial courts in appropriate locations promises to lower the costs of administering justice.

To be sure, firms can choose to be governed by a state's corporation law without bearing the burden of litigating in that state. Delaware courts, for example, have no monopoly on the application of Delaware law. Under the state of incorporation doctrine, courts in other jurisdictions will apply Delaware law to the internal affairs of Delaware corporations. The courts of other states are not, however, an adequate substitute for Delaware courts in applying Delaware law. To begin with, a Delaware corporation cannot be certain that the courts of other states will accept disputes concerning the corporation's internal affairs. Rather,

courts may⁸ – and sometimes will⁹ – invoke the doctrine of *forum non conveniens*¹⁰ to refuse to hear cases relating to the internal affairs of foreign corporations. Moreover, cases involving Delaware law that are litigated outside of Delaware are beyond the influence of the Delaware judiciary, and thus bring the risk of undermining the coherence and uniform application of Delaware law. Finally, one of the great advantages of Delaware incorporation, it is widely felt, lies in access to Delaware’s uniquely capable and efficient judiciary.¹¹ In fact, it is arguable that Delaware’s judiciary, rather than the body of substantive doctrine offered by Delaware corporate law, is today the principal attraction of Delaware incorporation.¹²

But is it really a big burden for Delaware corporations to litigate in Delaware’s courts? Two considerations might suggest not.

⁸ For an exemplary definition of the *forum non conveniens* doctrine see *Gulf Oil Corp. v. Gilbert*, 330 U.S. 501, 508-09 (1947).

⁹ *Cf.*, e.g., *Kelley v. American Sugar Refining Co.*, 42 N.E. 2d 592, 594 (Mass. 1942) (coming to the conclusion that the questions at issue should be decided by the courts of the state of issue incorporation); *Thompson v. Southern Connellsville Coke Co.*, 112 A. 533, 534-35 (Pa. 1921) (refusing to exercise jurisdiction over the internal affairs of a foreign corporation); *Meade v. Pacific Gamble Robinson Co.*, 153 P.2d 686, 689 (Wash. 1944) (holding that “[w]here, as in the case at bar, the controversy necessitates interpretation of a statute of the state creating the corporation the general rule against interference with the internal affairs of a foreign corporation is strictly applied”).

¹⁰ The internal affairs rule was originally considered to be not only a choice of law doctrine, but also a jurisdictional doctrine. As a result, courts would sometimes decline to hear cases relating to the internal affairs of foreign corporations based on the assumption that they lacked jurisdiction. See, e.g., *Boyette v. Preston Motors Corp.*, 89 So 746, 748-49 (Ala. 1921). However, the modern trend is to apply the *forum non conveniens* doctrine in deciding the question of whether or not to exercise jurisdiction over the internal affairs of foreign corporations. See, e.g., *In re Mercantile Guar. Co.*, 48 Cal. Rptr. 589, 593 (Cal. App. 1st Dist. 1965); *Lonergan v. Crucible Steel Co. of America*, 229 N.E.2d 53, 539 (Ill. 1967); *State v. Iowa Southern Utilities Co. of Delaware*, 2 N.W.2d 372, 390-91 (Iowa 1942); *Amatuzio v. Amatuzio*, 410 N.W. 2d 871, 874 (Minn. App. 1987); *Sterling Grace & Co. v. Seeman Bros., Inc.*, 215 N.Y.S. 2d 559, 560-61 (1961).

¹¹ See, e.g., ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* 40 (1993) (praising the expertise of Delaware’s judges); Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1911 (1998) (noting a consensus that Delaware’s judges are one of the reasons for Delaware’s success in the charter market); David A. Skeel, *Bankruptcy Judges and Bankruptcy Venue: Some Thoughts on Delaware*, 1 DEL. L. REV. 1, 16 (1998) (arguing that Delaware’s judges play an “important part” in explaining Delaware’s success in the charter market); Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 708 (2002) (claiming that “[a] principal attraction of incorporating in Delaware is the high quality of its chancery court”).

¹² See, e.g., Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542, 586-89 (1990).

a. *The Ease of Litigating from a Distance*

To begin with, litigating at a distance has become fairly simple, especially in Delaware. You do not have to go to Delaware to prepare briefs or memoranda, review documents, interview witnesses, or take depositions. In fact, the Chancery Court Rules even provide for the electronic filing of documents.¹³

However, while much of the work to be done in litigation can be done without coming to Wilmington, personal appearances by counsel and litigants are still often unavoidable. And, even if one can litigate from a distance, this may not always be the most efficient way to conduct a trial. It is quite possible that corporate clients and their counsel would spend more time before the Chancery Court if it were not located so inconveniently.

Moreover, even rare appearances before a court can be quite burdensome for foreign-based firms. For foreigners, the inconveniences of litigating in Delaware include not just the problem of travel and of litigating in a foreign language, but also, today, permission to enter the country. In the worst case, a past violation of visa rules or some other misstep proves to be a permanent obstacle to entry into the United States. The unpredictability of United States immigration policy is now a significant deterrent to incorporating in the United States.¹⁴

Perhaps more importantly, the argument that the costs and difficulties of communicating at a distance have declined and will continue to decline cuts both ways. Admittedly, lower communication costs mean that litigating in a far-away court becomes much easier, thereby reducing the need for extraterritorial courts. At the same time, however, any decline in the costs of communicating at a distance also means that the number of corporations for which incorporation in a foreign jurisdiction becomes feasible increases. Thus, the demand for extraterritorial courts grows. It is noteworthy in this context that U.S. law firms have steadily increased their presence in other countries. For example, Sullivan & Cromwell, Debevoise, and Skadden Arps now have offices in Frankfurt. To be sure, there are many differences between the services provided by courts and those provided by law firms.¹⁵ Nevertheless, the thesis that low communication

¹³ Cf. DEL. CH. CT. R. 79.1 (2004) (leaving it up to the Chancellor to determine whether or not it is appropriate, in a civil case or in a category of cases, to follow the procedures for eFiling).

¹⁴ For a more detailed analysis of why non-U.S. firms may be reluctant to incorporate in Delaware see Jens C. Dammann, *A New Approach to Corporate Choice of Law*, 39 VAND. J. TRANSNAT'L L. (forthcoming 2005) [hereinafter Dammann, *New Approach*].

¹⁵ One might reason, for example, that courts need not be located as close to the litigants as lawyers are because courts deal with legally experienced players -- namely corporate lawyers -- whereas law firms interact with clients who have no legal training and therefore depend more on face-to-face communication. Since most large corporations have in-house counsel, however, the force of this logic is unclear.

costs will necessarily lead rational providers of law-related services to reduce their physical presence in other jurisdictions seems premature.

b. *The Prevalence of Public Corporations*

Another reason why the geographic remoteness of the courts of Delaware, and of would-be Delawares, might seem unimportant is that Delaware's lead in the charter market exists mainly among large, publicly-traded corporations for whom litigation in a geographically distant location is not as onerous as it might be for smaller litigants.¹⁶

Yet the problems just recited affect even publicly traded corporations, and especially foreign firms. Moreover, while Delaware's lead is indeed greatest among publicly traded corporations, that state is currently home to roughly 300,000 corporations,¹⁷ a number far larger than the total of all publicly traded corporations in the United States. Indeed, the overall number of U.S. corporations whose stock is listed on stock exchanges is less than 2,500.¹⁸ Of course, many large companies are not, in fact, listed. However, IRS data suggests that the number of large U.S. firms is not, in fact, terribly large. Indeed, as late as 2002, the number of income tax returns filed by corporations with total assets equal to or exceeding \$5 million was only 137,163 – well below the total number of Delaware corporations.¹⁹ Moreover, the total number of income tax returns filed by corporations with total assets of ten million dollars or more was only 79,755.²⁰

It follows that there may be many Delaware corporations for which the costs of litigating outside the headquarters state actually matter. In fact, despite the large number of closely held firms incorporated in Delaware, that state's dominance in the charter market does not extend to close corporations in

¹⁶ Cf., e.g., Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1442 (1992) (“[C]lose corporations generally incorporate in the states in which their principal places of business are located”); David A. Skeel, Jr., *Rethinking the Line Between Corporate Law and Corporate Bankruptcy*, 72 TEX. L. REV. 471, 522-523 (1994) (“[C]losely held corporations almost always incorporate in the same state in which they do all (or most) of their business.”).

¹⁷ On December 31, 2003, the number of Delaware corporations totaled 297,602. E-mail from Cheryl Wyatt, Delaware Division of Corporations (August 24, 2004, 19:43:12 EST) (on file with author).

¹⁸ Cf. SECURITIES EXCHANGE COMMISSION, SELECT SEC AND MARKET DATA 2005, p. 30, Table 13: Securities Listed on Exchanges 1, available at: <http://www.sec.gov/about/secstats2005.pdf> (last visited on March 6, 2006). According to that table, the total number of common stocks listed on U.S. stock exchanges at the end of 2004 was 2930. That number already appears to count double any dual listings. Also, the number includes 549 foreign stocks, so the the number of U.S. common stocks is equal to or less than 2381.

¹⁹ See INTERNAL REVENUE SERVICE, SOI TAX STATS – CORPORATION DATA BY SIZE

²⁰ See id.

general, which still typically incorporate in the state in which they are headquartered.²¹ While there are several considerations that may help to explain this pattern,²² the relatively large potential costs to a small firm of having to litigate in Delaware rather than in the firm's headquarters state appear to be particularly important.²³ Indeed, the geographical limits on Delaware's judicial system may explain why Delaware has only a limited incentive to compete for close corporations in the first place. Given that such corporations will often litigate in their headquarters state rather than in their state of incorporation, a successful effort by Delaware to attract many small out-of-state corporations might be self-defeating: The quality of Delaware's case law might deteriorate as a result of conflicting decisions handed down by courts in other states.

2. Invigorating Regulatory Competition

Another potential benefit of extra-territorial courts lies in stimulating regulatory competition in corporate law. To be sure, not all scholars are convinced that regulatory competition benefits shareholders.²⁴ We will not pursue that debate here, but will simply accept, for the sake of analysis, the prevailing view that, on balance, the ability of firms to choose their state of incorporation contributes to overall social welfare.²⁵

Extraterritorial courts could invigorate charter competition in several ways. We begin with the situation inside the United States and then turn to the international context.

²¹ See the sources cited *supra* note 16.

²² See Jens C. Dammann, *Adjudicative Jurisdiction and the Market for Corporate Charters*, Working Paper (November 2003), available at: <http://ssrn.com/abstract=466760> [hereinafter: Dammann, *Adjudicative Jurisdiction*] (listing and analyzing various factors).

²³ *Cf.* Dammann, *Adjudicative Jurisdiction*, *supra* note 22 (noting that the need to litigate in the state of incorporation is likely to deter close corporations from incorporating out of state). *Cf. also* Ian Ayres, *Judging Close Corporations in the Age of Statutes*, 70 WASH. U. L. Q. 365, 374-375 (1992) (arguing that the risk of having to litigate outside of the headquarters state constitutes one of the factors motivating close corporations to incorporate locally).

²⁴ For a critical view see, e.g., Lucian Bebchuk, Alma Cohen & Allen Ferrell, *Does the Evidence Favor State Competition in Corporate Law?*, 90 CAL. L. REV. 1775, 1820 (2002) (empirical evidence fails to show that state competition benefits shareholders).

²⁵ See, e.g., FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 222 (1991) (while one may search in vain for a race to the top, state competition creates a "powerful tendency" to enact laws benefiting shareholders); Roberta Romano, *Competition for Corporate Charters and the Lesson of Takeover Statutes*, 61 FORDHAM L. REV. 843, 847 (1993) (state competition benefits shareholders "on balance").

a. Within the United States

We have already observed that extraterritorial courts would help make out-of-state incorporation a feasible alternative for close corporations. Thus, the phenomenon of charter competition, which remains largely restricted to publicly-traded corporations,²⁶ could potentially be extended to close corporations. In addition, extraterritorial courts might help other American states compete with Delaware for corporations of all types. While there are many reasons why Delaware has risen to dominance in the charter market, one mundane but important factor may simply be that Delaware is located more advantageously than many of its potential competitors, such as Nevada.²⁷

b. Between Nations

If U.S. jurisdictions – most conspicuously, Delaware – were to establish courts in leading European or Asian cities, the presently modest rate at which foreign corporations seek U.S. charters might expand considerably.

There are, of course, potential obstacles to the incorporation of foreign firms under U.S. law quite apart from the transaction costs of litigating in courts situated in the U.S.²⁸ – obstacles that subsist even where foreign countries, like U.S. states, apply the state of incorporation doctrine.²⁹ Most importantly,

²⁶ As pointed out above, the majority of close corporations incorporate locally. See the sources cited *supra* note 16.

²⁷ In this connection, it is worth noting that New Jersey, which borders the state and city of New York, was the first leading state of incorporation, until it lost its position to nearby Delaware as a result of inopportune legal reforms. See, e.g., Demetrios G. Kaouris, Note, *Is Delaware Still a Haven for Incorporation?*, 20 DEL. J. CORP. L. 965, 970 (1995); Kahan & Kamar, *supra* note 11, at 731.

²⁸ For a detailed description and analysis of these obstacles see Jens C. Dammann, *Freedom of Choice in European Corporate Law*, 29 YALE J. INT'L L. 477, 483-507 (2004).

²⁹ Traditionally, many European countries have applied the so-called real seat doctrine according to which the internal affairs of a corporation are governed by the law of the real seat country. See, e.g., Dammann, *Freedom of Choice*, *supra* note 28, at 479. To be sure, a number of recent decisions by the European Court of Justice have made it clear that the real seat state cannot, as a general rule, apply its own corporate law to a corporation formed in another Member State, without violating the Freedom of Establishment guaranteed by the Treaty Establishing the European Community. However, given that U.S. corporations are not protected by the Freedom of Establishment, the afore-mentioned case law is without immediate relevance to them. This said, the situation of U.S. corporations based in Europe gets even more complicated as one considers bilateral treaties concluded between the United States and European Countries. For example, art. XXV of the Treaty of Friendship, Commerce and Navigation (TFCN) between the Federal Republic of Germany and the United States provides that “companies constituted under the applicable laws and regulations within the territories of either Party [...] shall have their juridical status recognized within the

depending on the law of the foreign country at issue, incorporation in the United States can have adverse tax consequences.³⁰ Moreover, it would expose the relevant corporations to non-corporate litigation in the United States³¹, and would often prompt the application of the U.S. rules on securities regulation.³² Nonetheless, there are likely to be many firms – including particularly new firms – that would take advantage of Delaware incorporation today if corporate law litigation could be conducted closer to home. Indeed, while it is difficult to get exact figures,³³ there is evidence of substantial demand from abroad for Delaware corporate law. In particular, many incorporation services specifically cater not only to incorporators residing in the United States but also to would-be-entrepreneurs from countries all over the world,³⁴ sometimes with rates with special rates for Canadian customers.³⁵ Surely, such services would not be offered if there were no demand. Furthermore, the obstacles to U.S. incorporation may well diminish with time, and there may be pressure to eliminate them even faster if U.S. incorporation could otherwise be made more attractive to foreign firms.

Cross-national corporate chartering need not, moreover, be limited to attracting non-U.S. firms to Delaware. Extraterritorial courts could help other nations, as well, become attractive jurisdictions for incorporation. Singapore, as we have mentioned, might play such a role in East Asia and the Pacific. And there could be similar developments within the European Union. Incorporation in other Member States is much more feasible for European-based firms than is incorporation in a U.S. jurisdiction such as Delaware.³⁶ As European law, in the

territories of the other Party.” See Treaty of Friendship, Commerce and Navigation, Oct. 29, 1954, U.S.- F.R.G., 7 U.S.T. 1839.

³⁰ See Dammann, *New Approach*, *supra* note 1.

³¹ Dammann, *New Approach*, *supra* note 1.

³² Dammann, *New Approach*, *supra* note 1. For some firms, of course, exposure to U.S. securities regulation may be an advantage rather than a disadvantage. In particular, it has been suggested that foreign firms may see the application of U.S. securities law as a valuable bonding device. See, *in particular*, John C. Coffee, Jr., *The Future As History: The Prospects for Global Corporate Convergence in Corporate Governance and Its Implications*, 93 NW. U. L. REV. 641, 674 (1999).

³³ Delaware, for one, does not record the principal place of business of firms incorporated under its laws. E-mail from Robin Mendes, Delaware Division of Corporations (March 6, 2005, 13:35) (on file with authors).

³⁴ This is evidenced by the fact the forms for filling in the address of the corporation frequently list a broad number of countries. See, e.g., the websites of TheCompany Corporations (available under corporate.com), MyCorporation.com, or ActiveFilings (available under ActiveFilings.com). Some services, such as MyCorporation.com or ActiveFilings, explicitly offer special rates and services from customers from abroad,

³⁵ See, e.g., the website of ActiveFilings (available at ActiveFilings.com).

³⁶ To be sure, the act of reincorporation is expensive, because the Member States often lack clear-cut provisions allowing cross-border mergers, and where corporations cannot reincorporate via cross-border mergers, reincorporation may lead to

wake of the *Centros* decision³⁷, moves toward freedom for EU companies to incorporate in any EU member state,³⁸ the opportunity increases for a small state, such as Luxemburg or Malta – or even a larger state, such as the UK -- to become the Delaware of Europe. And, while the distances separating the EU member states are not enormous, it is still far more convenient for German firms to litigate in Frankfurt than in Malta.

One may, of course, reasonably believe that not all jurisdictions worldwide should be allowed to compete in the market for corporate charters. However, the question of who should or should not be permitted to compete in the charter market is one that can most appropriately be solved at the level of the rules governing corporate conflict of laws. If one believes that certain jurisdictions should not be allowed to compete for incorporations, the obvious solution is a rule according to which the law of those jurisdictions will not be applied despite the fact that firms are incorporated there.

3. Creating Competition in the Area of Judicial Services

Extraterritorial courts would be a start in bringing the benefits of competition, not just to substantive corporate law, but also to judicial services. To be sure, litigants eager to get the best judicial services at the lowest price have a certain degree of choice even under the present system. By means of forum selection clauses, which federal courts³⁹ and most state courts⁴⁰ in the U.S. generally recognize as valid, litigants can select among a broad menu of state courts, and, provided federal courts have jurisdiction, can also litigate in the latter. However, as long as state courts are limited to the territory of their respective states, problems of distance render that freedom to choose

significant tax penalties. See, e.g., Dammann, *Freedom of Choice*, *supra* note 28, at 489-90. However, that problem does not arise with regard to a corporation's first choice of domicile. There, a corporation is free to choose the Member State whose law it prefers.

³⁷ Case 212/97, *Centros Ltd. v. Erhvers-og Selskabsstyrelsen*, 1999 E.C.R. I-1459, [1999] 2 C.M.L.R. 551 (1999).

³⁸ See, e.g., Dammann, *Freedom of Choice*, *supra* note 28 at 483-507 (describing the development in the Community and contrasting the situation in the European Community with that in the United States).

³⁹ See, e.g., *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 10, 15 (1972).

⁴⁰ See, e.g., *Volkswagenwerk, A.G. v. Klippan, GmbH*, 611 P.2d 498, 503 (Alaska 1980), cert. denied, 449 U.S. 974 (1980); *SD Leasing, Inc. v. Al Spain & Assocs., Inc.*, 640 S.W.2d 451, 452 (Ark. 1982); *ABC Mobile Sys., Inc. v. Harvey*, 701 P.2d 137, 139 (Colo. Ct. App. 1985); *Funding Sys. Leasing Corp. v. Diaz*, 378 A.2d 108, 109 (Conn. C.P. 1977); *Elia Corp. v. Paul N. Howard Co.*, 391 A.2d 214, 216 (Del. Super. Ct. 1978); *Manrique v. Fabbri*, 493 So. 2d 437, 440 (Fla. 1986); *Calanca v. D & S Mfg. Co.*, 510 N.E.2d 21, 23 (Ill. App. Ct. 1987); *Prudential Res. Corp. v. Plunkett*, 583 S.W.2d 97, 99 (Ky. Ct. App. 1979); *Hauenstein & Bermeister, Inc. v. Met-Fab Indus., Inc.*, 320 N.W.2d 886, 890 (Minn. 1982); *High Life Sales Co. v. Brown-Forman Corp.*, 823 S.W.2d 493, 497 (Mo. 1992).

meaningless for the vast majority of litigants. Indeed, only those corporations for whom the additional costs of litigating in Delaware are relatively insignificant have a clear choice between forums in different states.

With extraterritorial courts, the costs of choosing among alternative judicial forums would decrease appreciably. Differences in the speed and quality of adjudication between home state courts and (say) Delaware courts would become apparent, with consequent pressure on the former to improve. That pressure might come as much from force of example as from any desire to retain jurisdiction over corporate disputes. It is noteworthy, in this respect, that the federal bankruptcy proceedings in Delaware are conspicuously efficient in comparison to those in federal courts elsewhere in the country.⁴¹ This is not because of direct competition between federal and state courts in Delaware, since bankruptcy law is federal and proceedings must be in federal courts.⁴² One reason may be that in practice nominees for Delaware's bankruptcy court are likely to be chosen from among the number of the Delaware bar.⁴³ As David Skeel has pointed out, the Delaware bar has every incentive to be just as careful in nominating bankruptcy court judges as it is in nominating candidates for the Chancery Court or Supreme Court.⁴⁴ However, there may also be a more mundane explanation for the efficiency of Delaware's bankruptcy court: At close range, Delaware's judicial culture may simply be infectious by virtue of the example that the Chancellors and Vice-Chancellors set.

Competition in the field of judicial services may be even more important in the international context, and particularly when there is a choice between common law and civil law courts. Partisans of common law courts extol their political independence.⁴⁵ Partisans of civil law courts extol their proficiency at fact-finding.⁴⁶ Extraterritorial courts would expose the partisans of each judicial culture to the actual functioning of the other, enlarging the possibility that both cultures might be influenced for the better.

⁴¹ See, in particular, David A. Skeel *What's So Bad About Delaware*, 54 VAND. L. REV. 309, 310 (2001). (noting that "bankruptcy process seems to be unusually efficient in Delaware").

⁴² See David A. Skeel, Jr., *Bankruptcy Judges and Bankruptcy Venue: Some Thoughts on Delaware*, 1 Del L. Rev., 1, 31 (1998).

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ See, e.g., Gene R. Shreve, *Section I: Rhetoric, Pragmatism and the Interdisciplinary Turn in Legal Criticism - A Study of Altruistic Judicial Argument*, 46 AM. J. COMP. L. 41, 48 n.25 (1988, Supplement) (claiming that "compared to their colleagues in civil-law countries, American judges enjoy enormous political independence to decide what the law is and how it should be applied.").

⁴⁶ John H. Langbein, *The German Advantage in Civil Procedure*, 52 U. CHI. L. REV. 823, 824 (1985) (praising the German approach to fact-gathering, which accords judges a more central role than U.S. law does).

B. *The Potential Drawbacks*

From the point of view of society as a whole, extraterritorial courts for corporate law seem to have few drawbacks. There are, however, some potential difficulties worth considering.

1. The Lack of a Uniform Environment

To begin with, there is a risk that extraterritorial courts would compromise the quality of the law of the exporting state. There is reason to believe, in particular, that the effectiveness of Delaware's courts derives in important part from an ethic fostered by the local environment – which consists of other judges, legislators, and local lawyers, all of whom have an interest in keeping the Delaware courts functioning well. A single judge sitting in, say, Frankfurt might be more influenced by the local legal culture in Frankfurt than by the legal culture in Wilmington, and hence might not, in the long run, function as effectively as the core Delaware judiciary.

The problem could be particularly acute for the highly independent judges of common law systems who, in contrast with their counterparts in some of the more administratively organized judicial systems of civil law countries, cannot easily be disciplined if they do not perform as expected. Removing a judge who does not seem in line with his colleagues in Delaware is not really an option. Delaware judges are appointed for 12-year terms.⁴⁷ Any attempt to shorten that period could be perceived as an attempt to reduce the independence of judges. And where it is necessary to have judges skilled in languages different from that of the home state, the expedient of selecting for foreign posts only judges who have already proven themselves in the jurisdiction's domestic courts may not be workable.

Nevertheless, the threat that extraterritorial courts pose to the quality of Delaware law (or to the law of other popular states of incorporation) should not be overestimated. Judges could be brought back to Delaware at regular intervals for meetings and conferences to reinforce their cultural ties. Moreover, Delaware judges stationed abroad would have important reputational incentives to remain in step with the rest of the Delaware judiciary. If extraterritorial Delaware judges were to distance themselves from their Delaware-based colleagues, their judgments would likely be reversed more often. In addition, such a course of action would probably lead corporate litigants to avoid the extraterritorial court in question, be it by litigating elsewhere or by refraining from incorporating in Delaware in the first place. After all, corporations choose Delaware as a domicile precisely because they have a preference for Delaware law as it is typically applied by the Delaware judiciary. In sum, an extraterritorial Delaware judge driven by the desire to preserve her standing among her peers would be ill-advised to deviate from the Delaware style of judging.

⁴⁷ DEL. CONST. art IV, § 3 (2004).

2. Would There Be Enough Business?

There is also the risk that there might not be enough business in most foreign jurisdictions to make extraterritorial courts worthwhile. For example, the U.S. West Coast states seem distant enough from Delaware to provide a sufficient number of corporations that would like to litigate there instead of in Delaware. But perhaps the same would not be true for other regions of the U.S. For example, would a separate Delaware court with a permanent judge make sense in Chicago or Houston or Miami? Or Frankfurt or Paris or London? The answer is unclear, and of course depends importantly on whether the availability of an extraterritorial court would itself increase Delaware incorporations substantially in the region where the court sits.

It should also be noted that extraterritorial courts need not require the permanent presence of a Delaware judge. Rather, one can imagine a system of traveling judges who “ride circuit,” holding hearings in different locations as is convenient to litigating parties.⁴⁸ This approach might make extraterritorial proceedings cost-effective even in jurisdictions where there is insufficient litigation to sustain a permanently sitting court.

3. Abusive Litigation?

When the courts of, say, Delaware enter a judgment against a resident of a foreign jurisdiction, the courts of the foreign jurisdiction must, as a general principle, be involved before the judgment can be executed against that person or her property within the foreign jurisdiction.⁴⁹ To be sure, both within the United States and within the European Community, judgments from sister states typically undergo only a very limited amount of scrutiny before they are enforced. Thus, within the United States, many states⁵⁰ have enacted the Uniform Foreign Judgments Act,⁵¹ which provides that, once its filing and notice requirements are met, a judgment handed down by a sister state court “has the same effect ... as a judgment of a [court] of this state and may be enforced [...] in the same manner.” Similarly, in the European Community, Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and

⁴⁸ That was once the practice of U.S. Supreme Court Justices. See, e.g., Lawrence W. Pierce, *Appellate Advocacy: Some Reflections From the Bench*, 61 *FORDHAM L. REV.* 829, 831 (1993).

⁴⁹ With regard to the situation where a foreign judgment is to be enforced in the United States see, e.g., EUGENE F. SCOLES, PETER HAY, PATRICK J. BORCHERS & SYMEON C. SYMEONIDES, *CONFLICT OF LAWS* 1149 (3rd, ed. 2000) (noting that “judgment creditors must depend on the assistance of local courts for the recognition and enforcement of the judgment).

⁵⁰ For a list of the relevant states see *id.* at 1164.

⁵¹ 9A U.L.A. 488 (1964).

enforcement of judgments in civil and commercial matters⁵² greatly facilitates the enforcement of judgments handed down by courts in other Member States: According to art. 41 of that regulation, judgments from other Member States are declared enforceable as long as certain formal requirements are met.⁵³ Yet even these minimal procedural requirements arguably serve an important function. They provide safeguards against abusive rulings of courts against persons who have no political representation or other protective ties in the trial court's jurisdiction.

If extraterritorial courts were able to act directly on persons in the foreign jurisdiction in which they sat, one might be concerned that this protection would be lost. But there is no reason it should be. A judgment handed down by a foreign court remains a foreign judgment even if the relevant court is located in the territory of the state where the judgment is to be enforced. In other words, judgments of, say, Delaware's extraterritorial courts have to be treated just as if they were judgments entered in the local courts of Delaware. The purpose of extraterritorial courts is primarily to overcome communication barriers that impede out-of-state incorporation, and not to alter the balance of judicial power beyond that.

4. Forum Shopping

One might also be concerned that extraterritorial courts would facilitate forum shopping. To be sure, even now, Delaware does not usually force corporate litigants to sue in the Delaware Court of Chancery.⁵⁴ Hence, there already exists some room for forum shopping. However, the creation of extraterritorial courts might aggravate the problem. Two factors are particularly noteworthy in this regard. First, the availability of extraterritorial courts would allow plaintiffs to engage in forum shopping without having to forego the benefits of the Delaware judicial system. In other words, plaintiffs could choose the court where their chances of winning look best and would still profit from the advantages in expertise and speed that Delaware courts have to offer. Second, the existence of extraterritorial courts would make it much easier to use forum-shopping as a way of shopping for particular judges. After all, in at least some

⁵² Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, 2001 O.J. (L 12), 1-23.

⁵³ See *id.*, art. 41: "The judgment shall be declared enforceable immediately on completion of the formalities in Article 53 without any review under Articles 34 and 35. The party against whom enforcement is sought shall not at this stage of the proceedings be entitled to make any submissions on the application."

⁵⁴ Note, however, that in a number of cases, the parties have no choice but to deal with Delaware's Chancery Court. See, e.g., 8 DEL. C. § 203 (e) (2004) (vesting the Chancery court with exclusive jurisdiction to hear and determine all matters with respect to sec. 203 of the General Corporation Law); 8 DEL. C. § 145 (k) (2004) (vesting the Court of Chancery with exclusive jurisdiction to hear and determine all actions for advancement of expenses and indemnification).

cases, extraterritorial courts may not have enough business to justify the presence of more than one judge. Consequently, potential plaintiffs would know more or less exactly which judge will hear their case if they litigate in a particular extraterritorial court. As a result, forum-shopping would be considerably more attractive in a system involving extraterritorial courts.

Yet a substantial increase in forum shopping is not a necessary consequence of the creation of extraterritorial courts. To begin with, under Delaware law, litigants are free to make use of forum selection clauses.⁵⁵ Hence, if an extraterritorial court were established in, say, Frankfurt, Germany, Delaware corporations based in Germany could presumably include, in their certificate of incorporation, a provision prescribing that all suits brought by shareholders and directors and relating to the internal matters of the corporation are to be brought in the Frankfurt branch of the Chancery Court. In addition, the Delaware legislature could take various steps to reduce the risk of forum shopping. One particularly drastic step would be to curtail the jurisdiction of the Court of Chancery in Wilmington in favor of various extraterritorial branches of that court. For example, once a branch office of the Court of Chancery has been set up in Frankfurt, one could require all German-based firms to litigate there. A less far-reaching measure would be to modify the forum non conveniens doctrine as it is now applied by Delaware courts. At present, Delaware Courts will rarely disturb the plaintiff's choice of forum when a Delaware corporation is sued in Delaware. In fact, it will only invoke the forum non conveniens doctrine if it would mean an overwhelming hardship for the defendant to litigate in Delaware.⁵⁶ In order to use the forum non conveniens doctrine as a means for preventing forum shopping, the Delaware legislature need only enact a statute according to which all branches of the Chancery Court except the one that is closest to the principal place of business of the corporation will generally be considered inconvenient forums.

Moreover, it is not clear that the parties' ability to engage in forum shopping necessarily amounts, in this context, to a serious evil that must be avoided. There are benefits as well as costs to forum shopping, in that it potentially permits the parties to choose the forum that best suits their needs. For example, consider a Delaware firm that has its principal place of business in Germany. Such a firm may come to the conclusion that it would be highly advantageous to litigate its internal affairs before a judge who actually speaks German. In that case, litigating in a Frankfurt branch of the Delaware Court of Chancery would be an obvious choice, presuming that the vice-Chancellor in charge of that branch has a command of the German language. By contrast, if the relevant firm is a multinational giant, whose boardroom language has long

⁵⁵ *Elia Corp. v. Paul N. Howard Co.*, 391 A.2d 214, 216 (Del. Super. 1978).

⁵⁶ See *Kolber v. Holyoke Shares*, 213 A.2d 444, 446-47 (Del. 1965); *Chrysler First Bus. Credit Corp. v. 1500 Locust Ltd. Partnership*, 669 A.2d 104, 108 (Del. 1995); *Taylor v. LSI Logic Corp.*, 689 A.2d 1196, 1197-98 (Del. 1997).

since been changed from German to English, litigating in Wilmington may seem as or more attractive.⁵⁷

C. Extraterritorial Courts versus Arbitration

The question remains whether extraterritorial courts are not superfluous because of the availability of international commercial arbitration, which is already well developed under the auspices of organizations such as the International Chamber of Commerce (ICC), the American Arbitration Association (AAA), and the London Court of International Arbitration (LCIA). If, say, a Belgian firm wants to take advantage of Delaware corporation law, but would like a more convenient forum for litigation than Delaware, could I not incorporate in Delaware and simply provide in its charter that disputes concerning the corporation's internal affairs are to be resolved by arbitration in, say, Brussels or Paris?

For matters of corporate law, however, arbitration does not appear to be an adequate substitute for extraterritorial courts. The best evidence for this conclusion is that, within the U.S., arbitration of corporate law disputes appears extremely rare. Even for states with judiciaries much less expert and efficient than that of Delaware, resolution of intra-corporate disputes takes place almost exclusively in the public courts – though those courts may include the federal courts, where cases are sometimes taken in search of greater expertise or impartiality. A review of the benefits and costs of arbitration for corporate disputes suggests why.

2. The Parties' Perspective

The advantages and drawbacks of commercial arbitration from the litigants' point of view are well known. In the area of corporate law, however, the

⁵⁷ To be sure, at least one of the arguments that have traditionally been advanced against forum shopping might be invoked even where the choice of forum is a consensual one. That is, one could argue that forum-shopping would lead the more popular courts to be overloaded with cases, while judges at other courts are twiddling their thumbs. Cf., e.g., Kimberly A. Moore & Francesco Parisi, *Symposium on Constructing International Intellectual Property Law: The Role of National Courts: Thinking Forum Shopping in Cyberspace*, 77 CHI.-KENT. L. REV. 1325, 1333 (2002) (noting that forum shopping has traditionally been criticized on the ground that it "overburdens preferred courts with a flood of cases"). Yet, at least in the context at hand, if the parties prefer certain courts despite the delays that result from an excessive case load, that only means that the benefits of having the relevant court decide those cases outweigh any harm caused by the one-sided distribution of litigation. See *id.* Moreover, Delaware could adjust the size of its courts to the demand that these courts are facing: If it turns out that everyone wants to litigate in the Singapore branch of the Chancery Court because that branch has proven to be even better than the Wilmington one, then the Delaware legislature would only have to increase the number of judges working in that branch.

benefits of arbitration have little importance, whereas the drawbacks weigh particularly heavily.⁵⁸

a. The Benefits of Arbitration

On the plus side, arbitration may offer speedy decisions,⁵⁹ expert decision-makers,⁶⁰ and (at least from the U.S. perspective) cost savings.⁶¹ The chances of preserving the underlying business relationship are also said to be greater in case of commercial arbitration.⁶²

Moreover, when it comes to international commercial arbitration, there may be additional advantages. At present it may be easier to get the resulting decision recognized and enforced in both countries. While the proposed Hague Convention on Jurisdiction, Recognition and Enforcement of Judgments in Civil and Commercial Matters⁶³ is still languishing on the negotiation table, more than 125 countries have signed the 1958 New York Arbitration Convention⁶⁴ or the

⁵⁸ As regards the U.S. context, a similar point is made by G. Richard Shell, *Arbitration and Corporate Governance*, 67 N.C.L. REV. 517, 572-573 (1989). According to him, „[p]ractical as well as transaction cost factors suggest that arbitration in the public shareholder context will remain the exception rather than the rule”. See *id.* at 572. He names three reasons to support that view. To begin with, he notes that disputes may arise with regard to the arbitration clause itself. He also points out that arbitration does not work particularly well in complex settings and that defendants may be concerned about the possibility that an arbitrator may award punitive or multiple damages. Finally, he points out to the particular expertise of Delaware’s judges.

⁵⁹ Cf. Christine Fahrenback, *Note, Vimar Seguros y Reaseguros v. M/V Sky Reefer: A Change in Course: COGSA Does Not Invalidate Foreign Arbitration Clauses in Maritime*, 29 AKRON L. REV. 371, 395 (1996); William Wang, *International Arbitration: The Need for Uniform Interim Measures of Relief*, 28 BROOKLYN J. INT’L L. 1059, 1060 (2003)

⁶⁰ Cf. Fahrenback, *supra* note 59, at 395 (noting that the parties can select their decision-makers in case of commercial arbitration).

⁶¹ Fahrenback, *supra* note 59, at 395. For a more qualified statement see William Wang, *International Arbitration: The Need for Uniform Interim Measures of Relief*, 28 BROOKLYN J. INT’L L. 1059, 1060 (2003) (“While consideration must be given to the fact that the arbitrators have to be paid (whereas judges of a court do not), it is not unusual to hear the suggestion that arbitration is cheaper than litigation.”). Although the view that arbitration is less expensive than litigation seems to be widely accepted in the U.S. literature, among German lawyers the opposite view is often expressed, perhaps reflecting differences in the cost structure of litigation in Germany.

⁶² Fahrenback, *supra* note 59, at 395; William Wang, *International Arbitration: The Need for Uniform Interim Measures of Relief*, 28 BROOKLYN J. INT’L L. 1059, 1060 (2003)

⁶³ Available at: <http://www.hcch.net/e/workprog/jdgm.html>.

⁶⁴ Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38 (entered into force with regard to the United States Dec. 29, 1970).

1961 European Convention on International Commercial Arbitration.⁶⁵ Moreover, in the case of arbitration, the parties can choose the language they like best, and they may also value the existence of a neutral forum.⁶⁶

Yet, despite the multitude of advantages that (international) arbitration is said to offer, they may often be unimportant in the context of corporate law. As far as the prospect of speedy decisions and expert decision-makers are concerned, Delaware law may offer the same advantages.⁶⁷ After all, speed and expertise are precisely the qualities that Delaware's judges are famous for. To be sure, as far as speed is concerned, arbitrators may reach their decision even faster than Delaware courts, namely by limiting discovery⁶⁸ and by making sure that there is no possibility to appeal their decision.⁶⁹ However, there is no reason to believe the parties are willing to pay that price. In particular, shareholders will often find it difficult to pursue their rights if discovery is limited, which in turn would make the relevant corporate law less attractive to investors.

It is also questionable whether arbitration can offer substantial advantages in terms of costs when compared to Delaware. To the extent that cost savings result from speed, they can largely be realized in Delaware courts as well. To the extent that they result from the avoidance of court fees, it is worth noting that Delaware courts charge only minimal fees.⁷⁰ Finally, to the extent that costs are saved by limiting discovery⁷¹ and by reducing the role of law in resolving conflicts, it is, once again, very dubious whether many parties are willing to pay that price. Many potential investors may be deterred if their rights are subject to the uncertainties of arbitration.

Similarly, the wish to salvage a business relationship typically will not play a major role in corporate law, at least where publicly traded corporations are

⁶⁵ See Helen Z. Kryshtalowych & Claudia T. Salomon, *Current Development: Enforcing Foreign Arbitral Awards and Foreign Judgments in Ukraine*, 12 AM. REV. INT'L ARB. 425, 425 (2001).

⁶⁶ See, e.g., William Wang, *International Arbitration: The Need for Uniform Interim Measures of Relief*, 28 BROOKLYN J. INT'L L. 1059, 1060 (2003) („Parties tend to prefer settlement in a neutral forum, rather than submitting to the jurisdiction of another party's home nation.)

⁶⁷ Cf. also Shell, *supra* note 58, at 572-573 (suggesting that arbitrators may not be superior to Delaware courts in terms of speed and expertise).

⁶⁸ Cf. Richard A. Bales, *The Discord Between Collective Bargaining and Individual Employment Rights: Theoretical Origins and a Proposed Solution*, 77 B.U. L. REV. 687, 755-56 (1997) (claiming that [a]rbitral discovery [...] is limited because arbitration derives its advantages of speed and low cost in large part from the fact that discovery arbitration is less extensive than in litigation“).

⁶⁹ Cf. Bales, *supra* note 58, at 757 (“Restrictions on the right to appeal effectively make the arbitral award final, eliminating a lengthy and expensive appellate process.“).

⁷⁰ See Kahan & Kamar, *supra* note 1, at 1256 n.160.

⁷¹ Cf. Bales, *supra* note 58, at 755-56 (1997) (claiming that “[a]rbitral discovery [...] is limited because arbitration derives its advantages of speed and low cost in large part from the fact that discovery in arbitration is less extensive than in litigation“)

concerned. A shareholder seeking to attack a self-dealing transaction has no interest in saving the relationship with the manager in question, and neither does a shareholder claiming that the managers of the corporation violated their fiduciary duties in defending against a hostile takeover attempt.

Even the particular advantages that arbitration seems to offer in the international arena lose much of their luster when analyzed in the context of corporate law. For example, the ability to pick a particular language in arbitration proceedings no longer presents an advantage if one assumes that Delaware courts offer the same benefit. Similarly, there is no reason to believe that Delaware courts will be biased against foreign plaintiffs. After all, neither the plaintiff nor the defendant will usually reside in Delaware. Of course, one could argue that Delaware courts may be biased in favor of managers, given that corporate managers have considerable influence in determining where the corporation will be incorporated.⁷² However, that argument has little weight in the context at hand, because arbitrators face a similar problem. Just as Delaware may seek to pander to managers rather than to shareholders, knowing that the former will decide about the future of the business-relationship, arbitrators may attempt to pander to managers,⁷³ knowing full well that managers rather than shareholders will end up devising the arbitration clause and picking the arbitrator. Of course, that bias should not be overestimated in either case. Just as Delaware wants to protect its reputation as a state with investor-friendly law, arbitrators will want to protect their reputation as well.

Finally, consider the problem of the recognition and enforcement of judgments. While there is no uniform practice regarding the international recognition and enforcement of judgments in corporate matters, there is little reason to believe that this issue presents significant practical problems, at least among western countries.⁷⁴ A crucial source for the non-enforcement of foreign

⁷² The claim that Delaware's courts will put the interests of managers over those of shareholders is at the heart of the race-to-the-bottom theory. After all, Cary, who thought that Delaware favored managers over shareholders in order to attract corporations, also argued that Delaware's judges closely identified with the interests of the state and the local bar. See William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 692 (1974).

⁷³ The risk that arbitrators might be biased in favor of "repeat players" is often noted in the context of employment arbitration. See, e.g., Lisa B. Bingham, *On Repeat Players, Adhesive Contracts, and the Use of Statistics in Judicial Review of Employment Arbitration Awards*, 29 MCGEORGE L. REV. 223, 224 (1998) (finding that "that repeat player employers do better in arbitration than one-shotters"); William R. Corbett, *Waiting for the Labor Law of the Twenty-First Century: Everything Old Is New Again*, 23 BERKELEY J. EMP. & LAB. L. 259 (2002) (noting the risk of a repeat player effect in case of mandatory arbitration).

⁷⁴ The conventional wisdom is that it may be difficult to get U.S. judgments recognized and enforced abroad. See, e.g., Linda J. Silberman, *Symposium: The Impact of Jurisdictional Rules and Recognition Practice on International Business Transactions: The U.S. Regime*, 26 HOUS. J. INT'L L 327, 351 (2004) (claiming that

judgments, namely the feeling that the court that has issued the judgment has interpreted its jurisdiction too broadly,⁷⁵ is unlikely to play a role in the area of corporate law, where the jurisdiction of Delaware courts is based on nothing less than the corporate domicile.⁷⁶ Similarly, two other central problems with respect to the enforcement of U.S. judgments, namely concerns about jury verdicts as well as about punitive damages awards⁷⁷, are not an issue when it comes to Delaware corporate law. As a court of equity, the Chancery Court has no jury. Moreover, the Chancery Court has made it very clear that it lacks jurisdiction to award punitive damages.⁷⁸

b. The Drawbacks of International Commercial Arbitration

While the advantages of (international) commercial arbitration seem modest in the area of corporate law, the disadvantages weigh particularly heavily. The drawbacks of (international) commercial arbitration are well-known. They include, in particular, the inability to receive interim relief,⁷⁹ a compromised instead of a clear-cut result,⁸⁰ limited discovery,⁸¹ lack of coercive power on the

“[m]any countries are quite restrictive when it comes to enforcing judgments rendered by courts in the United States.). However, the risk that U.S. judgments are not recognized abroad may tend to be overstated. Cf. Russell J. Weintraub, *How Substantial is our Need for a Judgments-Recognition Convention and What Should We Bargain Away to Get It?*, 24 BROOK. J. INT’L L. 167, 170-71 (suspecting that „judgments obtained by U.S. lawyers who follow proper procedures are readily recognized and enforced abroad”).

⁷⁵ With regard to the role of jurisdictional questions in the non-recognition of U.S. judgments abroad see, e.g., Silberman, *supra* note 74 at 351 (noting that “[o]rdinary, plain, vanilla U.S. money-judgments are often not enforced because certain countries restrict enforcement of foreign country judgments to those rendered on a limited set of jurisdictional grounds”).

⁷⁶ Silberman, *supra* note 74, at 351 n.79, cites the Swiss Private International Law Statute as an example of a statute recognizing only a limited set of bases of foreign jurisdiction. Yet according to her description of Swiss law, the defendant’s domicile is one of these bases.

⁷⁷ Cf. Peter Schlosser, *Speech/Lecture: Lectures on Civil-Law Litigation Systems and American Cooperation With Those Systems*, 45 KAN. L. REV. 9, 47 (1996) (describing European reservations vis-à-vis the enforcement of jury verdicts and punitive damage awards).

⁷⁸ See, e.g., *RHIS, Inc. v. Boyce*, 2001 Del. Ch. LEXIS 118, 8 n.1; *Beals v. Washington International, Inc.*, 386 A.2d 1156, 1159 (1978).

⁷⁹ Fahrenback, *supra* note 59, at 395.

⁸⁰ Fahrenback, *supra* note 59, at 395.

⁸¹ Fahrenback, *supra* note 59, at 395; G. Richard Shell, *ERISA and Other Federal Employment Statutes: When Is Commercial Arbitration an "Adequate Substitute" for the Courts?*, 68 TEX. L. REV. 509, 534 (1990) (noting that pretrial discovery is limited in case of arbitration); Richard A. Bales, *The Discord Between Collective Bargaining and Individual Employment Rights: Theoretical Origins and a Proposed Solution*, 77 B.U. L. REV. 687, 755-56 (1997) (claiming that [a]rbitral discovery [...] is limited because arbitration derives its advantages of speed and low cost in large part from the fact that discovery arbitration is less extensive than in litigation“). Of course, some scholars note

part of the court,⁸² and lack of judicial review.⁸³ Last but not least, arbitration may run into difficulties in case of multi-party suits.⁸⁴

All of these factors are particularly relevant in corporate law. Interim relief plays an immense role when it comes to corporate mergers and other decisions that cannot easily be corrected *ex post*. Similarly, the restrictions upon the discovery process are problematic, because shareholders will often find discovery indispensable to make effective use of their rights. Furthermore, corporate litigation often involves multiple parties. Most importantly, however, the informal, compromising character of arbitration puts the bonding value of corporate law norms at risk.

2. Society as a Whole

In addition to what has been said above, litigation also has advantages from the point of view of society as a whole that arbitration cannot match. Thus, there are considerable benefits to having the law of the state applied by the courts of that state itself. First, the resulting case law will probably be more coherent. Second and more importantly, the parties will find the application of the substantive law that is relevant to their case far more predictable if that law is applied by the same court that created the relevant case law in the first place. In other words, it is probably easier to predict how Delaware courts will apply Delaware law than it would be to predict how the International Chamber of Commerce will apply Delaware law. Hence, even institutionalized arbitration probably cannot function as an adequate alternative to extraterritorial courts.

D. *Should Access to Extraterritorial Courts be Restricted?*

Are there, however, particular reasons why access to extraterritorial courts should be restricted outside of corporate law? Two types of interests are in questions here: those of the litigants themselves, and those of the host state.

that broad discovery rules can, at times, be a disadvantage rather than an advantage. *Cf., e.g.,* Patricia Anne Kuhn, Comment, *Societe Nationale Industrielle Aerospatiale: The Supreme Court's Misguided Approach to the Hague Evidence Convention*, 69 B.U. L. REV. 1011, 1047 n.263 (1989).

⁸² William Wang, *International Arbitration: The Need for Uniform Interim Measures of Relief*, 28 BROOKLYN J. INT'L L. 1059, 1060-61 (2003) („A major disadvantage of arbitration is the arbitral tribunal's lack of coercive power necessary to support the process. Such powers might be required to compel discovery, the attendance of witnesses, or in the extreme, control over the movement of the parties and their assets. An arbitrator has no coercive power over third parties.“).

⁸³ Fahrenback, *supra* note 59, at 395.

⁸⁴ William Wang, *International Arbitration: The Need for Uniform Interim Measures of Relief*, 28 BROOKLYN J. INT'L L. 1059, 1061 (2003) (Multiparty disputes are an area where the tools of traditional litigation may be more helpful than arbitration.)

1. Protecting Litigants

One might be concerned that, by permitting one state to set up its courts in the territory of another state, one or another party to a dispute might be led to litigate in a court where their interests will be poorly protected. It is not obvious, however, that extraterritorial courts are particularly prone to this problem. The central issue here is which state's courts have jurisdiction over any given dispute. The creation of extraterritorial courts need not change the existing rules of law in that regard. And, once it is conceded that the courts of a given state have jurisdiction over a dispute, the fact that the state's courts are not just located within the state's territory, but in other locales as well, seems unlikely to prejudice significantly the interests of either party to a suit. On the contrary, it should increase the chances that the parties can find a convenient forum.

In the commercial matters for which extraterritorial courts seem best suited, parties often can and do put forum selection clauses in their agreements. Perhaps one might be worried that the availability of extraterritorial courts would increase the potential for an overreaching party to a contract to impose an inappropriate forum on the other contracting party. But here, too, the increased hazard seems small. Contractual clauses specifying foreign law and a distant forum are already available for opportunistic as well as advantageous use. It is not clear that choice of forum clauses selecting an extraterritorial foreign court create greater risk for the parties than do forum selection clauses selecting a foreign court that is located in the territory of another jurisdiction.

2. Protecting the Interests of the Host State

Might a host state have an interest in restricting access to foreign courts established on its territory, even when the parties directly involved are not disserved by litigating in extraterritorial courts? Again, the central issue seems one of jurisdiction. If a state already recognizes the authority of a another state's courts to try a given issue, in what ways might the interests of the first state be affected adversely if the second state's proceeding is held on the first state's soil? One can easily see that some discreditable interests might be served. For example, if the extraterritorial courts are more efficient or honest than those of the host state, their presence in the host state might facilitate invidious comparisons to the embarrassment of the host state's government.

Or perhaps, more broadly, a potential host state might be concerned that, by greatly facilitating access to a foreign state's courts, the presence of extraterritorial courts might lead a much larger share of the host state's citizens to choose to have their commercial affairs governed by foreign law, thereby undercutting the ability of the host state to rule its own citizens. But this concern, too, has a protectionist flavor. If the law of a given state is sufficiently unattractive to lead its citizens to wish to be governed by another state's laws, is there a good reason to deny them the choice? And if there is a good reason – for example, the need to maintain sufficient economies of scale in litigation to

keep the host state's courts (and perhaps legislature) functioning efficiently – then is this not also an argument for changing the choice of law rule to prevent the state's citizens from having recourse to foreign law, regardless of where the foreign courts do their business?

These concerns do not seem compelling in the field of corporate law, and they do not seem particularly more compelling in other areas of commercial law.

II. Are Extraterritorial Courts in the Interest of Popular States of Incorporation?

Speculating on the costs and benefits of extraterritorial courts would be a futile exercise if the states had insufficient incentives to set up such courts. However, at least with regard to Delaware or any other state that could become similarly popular in the future, the incentives seem, on balance, substantial.

A. The Costs

The initial investment required should be quite limited. It would be sufficient to rent a suitable hearing room and office space, and to have a competent judge visit when need arises. To be sure, the cost of operating permanent courts in foreign jurisdictions may be considerably higher than the costs of domestic courts. Loss of economies of scale seems a particularly important concern in this respect. At present, just one chancellor and four vice-chancellors handle all of Delaware's corporate litigation.⁸⁵ Litigation rates in foreign cities might be insufficient to occupy even one judge full-time. Nevertheless, the cost of maintaining a single judge and her staff should be modest.

B. The Benefits

Compared to the costs of extraterritorial courts, the benefits that such courts would yield for Delaware (or any state that might become similarly popular in the future) are likely to be substantial: In 2005, Delaware's total revenues from franchise fees exceeded 500 million \$ US.⁸⁶ If the creation of one or two extraterritorial courts, positioned in, say, London and Singapore, could increase that amount by only a couple of percentage points, the benefits should exceed the costs.

Even if Delaware were unable to attract any additional corporate charters as a result of creating extraterritorial courts, it could still recoup the costs by

⁸⁵ Cf. 10 DEL. C. § 307 (2004) (decreeing that there be one Chancellor and four Vice-Chancellors).

⁸⁶ See STATE OF DELAWARE, OFFICE OF MANAGEMENT AND BUDGET, *FY 2007 Governor's Financial Summary, Charts and Schedules 2* (2007).

means of court fees. At present, Delaware's court fees are insubstantial.⁸⁷ However, nothing would prevent Delaware from charging those corporations that choose to litigate abroad a "convenience fee" for the privilege. Would the income from such fees be significant enough to finance extraterritorial courts? Again, the answer is very likely yes. That is because it should be far cheaper to set up one Delaware judge in London and hire some supporting staff for him than to have parties, their non-Delawarian lawyers, and witnesses travel to Delaware. In particular, it is useful to recall that the lawyers, witnesses and attorneys that one tends to see in corporate litigation usually have fairly high opportunity costs.

III. Other Obstacles to Extraterritorial Courts

If the net benefits to be derived from the creation of extraterritorial courts are as great as we suggest, then one might reasonably ask why such courts have not been created already. And why should one expect such courts to be created in the future? We suggest here several considerations that may have inhibited the creation of extraterritorial courts in the past, but that should not prove major obstacles in the future.

A. Traditional Concerns about Sovereignty

As we show below, under both U.S. and international law, host states must give their permission for extraterritorial courts to be created. For historical reasons, however, many states may be reluctant to accede. In the past, Western nations have established extraterritorial courts to provide judicial services to their citizens in countries whose legal systems – or culture in general -- were deemed inferior. The result was to give extraterritorial courts an imperialist aura.⁸⁸

⁸⁷ Cf. Kahan & Kumar, *Price Discrimination in the Market for Corporate Law*, 86 Cornell L. Rev. 1205, 1244 n.160 (2001) (pointing to the fact that under D.Ch. R. 3 the fee for a new civil action with two or three defendants is \$200, while the fee for filing and recording any pleading is \$1 per page up to a maximum of \$50)

⁸⁸ A passage from the U.S. Supreme Court's decision in *In Re Ross*, 140 U.S. 453 (1891), is illustrative:

"The practice of European governments to send officers to reside in foreign countries, authorized [...] to watch the interests of their countrymen and to assist in adjusting their disputes [...], goes back to a very early period, even preceding what are termed the Middle Ages. During those ages these commercial magistrates, generally designated as consuls, possessed to some extent a representative character, sometimes discharging judicial and diplomatic functions. In other than Christian countries they were, by treaty stipulations, usually clothed with authority to hear complaints against their countrymen and to sit in judgment upon them when charged with public offences. After the rise of Islamism, and the spread of its followers over eastern Asia and other countries bordering on the Mediterranean, the exercise of this judicial authority became a matter of great concern. The intense hostility of the people of Moslem faith to all

That unattractive image may linger, causing many potential host states to view extraterritorial courts with suspicion, and likewise inhibiting potential exporting states, such as Delaware, from seeking to create them. Yet there is reason to believe that in the future there should be no scarcity of host states willing to accommodate Delaware's courts. To begin with, in today's age of globalization, the creation of extraterritorial courts would most likely be perceived at what it is, namely another means of making economic transactions more efficient. Moreover, many of the countries that would be most attractive as host states for extraterritorial courts, such as the United Kingdom, are unlikely to be concerned that admitting foreign courts might somehow brand them as inferior. To be sure, some states may still resent the fact that Delaware is more popular with incorporators. However, given that both in the United States and internationally, most jurisdictions that allow their corporations to incorporate elsewhere have embarked on this course voluntarily,⁸⁹ they have little to gain by preventing their corporations from gaining easier access to the courts where many of them will litigate one way or another. This is all the more true because the business resulting from such litigation would remain in the host country rather than be lost to Delaware. Finally, Delaware would need the assent of only a few other countries to secure most of the relevant benefits.

B. Opposition from Delaware Law Firms

A more important reason why Delaware may have been slow to establish extraterritorial courts may reside in the influence of Delaware's own law firms. Delaware lawyers might lack enthusiasm for extraterritorial courts for obvious reasons: If Delaware corporations started litigating in out-of-state courts, Delaware firms might lose clients. Moreover, it is not hard to see why Delaware

other sects, and particularly to Christians, affected all their intercourse, and all proceedings had in their tribunals. Even the rules of evidence adopted by them placed those of different faith on unequal grounds in any controversy with them. For this cause, and by reason of the barbarous and cruel punishments inflicted in those countries, and the frequent use of torture to enforce confession from parties accused, it was a matter of deep interest to Christian governments to withdraw the trial of their subjects, when charged with the commission of a public offence, from the arbitrary and despotic action of the local officials. Treaties conferring such jurisdiction upon these consuls were essential to the peaceful residence of Christians within those countries and the successful prosecution of commerce with their people."⁸⁸

⁸⁹ A striking exception to this is the European Union, the Member States of which have been forced, by the famous *Centros*-decision of the Court of Justice of the European Communities, to apply the law of the state of incorporation to firms that are headquartered locally but incorporated elsewhere. For details see Dammann, *supra* note 3, at 483 et seq. However, even in Europe, some countries such as England, Denmark and Ireland applied the state of incorporation doctrine even before the *Centros* judgment. See *id.* at 479 n. 9.

lawmakers might tend to give in to pressure exerted by the local bar. Not only is the Delaware bar a well-funded and highly organized interest group,⁹⁰ but the success of Delaware in the charter market rests, to a considerable part, on the shoulders of local lawyers. It is Delaware attorneys who, together with the Delaware courts, ensure the efficient litigation environment that allows the Delaware judiciary to flourish. It is also the local bar that provides the experts who are behind the regular modernizations of Delaware corporate law.⁹¹

This said, there may be ways of setting up extraterritorial courts that do not harm the interests of Delaware law firms. If the creation of extraterritorial courts would in fact increase the overall size of the pie for a jurisdiction like Delaware, then presumably there is a way to divide the benefits that permits Delaware lawyers to benefit. Rules like Delaware Chancery Court Rule 170, which effectively requires the hiring of Delaware lawyers as co-counsel,⁹² would of course be one possible approach.

Moreover, appellate litigation in Delaware's Supreme Court, which would presumably continue to conduct its business primarily within the state, would surely increase with the spread of Delaware incorporations. And even the business of the local Delaware chancery courts might increase with the growing number of Delaware firms worldwide, as parties for whom the burden of distance is not too great continue to prefer to litigate closer to the heart of the jurisdiction's legal culture.

C. Lack of Demand

Finally, at least outside the United States, the demand for U.S. corporate law was until recently presumably quite modest. After all, while the practice of incorporating abroad in order to avoid local law goes back centuries,⁹³ there does

⁹⁰ The advantages that Delaware lawyers enjoy as an interest group have been famously described by Macey & Miller, *supra* note 1, at 506-07.

⁹¹ See, e.g., Macey & Miller, *supra* note 1, at 489-490 (pointing out that "the Delaware legislature's drafting committees historically have been staffed with attorneys experienced in corporate law").

⁹² Cf. DEL. CH. CT. R. 170 (2004). Rule 170(a) provides that "[a]ny person admitted to practice in the Supreme Court of this State shall be entitled to practice as an attorney in this Court so long as such person remains entitled to practice in the Supreme Court and maintains an office in this State for the practice of law." According to Rule 170 (b), "[a]ttorneys who are not members of the Delaware Bar may be admitted pro hac vice in the discretion of the Court and such admission shall be made only upon written motion by a member of the Delaware Bar who maintains an office in this State for the practice of law ("Delaware Counsel"). Furthermore, Rule 170(d) makes it clear that "Delaware counsel for any party shall appear in the action in which the motion for admission pro hac vice is filed and shall sign or receive service of all notices, orders, pleadings or other papers filed in the action, and shall attend all proceedings before the Court, Clerk of the Court, or other officers of the Court, unless excused by the Court."

⁹³ Indeed, in the 19th century, European countries began to adopt the real seat rule precisely in order to prevent local businesses from incorporating elsewhere. See

not seem to be any evidence that foreign-based companies have shown a tendency to incorporate in the United States. In any case, Delaware players may not have been aware of whatever demand existed for Delaware corporate law and judicial services. However, that is certainly no longer the case: In the 2005 annual issued by the Delaware Division of Corporations, the Secretary of State notes that “[t]he message about Delaware as corporate home to the world spreads” and, more importantly, points out that “[a] major part of our overall strategy is to continuously expand Delaware’s global market share”.⁹⁴

IV. Extraterritorial Courts outside Corporate Law

To this point, we have largely limited our analysis to extraterritorial courts whose jurisdiction is limited to matters of corporate law. Much of what we have said, however, applies as well to other areas of commercial law. Moreover, even with regard to non-economic law, the establishment of extraterritorial courts may offer substantial benefits. We briefly touch here on some of the relevant considerations.

When it comes to assessing the usefulness of extraterritorial courts, it is helpful to distinguish among three types of litigation.

A. Extraterritorial Application of a Jurisdiction’s Law

To begin with, there are those cases where a jurisdiction’s law is applied to relationships between persons who will find it more convenient to litigate outside the territory of the jurisdiction in question. As pointed out above, corporate law falls into this category, because the vast majority of U.S. corporations, as well as their shareholders, have no substantial contacts with Delaware beyond the corporate domicile. However, there are similar cases outside the scope of corporate law. Contract law is a conspicuous example. Within the U.S., firms incorporated and doing business in other states frequently choose New York law to govern their contracts. Similarly, firms from different Member States of the European Community will often agree that UK law should govern their contracts, both in order to choose a “neutral” law and forum and because English has long become the lingua franca in Europe. In these cases, the establishment of extraterritorial courts would be beneficial for the same reasons that it would be beneficial in corporate law, the most important factor being the prospect that access to courts familiar with the relevant body of law is made cheaper and more convenient.

Berhard Großfeld, *Die Entwicklung der Anerkennungstheorien im internationalen Gesellschaftsrecht* [*The Development on the Theories of Recognition of Foreign Legal Persons in the Corporate Conflict of Laws*], in Festschrift für Harry Westermann 211-212 (Wolfgang Herfermehl et al eds., 1974).

⁹⁴ DELAWARE DEPARTMENT OF STATE, DIVISION OF CORPORATIONS, 2005 ANNUAL REPORT 2 (2006) (available at: <http://www.state.de.us/corp/2005%20doc%20ar.pdf>).

B. Uniform Law

A second area where the establishment of extraterritorial courts holds particular promise concerns the application of uniform law. As has been pointed out above, one of the advantages of extraterritorial courts is that they allow the consumers of judicial services to pick the courts that they like best. Of course, litigants will generally want to avoid courts that are not familiar with the substantive law at issue. Hence, as a general matter, few parties will want to litigate a dispute involving local law before a foreign court. However, concerns about a foreign court's lack of expertise should play a much smaller role if and to the extent that the applicable substantive law is uniform across jurisdictions. An obvious example within the United States would be the uniform commercial code; in the international arena, one could point to the United Nations Convention on Contracts for the International Sale of Goods (CISG).⁹⁵ To be sure, a caveat seems appropriate: Even to the extent that statutes are "uniform" across jurisdictions, the same need not be true of their interpretation. For that reason, the expertise of foreign courts may remain an issue even where the law governing a case is uniform law.

C. Other

Finally, there may be some benefits to the establishment of extraterritorial courts even in those cases where those courts would apply neither their own jurisdiction's law nor uniform law. For example, there may be situations where the reputation of a particular jurisdiction's court system is so bad that the parties would rather tolerate a possible lack of expertise on the part of a foreign court than entrust themselves to the courts of their own jurisdiction. We suspect, though, that these situations should be rare. To be sure, there is no lack of countries with inadequate judicial infrastructure. However, an inefficient court system will often go hand in hand with inefficient substantive law, if only because inept courts will find it difficult to produce a coherent body of precedent.

V. Legal Obstacles to Extraterritorial Courts

Under current law, the ability of jurisdictions to set up extraterritorial courts is severely restrained. Whether in the United States, in the European Community, or in the international arena, the general rule is that extraterritorial courts cannot be created without the permission of the jurisdiction where the court is to be established. We survey here the law as it currently stands between unrelated states, between states within the United States, and between states within the European Union. We then turn to a more general assessment of the relationship between sovereignty and extraterritorial courts.

⁹⁵ United Nations Convention on Contracts for the International Sale of Goods, Apr. 11, 1980, Annex I, U.N. Doc. A/Conf. 97/18, reprinted in 19 I.L.M. 668.

A. *Between Unrelated Sovereigns*

For the sake of simplicity, it is helpful to start with the prospect of creating a court in the territory of an unrelated sovereign -- that is, another country. There can be little doubt that this requires the permission of the host state. The principle of state sovereignty is generally acknowledged to imply that "officials of one state may not exercise their functions in the territory of another state without the latter's consent".⁹⁶ In other words, territorial sovereignty comprises the exclusive power to perform legislative, executive, and judicial functions.⁹⁷ Moreover, there is no question that state judges administering the law of their jurisdiction qualify as state officials.

To be sure, when it comes to the administration of justice, there are some grey areas with regard to the limits of the principle of territorial sovereignty. Perhaps most importantly, it is arguable to what extent the state of origin can act without permission of the host state where its behavior does not involve any compulsive measures. For example, one U.S. district court denied a violation of the territorial sovereignty of other states where a defendant on foreign soil was served with summons and notice, stressing the informational character of such an act.⁹⁸ By contrast, a violation of the principle of territorial sovereignty was thought to occur if compulsory process was served.⁹⁹ Even if one were to carry that line of reasoning to an extreme and argue that extraterritorial courts can be

⁹⁶ See Restatement (Third) of the Foreign Relations Law of the United States section 432 ct. b (1987) ("It is universally recognized, as a corollary of state sovereignty, that officials of one state may not exercise their functions in the territory of another state without the latter's consent.") Cf. also Michael Milde, *Sovereignty*, in *ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW*, VOL. IV, 500, 516 (Rudolf Bernhardt ed. 2000), IAN BROWNLIE, *PRINCIPLES OF PUBLIC INTERNATIONAL LAW* 310 (5th ed. 1998) 310 (stating the governing principle to be that a state cannot take measure on the territory of another state by way of enforcement of national laws without the consent of the latter). Cf. also Gunther Handl, *State Liability for Accidental Transitional Environmental Damage by Private Persons*, 74 A.J.I.L. 525 (1980) (defining territorial sovereignty as "the exclusive right to exercise the functions of a state within a certain portion of the globe"); Silvia B. Pinera-Vazquez, Comment, *Extraterritorial Jurisdiction and International Banking: A Conflict of Interests*, 43 U. MIAMI L. REV. 449 (1988) ("Simply stated, a state has exclusive authority over the exercise of governmental power within its borders."); Bernard H. Oxman, *The Choice Between Direct Discovery and Other Means of Obtaining Evidence Abroad: The Impact of the Hague Evidence Convention*, 37 U. MIAMI L. REV. 733, 764 (1983) ("The term 'judicial sovereignty' implies respect for the exclusivity of governmental organs within their own territories -- the monopoly of governmental power that lies at the heart of territorial sovereignty.").

⁹⁷ Douglas M. Zang, Note, *Frozen in Time: The Antarctic Mineral Resource Convention*, 76 CORNELL L. REV. 722, 738 (1991) ("Territorial sovereignty describes a sovereign's competence to exercise legislative, executive, and judicial functions within its dominion."). See further.

⁹⁸ *Federal Trade Commission v. Compagnie de Saint-Gobain-Pont-A-Mousson*, 636 F.2d 1300, 1313 (D.C. Cir. 1980).

⁹⁹ *Id.*

established without the consent of the host state if they do not rely on any sort of compulsion – a view that does not seem to ever have been adopted in the literature and one that we view with a considerable degree of skepticism – that still would not turn the unilateral creation of extraterritorial courts into a practical option. For it is easy to see that, while courts in the area of corporate law don't have to rely on compulsion very often, the possibility that compulsion will be necessary -- e.g., because a witness has to be ordered to appear before the court or has to be held in contempt – is always on the horizon. Moreover, it should not be forgotten that one reason why compulsion is rarely necessary in practice is that everyone knows the court can rely on compulsion if necessary. If courts did not have this possibility, witnesses in particular might be much more open to the possibility of failing to cooperate with legal proceedings. In other words, the idea of a legal process that does not involve even the possibility of any compulsive measures whatsoever may not be realistic.

Different views also exist as to whether the principle of territorial sovereignty is violated by acts that require the participation of public officials under the law of the country whose territorial sovereignty is at stake but not under the law of the country whose courts are in charge of the relevant legal proceedings. In the landmark case *Société Nationale Industrielle Aerospatiale v. United States*,¹⁰⁰ the U.S. Supreme Court took the view that U.S. Courts could order the taking of evidence by the parties' attorneys where the evidence was located in the territory of another nation, even though, under the law of the relevant foreign country, the taking of evidence constituted a public act.¹⁰¹ However, this line of reasoning, too, proves to be of limited relevance to the problem at hand. After all, the holding of a trial is regarded as a matter in the competence of public officials in any jurisdiction that we know of.

International treaties, moreover, do not change the outcome described here. The decisive treaty in this context is the Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters,¹⁰² which came into force in 1972. While that convention provides for the taking of evidence in the territory of another country, it does so within narrow limits. According to article 16 of the convention, a diplomatic officer or consular agent may, in the territory of another Contracting State, take the evidence, without compulsion, of nationals of the State in which he exercises his functions or of a third State. However, a competent authority designated by the State in which he exercises his functions must have given its permission either generally or in the particular case, and the

¹⁰⁰ *Societe Nationale Industrielle Aerospastiale v. United States*, 482 U.S. 522 (1987).

¹⁰¹ See *id.* at 539-540 (holding that „the Hague Convention did not deprive the District Court of the jurisdiction it otherwise possessed to order a foreign national party before it to produce evidence physically located within a signatory nation”).

¹⁰² The Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters, *opened for signature* March 18, 1970, 23 U.S.T. 2555, T.I.A.S. No. 7444, 847 U.N.T.S. 231.

diplomatic officer or consular agent must comply with the conditions which the competent authority has specified in the permission. Art. 17 provides for the taking of evidence by “a person duly appointed as a commissioner for the purpose”, but imposes the same requirements as art. 16. Art. 18 points out that the host country may allow a diplomatic officer, consular agent or commissioner authorized to take evidence to apply to the competent authority designated by the declaring State for appropriate assistance to obtain the evidence by compulsion. However, it is up to the host state to decide whether or not to grant that wish. In sum, the Hague Evidence Convention does little to restrain the territorial sovereignty of the host state.

B. Within the United States

Within the United States, the situation is somewhat more complex. Two questions need to be distinguished. First, can a state set up one of its own courts in the territory of a sister state without the latter's consent? Second, would an agreement between the states involved suffice to create such courts, or would one also have to secure the approval of the U.S. Congress under the Compact Clause of the U.S. Constitution?

1. The Consent of the Host State

The first of these questions is also the easiest to answer. It has been held that “[a] court of a state cannot legally hold hearings, or conduct trials, beyond its borders.”¹⁰³ To be sure, that statement has typically been based on the law of the

¹⁰³ Knight v. Younkin, 105 P.2d 456, 457 (Id. 1940). *Accord*, People v. Craig, 581 N.Y.S.2d 987, 989 (1992) (“It is a universally accepted principle of law that a court may not sit outside the territorial limits of its jurisdiction, for any reason whatsoever, even with (and a fortiori, without,) the consent of all parties, and any proceeding so conducted is a nullity [...]”). See also Board of Commrs. of Marion Co. v. Barker, 25 Kan. 258, 260 (1881). There, the county commissioners of Marion county, Kansas, were said to have levied taxes while meeting outside the state of Kansas or at least outside Marion county. The court pointed out that this made their acts void. “The commissioners”, the Court held, “are officers of the county, and in the absence of express provision their powers do not go beyond the territorial limits of their county. [...] They clearly have no powers to levy taxes when beyond the limits of the state. They could not convene as a board at Kansas City, or St. Joseph, in Missouri, and apportion or order the levy of taxes in Kansas. Such an order would be void, and of no validity whatever.” Interestingly, the Court also pointed out that the Commissioners “acted without jurisdiction, whether we consider the levying of taxes as acting ministerially, judicially, or legislatively.” Of course, most of the relevant statements do not refer to borders of a state. See, e.g., O'Daniel v. Inter-Island Resorts, 377 P.2d 609, 616 (Haw. 1962) (holding, with regard to the Circuit Courts of Hawaii, that “proceedings held in a law case at a place beyond the boundaries of the circuit are [...] a nullity”); Phillips v. Thralls, 26 Kan. 780, 781 (1882) (pointing out, in a case regarding the jurisdiction of a justice of the peace, who had been elected in a township, that “this is generally true of all officers, judicial or ministerial; their power to

state to which the relevant court belonged, rather than on the U.S. constitution.¹⁰⁴ However, there seems little doubt that a state cannot establish courts on the territory of another state where the latter has not given its permission.¹⁰⁵ To be sure, the principle of territorial sovereignty of states is no longer understood as rigidly as it once was. In particular, the notion that a state can only exercise jurisdiction over persons and property located in its territory¹⁰⁶ has long been rejected. However, no one seems to have suggested that states could go as far as to establish their institutions on the territory of other states without violating the territorial sovereignty of the latter.

2. The Approval of the U.S. Congress

Another question is whether two states can agree on the creation of extraterritorial courts without the approval of the U.S. Congress.

Under the Compact Clause of the U.S. Constitution, “[n]o State shall, without the Consent of Congress ... enter into any Agreement or Compact with another State.”¹⁰⁷ However, it is generally accepted that this provision must be read more narrowly than its wording suggests. The purpose of the Compact Clause is to “protect the full and free exercise of Federal authority”.¹⁰⁸ Consequently, “not all agreements between states are subject to the strictures of the Compact Clause.”¹⁰⁹ Rather, “the application of the Compact Clause is

act is circumscribed by certain territorial limits, and action outside those limits binds no one.”).

¹⁰⁴ In *People v. Craig*, 581 N.Y.S.2d 987, 989 (1992), the Court justified its decision by pointing out that “[t]here is nothing in CPL Art. 660 to suggest that it was intended to permit a conditional examination outside the state.” Similarly, in *O’Daniel v. Inter-Island Resorts*, 377 P.2d 609 (Haw. 1962), the Court invoked the statutory law of Hawaii. See *id.* at 614 (“The obvious purpose of this section is to restrict the exercise of judicial power by each of the four circuit courts to the territorial limits prescribed for it.”). In *Board of Commrs. of Marion Co. v. Barker*, 25 Kan. 258, 260 (1881), the Court also appears to base its decision on state law when it explains that the powers of county officers do not, “in the absence of express provision”, go “beyond the territorial limits of their county”. In *Knight v. Younkin*, 105 P.2d 456, 457 (Id. 1940), the Court fails to give an clear justification for its claim that that “court of a state cannot legally hold hearings, or conduct trials, beyond its borders.” However, the fact that it cites the afore-mentioned decision *Board of Commrs. of Marion Co. v. Barker*, suggests that the relevant principle is seen to be rooted in the law of the state to which the court belongs. The decision *Phillips v. Thralls*, 26 Kan. 780, 782 (1882), also fits this pattern, because the Court defends its decision, inter alia, by reference to the state’s Criminal Code.

¹⁰⁵ See also *Bragg v. Walker*, 1997 U.S. Dist. LEXIS 17575, p. 10 (referring to „those [...] principles of federalism which preclude the officers of one state from intentionally executing their warrants in a neighboring state”).

¹⁰⁶ See, *Pennoyer v. Neff*, 95 U.S. 714, 722 (1877), overruled by *Shaffer v. Heitner*, 433 U.S. 186 (1977).

¹⁰⁷ U.S. Const. art. I, § 10, cl. 3.

¹⁰⁸ See *Virginia v. Tennessee*, 148 U.S. 503, 520 (1893).

¹⁰⁹ *U.S. Steel Corp. v. Multistate Tax Comm’n*, 434 U.S. 452, 469 (1978).

limited to agreements that are directed to the formation of any combination tending to the increase of political power in the States, which may encroach upon or interfere with the just Supremacy of the United States.”¹¹⁰

An agreement between two or more states to the creation of extraterritorial courts would not realistically threaten the supremacy of the federal government, however, and hence should not require congressional approval under the Compact Clause. Admittedly, one might argue that such courts would enable Delaware to be even more successful in establishing its corporate law as a de-facto national law. Yet Delaware corporate law exists only by the grace of the U.S. Congress, and – as Mark Roe has argued¹¹¹ – even in the absence of federal legislation, the content of Delaware corporate law is strongly influenced by federal lawmakers.¹¹²

VI. Implications for the Understanding of Sovereignty

As the preceding parts of this article have made clear, we believe that the creation of extraterritorial courts is both desirable and feasible despite the fact that such a move will require the permission of the host state. Nevertheless, we believe that our insights on the benefits of extraterritorial courts should also be cause enough to question the current extent of state sovereignty.

As we have shown, the establishment of extraterritorial courts lies in the interest of society as a whole. What is more, the creation of such courts is a logical extension of the understanding of states as providers of legal services, an understanding that already has been embraced at the regulatory level. In other words, once we regard law as a product,¹¹³ it is only natural that we should hold

¹¹⁰ *Id.* at 471.

¹¹¹ Mark J. Roe, *Delaware's Competition*, 117 HARV. L.REV. 588, 601-634 (2003).

¹¹² In a 1978 case, the Supreme Court refused to classify the agreement establishing the Multistate Tax Commission as a compact requiring Congressional approval. *U.S. Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452 (1978). The Court argued, inter alia, that the agreement did not “purport to authorize the member States to exercise any powers they could not exercise in its absence,” that it did not provide for “any delegation of sovereign power to the Commission,” and that “each state [was] free to withdraw at any time.” *Id.* at 473. These considerations suggest ample scope for an agreement to create extraterritorial courts. Such an agreement would not increase the jurisdiction of the state to which the courts belong. Delaware, for example, would still be exercising the same power it exercised before, namely the power to adjudicate the internal affairs of Delaware corporations. Nor would the host state delegate its sovereign power. Nor would permission to establish a court on another state’s territory need be permanent.

¹¹³ The understanding of law as a product was pioneered, of course, by Roberta Romano. See Roberta Romano, *Law as a Product. Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORGAN. 225, 225 et seq. (1985).

the same view of judicial services, and if we believe that law should be readily exportable, then the same should be true of judicial services as well.

The decisive question then becomes whether the legal system should protect the export of judicial services to the same degree it protects the export of goods. It is curious, in this context, that the U.S. Constitution arguably protects the export of regulation by the very same mechanism it uses to ensure the freedom to export goods and services, namely the Commerce Clause: While the law is far from clear,¹¹⁴ the U.S. Supreme Court's Decision in *CTS Corp. v. General Dynamics of America*¹¹⁵ has been interpreted to "offer strong support" to the view that the internal affairs doctrine which lies at the heart of the freedom to "export" corporate law is mandated by the Commerce Clause.¹¹⁶

As a matter of black letter law, we so no basis for extending the scope of the Commerce Clause further to cover the creation of extraterritorial courts without Congressional intervention. Nor do we believe at this point that the principle of territorial sovereignty can – or should – be interpreted restrictively to allow for the creation of extraterritorial courts without the consent of the host state. However, we wish to stress that there is a clear tension between the concept of state sovereignty on the one hand and the underlying purpose of the Commerce Clause on the other, the Commerce Clause being aimed at protecting the export of goods and services against protectionist measures on the part of importing states. Ideally, this tension will be resolved by the decision of host states not to stand in the way of the creation of extraterritorial courts, and given the number of states in this country, there is every reason to believe that enough states will take such a course of action in order for a system of extraterritorial courts to be established. However, should this prove not to be the case, one may have to think about Congressional action in the form of a statute allowing for the extraterritorial creation of courts without the consent of the host state.¹¹⁷

¹¹⁴ For a detailed discussion of the issue see Richard M. Buxbaum, *The Threatened Constitutionalization of the Internal Affairs Doctrine in Corporation Law*, 75 CAL. L. REV. 29, 40-43.

¹¹⁵ 481 U.S. 69 (1987).

¹¹⁶ See *McDermott Inc. v. Lewis*, 531 A.2d 206, 217 n. 12 (Del. 1987).

¹¹⁷ A possible basis for such a statute might be the Interstate Commerce Clause (U.S. Const. art. I, § 8, cl. 3). Under the case law of the U.S. Supreme Court, the activities that Congress can regulate under the Commerce Clause fall into three categories. Congress "may regulate the use of the channels of interstate commerce," "the instrumentalities of interstate commerce or persons or things in interstate commerce," as well as "activities that substantially affect interstate commerce." See *United States v. Lopez*, 514 U.S. 549, 558 (1995). Of course, that third category has been narrowed considerably in recent years. Earlier decisions of the U.S. Supreme Court had been read to hold that Congress could regulate activities that, in aggregate, had a substantial impact on interstate commerce. See, *in particular*, *Wickard v. Filburn*, 317 U.S. 111, 125 (1942). Now, however, the U.S. Supreme Court adheres to a less generous understanding of the Commerce Clause. At least where non-economic activities are concerned, the aggregate theory no longer applies. See *United States v.*

VII. Conclusion

Substantive corporate law is becoming increasingly dissociated from the geographic jurisdictions that promulgate the law, as firms become ever freer to choose the jurisdiction whose law will govern their affairs. A logical next step is to remove as well the territoriality of the courts that decide matters of corporate law, and perhaps other matters of commercial law as well. The result could be not just one but several competing versions of a modern international law merchant, providing legal systems with the scope appropriate for increasingly global markets while avoiding the creation of a single centralized lawmaker whose monopoly position might make it unresponsive to the needs of commerce.

Lopez, 514 U.S. 549, 561 (1995). This said, one might make the case that a federal statute of the type at issue would be admissible even under this modern view of the Commerce Clause. After all, the act of incorporating in another state is an economic rather than a non-economic activity, and the same can be said of the resulting litigation. Of course, there is also the so-called Necessary and Proper Clause of the U.S. Constitution (U.S. Const. art. I, 8, cl. 18) to consider. The U.S. Supreme Court has made it clear that federal laws which violate state sovereignty cannot be proper for carrying into Execution the Commerce Clause. *Printz v. United States*, 521 U.S. 898, 924 (1997) (quoting *The Federalist* No. 33, at 204 (A. Habilton)); *Alden v. Maine*, 527 U.S. 706, 732-733 (1999) (quoting *Printz*). However, the fact that the unilateral creation of extraterritorial courts by a sister state would violate the sovereignty of the host state does not imply that the same is true for a Congressional statute allowing for the creation of such courts. Indeed, so far, the principle that federal laws must not violate the sovereignty of the host state has so far been interpreted fairly narrowly, violations of state sovereignty having been found in essentially three areas. In *New York v. United States*, the Court made it clear that Congress may not “commandeer the legislative processes of the States by directly compelling them to enact or enforce a federal regulatory program.” See 505 U.S. 144, 161 (citing *Hodel v. Va. Surface Mining and Reclamation Ass’n*, 452 U.S. 264, 288 (1981)). In *Printz v. United States*, the Court added that “Congress cannot circumvent that prohibition by conscripting the state’s officers directly.” See 521 U.S. 898, 935 (1997). In other words, “the Federal Government may [...] [not] command the States’ officers [...] to administer or enforce a federal regulatory program.” See *id.* Finally, in *Fmc v. S.C. State Ports Authority*, the Court has held that “the Eleventh Amendment prevents congressional authorization of suits brought by private parties against unconsenting states.”¹⁷ See 535 U.S. 743, 767-768 (2002). Each of these categories involve entrenchments on state sovereignty that seem far more serious than merely conducting civil litigation without involvement of the host state’s officials. Consequently, while existing precedent does not clearly authorize federal authorization of extraterritorial state courts, neither do the concerns reflected in that precedent argue strongly that such legislation would be unconstitutional.