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## **Extraterritorial Courts for Corporate Law**

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May 2005

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ECGI Working Paper Series in Law

## Extraterritorial Courts for Corporate Law

Working Paper N° 43/2005

May 2005

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## Abstract

A central goal in devising a system of courts is to make judicial services easily accessible. As a consequence, 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. In particular, 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 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 corporate 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, whatever the merits of extraterritorial courts as a practical proposal, in exploring their promise we gain important perspective on the basic relationships among substantive law, adjudication, and territoriality, and on the differences between private arbitration and public adjudication.

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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.<sup>2</sup> 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.<sup>3</sup> Under that doctrine, corporations are free to choose the state whose law will govern their internal affairs.<sup>4</sup> 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 consequence is that Delaware law governs most publicly-traded firms in the

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<sup>2</sup> It is easy to see, for example, that the structure of the federal court system in the United States follows the afore-described 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.

<sup>3</sup> 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.

<sup>4</sup> See FRANKLIN A. GEWURTZ, *CORPORATION LAW* 36 (2000).

U.S.<sup>5</sup>, 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. Moreover, 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 Delaware judiciary that many firms choose to incorporate in that state.<sup>6</sup> 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.<sup>7</sup> 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

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<sup>5</sup> Cf. DELAWARE DIVISION OF CORPORATIONS, *Why Choose Delaware As Your Corporate Home?*, available at <http://www.state.de.us/corp/default.shtml> (last visited September 24, 2004) (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”).

<sup>6</sup> 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).

<sup>7</sup> 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.

## I. ADVANTAGES OF EXTRATERRITORIAL COURTS

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

### A. 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 may<sup>8</sup> – and sometimes will<sup>9</sup> – invoke the doctrine of *forum non conveniens*<sup>10</sup> to refuse to hear cases relating to the internal affairs of foreign

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

<sup>9</sup> *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”).

<sup>10</sup> 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.

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.<sup>11</sup> 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.<sup>12</sup>

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

### 1. 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.<sup>13</sup>

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

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App. 1987); *Sterling Grace & Co. v. Seeman Bros., Inc.*, 215 N.Y.S. 2d 559, 560-61 (1961).

<sup>11</sup> 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").

<sup>12</sup> See, in particular, Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542, 586-89 (1990).

<sup>13</sup> 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).



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.<sup>14</sup>

## 2. 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.<sup>15</sup>

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,<sup>16</sup> a number far larger than the total of all publicly traded corporations in the United States. It follows that there may well be quite a few 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 general, which still typically incorporate in the state in which they are headquartered.<sup>17</sup> While there are several considerations that may help to explain this pattern,<sup>18</sup> 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.<sup>19</sup> Indeed, the geographical limits on

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<sup>14</sup> 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*].

<sup>15</sup> 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.").

<sup>16</sup> 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).

<sup>17</sup> See the sources cited *supra* note 15.

<sup>18</sup> 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).

<sup>19</sup> Cf. Dammann, *Adjudicative Jurisdiction*, *supra* note 18 (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

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.

## B. 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.<sup>20</sup> 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.<sup>21</sup>

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.

### 1. 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,<sup>22</sup> 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

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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).

<sup>20</sup> 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).

<sup>21</sup> 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").

<sup>22</sup> As pointed out above, the majority of close corporations incorporate locally. See the sources cited *supra* note 15.

important factor may simply be that Delaware is located more advantageously than many of its potential competitors, such as Nevada.<sup>23</sup>

## 2. 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.<sup>24</sup> – obstacles that subsist even where foreign countries, like U.S. states, apply the state of incorporation doctrine.<sup>25</sup> Most importantly, incorporation in the United States would subject foreign firms to U.S. federal income taxation,<sup>26</sup> would expose them to non-corporate litigation in the United States<sup>27</sup>, and would often

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<sup>23</sup> 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.

<sup>24</sup> 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).

<sup>25</sup> 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 24, 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 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. It is open to discussion whether and to what extent that provision compels German courts to apply U.S. corporate law to the internal affairs of U.S. corporations headquartered in Germany. For a detailed analysis of this issue see Jens C. Dammann, *Amerikanische Gesellschaften mit Sitz in Deutschland [U.S. Corporations Headquartered in Germany]*, 68 *Rabels Zeitschrift für ausländisches und internationales Privatrecht [RabelsZ]* 607, 609-652 (2004).

<sup>26</sup> See Dammann, *New Approach*, *supra* note 1.

<sup>27</sup> Dammann, *New Approach*, *supra* note 1.

prompt the application of the U.S. rules on securities regulation.<sup>28</sup> Nonetheless, there may 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. Furthermore, these other 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.<sup>29</sup> As European law, in the wake of the *Centros* decision<sup>30</sup>, moves toward freedom for EU companies to incorporate in any EU member state,<sup>31</sup> 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.

### C. 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

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<sup>28</sup> 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).

<sup>29</sup> 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 significant tax penalties. See, e.g., Dammann, *Freedom of Choice*, *supra* note 24, 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.

<sup>30</sup> Case 212/97, *Centros Ltd. v. Erhvervs-og Selskabsstyrelsen*, 1999 E.C.R. I-1459, [1999] 2 C.M.L.R. 551 (1999).

<sup>31</sup> See, e.g., Dammann, *Freedom of Choice*, *supra* note 24, at 483-507 (describing the development in the Community and contrasting the situation in the European Community with that in the United States).

forum selection clauses, which federal courts<sup>32</sup> and most state courts<sup>33</sup> 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 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.<sup>34</sup> 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.<sup>35</sup> One reason may be that in practice nominees for Delaware's bankruptcy court are likely to be chosen from the among the number of the Delaware bar.<sup>36</sup> 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.<sup>37</sup> 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.

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<sup>32</sup> See, e.g., *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 10, 15 (1972).

<sup>33</sup> 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).

<sup>34</sup> See, in particular, David A. Skeel *What's So Bad About Delaware* VAND. L. REV. 309-310 (2001). (noting that "bankruptcy process seems to be unusually efficient in Delaware").

<sup>35</sup> See David A. Skeel, Jr., *Bankruptcy Judges and Bankruptcy Venue: Some Thoughts on Delaware*, 1 Del L. Rev., 1, 31 (1998).

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

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.<sup>38</sup> Partisans of civil law courts extol their proficiency at fact-finding.<sup>39</sup> 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.

## II. 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.

### 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".<sup>40</sup> In other words, territorial sovereignty comprises the

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<sup>38</sup> 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.").

<sup>39</sup> 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).

<sup>40</sup> 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 (5<sup>th</sup> 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 power to perform legislative, executive, and judicial functions.<sup>41</sup> 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. Thus, different views 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 *Societe Nationale Industrielle Aerospatiale v. United States*,<sup>42</sup> 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.<sup>43</sup> Moreover, 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.<sup>44</sup> By contrast, a violation of the principle of territorial sovereignty was thought to occur if compulsory process was served.<sup>45</sup> In any event, no court appears to have taken the view that the holding of a trial in another country is possible under international law without the consent of the host state.

International treaties, moreover, do not change this outcome. The decisive treaty in this context is the Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters,<sup>46</sup> which came into force in 1972. While

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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.”).

<sup>41</sup> 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*.

<sup>42</sup> *Societe Nationale Industrielle Aerospatiale v. United States*, 482 U.S. 522 (1987).

<sup>43</sup> *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”).

<sup>44</sup> *Federal Trade Commission v. Compagnie de Saint-Gobain-Pont-A-Mousson*, 636 F.2d 1300, 1313 (D.C. Cir. 1980).

<sup>45</sup> *Id.*

<sup>46</sup> 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.

that convention provides for the taking of evidence in the territory of another country, it does so within narrow limits. According to art. 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 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. Three 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? Third, could the U.S. Congress allow states to establish extraterritorial courts in the territory of other states without the latter’s consent, or would a federal statute to this effect be unconstitutional?

### **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.”<sup>47</sup> To be sure, that statement has typically been based on the law of the

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<sup>47</sup> 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



state to which the relevant court belonged, rather than on the U.S. constitution.<sup>48</sup> 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.<sup>49</sup> 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 territory<sup>50</sup> 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

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

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

<sup>48</sup> 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.

<sup>49</sup> 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”).

<sup>50</sup> See, *Pennoyer v. Neff*, 95 U.S. 714, 722 (1877), overruled by *Shaffer v. Heitner*, 433 U.S. 186 (1977).

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.”<sup>51</sup> 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”.<sup>52</sup> Consequently, “not all agreements between states are subject to the strictures of the Compact Clause.”<sup>53</sup> Rather, “the application of the Compact Clause is 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.”<sup>54</sup>

When it comes to the creation of extraterritorial corporate law courts, there is no reason to believe that an agreement to this effect would threaten the Supremacy of the United States in any way. 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. However, it is hard to see how the prevalence of Delaware law can encroach upon or interfere with the Supremacy of the United States. After all, Delaware corporate law exists only by the grace of the U.S. Congress, and – as Mark Roe has argued – even in the absence of federal legislation, the content of Delaware corporate law may be shaped by the influence of federal lawmakers.<sup>55</sup>

Moreover, it is worth noting that the U.S. Supreme Court has given some guidance as to which factors are to be taken into account in applying the Compact Clause. In a 1978 case, the Court refused to classify the agreement establishing the Multistate Tax Commission as a compact requiring Congressional approval.<sup>56</sup> It 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.”<sup>57</sup> Arguably, these considerations can also be invoked with regard to the issue at hand. An agreement aiming at the creation of extraterritorial court would not increase the jurisdiction of the state to which the relevant 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. Finally, the permission to establish a court on another state’s territory need not be a

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<sup>51</sup> U.S. Const. art. I, § 10, cl. 3.

<sup>52</sup> See *Virginia v. Tennessee*, 148 U.S. 503, 520 (1893).

<sup>53</sup> *U.S. Steel Corp. v. Multistate Tax Comm’n*, 434 U.S. 452, 469 (1978).

<sup>54</sup> *Id.* at 471.

<sup>55</sup> See Mark J. Roe, *Delaware’s Competition*, 117 HARV. L.REV. 588, 601-634 (2003) (arguing the threat of federal intervention is bound to influence the shape of Delaware law).

<sup>56</sup> *U.S. Steel Corp. v. Multistate Tax Comm’n*, 434 U.S. 452 (1978).

<sup>57</sup> *Id.* at 473.

permanent one. In sum, there is little reason to believe that an agreement between two or more states stipulating the creation of extraterritorial courts would require congressional approval under the Compact Clause.

### 3. The Ability of the U.S. Congress to Allow the Creation of Extraterritorial Courts

The question remains whether the U.S. Congress could allow states, via a federal statute, to create extraterritorial states within the United States without the consent of the host state.

A possible basis for such a statute might be the Interstate Commerce Clause.<sup>58</sup> 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,"<sup>59</sup> "the instrumentalities of interstate commerce or persons or things in interstate commerce,"<sup>60</sup> as well as "activities that substantially affect interstate commerce."<sup>61</sup> Of course, that third category has been narrowed considerably in recent years. Earlier decisions of the U.S. Supreme Court<sup>62</sup> had been read to hold that Congress could regulate activities that, in aggregate, had a substantial impact on interstate commerce. 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.<sup>63</sup> 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, even if one agrees that a federal statute allowing for the extraterritorial creation of state commerce falls within the general scope of the commerce clause, there remains a second obstacle to overcome. Under the Necessary and Proper Clause of the U.S. Constitution<sup>64</sup>, Congress has the

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<sup>58</sup> U.S. Const. art. I, § 8, cl. 3.

<sup>59</sup> *United States v. Lopez*, 514 U.S. 549, 558 (1995).

<sup>60</sup> *Id.*

<sup>61</sup> *Id.* at 559

<sup>62</sup> See, *in particular*, *Wickard v. Filburn*, 317 U.S. 111, 125 (1942) (holding that "even if [an] activity be local and though it may not be regarded as commerce, it may still, whatever its nature, be reached by Congress if it exerts a substantial economic effect on interstate commerce")

<sup>63</sup> *United States v. Lopez*, 514 U.S. 549, 561 (1995). ("[The statute at issue] is not an essential part of a larger regulation of economic activity, in which the regulatory scheme could be undercut unless the intrastate activity were regulated. It cannot, therefore, be sustained under our cases upholding regulations of activities that arise out of or are connected with a commercial transaction, which viewed in the aggregate, substantially affects interstate commerce.")

<sup>64</sup> U.S. Const. art. I, 8, cl. 18.

power "to make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof." Accordingly, the U.S. Supreme Court has made it clear that legislation based on the power to regulate interstate commerce must be "proper for carrying into Execution the Commerce Clause".<sup>65</sup> Furthermore, the Court has held that federal laws which violate state sovereignty cannot be proper for carrying into Execution the Commerce Clause.<sup>66</sup> Thus, the decisive question becomes whether a statute of the type at issue here can be reconciled with constitutionally mandated principles of state sovereignty. The answer to that question remains unsettled.

Up to now, the U.S. Supreme Court has found violations of state sovereignty 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."<sup>67</sup> In *Printz v. United States*, the Court added that "Congress cannot circumvent that prohibition by conscripting the state's officers directly."<sup>68</sup> In other words, "the Federal Government may [...] [not] command the States' officers [...] to administer or enforce a federal regulatory program."<sup>69</sup> 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."<sup>70</sup> Each of these categories involve encroachments 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,

### **C. Within the European Community**

In the European Community, the Member States retain their territorial sovereignty unless Community law provides otherwise. As regards cross-border judicial cooperation, there are far-reaching limitations on the principle of territorial sovereignty, yet they remain restricted to the taking of evidence. The pertinent Community legislation is contained in the Council Regulation (EC) No 1206/2001 of 28 May 2001 on cooperation between the courts of the Member States in the

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<sup>65</sup> *Printz v. United States*, 521 U.S. 898, 924 (1997) (quoting *The Federalist* No. 33, at 204 (A. Hamilton)); *Alden v. Maine*, 527 U.S. 706, 732-733 (1999) (quoting *Printz*).

<sup>66</sup> *Printz v. United States*, 521 U.S. 898, 924 (1997) (quoting *The Federalist* No. 33, at 204 (A. Hamilton)); *Alden v. Maine*, 527 U.S. 706, 732-733 (1999) (quoting *Printz*).

<sup>67</sup> 505 U.S. 144, 161 (citing *Hodel v. Va. Surface Mining and Reclamation Ass'n*, 452 U.S. 264, 288 (1981)).

<sup>68</sup> 521 U.S. 898, 935 (1997).

<sup>69</sup> *Id.*

<sup>70</sup> 535 U.S. 743, 767-768 (2002).

taking of evidence in civil or commercial matters (CR-CCE).<sup>71</sup> Under art. 17 CR-CCE,<sup>72</sup> the court of one Member State can request to take evidence directly in another Member State, and the requested Member state can only reject that request on very limited grounds.<sup>73</sup> While this provision is far-reaching by international standards, it stops far short of complete freedom to establish extraterritorial courts.

Thus, the decisive question is whether the Community legislator could impose the relevant concept via Community legislation. Art. 5 (1) TEC establishes the general principle that the Community shall act within the limits of the powers conferred upon it by the TEC. The issue is therefore whether the Treaty provides a basis for enacting Community legislation of the type at issue.

One provision to be considered in this context is art. 65 TEC, according to which the Community shall take measures in the field of “judicial cooperation in civil matters” including measures that eliminate “obstacles to the good functioning of civil proceedings.” It is far from obvious, however, whether that provision would cover the legislation in question here. To be sure, a rule of the type at issue would certainly eliminate obstacles to the good functioning of civil proceedings, namely obstacles of a geographical nature. It is less clear, though, whether such a rule would not go beyond what can properly be described as “judicial cooperation.” After all, the rule at hand would have the effect of making

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<sup>71</sup> Official Journal L 174, 27/06/2001 P. 1-24.

<sup>72</sup> See art. 17 of the regulation, which reads: “1. Where a court requests to take evidence directly in another Member State, it shall submit a request to the central body or the competent authority referred to in art. 3(3) in that State, using form I in the Annex. 2. Direct taking of evidence may only take place if it can be performed on a voluntary basis without the need for coercive measures. Where the direct taking of evidence implies that a person shall be heard, the requesting court shall inform that person that the performance shall take place on a voluntary basis. 3. The taking of evidence shall be performed by a member of the judicial personnel or by any other person such as an expert, who will be designated, in accordance with the law of the Member State of the requesting court. 4. Within 30 days of receiving the request, the central body or the competent authority of the requested Member State shall inform the requesting court if the request is accepted and, if necessary, under what conditions according to the law of its Member State such performance is to be carried out, using form J. In particular, the central body or the competent authority may assign a court of its Member State to take part in the performance of the taking of evidence in order to ensure the proper application of this Article and the conditions that have been set out. The central body or the competent authority shall encourage the use of communications technology, such as videoconferences and teleconferences. 5. The central body or the competent authority may refuse direct taking of evidence only if: (a) the request does not fall within the scope of this Regulation as set out in Article 1; (b) the request does not contain all of the necessary information pursuant to Article 4; or (c) the direct taking of evidence requested is contrary to fundamental principles of law in its Member State. 6. Without prejudice to the conditions laid down in accordance with paragraph 4, the requesting court shall execute the request in accordance with the law of its Member State.”

<sup>73</sup> See *supra* note 72.

judicial cooperation unnecessary by allowing states to administer justice in other Member States without having to rely on the cooperation of local courts.

This said, a rule allowing the establishment of extraterritorial courts could very probably be based on art. 95(1)(2) TEC, which provides for the Council to adopt measures facilitating the establishment and functioning of the internal market. A rule of the type at issue would make it easier for corporations to make use of the freedom of establishment, which – like the other fundamental freedoms – is at the core of the internal market as defined in art. 14(2) TEC. Hence, the rule at issue would have as its objective the establishment and functioning of the internal market as required by art. 95(1)(2) TEC.

#### **D. What Is at Stake**

When interpreting the power of a state to exclude from its territory the courts of other states, or when interpreting the power of a federal government such as the United States or the European Union to require member states to accept such courts, it is of course critical to focus on the practical issues involved. The ability to hold trials in another state need involve no meaningful increase in the substantive authority of one state over the citizens of another, which is presumably the central issue in sovereignty. The disputes involved are already subject to the jurisdiction of the courts of the state that will conduct the trial. No increase in that jurisdiction is at stake. The only important question is where the trial will be held. Since we are dealing here with the internal affairs of corporations, there is an important sense in which the principal parties in interest – the corporation itself, its shareholders, and its managers – are on notice of, and have consented to, the law of the incorporating state, including any provisions of that law which provide for proceedings to be held in other states. Finally, the very purpose of conducting out-of-state proceedings is to make them less burdensome for the litigants.

This is not to deny that extraterritorial courts might have disadvantages. We explore those next. It is not clear, however, that any of these disadvantages can be considered a significant interference with the sovereignty of the host state.

### **III. 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.

#### **A. 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 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.<sup>74</sup> 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.

## **B. 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.<sup>75</sup> This approach might make extraterritorial proceedings cost-effective even in jurisdictions where there is insufficient litigation to sustain a permanently sitting court.

## **C. 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

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<sup>74</sup> DEL. CONST. art IV, § 3 (2004).

<sup>75</sup> 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).

principle, be involved before the judgment can be executed against that person or her property within the foreign jurisdiction.<sup>76</sup> 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 states<sup>77</sup> have enacted the Uniform Foreign Judgments Act,<sup>78</sup> 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 enforcement of judgments in civil and commercial matters<sup>79</sup> 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.<sup>80</sup>

In any case, one could argue that the procedural requirements that are imposed on a judgment creditor seeking to enforce a judgment from a foreign jurisdiction 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.

The obvious response is that 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.

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<sup>76</sup> 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”).

<sup>77</sup> For a list of the relevant states *see id.* at 1164.

<sup>78</sup> 9A U.L.A. 488 (1964).

<sup>79</sup> 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.

<sup>80</sup> *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.”



## D. Forum Shopping

One may also be concerned that the creation of extraterritorial courts makes it easier for plaintiffs to engage in forum shopping. To be sure, even now, Delaware does not usually force corporate litigants to sue in the Delaware Court of Chancery.<sup>81</sup> Hence, there already exists some room for forum shopping. However, the creation of extraterritorial courts might well aggravate the problem. Two factors are particularly noteworthy in this context. First, the creation 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 creation 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 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 it is not clear that the creation of extraterritorial courts would necessarily lead to a considerable amount of forum shopping. To begin with, under Delaware law, litigants are free to make use of forum selection clauses.<sup>82</sup> 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 shareholderholders 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

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<sup>81</sup> 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).

<sup>82</sup> *Elia Corp. v. Paul N. Howard Co.*, 391 A.2d 214, 216 (Del. Super. 1978).

defendant to litigate in Delaware.<sup>83</sup> 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. In sum, increased forum shopping is by no means a necessary consequence of the creation of extraterritorial courts.

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 board room language has long been changed from German to English, litigating in Wilmington may seem as or more attractive.<sup>84</sup>

#### **IV. DO STATES HAVE SUFFICIENT INCENTIVES TO SET UP EXTRATERRITORIAL COURTS?**

Another potential problem with extraterritorial courts is that, even absent legal or practical obstacles, no important chartering jurisdiction might choose to create them.

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<sup>83</sup> 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).

<sup>84</sup> 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.

## A. The Incentive to Set up Courts

One motivation for a jurisdiction to set up extraterritorial courts is to enlarge the number of companies incorporating in the jurisdiction, and hence to gain more revenue in the form of franchise fees. This has clearly been an important incentive for Delaware. To be sure, as others have pointed out, most other U.S. states may not be able to derive significant returns from the chartering business even if they choose to compete aggressively for corporate charters.<sup>85</sup> Nevertheless, that is not a sufficient reason to discount the motivational power of franchise fees. For extraterritorial courts to play a significant role in corporate law, it is not necessary or even desirable that many states create such courts. Extraterritorial courts only make sense for the few states that are likely to attract a significant number of out-of-state firms. In the United States, it is basically Delaware, Nevada,<sup>86</sup> and Maryland<sup>87</sup> that have fallen into this category. Thus, the decisive question is whether the prospect of additional franchise fees is sufficient to motivate one or more of those states to create extraterritorial courts.

From a purely financial perspective, the situation looks favorable. The initial investment required should be quite limited. It would be sufficient to rent 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.<sup>88</sup> 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.

In addition, there might arise substantial competitive pressure to create extraterritorial courts. For example, Nevada might find the creation of extraterritorial courts especially attractive, because Nevada has shown a special interest in close corporations,<sup>89</sup> which are likely to be particularly interested in being able to litigate close to the state where their businesses are conducted. Once Nevada starts setting up extraterritorial courts, however, Delaware may

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<sup>85</sup> Kahan & Kamar, *supra* note at 748 (concluding that even if states other than Delaware "attracted a substantial number of public corporations, they would neither earn meaningful additional franchises taxes under their current tax structures nor profit significantly from an increase in legal business").

<sup>86</sup> Of course, it has been rightly noted that Nevada's success in attracting out-of-state corporations has largely been restricted to close corporations. See *id.* at 716-720.

<sup>87</sup> See *id.* at 721 (acknowledging that "Maryland [...] attracts a fair number of companies headquartered elsewhere, [although] most of these firms are regulated investment companies").

<sup>88</sup> Cf. 10 DEL. C. § 307 (2004) (decreeing that there be one Chancellor and four Vice-Chancellors).

<sup>89</sup> Kahan & Kamar, *supra* note 1, at 717 (stressing that "Nevada's marketing efforts are principally directed at a particular segment of close corporations.).

feel pressure to follow suit, for fear of leaving Nevada an opening to challenge Delaware's dominance even among larger firms. A parallel can clearly be seen in Delaware's aggressive efforts to adopt attractive statutes for business trusts,<sup>90</sup> LLCs,<sup>91</sup> LLPs,<sup>92</sup> and LLLPs.<sup>93</sup>

## **B. Potential Incentives Not to Set up Courts**

The question remains, then, whether there are substantial incentives for states such as Delaware and Singapore *not* to set up extraterritorial courts. In this context, at least two factors deserve mentioning.

### **1. The Influence of Corporate Lawyers and Other Local Interest Groups**

First – taking Delaware as an example -- local Delaware law firms might lobby Delaware lawmakers not to set up extraterritorial courts. The motive is obvious: If Delaware corporations started litigating in out-of-state courts, Delaware firms might lose clients. It is not hard to see why Delaware 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,<sup>94</sup> 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.<sup>95</sup> And last but not least, Delaware's lawyers probably play an important role in communicating corporate preferences to Delaware lawmakers in an efficient way, given that they are uniquely positioned to distinguish purely strategic demands from real needs. In other words, should Delaware's community of corporate lawyers disintegrate, such a development might well have serious repercussions for the quality of Delaware corporate law.

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

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<sup>90</sup> Cf. 12 DEL. C. § 3801-3824 (2004) (governing domestic statutory trusts).

<sup>91</sup> Cf. 6 DEL. C. § 18 (2004) (governing the limited liability company)

<sup>92</sup> Cf. 6 DEL. C. § 15-1001 (governing the formation of limited liability partnerships).

<sup>93</sup> Cf. 6 DEL. C. § 17-214 (2004) (defining the preconditions for forming a limited liability limited partnership under Delaware law).

<sup>94</sup> The advantages that Delaware lawyers enjoy as an interest group have been famously described by ., Macey & Miller, *supra* note 1, at 506-07.

<sup>95</sup> 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”).

Delaware lawyers to benefit. Rules like Delaware Chancery Court Rule 170, which effectively requires the hiring of Delaware lawyers as co-counsel,<sup>96</sup> 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.

Much the same considerations apply to other local interest groups. Nevada, for example, has to date not sought to profit from corporate franchise fees, which remain at a token level. Rather, Nevada's incentive to attract corporate charters evidently is based heavily on its desire to attract business to local hotels, restaurants, places of entertainment, and service professionals. Those local interests might oppose extraterritorial Nevada courts, for fear of losing business. But that is not a foregone conclusion, since overall their business might well increase if the result of extraterritorial courts were to lead Nevada the state to play a much larger role in the nation's legal (and hence business) affairs.

## 2. The Threat of Federalization

Another factor worth mentioning is the threat of federalization. As Mark Roe has recently explained, Delaware lawmakers have every reason to be extremely sensitive to the threat that the U.S. Congress might federalize corporate law, thereby cutting off the stream of revenues that Delaware derives from the franchise business.<sup>97</sup> If Delaware were to establish courts in other U.S. states, it might appreciably increase the risk of federalization. For one thing, Delaware corporation law would become even more conspicuously national law, making true nationalization of corporation law seem like a much smaller step. For another, once Delaware law had largely displaced state corporation law even

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<sup>96</sup> 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."

<sup>97</sup> Cf. Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 601 (2003) (pointing out that "Delaware players have reason to fear that if they misstep, they will lose their lawmaking business").

for relatively small firms in other states, those other states would have less incentive to protest nationalization of corporation law, and might even, out of resentment toward the imperialistic Delaware, promote federalization.

On the other hand, if the U.S. Congress were to provide expressly for the creation of extraterritorial courts, that act alone might – or might be framed to – signal to Delaware and to other contenders in the charter market that the creation of extraterritorial state courts is considered beneficial and will not prompt the U.S. Congress to preempt state chartering.

## V. 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). There is good reason to believe, however, that arbitration is not an adequate substitute for extraterritorial courts.

### A. 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 benefits of arbitration have little importance, whereas the drawbacks weigh particularly heavily.<sup>98</sup>

#### 1. The Benefits of Arbitration

On the plus side, arbitration may offer speedy decisions,<sup>99</sup> expert decision-makers,<sup>100</sup> and (at least from the U.S. perspective) cost savings.<sup>101</sup> The chances

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<sup>98</sup> 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.

<sup>99</sup> C. 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)

of preserving the underlying business relationship are also said to be greater in case of commercial arbitration.<sup>102</sup>

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 Matters<sup>103</sup> is still languishing on the negotiation table, more than 125 countries have signed the 1958 New York Arbitration Convention<sup>104</sup> or the 1961 European Convention on International Commercial Arbitration.<sup>105</sup> 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.<sup>106</sup>

Yet, despite the multitude of advantages that (international) arbitration is said to offer, it is easy to see that they will often be relatively insignificant 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.<sup>107</sup> 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

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<sup>100</sup> Cf. Fahrenback, *supra* note 99, at 395 (noting that the parties can select their decision-makers in case of commercial arbitration).

<sup>101</sup> Fahrenback, *supra* note 99, 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.

<sup>102</sup> Fahrenback, *supra* note 99, at 395; William Wang, *International Arbitration: The Need for Uniform Interim Measures of Relief*, 28 BROOKLYN J. INT'L L. 1059, 1060 (2003)

<sup>103</sup> Available at: <http://www.hcch.net/e/workprog/jdgm.html>.

<sup>104</sup> 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).

<sup>105</sup> See Helen Z. Kryshalowych & Claudia T. Salomon, *Current Development: Enforcing Foreign Arbitral Awards and Foreign Judgments in Ukraine*, 12 AM. REV. INT'L ARB. 425, 425 (2001).

<sup>106</sup> 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.)

<sup>107</sup> Cf. also Shell, *supra* note 98, at 572-573 (suggesting that arbitrators may not be superior to Delaware courts in terms of speed and expertise).

limiting discovery<sup>108</sup> and by making sure that there is no possibility to appeal their decision.<sup>109</sup> However, there is no reason to believe the parties would be 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.<sup>110</sup> Finally, to the extent that costs are saved by limiting discovery<sup>111</sup> 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 will typically not play a major role in corporate law, at least where publicly traded corporations are 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.<sup>112</sup> However, that argument has little weight in

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<sup>108</sup> 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“).

<sup>109</sup> Cf. Bales, *supra* note 108, at 757 (“Restrictions on the right to appeal effectively make the arbitral award final, eliminating a lengthy and expensive appellate process.“).

<sup>110</sup> See Kahan & Kamar, *supra* note 1, at 1256 n.160.

<sup>111</sup> Cf. Bales, *supra* note 108, 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 arbitration is less extensive than in litigation“)

<sup>112</sup> 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



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,<sup>113</sup> 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.<sup>114</sup> A crucial source for the non-enforcement of foreign judgments, namely the feeling that the court that has issued the judgment has interpreted its jurisdiction too broadly,<sup>115</sup> 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.<sup>116</sup> Similarly, two other central problems with respect

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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).

<sup>113</sup> 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).

<sup>114</sup> 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 "[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").

<sup>115</sup> With regard to the role of jurisdictional questions in the non-recognition of U.S. judgments abroad see, e.g., Silberman, *supra* note 114, 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").

<sup>116</sup> Silberman, *supra* note 114, 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

to the enforcement of U.S. judgments, namely concerns about jury verdicts as well as about punitive damages awards<sup>117</sup>, are not an issue when it comes to Delaware corporate law.

## 2. 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,<sup>118</sup> a compromised instead of a clear-cut result,<sup>119</sup> limited discovery,<sup>120</sup> lack of coercive power on the part of the court,<sup>121</sup> and lack of judicial review.<sup>122</sup> Last but not least, arbitration may run into difficulties in case of multi-party suits.<sup>123</sup>

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

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jurisdiction. Yet according to her description of Swiss law, the defendant's domicile is one of these bases.

<sup>117</sup> 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).

<sup>118</sup> Fahrenback, *supra* note 99, at 395.

<sup>119</sup> Fahrenback, *supra* note 99, at 395.

<sup>120</sup> Fahrenback, *supra* note 99, 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 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).

<sup>121</sup> 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.“).

<sup>122</sup> Fahrenback, *supra* note 99, at 395.

<sup>123</sup> 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.)

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.

## **B. 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.

## **C. Practical Experience**

Strong evidence that, when all is considered, private arbitration will not provide a clearly superior alternative to extraterritorial courts 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, dispute resolution 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.

# **VI. 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 certain benefits. We briefly touch here on some of the relevant considerations.

## **A. The Usefulness of Extraterritorial Courts outside of Corporate Law**

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

## 1. 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.

## 2. 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).<sup>124</sup> 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.

## 3. Other

Finally, there may 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. After all, there may be situations where the reputation of a particular jurisdiction's court system is so bad that the parties

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<sup>124</sup> 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.

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. It should be noted, in this context, that while precedents are formally binding only in common law systems, the practical importance of case law is paramount in civil law jurisdictions as well.

## **B. 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.

### **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. Choice of forum clauses selecting an extraterritorial foreign court seem unlikely to 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.

## **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.

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