The Trading With the Enemy Act and the Controlled Canadian Corporation

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The purpose of this paper is to study the *Trading with the Enemy Act*[1] and the *Foreign Assets Control Regulations*[2] issued thereunder in the limited area in which they apply to prevent Canadian corporations controlled by persons subject to the jurisdiction of the United States from exporting goods or engaging in commerce with "designated foreign countries".[3] We shall be especially concerned with trade with China, a designated foreign country, as we consider the effect which the statute and regulations have on exports of United States controlled Canadian corporations.[4] Canada trades freely with China subject to the Consultative Committee (COCOM) list of strategic goods.[5] The United States embargoes trade with China, including trade by United States controlled Canadian corporations; it effectuates this embargo on domestic United States corporations under the provisions of the *Export Control Act.*[6] The embargo is enforced against United States controlled foreign corporations by means of the *Trading with the Enemy Act* and the *Foreign Assets Control Regulations.* In fact, the *Foreign Assets Control Regulations* expressly exclude domestic United States corporations from the

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* Of the Bars of the State of Ohio and the Commonwealth of Massachusetts.

1 50 USC App. § 1-44 (1964).

2 31 CFR § 500.101-.808 (1967).

3 China, North Korea, North Vietnam: 31 CFR Part 500.201 (d). In June, 1966, the "National Liberation Front of South Vietnam", the Viet Cong, and the "Liberation Red Cross" were determined to be "specially designated nationals" of North Vietnam, and as such, subject to all the restrictions imposed by the act and regulations on trade and transfer of goods and currency to North Vietnam. (31 Fed. Reg. 8586) (1966).

4 The *Trading with the Enemy Act* has also disturbed Canadian-United States relations in a series of incidents involving United States citizens who have attempted to send medical supplies for war relief to civilians in North Vietnam, and have sought to circumvent the act by transporting goods and money to Canada for transmission to North Vietnam. See e.g., *New York Times*, December 29, 1967, p. 1.

5 The Consultative Committee, with headquarters in Paris, is comprised of the members of NATO minus Iceland, and plus Japan; it regulates trade with communist countries on a multilateral basis.

6 50 USC App. § 2021.

purview of the regulations provided that, for any transaction, the applicable terms and conditions of the *Export Control Act* are complied with.[7]

I

The Statutory Framework

An examination of the statute and regulations in their present form may help in understanding the nature of the conflict between Canada's national interest and the asserted statutory interest of the United States. Since its first enactment in 1917, the *Trading with the Enemy Act* has, in succeeding statutory incarnations, delegated broad powers to the President to issue regulations and enforce the act. It is understood that the broad delegation of authority by Congress is legitimated by and referable to the war power and the foreign affairs power. The precincts of war and foreign affairs are areas in which the United States Supreme Court has upheld broad grants of power by Congress to the Executive.[8] It therefore seems unlikely that the delegation of power by Congress to the President in section 5 of the act will be successfully attacked in the courts as an excessive, and therefore, unconstitutional delegation of legislative power. However, in view of the fact that section 5 of the act not only authorizes the President to embargo and regulate all foreign trade during a declared war or during a "national emergency", but also gives the President the power to declare a national emergency, it may be that if the doctrine of unconstitutional delegation of legislative power is not completely moribund, it might be employed to strike down executive action under the statute.

The most recent enactment of the statute, that of 1941, reads in pertinent part, as subsequently amended, as follows :

> During time of war or during any other period of national emergency declared by the President, the President may, through any agency that he may designate, or otherwise, and under such rules and regulations as he may prescribe, by means of instructions, licenses, or otherwise ... investigate, regulate, direct, and compel, nullify, void, prevent or prohibit, any acquisition, holding, withholding, use, transfer, withdrawal, transportation, importation or exportation of, or dealing in, or exercising any right, power, or privilege with respect to, or transactions involving, any property in which any foreign country or a national thereof has any interest, by any person,

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[7] 31 CFR § 500.533.

[8] *United States* v. *Curtiss-Wright Export Corp.*, (1936), 299 U.S. 304; *Zemel* v. *Rusk*, (1966), 381 U.S. 1.

> or with respect to any property, subject to the jurisdiction of the United States; . . .[9]

By Presidential Proclamation on the 16th of December, 1950,[10] a declaration of national emergency was made in response to the entrance of Chinese forces into the Korean conflict. The President thus set in motion the administrative machinery necessary to enforce the act. This declaration of national emergency remains in effect at present.[11]

The administrative mechanism by which control is exercised is somewhat intricate. Because the *Trading with the Enemy Act* includes restrictions on a variety of transactions other than export trade, and because many of these transactions are related to currency controls and the freezing of foreign assets in the United States, the President has delegated the administration of the act to the Secretary of the Treasury.[12] The Secretary has promulgated the *Foreign Assets Control Regulations,* the relevant part of which reads as follows:

> All of the following transactions are prohibited, except as specifically authorized by the Secretary of the Treasury (or any person, agency, or instrumentality designated by him) by means of regnlations, rulings, instructions, licenses or otherwise, if such transactions involve property in which any designated foreign country, or any national thereof, has at any time on or since the effective date of this section had any interest of any nature whatsoever, direct or indirect;
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> (1) All dealings in, including, without limitation, transfers, withdrawals, or exportations of, any property or evidences of indebtedness or evidences of ownership of property by any person subject to the jurisdiction of the United States; . . .[13]
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> The term "designated foreign country" means a foreign country in the following schedule and the term "effective date of this section" means with respect to any designated foreign country or national thereof, 12:01 a.m., eastern standard time, of the date specified in the following schedule:
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> 1. China: December 17, 1950.
> 2. North Korea, i.e., Korea north of the 38th parallel of north latitude: December 17, 1950.

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[9] 50 USC App. § 5(b)(1).

[10] Presidential Proclamation #2914, 3 CFR, p. 100 (1950).

[11] It is interesting to note that the new regnlations concerning foreign direct investment by United States persons (15 CFR § 100.101-804), issued on January 1, 1968, which severely limit United States direct investment abroad, were issued under the presidential powers which exist pursuant to the same Presidential Proclamation of a state of emergency in 1950. On March 22, 1968, direct investment in Canada was excepted from these regnlations.

[12] Exec. Order #9193, 7 Fed. Reg. 5205 (1942).

[13] 31 CFR § 500.201 (b).

3. North Viet-Nam, i.e., Viet-Nam north of the 17th parallel of north latitude: May 5, 1964...[14]

The term "person subject to the jurisdiction of the United States" includes:

(1) Any person, wheresoever located who is a citizen or resident of the United States;

(2) Any person actually within the United States;

(3) Any corporation organized under the laws of the United States or of any state, territory, possession, or district of the United States; and

(4) Any partnership, association, corporation, or other organization wheresoever organized or doing business, which is owned or controlled by persons specified in (1), (2), or (3).[15]

If the regulations generally serve to limit the global scope of statutory language as in defining "designated foreign country", they do not so operate in defining the "person subject to the jurisdiction of the United State". It is in this area that the conflict of jurisdiction between Canada and the United States arises, for the regulations assert jurisdiction over Canadian corporations on the basis of United States ownership or control, regardless of whether the Canadian corporation is present or doing business in the United States. Although controlled foreign partnerships, associations, or corporations, as defined in paragraph (4) of the above quoted regulations are subject to the jurisdiction of the United States, they are frequently not amenable to process by United States courts. In order to avoid direct jurisdictional challenge and public conflict with Canada, and in spite of the fact that the act asserts jurisdiction over Canadian subsidiaries, the United States proceeds by way of enforcement only against the United States person or persons who control the Canadian corporation. The Treasury Department notifies the United States shareholders who control the Canadian corporation that a prohibited export transaction by the subsidiary will render the shareholders liable to sanctions for violation of the act. Likewise, it appears that the procedure for securing a license-exception to engage in otherwise prohibited transactions is for the United States person who controls a Canadian corporation to apply to the Treasury Department on behalf of the Canadian corporation. In this way the act is applied to United States controlled Canadian corporations and has an impact in Canada, but enforcement is threatened only against United States citizens, residents or corporations, persons clearly subject to the process of

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[14] 31 CFR § 500.201 (d).
[15] 31 CFR § 500.329 (a).

the United States federal courts; no Canadian corporation is placed in the position of a petitioner to the United States Treasury Department. This technique seems to avoid, at least on a formal level, invasion of Canadian sovereignty over Canadian corporations. But history has shown that even though the principles of sovereignty and jurisdiction remain inviolate, the United States has secured compliance with the act and regulations.

Some Problems of Construction. The failure of the regulations to provide a satisfactory definition of "owned or controlled" foreign corporations, partnerships, or associations raises a number of questions. The first problem is the construction which we are to put on these conspicuously undefined terms "owned or controlled" insofar as they purport to determine the scope of United States jurisdiction over foreign corporations and other foreign entities. It would seem reasonable to construe this language to require that a majority of the voting stock or a majority of the outstanding stock of all classes be held by United States persons in order to assert jurisdiction over a foreign corporation. The regulations do not deal specifically with the problem of widely held shareholder control by United States persons, although in other contexts, including sub-chapter F of the United States *Internal Revenue Code* (ss. 951 *et seq.*) dealing with income of controlled foreign corporations, it is usual to set a threshold limit of 5 or 10% control by a United States person in order to have his shares count in determining United States control or ownership. In the absence of such a threshold, it would appear that the regulations authorize a strictly arithmetical control test, and that 51% ownership of the voting stock is control. One may quarrel with the wisdom of an approach which asserts jurisdiction over a foreign corporation on the basis of simple arithmetic control of that corporation by United States persons, but the regulations can be most reasonably construed to authorize such an assertion of jurisdiction.

A more serious problem arises as the result of the policy of the United States Treasury in seeking compliance with the act and regulations by asserting that they apply to United States controlling persons by virtue of their share ownership alone. The initial question is whether criminal penalties[16] under a statute requiring "wilful" violation can ever attach to shareholders *qua* shareholders for acts engaged in by their corporation. It would seem a novelty in

[16] We should not forget that the *Trading with the Enemy Act* is a criminal statute, a violation of which might lead to fines of up to $10,000 and prison sentences of up to 10 years. Furthermore, the statute and regulations specify that a violation must be "wilful". 50 USC App. § 5(b); 31 CFR § 500.701.

the criminal law, and indeed a derogation from the biblical injunction, if the punishment for the sins of the children were visited on their parents. Yet it is this strained and curious policy which the Treasury has adopted to hold United States corporate parents (or United States shareholders) liable for the acts of their corporate children. It is a novel use of the doctrine of "piercing the corporate veil" which permits us to ascribe to shareholders criminal liability for the acts of the corporations in which they own shares. Although there do not appear to be any litigated cases on this point, it seems clear that the Treasury does assert the responsibility of the United States shareholder for the action of a foreign corporation in which he holds shares, and the responsibility of the United States shareholder to apply for license-exceptions to the act and regulations on behalf of the foreign corporation.

If it is ever permissible to transfer criminal responsibility for an act from a corporation to its shareholders, such a transfer is only acceptable under narrowly drawn limitations which effectively establish that the act of the corporation is in fact the act, the wilful act, of a shareholder. In view of the failure of the regulations to provide specifically that the act applies to United States persons in their capacity as shareholders, it does not seem permissible to construe the regulations to apply to United States persons holding shares on the basis of such share ownership. On the contrary it seems proper to interpret them to require that the person subject to the jurisdiction be the one who engages in the prohibited dealing, and that the person subject to the jurisdiction (in this case the controlled foreign corporation) be the one who ultimately incurs the penalties provided for in the act.

This assertion of shareholder liability for corporate action is made more dubious by the failure of the regulations to define adequately the terms "owned or controlled", because in the absence of definition, it seems consistent to assert that United States persons owing 1% or less of the shares of a controlled foreign corporation could be subject to criminal sanctions or expected to apply for a license on behalf of a controlled foreign corporation in which he held shares. The failure to distinguish between the case in which the United States control is exercised by 100% ownership of the stock of a foreign corporation by a United States parent corporation and the situation in which United States control is by widely held shareholding seems fatal to the Treasury interpretation of the regulations and a conclusive indication that the Treasury approach was not contemplated by or authorized in the regulations. Nor is it immediately clear that in the absence of other compelling factors

a threshold percentage approach to this problem with a threshold below 51% ownership by one United States person (and his affiliates) can justify this rather novel extension of criminal liability. It seems inappropriate to transfer the percentage threshold approach from the area of taxation, which the average investor can be expected to consider and appraise prior to investing, to an area of criminal law where future contingencies including the possibility that a corporation not now controlled will become so, and that it may subsequently engage in isolated sales transactions in violation of the act, cannot be assessed. Even if a controlled corporation were to engage in prohibited transactions, it would seem that something more than a minority percentage control of shares should be required to permit a finding of "wilful" violation.

Mr. Kingman Brewster posed the case of the controlled foreign corporation with shares widely held in the United States as a hypothetical in *Law and United States Business in Canada.*[17] Mr. Brewster's hypothetical was all too real a problem for Canada at the time his pamphlet went to press, and one must suspect that he was aware of the fact. As early as January, 1959, there is mention in *Hansard*[18] of the refusal of a million dollar Chinese order by the Aluminium Company of Canada Limited ("Alcan"), a Canadian corporation owned and controlled in the United States by widely held individual shareholdings.[19] Alcan was the sole aluminium reduction and milling entity in Canada. The refusal had come in 1958, in a period of economic recession in Canada and unemployment in the aluminium industry. Mr. Brewster appears to confirm our doubts about the applicability of the act and regulations to United States shareholders in an Alcan situation.[20] In general, however, he does not seem to doubt the wisdom and propriety of making the United States shareholder (presumably a corporate parent) liable for the subsidiary's actions. He says that "the hypothetical is the limiting

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[17] (Montreal, 1960).

[18] *House of Commons Debates,* Speech of Mr. Hazen Argue, 30 January 1959, I, p. 544.

[19] *1966 Annual Report,* Aluminium Company of Canada Limited, p. 3: Percentage of Common Shares held by residents of Canada (Dec. 31): 1966, Can. Res. 36.0%; 1965, 31.1%; 1966, U.S. Res. 60.1%; 1965, 65.0%; 1966, Other 3.9%; 1965, 3.9%. Number of common shareholders according to share register (Dec. 31): 1966, Res. Can. 29,308; 1965, 25,610; 1966, Res. USA 25,416; 1965, 24,762; 1966, Res. Other 1,965; 1965, 2,037.

[20] *Op. cit.,* p. 11: "Clearly the easiest thing is to find some pretext for turning down the order even though U.S. law probably does not apply, given the absence of ownership in U.S. hands sufficiently concentrated to constitute 'control' within the meaning of the regulations."

extreme, since most U.S. corporate interests in Canada cannot doubt the legal responsibility of the U.S. corporate parents".[21]

It would appear that the Treasury interpretation is an unwarranted and unauthorized gloss on the regulatory language developed when it became apparent that for reasons of jurisdiction and politics the regulations could not, as promulgated, meet the problem of the controlled foreign corporation. It seems clear that the regulations authorize the imposition of criminal penalties on the controlled foreign corporation if it violates the act and require that corporation to apply for license-exceptions. It is doubtful that they authorize more than this. Whether or not the regulations should be read to apply only to the controlled foreign corporation, or whether they can be read to apply directly to United States persons owning shares in such corporations, and in what circumstances this broader reading is proper, will probably never be judicially decided; the United States Treasury has been singularly successful in obtaining compliance by casting a wide net, and it has not found it necessary to haul in the nets in a judicial enforcement proceeding. Informal pressure on United States parent companies, including the threat of adverse publicity, and possible problems in securing government contracts are available to secure silent compliance and to deny the Canadian corporation a day in court. It is clear too that this sort of informal pressure can be effective even in the absence of control by a United States parent company. In the Alcan case, that corporation did accept the prohibition of the statute because of possible adverse effects on the United States market.[22] It seems apparent that Alcan, faced with possible problems in the United States market if it accepted the order, and possible problems in Canada if it applied to the United States Treasury for a license-exception to make a sale to China, chose the line of least resistance. Although Alcan is probably amenable to process of United States federal courts by reason of doing business within the United States, one must seriously question whether a criminal prosecution would have been brought against Alcan had it accepted the Chinese order. But the possibility of such a suit, however remote, must have been a substantial deterrent.

Some Problems of Enforcement. Another problem of construction, and one which Mr. Brewster injected into his "hypothetical" was the fact that a majority of the directors of the controlled Canadian corporation were United States citizens. At present, only four of

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[21] *Ibid.*

[22] *House of Commons Debates*, Speech of Mr. Hazen Argue, 30 January 1959, I, p. 544.

Alcan's fourteen directors are United states citizens;[23] but regardless of this, further questions must be asked before we can conclude that criminal penalties will attach for violation of the act.

If we assume that a majority of the directors are United States citizens, it is not apparent that they would be individually liable were the controlled Canadian corporation to engage in transactions in violation of the act, since most sales in the ordinary course of business are not matters for consideration of the board of directors. Mere inaction, with or without knowledge of a prohibited sale, would seem a rather slim ground on which to establish wilful violation. Whether or not the directors are obliged to take affirmative action in advance to establish a policy forbidding sales which would violate the act is not clear. In a situation in which United States citizens comprise less than a majority of the board, it is difficult to find any ground for individual prosecutions under the act. Further, it would seem, *a fortiori,* that if the directors who are United States citizens cannot be prosecuted for corporate action, then it is not permissible to prosecute United States shareholders whose legal relationship to the corporation and attendant responsibility for its acts are even more remote than those of the directors.

As far as can be determined, no prosecutions of individual directors have been brought by the Treasury Department in their efforts to enforce the act, although such individuals are presumably more clearly subject to prosecution than United States shareholders. One reason for this is the fact that such an enforcement technique can easily be frustrated, either by conscious action of all the shareholders of a controlled Canadian corporation, or by enactment of a statutory requirement by the Canadian federal or provincial legislature requiring that a majority of the board of directors of a corporation be other than United States citizens or residents.[24] Another technique is suggested by a case which arose in France

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[23] Aluminium Company of Canada Ltd., *1966 Annual Report.*

[24] The Ontario Provincial legislature showed itself ready to adopt legislation to frustrate United States anti-trust policy as it involved Canadian corporations. A United States Federal Grand Jury issued subpoenas *duces tecum* to more than fifty Canadian companies in connection with United States anti-trust violations. See e.g. *In re Grand Jury* Subpoenas Duces Tecum *Addressed to Canadian International Paper Company,* (1947), 72 Fed. Supp. 1013. In 1947, the Ontario Legislature passed an act which prevented the improper removal of business records from Ontario, subject to certain limited exceptions, and set out contempt sanctions to enforce the statutory requirement, *The Business Records Protection Act,* R.S.O. 1960, c. 44, s. 2(1).

in 1965 [25] when a French corporation owned ⅔ by Freuhauf Corporation of the United States and ⅓ by French interests was ordered by the United States parent company, which had apparently been notified by the Treasury Department, to cancel a contract for 60 Freuhauf trailers to be manufactured by the French company and sold to another French company for export to China. The French court stepped in at the request of the French minority shareholders, and appointed a receiver who was instructed to complete the contract. The court spoke of public policy considerations including employment levels in deciding upon this course of action. There is no evidence that any attempt was made in the United States to prosecute the parent company or any of its officers or shareholders, although the controlled foreign corporation clearly engaged in a prohibited transaction. This case suggests that at least in the case where Canadian persons hold a minority interest in controlled Canadian corporations it might be possible for them to block action by United States parent companies seeking to cancel prohibited orders once they have been accepted by a Canadian corporation. A *bona fide* Canadian stockholder may well have a sufficient economic interest to enable him to seek judicial intervention in such a situation; a Canadian court might well find that public policy considerations as well as the Canadian shareholder's interest would require intervention to secure performance of a contract. Canada has already taken legislative measures to secure Canadian participation in Canadian corporate enterprise. It might be possible to require in certain instances that controlled foreign corporations have at least a significant minority percentage of their shares held by Canadians who might act as watchdogs in situations involving prohibited transactions. There are two practical difficulties with such an approach, however. First, it is not clear that Canadian shareholders would have the necessary information, or the interest to acquire such information about corporate sales orders; secondly, as we shall examine in detail later, there are means of structuring corporate organization to assure with a high degree of certainty that orders from outside Canada never reach a controlled Canadian corporation for acceptance.

An analogous problem arises under the *Foreign Direct Investment Regulations*, promulgated on January 1st, 1968 by the United States Secretary of Commerce,[26] which also involve extra-territorial impact of United States legislation. The regulations require repa-

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[25] *Massardy* v. *Société Fruehauf-France*, Paris, 22 mai 1965, Gaz. Pal. 1965.2.86.
[26] See note 11, *supra*.

triation of earnings from certain controlled foreign corporations. To the extent that these repatriation requirements conflict with policies of foreign countries in which controlled foreign corporations are established, these foreign countries are free to take legislative action to limit or prohibit repatriation of funds as required under the *Foreign Direct Investment Regulations*. That such legislative action may be in the interest of the controlled foreign corporation as well as the foreign host country's economic policies suggests that this problem may well be encountered under these new regulations.

While the Treasury Department does not seem to know whom to prosecute for violations of the act, they have, by informal enforcement procedures, including the implied threat of adverse publicity and the carrot of government contracts, secured substantial compliance with the act although the global jurisdiction asserted therein has never been tested. The Treasury Department has been careful to keep its enforcement and license application procedures within the borders of the United States even though the regulations authorize a broader and different approach to the problem. Despite the undoubted wisdom of this approach as a means of avoiding conflict with foreign countries and leaving them relatively unaware of the impact of the act and regulations on their domestic economy, this informal procedure prevents judicial constructions and interpretation of the statute and regulations by effectively avoiding resort to a judicial forum. Whatever the means employed, compliance is secured without resort to the courts. In this situation, it is uncertain how effective any legislative effort by a foreign country can be in establishing the primacy of its own public policies, when these contravene the policy interest of the United States as set out in the act. Informal pressure and methods of corporate organization designed by a United States parent to secure compliance with the act are peculiarly unamenable to legislative redress by foreign countries.

II

The Policy Considerations Behind the Act

As Mr. Brewster suggests,[27] there seem to be two major policy considerations behind the *Trading with the Enemy Act*: one is to deprive the designated countries of goods and services as completely

[27] *Op. cit.*, p. 23.

as possible, and the other is to preserve equity between United States persons and corporations and controlled foreign corporations and to give no trade advantage to a foreign establishment. The former policy consideration seems to border on the fatuous in view of the fact that the United States alone among major western industrial nations imposes a trade embargo on China. To the extent that the *Trading with the Enemy Act* attempts to limit the access of China or any other designated foreign country to goods not covered by export prohibitions of COCOM,[28] such a prohibition is nearly certain to prove ineffective. The United States deprives itself of a potential market but does not substantially reduce the likelihood that designated foreign countries will be unable to supply their wants elsewhere in the world market. Indeed, this blanket export prohibition may work a greater hardship on United States business and agriculture than on any designated foreign country. In addition to the economic cost of maintaining this policy, there is the incremental cost in dollars and goodwill resulting from conflicts arising with foreign countries as a result of the extra-national application of the act. Further, if the initial policy consideration is unsound, then the second consideration, that of maintaining equity between domestic United States and foreign establishments likewise falls, premised as it is on the validity of the first consideration.

Taken on its own ground, the second policy consideration does make sense as between domestic United States corporations and controlled foreign corporations. It fails to take into account, however, the public policy of the foreign country in which the controlled foreign corporation is located, and poses an inevitable problem for the controlled foreign corporation which is incorporated under the laws of its foreign host country and subject to its jurisdiction. The relative importance the United States government places on this second consideration can be seen from the fact that in imposing its trade embargo on Cuba under the *Trading with the Enemy Act*,[29] controlled foreign corporations were excluded from the application of the regulations, in large measure in response to Canadian discontent with the existing *Foreign Assets Control Regulations*. While it might be reprehensible conduct to establish a controlled foreign corporation for the principal purpose of circumventing the act, there is no indication that United States persons would find it profitable to establish a corporation for such a purpose. Not only is it possible for most of the needs of designated foreign countries to be supplied by existing producers in foreign countries, but it

[28] See note 5, *supra*.

[29] *Cuban Assets Control Regulations*, 31 CFR § 515.101-808 (1967).

seems unlikely, in view of the Canadian experience in trading with China, that any one company is likely to secure a principal part of its business from designated foreign countries.

In supporting this "equity" consideration, Mr. Brewster suggests, however, that license-exceptions should be granted in those cases in which it can be demonstrated that the order is significant in its impact on the economy of the foreign country and when there are no alternative sources of supply in the country. It seems that these suggested exceptions fly in the face of the policy of equal treatment. Such an exception encourages conscious planning and solicitation of orders of considerable magnitude, and encourages the location of a foreign corporation in a country where it will be the sole producer of some product. Should an IBM plant in a Latin American country be permitted to engage in prohibited transactions? The fact that large orders are to be preferred over small also cuts across the deprivation theory. The exceptions may well make sense from the Canadian point of view; they are hardly consistent with the United States policy of "equal treatment" and discouraging avoidance of the *Export Control Act.*

While it is true that the *Trading with the Enemy Act* is global, and not designed solely for Canada, much of its impact is necessarily in Canada where a substantial proportion of United States foreign investment has been placed. The feasibility of making Canada a special exception from the act and regulations is slim;[30] such an exception would bring protests from other foreign governments and from United States business engaged in foreign corporate operations elsewhere. It would be such a substantial vitiation of the underlying policy of preventing the flow of goods to China, and of preserving equal treatment among Americans, that it seems doubtful whether an exception for Canada would not emasculate the entire act.

Canadian experience with the act, from the Ford case in 1957 to the present, and continued Canadian concern, when coupled with the United States decision to limit the Cuba embargo to domestic United States corporations, suggests that the high water mark of this act may have been reached and passed; the expanding scope of United States business abroad will doubtless result in further pressures, private and governmental, for the relaxation or repeal

[30] While it is true that the United States granted Canada a belated exemption from the application of the *Foreign Direct Investment Regulations* (see note 11, *supra*), the considerations of international monetary stability seem sufficiently compelling to justify an exception in that case but not in the case of the *Trading with the Enemy Act.*

of this act. In the meantime, the policy of enforcing the act against the United States parent works to minimize the discontent which this act must inevitably expect to encounter from foreign countries.

III

The Canadian Experience: An Historical Survey

Having examined the statute and regulations, and discussed briefly the policy behind them, it is now proposed to turn to the historical arena, and to learn how the statute and regulations are applied to United States owned or controlled Canadian corporations. We shall also examine the inevitable conflict between Canada and the United States on this issue, examining the historical and economic factors in which the conflict is grounded.

Canada's high level of industrial development and economic well-being has only been achieved by permitting the inflow of massive amounts of foreign investment capital to develop resources and industry. We are especially concerned, in our examination of the *Trading with the Enemy Act,* with manufacturing and processing branches of the Canadian economy. A substantial part, often a majority, of the stock of Canadian corporations in these branches of the economy is owned by foreigners. Of these foreign holdings, about 75% are held by United States persons. In a very real way, then, United States investors can be said to own and control the Canadian economy.

Foreign investment does benefit Canada by providing more jobs, higher tax revenues, and indeed all the gains of economic growth. Yet it is inevitable that capital controlled outside Canada may not conduct itself in Canada as Canadian capital would. It can be argued that so long as Canadians benefit substantially from the foreign investment, the fact that they do not benefit to the highest possible degree should not be a great concern; yet, the spectre of control, and the realization that foreign ownership does result in different behavior patterns, have produced considerable anxiety among Canadians and has been for a decade now a continuing domestic political issue.

In addition to Canadian anxiety about foreign control of domestic industry, there is another significant factor in the equation. Canada has a small population, about 20 million people, which is only one-tenth that of the United States. It is, of itself, often inadequate as a market area for mass-produced industrial goods. The pressure

to develop Canadian industry, to realize the economies of scale and mass production has directly increased the pressure to seek and expand export markets. It is an important fact that Canada, despite her relatively small population, has the fourth largest trading volume in the world;[31] that one in five Canadian workers is employed in a trade or industry directly in connection with export;[32] that this allocation of labor is reflected in the fact that about 20% of the gross national product is realized from exports.[33] Comparable figures for the United States indicate that exports comprise about 5% of the gross national product.[34] Thus, exports are vitally important to Canadian economic well-being.

Although the *Trading with the Enemy Act* embargo on China began in 1950, it was not until much later in the decade, in 1957 and 1958, that the implications of the act for Canada were recognized and discussed as part of the question of foreign control. Indeed, conformity by Canadian corporations to the *Trading with the Enemy Act* and regulations is only one form of business behavior that differs from what could be expected of a corporation owned and controlled by Canadians; but because this issue ties together concern about foreign control with the economically significant export trade, and because this difference in corporate behavior is a result not of individual choice of the United States investor but of a United States statute which poses a real challenge to Canadian sovereignty over Canadian corporations, it is not surprising that the *Trading with the Enemy Act* moved to center stage in the discussion and debate about foreign control of Canadian industry — foreign control taken to mean, as is generally the case in Canada, control by United States interests.

The first rumblings of concern about foreign control began in 1953, in the wake of the Korean War, which brought an economic recession to both Canada and the United States. Recession engendered discontent and a Royal Commission was established to report on Canada's economic prospects; also at this time, during a visit by President Eisenhower in 1953, the Joint United States - Canadian Committee on Trade and Economic Affairs was established, with cabinet ministers from both sides of the border agreeing to

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[31] *House of Commons Debates*, Speech of Mr. E. J. Broome, 14 April 1959, III, p. 2668.

[32] Canadian-American Committee, *A New Trade Strategy for Canada and the United States*, (Washington, 1966), p. 9.

[33] R. V. Anderson, *The Future of Canada's Export Trade*, (Royal Commission on Canada's Economic Prospects), (Ottawa, 1957).

[34] Canadian-American Committee, *op. cit.*, p. 9.

consult about common problems and further potential for trade and development. The committee first met on March 16, 1954, and again on September 26, 1955.

Foreign control became a full-fledged issue in the Canadian political campaign of 1957. Appeals to nationalist sentiment were made and received with enthusiasm but the *Trading with the Enemy Act* had not yet become an issue.

> The circumstances of the late fifties and early sixties were conducive to questions about the impact of foreign-owned companies. On the one hand the decline in the rate of economic growth and the persistence of substantial deficits in foreign trade in goods and services became linked with the capital inflow and the overvalued exchange rate. Foreign ownership and control, and the capital inflows, bore some of the brunt of criticisms of this state of affairs, even though much of it could more logically be ascribed to inappropriate federal fiscal and monetary policies.[35]

By 1957, several of the Royal Commission "blue books" had appeared, including volumes dealing with United States-Canadian relations, *The Future of Canada's Export Trade* and *Canada-United States Economic Relations*. These reports, based on careful analysis and documentation, provided some real evidence of the different behavior patterns of foreign controlled Canadian corporations. Six major areas of concern about subsidiary operation were discussed;[36] there was, however, no specific mention of the *Trading with the Enemy Act* restriction in either of these volumes. The authors indicated, albeit in a general way, that foreign control resulted in different behavior, and they suggested how it might be possible to make the foreign corporations more responsive to the Canadian environment and more involved in it. There was also an indication that legitimate business purposes accounted for much of the behavior to which Canadians objected.

The fact that there was no general Canadian awareness of the applicability of the *Trading with the Enemy Act* and the regulations to United States-controlled Canadian corporations in regard to exports to China deserves some comment. It is not easy to believe that in the seven year period from 1950 until 1957 that the appli-

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[35] A. E. Safarian, *Foreign Ownership of Canadian Industry*, (Toronto, 1966), p. 22.

[36] These areas were as follows: 1) issuance of equity securities by subsidiaries to Canadians; 2) personnel policies (including "outside directors"); 3) publication of annual financial report; 4) commercial policies — development of export potentials, use of domestic supplies; 5) research activities; 6) contributions to charity and education. Source: Irving Brecher and S. S. Reisman, *Canadian-United States Economic Relations*, (Royal Commission on Canada's Economic Prospects), (Ottawa, 1957), ch. 8 *passim*.

cability of the act and regulations, and the implications thereof were unknown. It appears, nonetheless, that this was substantially the case, at least insofar as Canadian government officials are concerned.

In parliamentary debate on the matter in July 1958, Mr. Pearson, then the Leader of the Opposition, asked:

> Mr. Chairman, perhaps my hon. friend will tell me the date on which the law in question [the *Trading with the Enemy Act*] was passed in Washington.

Mr. Churchill, Minister of Trade and Commerce, replied: "Certainly before June 10, 1957."[36a] Mr. Pearson answered:

> Indeed it was, Mr. Chairman, but not very long before June 10, 1957, and on no occasion while we were in power was the law in any way, shape or form used against any Canadian exporter to any country of the world and we had no reason to complain at all.[37]

It would be possible to credit these two political leaders with incredible ineptitude or failure to do their homework; yet, considering that each was very anxious to lay the blame for the imposition of the *Trading with the Enemy Act* on the doorstep of the other, it is hard to believe that, if Mr. Pearson had known of incidents (or indeed the date of passage of the act), he would have asked the question. It is equally hard to credit Mr. Churchill, who delights in the thrust and parry debate, with failure to raise incidents which occurred during the Pearson ministry. Faith in the competence of the participants and in the adversary system leads to a strong inference that little or nothing was known about the *Trading with the Enemy Act* and its impact on Canada until the Ford case, which came to public attention in early 1958.

This failure to recognize the existence and impact of the problem in Canada is not so much a criticism of Canadian politicians as it is a tribute to the success of the United States' tactic of exacting compliance by application of the act and regulations to United States parents. That it is not the result of lack of enforcement of the act in these first seven years is attested to by Mr. Harold Winch in a speech in the House of Commons on June 25, 1959, in which Mr. Winch presented detailed evidence of enforcement of the act during the preceding eight years.[38] His documentation reveals

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[36a] The date on which Mr. Diefenbaker's Progressive Conservative Party replaced Mr. Pearson's Liberal Party to form the government in power.

[37] *House of Commons Debates*, 18 July 1958, III, p. 2392.

[38] "... You will remember, Mr. Chairman, that when the aluminum company declined to make an export to the mainland of China I took up the matter in this house and the newspapers of our country were kind enough to make some mention of that fact. As a result of that I received a letter from this export-import company in which they told me of their experience of some 2½ or 3

not only the application of the *Trading with the Enemy Act* to United States-controlled corporations prior to 10 June 1957 but also another reason why discovery of the imposition, and the impact which this discovery made, were so long in coming: in almost all the letters cited,

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years ago. In this letter, which I have here, they give excerpts from the replies received from some of these companies. In order to illustrate how far-reaching this control is, I should like to give the committee a number of the excerpts from this letter. There is an excerpt from a letter from Canadian Sandpapers Limited, Preston, Ontario, which reads as follows:

> At the moment it would be impossible for us to ship any goods to China, for we are affiliated with a U.S.A. concern, and with the current U.S.A. state department policy, this precludes our shipping any goods to the iron curtain *(sic)* countries.

Here is an excerpt from a letter from Chain-Belt (Canada) Ltd., Willowdale, Ontario, dated February 27, 1956:

> All the export business of Chain-Belt Company and Chain-Belt (Canada) Limited is carried on through our export department in Chain-Belt Company, Milwaukee, Wisconsin.

The third excerpt is from Garlock Packing Company, Pallmyra, New York, dated March 12, 1956:

> This refers to your letter of March 5, addressed to our Canadian subsidiary, Toronto. As the latter does not engage in any export operation at present business is necessarily restricted to Hong Kong and Taiwan.

This excerpt is from a letter from Canadian Allis-Chalmers Limited, Lachine, Quebec, dated March 12, 1956:

> Your offer to represent our company in China has been noted with interest. Canadian Allis-Chalmers is a wholly owned subsidiary of Allis-Chalmers Manufacturing Company, Milwaukee, Wisconsin. All of our export negotiations are handled through Mr. P. Diatz, manager, export department, industries group, Allis-Chalmers Manufacturing Company, Milwaukee, Wisconsin.

The next letter is from United States Rubber, International, Rockefeller Centre, New York City, dated March 14, 1956:

> Your letter of March 6 to Dominion Rubber Company Limited, Montreal, has been referred to me. As Dominion Rubber Company is one of our subsidiaries, we handle any export business that might be developed through Canadian organizations.

Then there is a letter from Jones & Laughlin Steel Corporation, New York City, dated March 22, 1956:

> Your letter of March 13 addressed to our company in Toronto has been referred to this office for acknowledgment and reply, since all mattors pertaining to export are handled here.

I shall give just one more example, although I have plenty more. This letter is from Johns-Manville International, New York City, dated March 29, 1956:

> Your letter of March 6 addressed to Canadian Johns-Manville Company Limited has been referred to this division, since all overseas matters are our responsibility. We thauk you for your offering to assist us in sales in the Chinese market but regret that we cannot accept your kind offer,

House of Commons Debates, Speech of Mr. Harold Winch, June 25, 1959, V, pp. 5188-89.

the control of the export operations of Canadian subsidiaries was in the hands of the United States parent. Whether this is generally the case, and if it is, why it is, remain matters for speculations; legitimate business purposes may well be served by having a United States-based export operation.[39] One must suppose, though, that one of the factors entering into corporate decisions in this area is the applicability of the *Trading with the Enemy Act* and an unwillingness on the part of the corporation to arouse popular disapproval in Canada of corporate activity there. In some sense, the use of a United States export corporation is dictated by the United States Treasury interpretation of the act and regulations which imposes liability on the United States parent and, like the Treasury policy, the use of the United States export corporation is an exercise in the art of avoiding a confrontation with Canada on this issue.

It was in 1958, after the Canadian election, that the implications of the *Trading with the Enemy Act* first became a subject of political debate in Canada.

> The American corporation, the Ford Motor Company, refused to let its Canadian manufacturing subsidiary consider the sale of 1,000 vehicles to Communist China... because the *Foreign Assets Control Regulations* were ruled applicable to the transaction by the United States Treasury authorities.[40]

Canada trades freely with China, subject to the Consultative Committee COCOM list; in fact, in late 1957, a government sponsored trade mission to China had just returned.[41] Thus, one may conclude that it was a matter of Canadian government policy to encourage

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[39] A. E. Safarian's recently published study, *Foreign Ownership of Canadian Industry, supra,* footnote 35, offers some tentative conclusions. The study indicates that of 227 United States controlled firms, 32 export through their own organizations, 40 through parent organizations, 15 use both organizations, 4 have pooling arrangements in Canada, 75 have no export sales organization and 61 did not answer the question (p. 129). Safarian also suggests one sound reason for using the United States parent or a United States affiliate for export, the widened marketing contacts and knowledge, and the pooling of export resources. He concludes, somewhat optimistically:

> It does not appear that those exporting solely via the parent export organization show a worse performance than those exporting solely via the export sales organization of the Canadian subsidiary (p. 132).

Such a conclusion would appear to ignore both the corporations who have no export facilities available to their Canadian subsidiary and the 61 who did not reply, a group which amounts to more than 50% of his sample.

[40] *House of Commons Debates,* Speech of Mr. Hazen Argue, 23 May 1958, I, p. 403.

[41] *Ibid.,* Speech of Mr. Gordon Churchill, 6 December 1957, II, p. 1963; Speech of Mr. Gordon Churchill, 17 July 1958, III, p. 2324.

trade with China and despite this fact, a Canadian corporation was apparently prevented from accepting a substantial order because of laws and regulations of the United States. Canada was outraged, and the reverberations of the Ford incident have not ceased to echo in the halls of Parliament or, indeed, throughout Canada.

It is difficult to learn what actually happened in the Ford case, just as it was difficult to understand why no Foreign Assets Control problems had come to the attention of the Canadian government between 1950 and 1957. The problem in both instances is that the very nature of the regulations and the means by which they are applied against the United States parent results in techniques of avoiding the Canadian subsidiary's confrontations with the regulations and the American parent's maintaining silence. In any event, one of the problems in any historical attempt to deal with the *Foreign Assets Control Regulations*, as applied to exports of controlled Canadian corporations, is the great difficulty in discovering not only initial export opportunities, but also determining whether the regulations were the operative factor in any decision not to accept the order. Corporate behavior in the United States seems to be directed toward avoidance of the issue, even to the point of preventing the presentation of orders to Canadian subsidiaries. This approach may prevent many disputes, but it is inevitable that a policy of secrecy cannot be entirely successful, and in those instances, from the Ford situation onward, in which Parliament learned of a case in which an order had apparently been refused because of the Foreign Assets Controls, the reaction was strong. It is hardly surprising, for Canadians feel that the regulations amount to an invasion of Canadian sovereignty over the behavior of her own corporate creatures, and strong national feelings had already been aroused by the imposition of the *Sherman Act* on Canadian corporations.[42] A mitigating consideration may be found as regards the applicability of the *Sherman Act* in that, although there may be some challenge to Canadian sovereignty and jurisdiction, enforcement of the *Sherman Act* antitrust provisions may well be beneficial to Canadian and United States industrial development. In the Foreign Assets Control area, not only is there invasion of Canadian jurisdiction, but injury to Canadian economic interest in export trade as well. It is not hard, consequently, to see why Ford and subsequent cases have aroused so much Canadian discontent.

Despite the paucity of information about these cases and the possibility that the Chinese orders were rejected for *bona fide* business

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[42] See note 24, *supra*.

reasons or were merely inquiries intended to inflame relations between Canada and the United States, the fact remains that the act and regulations do exist and that they do pose a potential, if not an actual, threat to export potential of the United States controlled corporations. Although the dollar value of the trade actually prevented so far may be small, the magnitude of the Canadian reaction and concern is great — no doubt partly because the *Trading with the Enemy Act* became a focus for much discontent about all aspects of foreign ownership discontent based on economic and non-economic considerations alike. Canadians desire not only that foreign-owned Canadian corporations "act like Canadian corporations" in regard to marketing and export policies but also, despite the present apparent impossibility of fulfillment, that these corporations be owned and controlled by Canadian capital. Mere foreign control is frightening enough, but control linked with the implication of corporate policies which work against the economic interests of Canada is very serious.

The Ford Incident in Parliamentary Debate. One source of information about the Ford incident is Parliamentary debate on the matter. While these debates may not provide all the factual detail about the incident which one might desire, they provide important evidence of the depth of Canadian concern with the impact of the *Trading with the Enemy Act* on Canadian politics and the response of Parliament to this challenge to Canadian sovereignty.

On May 23, 1958, the following question was asked by Mr. Hazen Argue :

> Mr. Speaker, I wonder if I might direct a question to the Minister of Trade and Commerce. Can the minister say whether the inquiry which the government was to make into the United States law requiring Canadian subsidiaries of American companies to obtain a license to export automobiles has yet been made, and whether the shipment of a thousand automobiles by the Ford Motor Company has been prevented? Can the minister assure the house that in the future Canadian firms will need to comply only with Canadian law?[43]

The Minister replied that the matter was under study.

The following speech, delivered in Parliament by Mr. Harold Winch, suggests the general tenor of Canadian response.

> I believe that certain incidents of the past few days, and indeed, throughout the past year make it almost mandatory on the government to make its position clear with regard to Canadian control of our own policies and our own economy. To put the matter in blunt language, I think the government must now make it explicitly and implicitly clear that it is not going to be prone to deference to the United States. Deference to our powerful

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[43] *House of Commons Debates*, Speech of Mr. Argue, 23 May 1958, I, p. 403.

neighbour to the south must not give way to subservience either in the international field or with regard to our own economic policies.

I think it is important to our country that there be policy statements and, if required, legislation so it may be made clear to the people of Canada in particular and of the United States that Canada controls its own destiny, its own international and economic policies. It must be made clear to the people of Canada particularly that there is no longer going to be subservience to United States companies that may own or control subsidiary companies in Canada from the point of view of their directing whether or not we can produce and sell to other countries.

I refer, of course, in particular to the reported incident in which Canada was not permitted to sell automobiles to China because of a United States law. I say sir, that this is our country and no matter where companies are owned which are operating in our country, on our natural resources and on the wealth produced by our people, it must be made clear, by legislation if necessary, that we in Canada sell where we desire to sell.[44]

On June 24, 1958, in response to a further inquiry about the Ford case, Mr. Gordon Churchill, then Minister of Trade and Commerce said :

I cannot say that there is any direct proof that the order was placed or that it was cancelled by action of another government. There is a law in the United States supported by regulations which prohibit subsidiary companies trading with communist China, and that law and the regulations have apparently acted as a restraint to trade on the part of Canadian subsidiaries.

With regard to what can be done about it, we are looking into the matter very carefully and we hope by negotiation to have some relaxation of this restraint insofar as Canadian companies are concerned.[45]

It would be a mistake not to recognize the partisan note in the questions and debate concerning the Ford Motor incident; the Opposition, under Mr. Pearson, was quick to raise and discuss the issue and the Diefenbaker government was generally evasive, despite the strongly nationalist appeal which the Prime Minister had sounded on the hustings.

Legislative Response. One of the important things to note is the concern of Mr. Winch to find, if necessary, a legislative solution. Since the release of the Royal Commission "blue books", a variety of legislative solutions had been proposed to deal with aspects of the problem of foreign control and its effect on the behavior of the Canadian corporation. One of these would have required that, if the parent company were to be classified as a public company under the *Canada Corporations Act*,[45a] then the Canadian subsidiary, even if wholly owned, would be obliged to publish annual

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[44] *Ibid.*, Speech of Mr. Winch, 19 May 1958, I, p. 196.

[45] *Ibid.*, Mr. Churchill, 24 June 1958, II, p. 1559.

[45a] R.S.C. 1952, c. 53, as amended by 13-14 Eliz. II, S.C. 1964-65, c. 52.

financial reports open to public inspection.[46] (A private company, with less than fifty shareholders, was and is exempt under the *Canada Corporations Act* from such filing.)[46a] Subsequently, a Member presented a bill concerning directors' qualifications, which would have required that the majority of a company's directors be residents of Canada and that a majority of this majority be "outside" directors.[47] Another, later wrinkle was the 1963 proposal to raise the dividend withholding tax on corporations to 15%, and then to grant a 5% reduction for companies with at least 25% beneficial ownership by Canadians; this proposal was included in the law of 1963.[48] However, no legislative proposal intended to directly meet the challenge of the *Trading with the Enemy Act* has ever been introduced in the House; indeed, it is difficult to imagine what form such legislation would take for it is doubtful that corporations could be required to trade with China. A variety of legitimate business considerations can militate against such trade. The magnitude of the statutory drafting problem is attested to by the fact that, although a number of other legislative proposals have been made, and despite the fact that the *Trading with the Enemy Act* continues to operate and cause parliamentary concern, no legislation directed specifically to this problem has been introduced.

Some part of the difficulty in securing a legislative solution is based on the fact that the administration of the *Foreign Assets Control Regulations* has been limited to the United States side of the border; no Canadian company was required to file for a license-exception and no sanctions were visited against Canadian corporations. Application of the regulations to the parent was sufficient to induce subsidiary compliance. In the absence of a possible legislative solution, parliamentary pressure was brought to bear to secure discussions at the ministerial level with the United States to obtain relief from the regulations and their impact on Canadian corporations. There was no statement by the government in response to the inquiries posed in May of 1958 until the period of and the period subsequent to the visit of President Eisenhower to Ottawa in July, 1958. During that visit, the Ford case was one of the issues on the agenda for discussion between the Prime Minister and the President. The text of President Eisenhower's speech touched obliquely on the matter. He said, on July 9, 1958:

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[46] *Ibid.*, Speech of Mr. Broome, 10 February 1961, II, p. 1959.

[46a] This was so under the *Companies Act*, R.S.C. 1952, c. 53, s. 116(4) and remains so under s. 116(4) in the *Canada Corporations Act*, as amended by 13-14 Eliz. II, S.C. 1964-65, c. 52, s. 39.

[47] *House of Commons Debates*, Speech of Mr. Broome, 12 May 1961, V, p. 4744.

[48] Safarian, *op. cit.*, p. 26.

> Next, the flow of investment funds from the United States into Canada has led to expressions of concern on your part. These funds have been attracted to your country by the business opportunities Canada has offered. Though they may raise questions on specific cases respecting control of an industry by United States citizens, these industries are, of course, subject to Canadian law...[49]

The joint communiqué issued by the two chiefs-of-state contained the following assurance:

> The Canadian and United States governments have given consideration to situations where the export policies and laws of the two countries may not be in complete harmony. It has been agreed that in these cases there will be full consultation between the governments with a view to finding through appropriate procedures a satisfactory solution to concrete problems as they arise.[50]

On July 11, Prime Minister Diefenbaker made the following report to the House:

> I raised with the President the question that some Canadian subsidiaries of United States companies may have been prevented from accepting orders from communist China, or from people of that country, by the application of the United States *Foreign Assets Control Regulations*, even though acceptance of such orders would be permitted by the policy of the Canadian government. The President expressed the view that the United States regulations should not be applied in any way to the disadvantage of the Canadian economy. If cases arise in the future where refusal of orders by companies operating in Canada might have any effect on Canadian economic activity, the United States government would consider favorably exempting the parent company in the United States from the application of the *Foreign Assets Control Regulations* with respect to such orders.[51]

The result of all this was, apparently, that consultation on a case-by-case basis was agreed to. One member raised the practical problem of to whom a Canadian export agent should apply for a license before trying to obtain goods from United States controlled Canadian corporations for export to China. In making this inquiry on July 17, 1958, Mr. Broome also disclosed that attempts to make a sale of bleached sulphite pulp to China had been frustrated because of United States control of the industry in Canada. This appears to be the Rayonier case to which Mr. Brewster refers,[52] although the facts are somewhat differently stated in the *Debates*.

> I have been told that within the past few weeks agents have tried to buy quantities of bleached sulphite pulp for shipment to China but have not been successful. This commodity is produced only out of mills on the coast

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[49] *House of Commons Debates*, Mr. Pearson, 10 July 1958, II, p. 2089.

[50] Department of State Bulletin 39:209 (1958).

[51] *House of Commons Debates*, Speech of Mr. Diefenbaker, 11 July 1958, II, p. 2142.

[52] Brewster, *op. cit.*, p. 25.

> that are United States-owned. The question I have is this: To whom should the agent go if he wished to get clearance to make a deal with Rayonier or Crown Zellerbach subsidiaries or whatever company it might be, to get that trade moving?[53]

It appears that the Rayonier license was quickly granted by the United States after the Eisenhower visit; the sale was not, however, completed.[54] Among his other concerns, Mr. Broome was worried that Canadian corporations would have to apply directly to Washington for a license; he felt that it would be more appropriate to have the application made to the Canadian government which would then raise the issue with Washington. This is, in fact, what appears to have resulted. The subsidiary notifies the parent, who may file for a license; the subsidiary also notifies the Canadian government of the order and, when the Canadian government determines that the order is *bona fide*, and not a security threat, and that its rejection would be liable to be harmful to the Canadian economy, it then raises the issue in Washington.[55] The standard of economic impact on the Canadian economy is a deliberately vague one; any order would have some economic impact on the economy. Such a procedure is not necessarily calculated to solve the problem, although it may provide a solution for those cases which cannot be otherwise kept from public view. If the subsidiary does not desire to export, however, no issue would be raised in Washington or in Ottawa; those devices which United States parent corporations have employed to prevent the receipt of orders by controlled Canadian corporations still operate.

One of the difficulties which the Rayonier case presents is the role of the export agency corporation, engaged solely in trading with foreigners. These corporations accept orders for a wide variety of merchandise which they know can be obtained in Canada, and then secure the merchandise from Canadian manufacturers and ship it abroad. Although the institutional devices adopted by controlled corporations may, to some extent, frustrate these attempts to increase Canadian exports, these Canadian export corporations are more likely to complain about failure of controlled Canadian corporations to export than are the foreign purchasers who may send an occasional order or inquiry direct to a controlled Canadian corporation. These Canadian export corporations have a continuing Canadian interest in the maximization of exports from Canada, and they are

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[53] *House of Commons Debates*, Speech of Mr. Broome, 17 July 1958, III, p. 2336.

[54] *Ibid.*, Mr. Gordon Churchill, 30 July 1958, III, p. 2859; Brewster, *op. cit.*, p. 25.

[55] *New York Times*, July 12, 1958, 3:3.

generally intimately familiar with the policies and the devices employed by United States controlled corporations in Canada. However, it is interesting to note that in one other incident involving a Canadian export company, in 1963 and 1964, the Canadian government refused to involve itself in aid of the exporter when United States controlled Canadian corporations refused, for unspecified reasons, to sell automobile parts to the exporters.[56]

Thus, the only situations in which the Canadian government is clearly willing to involve itself are those in which the controlled corporation is prepared to make the sale; unless the United States parent is very careless, no orders will be accepted without some sort of consultation between parent and subsidiary. And since the parent must itself apply for the export license, it is difficult to see how a license could be issued unless the parent consented. As the Alcan case suggests, strong non-statutory pressures, whether from United States government, United States industrial consumers, or the United States public, make it unlikely that even substantial orders will be accepted. And so long as there is no effective mechanism of presenting each order to a Canadian corporation with maximum publicity in Canada, there will be no strong countervailing pressure to urge the acceptance of such orders.

Just as application of the *Foreign Assets Control Regulations* only on the United States side of the border avoids direct jurisdictional conflict with Canada, so this consultation procedure, linked with corporate practices and corporate secrecy, avoids confrontation of the issue in most cases while providing an official channel of last resort for those cases in which avoidance techniques have not been successful, and where there is some substantial desire on the part of the corporation involved to complete the sale.

The subsequent history of the act in Canada gives further evidence of the fact that the administrative solution proposed is directed primarily at avoiding, rather than solving, the problem, and there does not appear to have been a substantial increase in licensed transactions. The Parliamentary *Debates* for the remainder of 1958 contain additional inquiries about the statute or the administrative machinery; there is little of substantial importance. The Joint United States - Canadian Committee issued a statement in January of 1959 which indicated that a routine review of the

[56] *House of Commons Debates*, Mr. Mather, 17 June 1963, II, p. 1228.

administrative machinery was being made.[57] However, in the same month, Mr. Argue stated on the floor of the House that the possible sale of rubber belting by a Canadian subsidiary of B. F. Goodrich Corp. of Akron, Ohio had been prevented by the parent.[58] It was in the same statement that reference to the Alcan case made its appearance in the *Debates*. Another incident, involving Fairbanks-Morse, and the reconditioning for sale to China of used railway engines owned by the Canadian National Railway, also resulted in the grant of a license to the United States parent to permit the Canadian subsidiary to recondition the engines; this sale, like the Rayonier sale, was never consummated.[59] In view of the fact that the Canadian government owned the engines, there was a unique interest in obtaining the license in this case.

The problem continued. In 1961, Massey-Ferguson Ltd. refused to supply China with 400 tractors, and it was alleged that the Canadian corporation did not have sufficient manufacturing capabilities in Canada to complete the order.[60] There was also further mention of the Alcan incident in 1961 with special attention to the economic impact which this refusal to sell must have had in the recession year of 1958. Additional fuel was thrown on the fire in 1963 and 1964 by the refusal of United States controlled companies to supply Canadian export corporations with automobile parts for sale to China.[61] Coupled with this, in 1964, Canadian subsidiaries of United States heavy machinery manufacturers refused to permit the export of Canadian manufactured heavy machinery to a trade fair in Moscow; the *Trading with the Enemy Act* does not apply to the Soviet Union, and the corporations were apparently toeing the line prescribed for domestic United States corporations under the *Export Control Act.* In 1965, further inquiry into the inability of Canadian export corporations to secure automobile parts for export to China was made. Canadian exporters were unable to

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[57] "Some aspects of the relations between Canadian subsidiaries and their parent companies in the United States came under examination. The ministers reviewed the arrangements made last summer under which the United States undertook to consider licenses to parent companies in the United States on the case-by-case basis which would relieve them from the prohibition against transactions with communist China insofar as their Canadian subsidiaries were concerned." (State Department Bulletin 40:130 [1959]).

[58] *House of Commons Debates,* Speech of Mr. Argue, 30 January 1959, I, p. 544.

[59] Brewster, *op. cit.,* p. 25.

[60] *House of Commons Debates,* Hon. George Hees, 8 February 1961, II, p. 1852.

[61] *Ibid.,* Mr. Mather, 17 June 1963, II, p. 1228; Hon. Mitchell Sharp, 24 March 1964, II, p. 1398.

obtain the parts from two United States controlled Canadian corporations.[62] Appeals to the Canadian government by the exporter were fruitless, for, as we have indicated, the Canadian government refuses to intervene between suppliers, local dealers, and customers in their business arrangements.

Despite the adoption of the administrative and consultative machinery, both institutionally, as in the Joint Committee, and on an *ad hoc* basis vis-à-vis individual export cases, Canada does not consider the problem to be solved. Concern over United States control in general, and over exports in particular still remains. The letter and questionnaire sent out in March 1966 by the Minister of Trade and Commerce attest to this fact.[63] Speaking of the problem in the House on March 31, 1966, Mr. Douglas said:

> I hope the minister's letter, and the questionnaire he is sending out, will enable him to get information that will permit the government to formulate a policy, but I want to point out that the real nub of the question is contained in No. 3 of the guidelines, which says:
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> > Maximum development of market opportunities in other countries as well as in Canada.
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> ...I believe it will have to be made clear to the United States government that they had better get over the idea that the United States subsidiaries in this country are subject te United States legislation, particularly having regard to trading with the enemy legislation, which has been used in the past to exercise control over United States subsidiaries in this country, which control has often been exercised to the disadvantage of Canada.[64]

As the letter sent out by the Minister indicates, all of the problems arising from control are to be the subject of further study, and they are all matters of continuing concern. However, Mr. Douglas' remarks are particularly important because they narrow the focus to the *Trading with the Enemy Act* and its impact. They stand as proof that the current administrative and regulatory situation is not a solution from the Canadian point of view; this does not, of course, imply that, if the policy reasons which resulted in the adoption of the act and regulations in the first instance are still valid, that there is another, perhaps better, solution, in either the administrative, diplomatic, or legislative field.

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[62] *Ibid.*, Hon. Mitchell Sharp, 24 March 1964, II, p. 1398; Mr. T. C. Douglas, 22 March 1965, XII, p. 12630.

[63] The text of the letter appears *ibid.*, 1966, IV, pp. 3713-4.

[64] *Ibid.*, Mr. Douglas, 31 March 1966, IV, p. 3644.

IV

The Cuban Situation

One other area must be considered as a part of the general problem of United States *Trading with the Enemy Act* and its impact on Canadian industry, for it also reflects the difficulties which we have encountered in examining the *Foreign Assets Control Regulations* as they apply to Canadian business. On October 19, 1960,[65] the United States placed a complete trade embargo on exports of all but a few commodities to Cuba. The embargo action was taken under the *Export Control Act,* which, as we have seen, does not apply to foreign subsidiaries of United States corporations. One can speculate that among the considerations militating against the imposition of an embargo under the *Trading with the Enemy Act,* was the unwillingness of the United States government to further exacerbate the existing Canadian sensitivity in this area.

Canada had traded with Cuba prior to the United States embargo and continued to do so afterwards; the Prime Minister expressed Canada's trade policy toward Cuba: "It is, of course, not our purpose to exploit the situation arising from the United States embargo..."[66] Canada agreed not to permit transshipment of United States goods to Cuba on 16 December 1960.[67] The changes necessitated in Canadian export licensing to prevent transshipment were doubtless the result of inter-governmental negotiation; the fact that negotiation occurred permits an inference that the United States had considered the possibility of imposing the *Trading with the Enemy Act* restrictions, and had chosen to pursue this less restrictive alternative. In February 1962, very shortly after the announcement of the embargo, the Canadian-American Committee, a private group of business leaders from both sides of the border, released a report on *Canada's Trade with Cuba and Canadian American Relations.* This report indicated that, apart from prohibitions of transshipment of goods from the United States to Cuba via Canada, the area was not a source of problems. On February 6, 1962, however, the *Cuban Import Regulations,* issued under the *Trading with the Enemy Act* were promulgated in the Federal Register. Although these regulations were to be short-lived, and although they did not in any way affect the exports of controlled Canadian

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[65] State Department Bulletin 43:715 (1960).
[66] *House of Commons Debates,* Mr. Diefenbaker, 12 December 1960, I, p. 701.
[67] *Canada's Trade With Cuba and Canadian-American Relations,* p. 10.

corporations, they did indicate a further concern about Cuba in the United States. These regulations were superseded on July 9, 1963 by the *Cuban Assets Control Regulations* [68] which extended the United States economic sanctions against Cuba beyond the the United States border. These regulations provided a wholesale exemption for controlled corporations abroad provided they engaged in trade with Cuba in goods produced or manufactured outside the United States, did not use United States financing, and did not employ United States bottoms.[69] These regulations remain in effect at present.

Despite the fact that the Cuban embargo does not affect controlled Canadian corporations, and despite the fact that the United States has been careful in this instance to limit jurisdictional reach to its own territorial grasp, misapprehensions and difficulties have appeared.

A Presidential Proclamation issued in early 1962 [70] extended the scope of the Cuban embargo, this time utilizing the statutory framework of the *Foreign Assistance Act* of 1961.[71] The *New York Times* incorrectly reported that the Cuban embargo had been placed under the *Trading with the Enemy Act*; a retraction appeared on January 27, 1962.[72] Despite the fact that no regulatory attempt was made to interfere with Canadian trade with Cuba, United States parent corporations, reflecting domestic trade policy, have prevented

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[68] 31 CFR § 515.101 - .808.

[69] 31 CFR § 515, 541. This section specifically excludes from the application of the act and regulations only the controlled foreign corporation itself; it does not authorize any person subject to the jurisdiction of the United States other than the controlled foreign corporation itself to engage in or participate in or be involved in any transaction. It provides specifically that no person shall be deemed to be engaged in or participating in or involved in a transaction solely because of his financial interest in a foreign corporation. Despite the clear words and plain intent of the regulations, however, the Treasury department has sought, with considerable success, to prevent controlled foreign corporations from engaging in trade with Cuba by threat of prosecution of United States citizens who are directors or officers of controlled foreign corporations. Thus, what the Treasury regulations appear to give with one hand, the Treasury is attempting to withhold by brandishing in its other hand threats of prosecution against United States persons who are officers or directors of controlled foreign corporations. In view of the discussion in Part I of this article concerning liability of directors and officers under the act, it is submitted that this threat of prosecution could not generally result in conviction. That the threats are effective nonetheless is shown by the instances cited further on in this article.

[70] Presidential Proclamation #3447, 27 Fed. Reg. 1085.

[71] 75 Stat. 445, § 620 (a) as amended.

[72] *New York Times*, January 27, 1962, 3:7.

Canadian subsidiaries from engaging in that trade.[73] The most significant instance was the refusal of United States controlled Canadian milling companies to mill wheat purchased by the Soviet Union for transshipment to Cuba.[74] This occurrence in the summer of 1965 indicates again the complexity of the problem of corporate behavior of foreign owned corporations. Even without applicable United States regulation, some United States parent corporations are unwilling, as a matter of policy, to permit their subsidiaries to engage in activity which may be, in some way, contrary to United States policy.

Mr. Douglas, speaking in Parliament on March 31, 1966 analyzed the problem in the following manner:

> The real problem,... is that the decision-making power may be located outside Canada. That decision-making power may not be used in the interests of Canada but in the interests of some other country.[75]

At the conclusion of the tenth meeting of the Joint Canadian-United States Committee on the 5th of March 1966, Mr. Martin, then Minister of External Affairs, reported to the House:

> There was also a thorough and useful discussion of United States foreign assets controls which have on occasion created serious difficulty for Canadian companies trading with such countries as communist China and Cuba *(sic)*. As the communiqué states:
>
> > The United States members reaffirmed their readiness to consult promptly on any transactions of importance to Canada which are affected by the United States foreign assets control.[76]

It seems clear from an article which appeared in the *Montreal Star* on November 4, 1967, that there is a continuing misapprehension about the applicability of the *Trading with the Enemy Act* to trade by controlled Canadian corporations with Cuba.[77] This article

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[73] *House of Commons Debates,* Mr. André Bernier, 19 October 1962, I, p. 704. There is mention here of denial of an export license to a Canadian Corporation by the United States.

[74] *Ibid.*, Mr. Douglas, 31 March 1966, IV, p. 3644.

[75] *Ibid.*

[76] *Ibid.*, Mr. Paul Martin, 7 March 1966, III, p. 2259.

[77] *Montreal Star,* November 4, 1967, 7:1. That serious confusion exists about the applicability of the *Cuban Assets Control Regulations* to trade by controlled foreign corporations with Cuba can be seen from an article in the New York *Times* entitled "Belgium Resents U.S. Order Barring Sale to Cuba." A Belgian subsidiary of Sperry Rand was forced to rescind a $1.2 million dollar order for agricultural machinery from Cuba, allegedly because of failure to secure a license. Mention is also made in the article of possible criminal liability of United States directors of the Belgian company. (*New York Times,* February 7, 1968, 3:2).

indicated that a relatively small export transaction involving agricultural machinery parts by a controlled Canadian corporation with Cuba had been approved subsequent to high level ministerial negotiations between Canada and the United States. The article stated that such transactions were prohibited by the *Trading with the Enemy Act*. While it may be that the United States has not taken particular care to make known the fact that Cuba is not a designated foreign country under the *Foreign Assets Control Regulations* and that the *Cuban Assets Control Regulations* contain an exception for controlled foreign corporations, it is clear that there is no regulatory authority for preventing such export transactions subject to the narrow conditions imposed by the *Cuban Assets Control Regulations*.[78]

If Canadians are angered by the imposition of United States regulations upon Canadian corporations when those regulations prohibit trade activity permitted by the Canadian government, they experience both anger and frustration when United States owned companies adopt such positions without being legally obligated to do so, and when such actions have the apparent effect of deviating from profit maximization (at least in the Canadian sector) and thus result in an economic imposition on the Canadian economy. When United States governmental regulations are involved, it is possible to have recourse to inter-governmental negotiation in an effort to resolve the difficulty; when United States corporations act in a similar manner without being required to do so by United States law, the method of resolving the difficulty is less clear. One possibility might be to attempt a legislative solution. Yet, as we have seen, refusal to export is not well suited to remedy by statute. Given the refusal of the Canadian government to intervene between Canadian export corporations and United States controlled Canadian manufacturers of auto parts, it is difficult to believe that a necessarily more rigid and inflexible legislative solution to the problem is likely, or indeed within the realm of possibility. The Cuban situation is merely another indication of the complexity of the issue involved in United States control of Canadian corporations, and testamonial to the difficulty of achieving a solution.

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[78] See note 69, supra.

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Conclusion

Canadian concern over the application of the *Trading with the Enemy Act* and the *Foreign Assets Control Regulations* to Canadian corporations controlled by United States interests is only one aspect of the concern which Canadians feel about United States control. The economic situation of the fifties fostered that concern, and the Ford case, arising when it did, served to focus control anxieties narrowly on the *Trading with the Enemy Act*; yet it is important to realize that some part of the Canadian concern and anxiety about the act is not directly attributable to the legislation, but to other, wider problems of foreign control.

The control issue is central to the problem of the behavior and decision-making process of controlled Canadian corporations. There are two separate factors which can result in different behavior patterns for United States controlled Canadian corporations. One is the fact of parental corporate control and the resulting corporate decisions made in terms of the entire corporate organization in such areas as pricing, personnel, research, charitable contributions, purchases of supplies, and marketing in Canada and elsewhere. Insofar as corporate policy in these areas runs counter to the interests of the Canadian economy, and insofar as a Canadian owned corporation could be expected to behave differently, a problem exists, but only on the corporate and economic plane. The other fact is the imposition of government regulations by the government under which the parent corporation is incorporated on the operations of the controlled subsidiary. The *Trading with the Enemy Act* and the regulations do effect a restriction on the activity of a United States controlled Canadian corporation; the sphere of regulation is small — it concerns only exports to China, North Korea, North Viet Nam, and Cuba. Yet the legislation clearly operates in a manner adverse to Canadian economic interest; thus the fact of economic impact is heightened by the fact of an assertion of limited jurisdiction over a Canadian corporation.

In applying the regulations, the United States has sought to avoid the appearance of an invasion of Canadian jurisdictional sovereignty, inducing Canadian compliance by pressure on United States parents.

However successful this technique is as a formal device, and as a means of minimizing Canadian awareness and concern, it necessarily results in a blurring of the distinction between business policy effects on the controlled Canadian corporation and those effects which can be characterized as governmental. The undoubted wisdom of the United States technique brings with it the risk that when Canadian attention focuses on the *Trading with the Enemy Act,* the response will be one quite disproportionate to the amount of injury caused by that act and measured in either terms of sovereignty or of dollars and cents; the form of enforcement through the corporate parent encourages a fusion of Canadian dissatisfaction resulting from the *Trading with the Enemy Act* with that from all other areas of the control problem.

The very complexity and uncertainty about the wider variety of problems which foreign control poses help to make the *Foreign Assets Control* area a *cause célèbre* around which Canadians can rally their concern about United States control; it is also an area where immediate and inherently inflexible legislative solutions do not appear to be available in Canada. Through negotiation and discussion, it may be hoped that the problem in this area may be eased; the administrative machinery and the Joint Committee cannot completely resolve the conflict inherent in the application of the *Trading with the Enemy Act,* but they serve as an escape valve for pressure in this area.

For the United States, the question of the validity of the policy considerations behind the *Trading with the Enemy Act,* especially as it applies to trade with China, must remain in doubt. It can further be questioned, even if the policy considerations behind the act are sufficiently important to justify continuation of the act, whether the act might not be restricted in application and impact to the territorial limits of United States jurisdiction, as has been done under the *Export Control Act.*

Of additional concern to the United States is the fact that this act is one of many which allows the President and his delegates to exercise vast powers — powers usually exercised by Congress, albeit in time of war or national emergency as declared by the President. The act is part of a real evolution of the power equation between the executive and legislative branches of the United States government, which is placing the power to make vitally important decisions about national policy in the hands of the Chief Executive. Such an evolution is resulting in a situation factually similar to the power of the Prime Minister and Cabinet, and the promulgated regulations under the act can be likened to Orders in Council.

For Canada, it seems clear that the *Trading with the Enemy Act* is a convenient hook on which to hang discontent about a wider variety of problems arising as a result of United States control of Canadian business. The act is a challenge to Canadian sovereignty over Canadian corporations, and it does have adverse economic impact in Canada. It seems unlikely that the scope and constitutionality of the act will be tested in United States courts; the Treasury clearly prefers to avoid judicial test of the regulations. Canada's best hope for improvement in this area is a continued effort on the part of Canadian economists, business men, and politicians to discover incidents in which the act has had an adverse impact on Canada, or incidents in which, if a controlled Canadian corporation were free to accept export orders, it might have done so, although the United States parent requires that all export orders pass through its offices. It was, after all, in large measure the pressure of Canadian discontent with caused the United States to retrench in imposing its embargo on Cuba. It seems likely that the best solution to this problem is continued pressure, political and diplomatic, to secure withdrawal of the regulations as they apply to the controlled foreign corporation's export business. To remove the offending regulations would not, perhaps, correct matters completely, for we have seen that in instances involving Cuba and even the Soviet Union, United States parent companies, in what must appear an *embarras de zèle*, have prohibited their controlled Canadian subsidiaries from engaging in transactions which are legel under United States and Canadian law; this solution would not meet the problems of informal pressure for "voluntary" compliance exerted by the Treasury against United States parent companies. But it would remove an offensive piece of legislation from the United States Code and should lead in time to a broadening of Canadian export trade with designated foreign countries.