The Trading With the Enemy Act: The Impact of the Amended Foreigu Assets Control Regulations On Canadian Corporations Owned by Americans

James I. W. Corcoran *

In 1968, in these pages,[1] there appeared a lengthy study of the impact of the *Trading With the Enemy Act*[2] and the *Foreign Assets Control Regulations*[3] promulgated thereunder. The scope of the study was, broadly described, an examination of the limitations imposed by the United States with respect to the right of foreign business organizations to engage in the export trade with the People's Republic of China, North Korea, and North Viet Nam.[4] At that time, the United States purported to interdict all trade with these nations by such foreign business organizations if they were "owned or controlled"[5] by "persons subject to the jurisdiction of the United

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

[1] Corcoran, *The Trading With the Enemy Act and the Controlled Canadian Corporation*, (1968), 14 McGill L. J. 174.

[2] 50 U.S.C. app. § § 1-39, 41-44(1964).

[3] 31 C.F.R. § § 500.001-.809(1969), *as amended* 31 C.F.R. § § 500.001-.809(1970).

[4] The regulations, in their pre-amendment and post-amendment forms, prohibit all trade with "designated foreign countries" or nationals thereof. (31 C.F.R. § 500.201(a)(1970)). The "designated foreign countries" and the dates of their designation as such are: (1) China: December 17, 1950; (2) North Korea, *i.e.*, Korea north of the 38th parallel of north latitude: December 17, 1950; (3) North Viet Nam, *i.e.*, Viet Nam north of the 17th parallel of north latitude: May 5, 1964.

[5] Substantial uncertainty exists with respect to the definition of the terms "owned or controlled". (See Corcoran, *op. cit.*, n. 1, at p. 179). While these terms clearly cover the 100% owned foreign subsidiary of a United States corporation, they may also include foreign corporations of which less than 50% of the voting shares are owned by United States persons but which are in fact controlled by such persons. The United States Treasury is reported to have taken the view that less than 50% ownership may constitute sufficient control for purposes of the regulations where 40% of the shares of a foreign corporation are owned by a United States corporation and the remaining shares are widely held by foreigners. (Flynn, *Trading With Communists: Use of Foreign Trade for Policy Objectives*, (1963), 41 A.B.A.J. 1092, at p. 1094, n. 24). Also included in the definition of "owned or controlled" may be such foreign corporations as Alcan Aluminum Ltd., more than 50% of the shares of which are widely held by citizens and residents of the United States.

For purposes of convenience, the term "controlled foreign (Canadian) corporation" will be used in this article as a shorthand for business entities

States".[6] Although the impact of the act and regulations extends far beyond Canada, the scope of our study was more narrowly focused on the Canadian scene and upon Canadian business organizations. Because of the substantial number of Canadian business organizations which were subject to the *Act* and regulations by virtue of United States ownership or control, it is probable that no other nation has felt the impact of the *Act* and regulations on its sovereignty and economic well-being to the same extent as Canada.

The *Trading With the Enemy Act* and the regulations thereunder unilaterally impose a total embargo on trade with China by "persons subject to the jurisdiction of the United States" which far surpasses the multi-lateral restraints on trade with communist bloc countries in strategic goods imposed by the Consultative Committee (COCOM).[7] Canada trades freely with China subject to the COCOM list. The United States embargoes all trade with China. Domestically, in the United States, the embargo is now imposed under the recently enacted *Export Administration Act of 1969*.[8] The embargo

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incorporated or organized under the laws of a jurisdiction other than the United States and "owned or controlled" by "persons subject to the jurisdiction of the United States" (n. 6 below). It should be bourne in mind that foreign partnerships, associations, trusts, and other foreign business entities are likewise subject to the act and regulations and are subsumed in our definition of "controlled foreign corporations."

[6] The *Foreign Assets Control Regulations* in the pre-amendment and post-amendment forms prohibit transactions by "persons subject to the jurisdiction of the United States" with "designated foreign countries" (n. 4 *supra*) or nationals thereof. "Persons subject to the jurisdiction of the United States" include:

(1) Any person, wherever 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 subparagraph (1), (2), or (3) of this paragraph. (31 C.F.R. § 500.329(1970)).

[7] The Consultative Committee includes all members of NATO except Iceland and, in addition, Japan.

[8] The *Export Administration Act of 1969*, 50 U.S.C. app. § 2401 - 2413, took effect upon the expiration of the *Export Control Act of 1949*, 50 U.S.C. app. § 2021 - 2032, which expired on December 31, 1969. An indication of the liberalized nature of the 1969 legislation can be inferred from the shift from the word "control" in the title of the 1949 act to the word "administration" in the title of the 1969 act.

is imposed on foreign business organizations owned or controlled by United States persons under the *Trading With the Enemy Act* and the *Foreign Assets Control Regulations* issued thereunder. One cannot quarrel with the jurisdictional right of the United States to impose further restrictions on its own nationals and domestic corporations beyond those authorized by COCOM; this right is based on the clearly accepted principle of territoriality, a principle which is subject to an exception generally recognized in international law to permit a country to exercise extraterritorial jurisdiction over its own nationals, whether they be individuals or legal entities organized under its laws.

It is, however, dubious that the United States should, as a matter of international law, or as a matter of policy, attempt to regulate the export policies of business entities organized under the laws of foreign countries and having no permanent establishment or other substantial contact with the United States apart from the fact that shareholder control resides in United States nationals or residents. Corporations or other business entities organized under the laws of a foreign country are not, as a matter of United States law, generally considered to be nationals or residents of the United States.[9] Yet it seems clear that the assertion of jurisdiction over controlled foreign corporations in the *Act* and regulations is based upon the assertion that determination of country of incorporation or organization of a business entity does not finally determine the nationality of such an entity, so that a business entity organized under the laws of a foreign country may be deemed to be a national of the United States merely because United States nationals own or control the business entity.

The fact that the United States and Canada are both members of the Consultative Committee which established the multi-national COCOM limitations on trade with communist bloc nations leads to the unfortunate inference that, when the United States is unable to achieve its international policy objectives on the basis of multilateral negotiation, it will resort to unilateral measures with dubious basis in generally recognized principles of international law to achieve those objectives.

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[9] Compare with Craig, *Application of the Trading With the Enemy Act to Controlled Foreign Corporations Owned by Americans*: *Reflections on Freuhauf* v. *Massardy*, (1970), 83 Harv. L. Rev. 579, at pp. 586 *et seq.*, which contains a thorough analysis of the legal basis in United States and international law for the assertion of extraterritorial jurisdiction on the basis of ownership or control of a foreign business entity.

In Canada, the offense to sovereignity inherent in the assertion of extraterritorial control under the *Act* and regulations has been heightened by the significant impact which the *Act* and regnlations have apparently had on the Canadian economy for more than two decades. Our 1968 study set forth in some detail a number of cases in which the *Act* resulted in the frustration of substantial export transactions to China by Canadian corporations.[10] We shall now examine the 1969 amendments to the *Foreign Assets Control Regulations* to determine their probable impact on exports by controlled Canadian corporations to China.

The Amended Foreign Assets Control Regulations

Regardless of the actual economic impact of the *Act* and regulations, which defies quantification, and regardless of the theoretical justification in international law for the assertion of extraterritorial jurisdiction in the *Act*, the promulgation by the Director of the Office of Foreign Assets Control of a series of amendments to the *Foreign Assets Control Regulations* on December 24, 1969 [11] was properly heralded as a significant and desirable change in United States policy.[12] Following quickly on the heels of the new regulations, President Nixon signed into law the *Export Administration Act of 1969* a few days later.[13] The *Export Administration Act* evidences a reversal in the policy considerations underlying control of exports to communist bloc nations.[14] It is generally conceded that both the amendments to the *Foreign Assets*

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[10] Corcoran, *op. cit.*, n. 1, at pp. 189 *et seq.*

[11] 34 Fed. Reg. 20189 *et seq.* (1969).

[12] *E.g.*, New York Times, 2 January 1970, at p. 40, col. 3.

[13] December 30, 1969.

[14] The findings, set forth in section 2 of the *Act*, read as follows: "The Congress makes the following findings:

(1) The availability of certain materials at home and abroad varies so that the quantity and composition of United States exports and their distribution among importing countries may affect the welfare of the domestic economy and may have an important bearing upon fulfillment of the foreign policy of the United States.

(2) The unrestricted export of materials, information, and technology without regards to whether they make a significant contribution to the military potential of any other nation or nations may adversely affect the national security of the United States.

(3) The unwarranted restriction of exports from the United States has a serious adverse effect on our balance of payments.

(4) The uncertainty of policy toward certain categories of exports has curtailed the efforts of American business in those categories to the detriment of the overall attempt to improve the trade balance of the United States."

Control Regulations and the *Export Control Act of 1969* are part of a concerted effort by the United States government to ameliorate the political and diplomatic climate between the United States and the People's Republic of China.[15] It is, perhaps, ironic justice, that Canada, whose long standing efforts to establish normal diplomatic relations with China have recently been crowned with success,[16] should become an incidental beneficiary of a shift in United States policy aimed at achieving better relations with China.

The amended *Foreign Assets Control Regulations* were heralded in the press as a *carte blanche* for controlled foreign corporations to trade with China, subject to the COCOM list and other applicable foreign restraints, if any.[17]. An examination of the amendments reveals that the emendations are neither so sweeping nor so precise as suggested in the press. Nonetheless, they represent, on their face, a substantial reversal of previous policy, and contingent upon further clarification and interpretation, may result in the development of significant export trade with China in non-strategic items by controlled foreign corporations.

The Structure of the Amendments

The amendments do not substantially alter any of the existing regulatory language. Instead, a new section covering certain transactions by persons in foreign countries is added to the existing regulatory framework.[18] One significant fact about this method of amendment is that it does not alter the claim by the United States to extraterritorial jurisdiction over controlled foreign corporations, but instead licenses certain transactions with China; although this difficulty may be theoretical, in view of the fact that the United States apparently has not yet attempted to exercise the claimed extraterritorial jurisdiction directly over controlled foreign corporations, preferring to act against United States shareholders, it does indicate that the amendment reflects an adjustment deemed expedient for political or diplomatic reasons and not a retreat from the philosophy of extraterritorial jurisdiction which has always

[15] New York Times, 11 January 1970, at § 4, p. 6, col. 7.

[16] Canada reached an accord with the People's Republic of China on October 10, 1970 with respect to the opening of diplomatic relations; the accord was announced on October 13, 1970. (New York Times, 25 October 1970, at p. 29, col. 1).

[17] *E.g.*, New York Times, 19 April 1970, at § 3, p. 1, col. 1.

[18] 31 C.F.R. § 500.541(1970).

been a troublesome aspect of the regulations. New section 500.541 reads as follows:

> §500.541 *Certain transactions by persons in foreign countries.*
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> (a) Except as provided in paragraphs (b), (c), (d), (e) and (f) of this section, all transactions incident to the conduct of business activities abroad engaged in by any individual ordinarily resident in a foreign country in the authorized trade territory, or by any partnership, association, corporation or other organization which is organized and doing business under the laws of any foreign country in the authorized trade territory, are hereby authorized.
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> (b) This section does not authorize any transaction involving U. S. dollar accounts or any other property subject to the jurisdiction of the United States.
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> (c) This section does not authorize any transaction involving the purchase or sale or other transfer of:
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> (1) Any merchandise of U. S. origin, except as authorized by § 500.533;
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> (2) Any merchandise regardless of origin of a type included in the Commodity Control List of the U. S. Department of Commerce set forth in 15 CFR Part 399 and followed on that list by the letter "A" in the column headed "Special Provisions List" or of a type the unauthorized exportation of which from the United States is prohibited by any of the several regnlations referred to in 15 CFR 370.10; or
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> (3) Any technical data, as that term is defined in § 500.543, except to the extent authorized by that section.
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> (d) This section does not authorize the transportation aboard any vessel which is owned or controlled by any person described in paragraph (a) of this section of any merchandise directly to or from mainland China except when export of such merchandise is authorized by § 500.533.
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> (e) This section does not authorize the supply of petroleum products to any vessel.
>
> (f) This section does not authorize any transaction involving North Korea or North Viet Nam or their nationals, or merchandise the country of origin of which is North Korea or North Viet Nam.

This new section, with the exceptions contained therein, broadly describes the scope of transactions in which controlled foreign corporations can now engage with China.

The other amendments which may have direct impact on controlled foreign corporations are section 500.538,[19] dealing with transportation and insurance of certain merchandise, and section 500.543 [20] governing technical data. Additional amendments in sections 500.544 [21] and 500.545 [22] have been added to permit persons

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[19] 31 C.F.R. § 500.538(1970).
[20] 31 C.F.R. § 500.543(1970).
[21] 31 C.F.R. § 500.544(1970).
[22] 31 C.F.R. § 500.545(1970).

bearing United States passports to make necessary expenditures incident to travel in China and to authorize United States persons to acquire for personal and household use or gift, personal and household goods of Chinese origin; a specific provision that organizations exempt from United States income tax pursuant to section 503(c)(3) of the *Internal Revenue Code* of 1954, as amended, may acquire Chinese merchandise for their own use was clearly designed to permit the acquisition of Chinese *objet d'art*, printed materials and the like, by museums, eductional institutions and similar non-profit organizations in the United States.

The amended regulations specifically maintain the general embargo on all transactions with North Korea and North Viet Nam,[23] a fact consistent with the apparent policy decision underlying the amended regulations and the *Export Administration Act of 1969* to expand economic contacts with China.

A paragraph by paragraph examination of the core section of the amendments, section 500.541, yields some interesting results. The class of persons authorized to engage in "transactions incident to the conduct of business activities abroad" in section 500.541(a) includes not only any partnership, association, corporation or other organization organized and doing business under the laws of any foreign country in the authorized trade territory,[24] but also any individual ordinarily resident in a foreign country in the authorized trade territory.[25] The class of persons authorized under this paragraph is broader than the class of persons which the regnlations purport to regulate, since it extends to all individuals ordinarily resident in a foreign country in the authorized trade territory (and not merely United States citizens) and to all foreign corporations, partnerships, associations, or business organizations organized and doing business under the laws of a foreign country in the authorized trade territory, without regard to control or ownership thereof

[23] 31 C.F.R. § 500.541(f)(1970).

[24] The "authorized trade territory" is virtually global in scope; notable exclusions are Cuba, the Soviet Union, China, the socialist republics of eastern Europe (except Yugoslavia), North Korea and North Viet Nam. (31 C.F.R. § 500.322(1970)).

[25] This broad licence does not, however, extend to individuals (whether or not they are United States citizens) who are ordinarily resident in the United States; such individuals may be officers or directors of controlled foreign corporations, and may be liable to prosecution under the act. This problem is explored in greater detail in the section of this article which compares the amended *Foreign Assets Control Regulations* with the *Cuban Assets Control Regulations.*

by United States persons. We see in this authorizing language an assertion of extraterritorial jurisdiction even broader than that previously contained in the regulations. It should be noted that the regulations (in both their amended and unamended forms) purported to regulate only "persons subject to the jurisdiction of the United States".[26] In view of this fact, the language in this paragraph of section 500.541 seems, at very least, a curious approach to draftsmanship.

Section 500.541(b) specifically provides that the transactions authorized in section 500.541(a) may not be made in U.S. dollars, U.S. dollar accounts, or in other "property subject to the jurisdiction of the United States".[27] These limitations should not impose any substantial burden upon the development of trade with China.

Section 500.541(c) excludes from the authorization two important categories of goods: (1) any merchandise of U.S. origin, except as authorized in section 500.533,[28] and (2) merchandise regardless of origin of a type included on the Commodity Control List of the United States Department of Commerce set forth in 15 C.F.R. Part 399 and followed by the letter "A", or merchandise described in 15 C.F.R. 370.10.[29] The exclusion of items on the Commodity Control List should not raise significant difficulties or substantially limit the development of trade with China. The categories of merchandise included on the Commodity Control List and followed by an "A" thereon closely conforms to the COCOM list[30] to which Canada adheres. The items described in 15 C.F.R. 370.10 include arms, ammunitions, impliments of war (all generally included on the COCOM list), gold, coins containing silver, narcotics, commodities subject to the *Atomic Energy Act* (likewise apparently included on the COCOM list), watercraft, natural gas and electricity, and tobacco seeds and plants.

However, serious difficulty arises with respect to the exclusion of "merchandise of U.S. origin". The Office of Foreign Assets Control has not, as yet, further clarified the interpretation of this language. In its present form, it could result in the interdiction

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[26] See n. 6, *supra.*

[27] 31 C.F.R. § 500.313(1970).

[28] Merchandise of U.S. origin may be licensed for export to China in the discretion of the Department of Commerce under the *Export Administration Act of 1969.* (31 C.F.R. § 500.533 (1970)).

[29] 15 C.F.R. § 370.10(1970).

[30] Berman and Garson, *United States Export Controls — Past, Present, and Future,* (1967), 67 Colum. L. Rev. 791, at p. 839.

of trade in merchandise manufactured by a controlled foreign corporation of which a raw material or minor component part originated in the United States, even if the cost of the raw material or component of U.S. origin was only an insignificant portion of the cost of the finished merchandise. Thus, for example, the use of chemicals manufactured in the United States by a controlled Canadian corporation in the production of newsprint from wood pulp could result in the interdiction of newsprint exports by such a controlled Canadian corporation to China. A more serious problem arises with respect to motor vehicles produced in Canada by controlled foreign corporations pursuant to the terms of the *United States-Canadian Automotive Products Agreement of 1965*,[31] despite the fact that one of the earliest and most celebrated cases of application of the *Act* and regulations to a controlled foreign corporation in Canada was the refusal to permit sales of 1,000 motor vehicles to China.

Substantially all of the motor vehicles manufactured in Canada are manufactured by Canadian corporations owned or controlled by United States persons; it seems likely, as a result of the *United States-Canadian Automotive Products Agreement of 1965*, that every motor vehicle manufactured in Canada by these corporations contains at least some parts manufactured in the United States.[32]

In view of the fact that the regnlations contain approximately ten pages of material defining material of Chinese, North Korean, and North Viet Namese origin,[33] the purchase, transport, importation or other dealing which is prohibited, the laconic character of section 500.541(c)(1) seems to have been deliberate; in the light of section 500.204, the Office of Foreign Assets Control cannot plausibly argue that they were unaware of the definitional problem in section 500.541, or that they were not able to provide reasonably precise clarification of their intent. Section 500.204 includes exhaustive, detailed lists of merchandise and goods, requires certificates of origin for certain kinds of merchandise, and specifically includes lists of raw materials of Chinese origin notwithstanding the fact that such materials may have been substantially transformed or processed in a country other than China, North Korea, or North Viet Nam. Since the export from a United States parent company to its foreign subsidiary of components or manufacturing

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[31] [1965] 17 U.S.T. 1372, T.I.A.S. No. 6093.

[32] See New York Times, 2 January 1970, at p. 42, col. 1. We do not counsel reliance on the *de minimis* principle.

[33] 31 C.F.R. § 500.204(1970).

supplies is a common aspect of the manufacturing operations of controlled foreign corporations, the failure to provide some further definitional guidelines is a serious deficiency. Without further clarification of the scope of the term "merchandise of U.S. origin" the practical significance of the amendments to the regulations may be virtually nil, especially with respect to controlled foreign corporations in Canada. At present, the only means whereby a product containing any "merchandise of U.S. origin" can be shipped to China is pursuant to a validated license issued by the United States Department of Commerce. The inhibitory effect on trade of such case-by-case licensing is substantial.

In the search for a workable solution, one relevant analogy in United States law can be found in sub-part F of the *Internal Revenue Code of 1954*, as amended. The regulations under Section 954 of the *Code* set out two alternative tests for determining when raw materials or components shall be deemed to have lost their character as such and be deemed to be merchandise manufactured by the foreign corporation.[34] These tests are: (1) a 20% of value test which provides that when at least 20% of the value of the fully manufactured end product resnlts from foreign manufacture or processing, the goods will be deemed to have been manufactured abroad; and (2) a "substantial transformation test" which provides that when the nature or character of the raw material or component is substantially altered, the merchandise so altered will be deemed to have been manufactured abroad. Examples of "substantial transformation" in the regulations include:

> Controlled foreign corporation B, incorporated under the laws of foreign country X, purchases steel rods from a related person which produces the steel in foreign country Y. Corporation B operates a machining plant in country X in which it utilizes the purchased steel rods to make screws and bolts. The transformation of steel rods to screws and bolts constitutes the manufacture of production of property for purposes of this subparagraph.[35]
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> Controlled foreign corporation C, incorporated under the laws of foreign country X, purchases tuna fish from unrelated persons who own fishing boats which catch such fish on the high seas. Corporation C receives such fish in country X in the condition in which taken from the fishing boats and in such country processes, cans, and sells the fish to related person D, incorporated under the laws of foreign country Y, for consumption in foreign country Z. The transformation of such fish into

[34] Treas. Reg. § 1.954-3(a)(4)(1970).

[35] Treas. Reg. § 1.954-3(a)(4)(ii) Ex. 2 (1970).

canned fish constitutes the manufacture or production of property for purposes of this subparagraph.[36]

Although it is conceded that the policy considerations underlying sub-part F and those underlying the *Trading With the Enemy Act* may differ substantially, and that this divergence in policy goals may support a different test or tests for purposes of clarifying the term "merchandise of U.S. origin", the need for adequate definition of this term remains clear. A failure to relieve the patent uncertainty will effectively emasculate the amended regulations in many cases. A failure to clarify by providing a reasonable and practical test will go far to undermine the credibility of the United States and the economic impact of its asserted change in policy. (It is, of course, assumed that the embargo would remain on all COCOM list items.)

Although the amendment restricts exports to China by controlled foreign corporations to merchandise not of United States origin and not on the COCOM list, controlled foreign corporations may export any other merchandise to China. Further, no restrictions of any kind apply to purchases of merchandise of Chinese origin by controlled foreign corporations. United States persons are still under a total embargo with respect to such exports or purchases. This is, perhaps, the most important aspect of the amended regulations.

Section 500.541 also excludes transactions involving "technical data" as that term is defined in amended section 500.541, unless specifically authorized in amended section 500.543. The term "technical data" is defined in section 500.543(a) by reference to the definition in the regulations under the *Export Administration Act of 1969*. "Technical data" is defined as follows:

(a) As used in this section and in § 500.541, the term "technical data" means technical data as defined in § 379.1 of Part 379 of the Export Control Regulations of the Department of Commerce (15 C.F.R. Part 379).[37]

Section 379.1 of Part 379 of the Export Control Regulations of the Department of Commerce defines "technical.data" as follows:

(a) *Technical data.* 'Technical data' means information of any kind that can be used, or adapted for use, in the design, production, manufacture, utilization, or reconstruction of articles or materials. The data may take a tangible form, such as a model, prototype, blueprint, or an operating manual; or they may take an intangible form such as technical service.[38]

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[36] Treas. Reg. § 1.954-3(a)(4)(ii) Ex. 3 (1970).
[37] 31 C.F.R. § 500.543(a) (1970).
[38] 15 C.F.R. § 379.1(1970).

For purposes of section 500.543, technical data is divided into two classes, "technical data of U.S. origin", and "technical data not of U.S. origin". Technical data of United States origin may be exported to China by a controlled foreign corporation only if the exportation is authorized under a general or validated license from the U.S. Department of Commerce.[39]

Technical data of non-United States origin may be exported to China by controlled foreign corporations under any one of the following circumstances:

1. similar technical data of U. S. origin is authorized to be exported to any destination (data generally available to the public); or
2. technical data in the form of manuals, instruction sheets, or blueprints, provided:
   a. they are sent pursuant to a transaction involving a commodity licensed under section 500.541; and
   b. they are sent no later than one year after the shipment of the commodity to which related; and
   c. they are of a kind ordinarily delivered with the commodity under usual business circumstances; and
   d. they are necessary to the installation, maintenance, or repair of the commodity; and
   e. they are not related to the construction, production or manufacture of the commodity;

or, if such data is supplied in support of a prospective or actual quotation, bid or offer to sell, lease, or otherwise supply a commodity licensed under section 500.541, provided:

   a. that such technical data is customarily provided in connection with such quotation, bid, offer, etc.; and
   b. that the exportation of such data will not disclose the detailed design, production, manufacture, or means of reconstruction of either the quoted commodity or its product.[40]

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[39] A general license is one granted with respect to a class of goods and/or transactions pursuant to published regulations; a validated license is issued to an exporter to authorize the export of a particular commodity shipment to a particular consignee in a particular country for a particular use.

[40] 31 C.F.R. § 500.543(c)(1970). A news item highlights the scope and complexity of this section of the regulations. Xerox, the United States company, announced recently that it was actively exploring the possibility of sales to China through Rank Xerox Limited. (New York Times, May 21, 1971, p. 53, col. 2.) Rank Xerox Limited, organized under the laws of the United Kingdom, is an incorporated joint venture between Xerox and the Rank Organization. Xerox holds a majority of the voting shares and thus Rank Xerox is a controlled foreign corporation for purposes of the *Foreign Assets Control Regulations*. Much of Xerox' interest in Rank Xerox was acquired in exchange for patents, patent applications, and know how owned by Xerox. In connection with the proposed sales of merchandise to China, not only must such mer-

Although the regulations governing the exportation of technical data of non-United States origin conform rather closely to prudent business practice, it may be argued that the imposition of any limitations on controlled foreign corporations with respect to technical data of non-United States origin is an unwarranted interference with the economic freedom of foreign business entities; since their competitors not owned or controlled by United States persons engage in exportation to China of technical data of non-United States origin free of any limitation in United States law, it is not clear what policy objective is achieved. It seems certain that these regulations will not prevent the Chinese from obtaining technical data of non-United States origin. It may place controlled foreign corporations at a disadvantage in developing Chinese exports.

Amended section 500.538 [41] provides some limited authorization for transportation and insurance by controlled foreign corporations of merchandise going to or from China. No authorization is given for transport of merchandise *directly* to or from mainland China; however, transport or insurance of merchandise in transit *indirectly* to or from China is permitted, excluding, however, transport or insurance of merchandise of U.S. origin or items on the Commodity Control List (followed by an "A" thereon) and items in 15 C.F.R. 370.10. The prior version of section 500.538 [42] specifically embargoed shipments to Hong Kong and Macao in certain cases; it appears that amended section 500.538 permits shipment and insurance of shipments by a controlled foreign corporation to or from China via Hong Kong or Macao of licensed merchandise. Transportation or insurance of merchandise *en route* directly or indirectly to or form North Korea and North Viet Nam by controlled foreign corporations are specifically prohibited in the amended regulations.

chandise not be or contain merchandise of United States origin, but also, the inevitable transfer of technical data which must accompany such sale must conform to the provisions of section 500.543 as it applies to technical data of United States origin. This means, of course, that the export of such data to China from Rank Xerox must be approved by the United States Department of Commerce under 15 C.F.R. Part 379. As of this writing, it does not appear that any general license exists for this purpose; perhaps Xerox has or will obtain a validated license for the technical data involved in the proposed transaction.

41 31 C.F.R. § 500.538(1970).

42 31 C.F.R. § 500.538(1969).

Cuban Assets Control Regulations and the Amended Regulations: A Brief Comparison

In our earlier study, note was made of the fact that the United States, unable to secure any COCOM sanctions against Cuba, imposed sanctions under the *Act.* The *Cuban Assets Control Regulations* became effective on July 8, 1963.[43] However, the embargo imposed by these regulations was limited by §515.541,[44] which provided a broad authorization for controlled foreign corporations to trade with Cuba. Section 515.541 of the *Cuban Assets Control Regulations* differs only in minor points from section 500.541 of the amended *Foreign Assets Control Regulations.* From a drafting standpoint, the structure of each is identical: controlled foreign corporations are subject to the jurisdiction of the United States and are specifically licensed under the regulations to engage in business transactions with the designted foreign countries. However, it should be noted in passing that the *Cuban Assets Control Regulations* do not grant a license to controlled foreign corporations in the banking business, while the amended *Foreign Assets Control Regulations* make no such distinctions in licensing all controlled foreign corporations. The prohibition from using United States currency to effect licensed transactions appears in both sets of regulations. The limitation on transport by vessels owned by controlled foreign corporations is likewise equally applicable under both sets of regulations. The limitation on transfer of merchandise of United States origin is likewise substantially similar. However, in the *Foreign Assets Control Regulations,* as amended, the embargo includes the Commodity Control List "A" items (substantially corresponding to the COCOM list of strategic goods) regardless of their origin; the *Cuban Assets Control Regulations* do not impose an embargo on non-United States origin strategic goods trade with Cuba by controlled foreign corporations. COCOM has refused to embargo or restrict trade with Cuba; apparently, it was felt that an attempt to impose this COCOM list restriction on controlled foreign corporations on a unilateral basis where COCOM had rejected *any* embargo was imprudent — although at that time, the United States "reinforced" the COCOM list by imposing a total embargo for controlled foreign corporations on trade to China, North Korea and North Viet Nam where COCOM imposed only a partial embargo on strategic goods.

There is no provision for the export of technical data in the *Cuban Assets Control Regulations.* This omission may be an over-

[43] 31 C.F.R. § 515.101-.809(1970).
[44] 31 C.F.R. § 515.541(1970).

sight. It is also possible that the broad language of the *Cuban Assets Control Regulations*[45] is sufficient in itself to permit export of technical data to Cuba, at least if such technical data is of non-United States origin. It is a more difficult question whether technical data of United States origin exported to a controlled foreign corporation may be, under the *Cuban Assets Control Regulations*, exported to Cuba by the controlled foreign corporation incident to a business transaction with Cuba. It may be United States policy to prevent such transshipment pursuant to the terms of the initial license granted for the export of the technical data to the controlled foreign corporation.

The *Cuban Assets Control Regulations* contain no explicit limitation on the supply of petroleum products to Cuban vessels by controlled foreign corporations. They do contain one provision which was especially troublesome and which has been deleted from s. 500.541 of the amended *Foreign Assets Control Regulations*. This limitation states that the authorization to trade with Cuba did not apply to "any person subject to the jurisdiction of the United States other than an organization described in paragraph (a)" — that is, controlled foreign corporations. This language raised specific problems concerning the possibility of sanctions for violation of the embargo with respect to United States citizens who were officers and/or directors of the controlled foreign corporation. It appears that the United States Treasury has taken the position that the mere presence of a United States citizen as a director of a controlled foreign corporation is sufficient, regardless of his involvement in, or perhaps even opposition to, sales to Cuba, to result in the imposition of criminal penalties on such person under the *Act*.[46] As a matter of law, this position seems doubtful since the *Act* requires that violations be "wilful",[47] but the *in terrorem* effect of such a position could easily assure that no sales to Cuba would be made. Since virtually all controlled foreign corporations have one or more directors and officers who are United States citizens, the practical effect of the broad license granted for trade with Cuba may have been nullified by this narrow interpretation of the regulations.

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[45] "... all transactions incident to the conduct of business activities abroad..." (31 C.F.R. § 515.541(a)(1970)).

[46] See Craig, *op. cit.*, n. 9, at p. 600, n. 95, indicating that the United States Treasury has in fact taken the position that mere evidence that a United States citizen or resident is a director of a controlled foreign corporation trading with Cuba is sufficient to threaten such director with prosecution.

[47] 50 U.S.C. app. § 5(b)(1970); 31 C.F.R. § 500.701 (1970).

The amended *Foreign Assets Control Regulations* meet this problem in two ways. First, there is no language in section 500. 541 which explicitly forbids any United States citizen from engaging in, participating in, or being involved in any licensed transaction. Secondly, section 500.541(a) specifically grants a license to "... any individual ordinarily resident in a foreign country in the authorized trade territory ...". Thus, at least with respect to United States citizens resident abroad, the ambiguity and uncertainty in the *Cuban Assets Control Regulations* has been removed in the amended *Foreign Assets Control Regulations.* On the basis of the United States Treasury Department interpretation of the *Cuban Assets Control Regulations,* however, it is still possible that the Treasury will take the position that where any officer or director of a controlled foreign corporation is ordinarily resident in the United States, that such person will incur liability under the *Act* if the controlled foreign corporation with which he is associated engages in a licensed transaction with China. Since virtually all controlled foreign corporations have one or more such directors or officers, the remaining uncertainty in this regard will certainly have a "chilling effect" upon the development of trade with China by controlled foreign corporations.

Although it may appear that the amended *Foreign Assets Control Regulations* represent an advance in clarity over the *Cuban Assets Control Regulations,* until some further clarification is forthcoming upon the application of the amended regulations to officers, and most especially to directors, of controlled foreign corporations, who are resident in the United States, the amendment may rightly be viewed as an attempt to mollify foreign concern over extraterritorial jurisdiction while, at the same time, achieving the same result through pressure on persons resident in the United States. In view of the reluctance of controlled foreign corporations in Canada and elsewhere to trade with Cuba under the general license, it seems that the practical impact of the amended *Foreign Assets Control Regulations* may be nil, at least until some further clarification of this problem is obtained.

Rhodesian Sanction Regulations

One other set of regulations under the *Trading With the Enemy Act* deserves special notice, involving, as it does, international trade. The *Rhodesian Sanctions Regulations,*[49] effective July 29, 1968, re-

[48] 31 C.F.R. § 530.101-.809(1970).
[49] 31 C.F.R. § 530.201(1970).

placed the earlier *Rhodesian Transaction Regulations* issued as of January 5, 1967. The *Rhodesian Sanctions Regulations* impose prohibitions on transactions in property destined to or exported from Rhodesia or transfers for the account of Rhodesian nationals.[50] The scope of this embargo, similar to that of the *Foreign Assets Control Regulations* in their unamended form, applies to all controlled foreign corporations. Although the *Rhodesian Sanctions Regulations* can be seen as a temporary regression on the evolutionary path begun with the *Cuban Assets Control Regulations* in 1963 and continuing now with the amendments to the *Foreign Assets Control Regulations,* there may be a qualitative difference similar to the difference noted above with respect to the inclusion of the COCOM list "A" goods in the amendment to the *Foreign Assets Control Regulations*; that is, both the COCOM list "A" goods and the Rhodesian sanctions correspond broadly to the guidelines set forth but a multi-national body as an instrument of international policy.[51] Although it can be argued that it is, nonetheless, inappropriate to enforce these multilateral agreements by extending the jurisdiction of one of the parties thereto beyond its traditional territorial limits, this argument is solely based on the rather jealousy guarded field of sovereignty and jurisdiction. Practically speaking, the economic impact of such regulations must be minimal.

Conclusion

The amended *Foreign Assets Control Regulations* do represent an advance over the previous regulations, permitting, as they do, controlled foreign corporations and U.S. citizens resident abroad, to engage in many transactions with China which were heretofore forbidden. However, the new regulations require some substantial clarification if their impact is not to be severely limited, especially with respect to controlled Canadian corporations; specifically, some reasonable and practical definition of the term "merchandise of U.S. origin" must be forthcoming; the lurking uncertainty with respect to officers and directors of controlled foreign corporations who are resident in the United States must also be clarified.

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[50] The *Rhodesian Sanctions Regulations* make specific reference to 22 U.S.C. § 289, a section of the *United Nations Participation Act,* and to two Executive Orders issued with respect to Rhodesian trade: Exec. Order No. 11322, 3 C.F.R. 426 (1970) and Exec. Order No. 11419, 3 C.F.R. 438 (1970). (31 C.F.R. § 530.101(b) (1970)). These regulations implement the United Nations embargo on trade with Rhodesia.

[51] New York Times, 2 January 1970, at p. 40, col. 3.

The amended regulations, like the *Cuban Assets Control Regulations* before them, do not permit controlled foreign corporations to trade with China by placing a limit on United States jurisdiction over controlled foreign corporations or their United States shareholders, but rather by granting a license for transactions with China, subject to limitations noted above. Since blanket embargoes still exist with respect to North Korea, North Viet Nam and Rhodesia, it seems clear that a blanket retraction of jurisdiction was not deemed a possible solution by the United States. Limitations on controlled foreign corporations' trade with Rhodesia, North Korea and North Viet Nam may be more palatable to the international community; certainly the real economic impact of these embargoes is small.

One remaining question is what the impact of the amended regulations will be on Canadian trade with China. Although some of this impact must necessarily await a clarification of the terms "merchandise of U.S. origin", Canada should be in a favorable position to market goods in China in view of her already substantial sales of grains to China. It seems clear that Canada will face stiff competition from Japan and Western Europe, especially West Germany with respect to sales of manufactured goods to China. A study now in preparation by M. Claude E. Forget for the Private Planning Association will apparently document the feasibility of such trade on a competitive basis, although the Japanese competition is apparently acknowledged to be very difficult to beat. The New York Times indicated that as of January 2, 1970, only a little more than two weeks after the announcement of the amended regulations, that there were few signs that Canadian businessmen were hustling to explore the implications of the newly amended regulations.[52]

It is to be hoped that one problem which arose subsequent to the promulgation of the *Cuban Assets Control Regulations* in 1963 will not recur. This problem is the unwillingness of controlled foreign corporations, whether as the result of actions of United States citizens who are officers or directors of such corporations, or as a result of the management structure or pressure from United States corporate parents, to engage in trade with designated foreign countries for which no general license exists for United States corporations. This problem is admittedly not entirely a legal problem, (although some officers and directors of controlled foreign corporations might have been subject to criminal prosecution), but

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[52] *Id.*

a problem of management and of the willingness and ability of the controlled foreign corporation to act as a national of the jurisdiction of its incorporation would act; it is a question of real integration into the foreign environment where the controlled corporation is organized and operating. It is a significant problem, however, in which the *Trading With the Enemy Act* has played no inconsequential part. It is to be hoped that further clarification of the presently existing uncertainties in the amended *Foreign Assets Control Regulations* will be promptly forthcoming, and that controlled foreign corporations in Canada and elsewhere will not hesitate to avail themselves of the license exemption which authorizes them to trade with China. Certainly, this objective is consistent with declared United States policy.

A Postscript

Since the receipt of the galley proofs of this article by the author, further changes in the *Foreign Assets Control Regulations* have been promulgated following the now famous United States-Chinese table tennis tournament in Peking in April of 1971. In close conjunction with that tournament, President Nixon announced, on April 14, 1971, a five point program of relaxation of the United States embargo on trade with China.[53]

[53] See *Statement of President Nixon Announcing Changes in U.S. Trade and Travel Restrictions,* April 14, 1971, 7 Weekly Pres. Docs. 628 (1971); New York Times, April 15, 1971, at p. 1, col. 8; Wall Street Journal, April 15, 1971, at p. 2, col. 2. The five points are, in general terms as follows: (1) expediting of visas for Chinese nationals desiring to travel to the United States, (2) promulgation of a list of non-strategic goods of United States origin for export to China and a list of merchandise of Chinese origin which may be purchased and/or imported by United States persons, (3) relaxation of United States currency controls to permit the use of United States dollars in transactions with China, (4) permission for United States flag vessels (which must be owned by United States persons under applicable United States law) to transport cargoes of licensed merchandise between non-Chinese ports and permission for foreign flag vessels owned or controlled by United States persons, controlled foreign corporations, or persons ordinarily resident abroad to transport certain cargoes to and from Chinese ports; insurance of such cargoes by United States persons, controlled foreign corporations and persons ordinarily resident abroad is also permitted, and (5) permission for the supply of petroleum products to Chinese owned or operated vessels or aircraft by United States persons, controlled foreign corporations, and persons ordinarily resident abroad.

On May 8, 1971, amendments to the *Foreign Assets Control Regulations* were published in the Federal Register.[54] The amendments of May eighth implement only three of President Nixon's five points, those with respect to currency controls, transport and insurance of cargoes, and supplying of fuels to Chinese owned or operated vessels.

Subsequently, on June 10, 1971, President Nixon annonnced the removal of the embargo on the sale of certain non-strategic goods of United States origin to China,[55] and by further amendment to the *Foreign Assets Control Regulations*, the complete removal of the nearly total embargo on the importation or purchase of merchandise of Chinese origin by United States persons.[56] These announcements implement what appears to be the most significant of President Nixon's five points — the relaxation of the trade embargo. The impact, however, is greater for United States persons than for controlled foreign corporations and persons ordinarily resident abroad, since the latter two classes were licensed to purchase or import into foreign countries, prior to May 7, 1971, merchandise of Chinese origin.

It should be noted that the first of President Nixon's five points, that of expediting visas for Chinese nationals coming to the United States will not directly involve the *Trading with the Enemy Act* or the *Foreign Assets Control Regulations.*

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[54] 36 Fed. Reg. 8584 (1971). These amendments were effective May 7, 1971.

[55] Fed. Reg. 11808 (1971). The relaxation of the embargo on the sale of merchandise of United States origin to China was effected by amendment to regulations under the *Export Administration Act of 1961*. As amended, 15 C.F.R. 371.3 provides a general license for sale of enumerated classes of non-strategic merchandise to China. Sales of such merchandise of United States origin may be made by United States persons, controlled foreign corporations or persons ordinarily resident abroad. Although not published in the Federal Register until June 19, 1971, this amendment was effective as of June 11, 1971.

[56] 36 Fed. Reg. 11441 (1971), amending the *Foreign Assets Control Regulations* by adding section 500.547 thereto. This section, effective June 10, 1971, provides a general license for United States persons to purchase, deal in, and import into the United States, merchandise of Chinese origin. As noted (see n. 21 and n. 22 *supra*) certain limited non-commercial purchases and/or importation into the United States of merchandise of Chinese origin were permitted under the prior regulations; by virtue of the broader license in section 500.547, the limited license in section 500.544 is deleted as unnecessary. This amendment has limited impact on the controlled foreign corporation or the person resident abroad, since they were permitted to purchase, deal in and import into foreign countries merchandise of Chinese origin prior to June 10, 1971; however, the controlled foreign corporation and persons ordinarily resident abroad may now engage in sales of merchandise of Chinese origin to the United States.

We shall first review the amendments of May 8, 1971, and then consider the more recent amendments of June 10, 1971. The new regulations promulgated on May eighth include (1) a revision of § 500.538, (2) a revision of § 500.541 (which section applies only to persons ordinarily resident abroad and to controlled foreign corporations), and (3) a new section 500.546. A brief analysis of these new or revised sections will provide an understanding of the scope of the relaxation effected by the May eighth amendments.

Amended § 500.538 authorizes United States persons, controlled foreign corporations and persons ordinarily resident abroad to transport and/or insure cargoes bound directly or indirectly to or from China, provided, however, that such cargoes destined to China may not include merchandise of United States origin or COCOM list items, unless a general or validated license has issued with respect thereto. (Under the amendments of June 10th, a general license for sale of certain non-strategic merchandise of United States origin to China has been issued.) There is no restriction on the type of merchandise which may be transported from China, but merchandise in transit directly or indirectly to or from North Korea or North Viet Nam is excluded from the scope of the amendment to § 500.538. An important *caveat* is in order, however. United States flag vessels and aircraft of United States registry (which ships and aircraft must be owned by United States persons) may not call at Chinese ports by virture of amended regulations recently issued by the Commerce Department.[57] Thus, United States persons who desire to transport merchandise to or from China may do so, subject to the restrictions set forth above with respect to the classes and destinations of merchandise, only in foreign flag vessels or aircraft of foreign registry.

The commercial impact of the transportation license may have been broadened considerably by the licensing of sales to China of

[57] 36 Fed. Reg. 8672 (1971). Published on May 11, 1971, this amendment was effective May 7, 1971. United States flag vessels and aircraft of United States registry may not call at Chinese ports, nor may they transport merchandise directly or indirectly to China, except that transport of merchandise consigned to China between non-Chinese ports by United States flag vessels and United States aircraft is permitted if a general or validated license has been issued with respect to such merchandise by the United States Department of Commerce. Merchandise of non-United States origin consigned to China may be transported between non-Chinese ports if of a type for which a general license has been issued under the *Export Administration Act of 1969*. Transport of merchandise of Chinese origin between non-Chinese ports is generally permitted; however, no merchandise of North Korean or North Viet Namese origin may be transported.

non-strategic merchandise of United States origin and the general license to import into the United States merchandise of Chinese origin; however, most experts feel that it will be several years before United States-Chinese trade volumes reach significant levels, primarily due to China's shortage of foreign exchange.

Amended section 500.541 broadens the general license granted to controlled foreign corporations and persons ordinarily resident abroad under old section 500.541.[58] The new regulations grant a general license authorizing transactions with China and her nationals in United States dollars and "property subject to the jurisdiction of the United States."[59] However, Chinese assets "frozen" on or prior to May 6, 1971 remain "frozen."

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[58] New section 500.541 reads as follows:

"Certain transactions by persons in foreign countries:

(a) Except as provided in paragraph (b), (c), (d), (e), and (f) of this section, all transactions incident to the conduct of business activities abroad engaged in by any individual ordinarily resident in a foreign country in the authorized trade territory, or by any partnership, association, corporation, or other organization which is organized and doing business under the laws of any foreign country in the authorized trade territory, are hereby authorized.

(b) This section does not authorize any transaction involving property subject to the jurisdiction of the United States as of May 6, 1971 in which there existed or had existed at any time on or since the effective date, any direct or indirect interest of China or nationals thereof.

(c) This section does not authorize any transaction involving the purchase or sale or other transfer of:

(1) Any merchandise of U.S. origin, except as authorized by § 500.533;

(2) Any merchandise regardless of origin of a type included in the Commodity Control List of the U.S. Department of Commerce set forth in 15 C.F.R. Part 399 and followed on that list by the letter "A" in the column headed "Special Provisions List" or of a type the unauthorized exportation of which from the United States is prohibited by any of the several regulations referred to in 15 C.F.R. 370.10; or

(3) Any technical data, as that term is defined in section 500.543, except to the extent authorized by that section.

(d) (Deleted).

(e) This section does not authorize the supply of petroleum products to any vessel bound to or from North Korea, North Viet Nam or Cuba.

(f) This section does not authorize any transaction involving North Korea or North Viet Nam or their nationals, or merchandise the country of origin of which is North Korea or North Viet Nam."

[59] This term apparently includes all "property" (defined at 31 C.F.R. 500.311 (1970)) of any nature whatsoever which is subject to the jurisdiction of the United States and includes, without limitation, securities issued by United States persons or securities issued by any person if the certificate evidencing the security is located in the United States (31 C.F.R. 500.313 (1970)). It appears

The principal significance of the permission to effect transactions with China involving United States currency will be to permit China to build her currency reserves in United States dollars and to provide commercial flexibility in export transactions with China. Controlled foreign corporations in the banking business may increase their involvement with China.

Old § 500.541(d) which operated to prohibit the indirect transport to China or insurance of unlicensed merchandise of United States origin or COCOM list items by controlled foreign corporations and persons ordinarily resident abroad has been deleted. However, this prohibition, including a prohibition of direct transportation to China and/or insurance of such unlicensed merchandise, is now contained in § 500.538(d) and applies to controlled foreign corporations, persons ordinarily resident abroad, and United States persons alike.

Section 500.541(e) has been amended to permit supplying of petroleum products to vessels or aircraft owned by or under charter to China or her nationals. It appears that such products must be for use on the vessel or aircraft. The embargo on the supply of petroleum products to vessels bound to North Korea or North Viet Nam remains in effect. In the interest of regulatory economy, new § 500.541(e) of the *Foreign Assets Control Regulations* also prohibits supply of petroleum products to any vessel bound to or from Cuba. The absence of such a provision in the *Cuban Assets Control Regulations* was noted in the body of this article. By choosing to include Cuba under this section of the *Foreign Assets Control Regulations* instead of under the *Cuban Assets Control Regulations*, the Office of Foreign Assets Controls may have laid a trap for the unwary. This can, of course, be corrected by appropriate amendment of the *Cuban Assets Control Regulations*.

New § 500.546 provides a blanket license to United States persons, controlled foreign corporations, and persons ordinarily resident abroad for transactions with China and her nationals, excluding

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that "property subject to the jurisdiction of the United States" is a generally broader class of property than "merchandise of United States origin", although "merchandise" is defined as "... all goods, wares and chattels of every description without limitation of any kind" at 31 C.F.R. 500.331 (1970). *Quaere* whether "merchandise" includes intangible personal property? This seems unlikely, since otherwise the announced relaxation on currency controls and banking transactions would not be effected by the amended regulations. Can Chairman Mao buy shares of IBM?

"frozen" assets, exports of COCOM list items and unlicensed merchandise of United States origin, exports of technical data, and import and/or purchase of Chinese merchandise, except to the extent that such transactions were already permitted to controlled foreign corporations or persons ordinarily resident abroad prior to May 7, 1971. The June 10th amendments license export of certain classes of merchandise of U.S. origin and provide blanket permission for import and/or purchase of Chinese merchandise. The impact of this new section is primarily with respect to United States persons.

Under new § 500.546, United States persons are permitted to sell to China any merchandise not included on the COCOM list and not of United States origin; the effect of this is to place United States persons on a par with controlled foreign corporations and persons ordinarily resident abroad who were licensed to engage in such sales to China under § 500.541 prior to May 7, 1971. The June 10th amendments also permit sales to China of certain merchandise of United States origin.

Section 500.546 also permits United States persons to engage in transactions with China and her nationals involving United States dollars and in property subject to the jurisdiction of the United States to the same extent as permitted to controlled foreign corporations and persons ordinarily resident abroad under amended § 500.541. United States banks and their foreign branches are now permitted to engage in all varieties of banking transactions with China and her nationals in United States or foreign currencies, except transactions involving "frozen" assets, or involving COCOM list items, merchandise of United States origin, or merchandise of Chinese origin.

A further effect of new section 500.546 is to permit United States persons to supply petroleum products to vessels or aircraft owned or chartered by China or her nationals for use on the vessel or aircraft, provided, however, that no such supplies can be made to vessels bound to or from North Korea, North Viet Nam or Cuba.[60] The Office of Foreign Assets Controls apparently takes the position that such supply activities must take place outside the geographic

[60] It appears that controlled foreign corporations and persons ordinarily resident abroad may supply petroleum products to Cuban aircraft, provided that such products are not of United States origin. However, such action invites informal sanctions by the Office of Foreign Assets Controls.

limits of the United States.[61] The regulations do not, on their face, support such a construction. This position may reflect a rather broad definition of the term "merchandise of United States origin." [62]

It is interesting to note that section 500.541 which applies only to controlled foreign corporations and persons ordinarily resident outside the United States has been retained in the May eighth amendments. The historical reason for the promulgation of this section was to permit the imposition of slightly lesser restraints upon such persons than were imposed upon United States persons. However, the thrust of the form and substance of the amendments of May 8, 1971 has been to eliminate most differences between United States persons on the one hand and controlled foreign corporations and persons ordinarily resident abroad on the other.

Of the remaining disparities between United States persons and controlled foreign corporations and persons ordinarily resident abroad, some result from the interposition of prohibitions on United States persons by the United States Department of Commerce. However, controlled foreign corporations and persons ordinarily resident abroad are permitted to transfer technical data of non-United States origin to China under the rules in section 500.543 and to import and/or purchase for resale merchandise of Chinese origin. United States persons still have no general license for these transactions under the May eighth amendments.

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[61] The text of the explanatory note accompanying the amendments of May 8, 1971 states "...removes the controls on... the bunkering by American oil companies *abroad* of Chinese vessels..." (36 Fed. Reg. 8584 (1971)). (Emphasis added).

[62] On May 15, 1971, the United States Department of Commerce published in the Federal Register revised general licenses with respect to the supply (i.e. export) from the United States of petroleum products and other stores for use on ships and aircraft. (36 Fed. Reg. 8932 (1971)). These provisions, amending 15 C.F.R. 371.9 and C.F.R. 371.10 (1971) were effective as of May 7, 1971.

As amended, these licenses permit the supply of petroleum products and other ship and plane stores to vessels or aircraft owned or operated by China or her nationals, excluding vessels or aircraft which have called or will call at ports of North Korea or North Viet Nam within specified time periods or which will carry within 120 days any unlicensed commodities destined, directly or indirectly to North Korea or North Viet Nam. Vessels owned or operated by North Viet Nam, North Korea or Cuba are excluded. Thus, ship and plane stores are the first merchandise of United States origin for which a general license for export to China has been issued. United States persons are licensed to sell such supplies to Chinese vessels or aircraft within the United States.

In conclusion, the May eighth amendments relax restrictions on United States persons, controlled foreign corporations, and persons ordinarily resident abroad with respect to the use of United States currency, transportation and insurance of merchandise bound to or from China, and the fueling of Chinese vessels and aircraft.

The *Foreign Assets Control Regulations* amendment effective on June 10, 1971 appeared in the Federal Register on June 12, 1971.[63] This amendment, adding a new section 500.547, provides a general license for the purchase of merchandise of Chinese origin; prior to June tenth, United States persons were prohibited, with limited exceptions,[64] from purchasing, dealing in, or importing into the United States any merchandise of Chinese origin as described in section 500.204 of the regulations. The general license applies to all transactions in Chinese merchandise after June 10, 1971; however, merchandise of North Korean or North Viet Namese origin is still embargoed. Although the amendment is applicable by its terms to controlled foreign corporations and persons ordinarily resident abroad, the effect on such corporations or persons is negligible in view of the license granted to them previously under 500.541 to purchase, deal in, or import into foreign countries merchandise of Chinese origin. Some controlled foreign corporations or foreign residents may take advantage of the license to purchase Chinese goods for resale to the United States, or to purchase components, materials, or products of Chinese origin for further manufacture or processing prior to sale in the United States.

The more significant action taken on June 10, 1971 was the announcement of the classes of merchandise of United States origin for which a general license was granted to permit export to China. This action was taken by amendment to the *Export Control Regulations*[65] which are issued under the *Export Administration Act of 1969*. The amendment was promulgated by the Export Control Office of the Commerce Department which has primary authority to regulate the export policy of the United States.

The scope of the general license is not terribly broad — although Schedule 1 under amended Part 371 which lists the licensed merchandise is lengthy and complex. Foodstuffs, medecines, fertilizers and

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[63] 36 Fed. Reg. 11441 (1971).

[64] See n. 21 and n. 22 *supra*; the June amendment deletes section 500.544 as no longer necessary.

[65] 36 Fed. Reg. 11808 (1971) amending 15 C.F.R. 371.3 and adding Supplement No. 1 to Part 371. This amendment, published June 19, 1971 is effective June 11, 1971.

a host of other non-strategic items are included. Despite speculation on the scope of the list prior to its appearance,[66] one must conclude that the list was probably prepared prior to the April 14th announcement by President Nixon. It is, if anything, on the restrictive side — narrower than the COCOM list embargo on China, and narrower than the United States embargo on trade with the Soviet Union. It is, however, primarily an embargo on United States persons; the embargo respects the territorial principal embodied in private international law. Further, it seems likely that the scope of the license will be broadened to reflect or induce additional diplomatic contacts between China and the United States.

The impact of amended Part 371 on controlled foreign corporations and persons ordinarily resident abroad is indirect, but not unimportant. The *Foreign Assets Control Regulations* prohibit sales of merchandise of United States origin to China unless a general or validated license therefor has been issued by the Commerce Department. While this restriction is essentially surplusage with respect to United States persons, since they are restrained by the *Export Control Regulations*, the regulations are effective to limit the sale of merchandise of United States origin by controlled foreign corporations and persons ordinarily resident abroad.[67] As indicated above in the body of this article, this restriction may have played a significant part in limiting the development of exports by controlled Canadian corporations to China.

While the regulations as amended license the export of a host of finished products, including agricultural equipment, there is no good indication whether the license to export a tractor made in the United States includes a license to export a tractor manufactured in Canada which contains some parts made in the United States. Even if we assume that when the completed products are licensed, the components are licensed *a fortiori*, it is not clear whether similar components in a light truck manufactured in Canada would be licensed. (Light trucks are not licensed). Thus, the amended regulations provide no real solution to the "merchandise of United

[66] See *e.g.*, New York Times, April 15, 1971, at p. 1, col. 8; Wall Street Journal, April 15, 1971, at p. 2, col. 2 in which Professor Stanley Lubman of the Faculty of Law of the University of California expresses concern that pressure from the Department of Defense sought to restrict narrowly the classes of "non-strategic goods" for which a license was granted.

[67] 31 C.F.R. 500.533 (1971) licenses all exports of merchandise of United States origin to China for which a general or validated license has been issued by the Commerce Department.

States origin" problem which we examined in the body of this article. In part, this is due to the curious nature of the regulatory framework whereby the Commerce Department licenses exports from the United States, presumably with little or no consideration of the impact of these regulations as incorporated by reference into the *Foreign Assets Control Regulations.*

The recent amendments to the *Foreign Assets Control Regulations* and the *Export Control Regulations* have reduced the differential and preferred treatment which was afforded to control foreign corporations and persons ordinarily resident abroad by broadening the scope of licensed activities for United States persons. Problems still remain with the *Foreign Assets Control Regulations* as they apply to controlled foreign corporations and foreign residents; for example, the question of director liability remains a significant impediment to trade development. Since it seems likely that further amendments to the Commerce Department list and the *Foreign Assets Control Regulations* may be forthcoming, it would appear appropriate for controlled foreign corporations, persons resident abroad, and interested foreign governments to make their views known to the State Department, the Commerce Department, and the Office of Foreign Assets Controls.