

German Investors under US Jurisdiction

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“As a moth is drawn to the light, so is a litigant drawn to the United States. If he can only get his case into their courts, he stands to win a fortune. At no cost to himself, and at no risk of having to pay anything to the side. The lawyers there will conduct the case ,on spec’ as we say, or on a ,contingency fee’ as they say. The lawyers will charge the litigant nothing for their services but instead they will take 40 % of the damages, if they win the case in court, or out of court on a settlement. If they lose, the litigant will have nothing to pay to the other side. The courts of the United States have no such court deterrents as we have. There is also in the United States a right to trial by jury. These are prone to award fabulous damages. They are notoriously sympathetic and know that the lawyers will take their 40 % before the plaintiff gets anything. All this means that the defendant can be readily forced into a settlement. The plaintiff holds all the cards.”

Lord *Denning* in
Smith Kline & French Laboratories Ltd. v. Bloch [1983] 2 All ER 72, 74 (C.A.)

I. Introduction

Most parts of this text were originally drafted to serve as an overview of some characteristics of the American legal system which may seem

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peculiar to foreign investors brought to trial before a U.S. court: (1) The exercise of jurisdiction, (2) the class action, (3) the concept of punitive damages and (4) special characteristics of lawsuits in the United States. Those special features of the law are of singular nature; they don't exist in most of the world's developed legal systems. Therefore, it is not surprising that a large percentage of foreign investors get into legal trouble due to their lack of knowledge and preparation. Legal advice and counseling can avoid such trouble in large part.

II. Extensive Jurisdiction of US Courts

The starting point is the strict common law principle of territoriality. Under this principle, a court may only exercise jurisdiction over a person if this person is physically present (or owns property) in the court's territory (later referred to as the forum). Back in 1877, this principle was applied to separate the federated states' jurisdiction in the classic *Pennoyer v. Neff*² case. Every other assertion of jurisdiction is an extension of the principle of territoriality.

In case of such an extension, the due process requirement (Amendment XIV) is met only if the defendant has certain minimum contacts to the respective forum state, in order to not violate „traditional notions of fair play and substantial justice“³.

The following comments apply for the relationship between the different states as well as for the relationship between a state to a foreign country.

1. General Personal Jurisdiction

Minimum contacts are established if the domicile of the defendant is in the forum state. In cases where the defendant is a legal entity, the deciding factor is its principal place of business, the place of its

² 95 U.S. 714 (1877).

³ So die neuere Rechtsprechung im Fall *International Shoe Co. v. Washington*, 326 U.S. 310 (1945).

incorporation or every other place where the „company is doing continuous and systematic business“. „Casual business contacts“ are not sufficient. In regards to this classification, most legal problems emerge from commercial websites.

At the locations mentioned, courts have general jurisdiction over the respective person or legal entity. Courts can decide about all claims that are filed against the person or legal entity in question, even if these claims are not related to the forum state at all.

Concluding, general personal jurisdiction is about the general proximity between forum and defendant. If sufficient proximity is given, (i.e. domicile/principal place of business in the forum state), the minimum contact requirement is not considered to be violated even if the respective claim is not related to the forum state.

2. Specific Personal Jurisdiction

To a U.S. lawyer, the question whether a plaintiff can cite the defendant from Maine to an Oregon court is exactly the same as the question whether a company with its headquarters in Stuttgart, Germany, can be cited to a Delaware court.

In contrast to general jurisdiction, specific jurisdiction refers to the individual case. If the defendant's domicile or principal place of business does not lie within the forum state, he can be subject to specific jurisdiction, which only requires that the claim arises out of the forum contact. However, in these cases the US constitution requires minimum contacts, which are regulated by long-arm-statutes enacted by the states. Normally, these statutes stipulate starting points which establish international jurisdiction for state and federal courts.

Georgia for example, has the following grounds for exercise of personal jurisdiction over nonresidents:

9-10-91. Grounds for exercise of personal jurisdiction over nonresident.

*A court of this state may exercise **personal jurisdiction over any***

nonresident or his executor or administrator, [...] if in person or through an agent, he:

(1) **Transacts any business** within this state;

(2) **Commits a tortious act or omission** within this state [...];

(3) **Commits a tortious injury** in this state caused by an act or omission outside this state **if the tort-feasor regularly does or solicits business, or engages in any other persistent course of conduct, or derives substantial revenue from goods used or consumed or services rendered in this state;**

(4) **Owns, uses, or possesses any real property** situated within this state; or

(5) [...]

Recently, the U.S. Supreme Court tends to apply stricter standards to the minimum-contacts-requirement: these contacts have to be „**truly voluntary and intentionally directed towards the forum state**“. Thus, not only the objective existence of grounds for exercise of personal jurisdiction is necessary; also intention as a subjective element is required. However, this prerequisite can create problems in regards to evidence. Intention can be assumed if a company wants to supply or open up one particular market and therefore delivers a greater amount of a specific good to this market⁴. However, it probably won't suffice if a customer transports a certain article into the respective forum state or if, accidentally, smaller amounts of an article reached the forum state indirectly.

For example, in *Asahi Metal Industry Co., Ltd. v. Superior Court of California* the US Supreme Court discussed whether jurisdiction could be established on the sole ground that the defendant brought goods into the US “stream of commerce”, where they reached the forum state in which

⁴ Burnham, Legal System of the US, 2nd Ed., p. 246.

they caused damage. In the end, the court did not decide on this matter. Usually, courts of lower instances follow the reasoning of Justice O'Connor, who established the following criteria:

Between defendant and forum state has to be a connection resulting from a conduct of the defendant that is purposefully directed towards the forum state. In addition to bringing goods into the stream of commerce, the defendant has to:

- intentionally serve the market of the forum state, or
- develop a product specifically for the market of the forum state, or
- advertise for a particular product in the forum state, or
- regularly consult customers and consumers in the forum state, or
- have a sales representative who put the products on the market of the forum state.

According to Justice Stevens' opinion, the following criteria should determine whether jurisdiction is given or not in stream of commerce cases:

- trade volume
- value of the goods brought into the stream of commerce
- hazard deriving from the goods brought into the stream of commerce

The greater one of these individual factors, the more likely the existence of jurisdiction.

3. Conclusion

As a result, everybody who seriously considers doing business in the US has to expect being sued before a US court at any given occasion. In this case one has to prepare for further complications and procedural elements that are unknown in Germany. These specialities will be explained in the further paragraphs. In general, legal advice at the future business location is imperative.

III. Class actions

The term “class action“ has become widely spread during the last years as a result of its presence in the media due to the holocaust-litigation. It concerns the accumulation of similar cases in one lawsuit. This procedural tool is mostly justified with the argument that only the class action procedure provides ordinary people with the possibility of suing a big company, which otherwise would be left in peace due to its superior financial position. However, during the last years, a growing tendency can be spotted towards the use of class actions to apply pressure on the respondent in order to enforce a settlement. Therefore, class actions should be generally handled with great care.

The advantage of class actions for the respondent is that the once rendered judgement is res-judicata, i.e. binding for the whole class of similar cases. Hence, the respondent does not have to fear further actions on the same issue. This enables the respondent and its insurance carrier respectively to determine the final amount of damages and to assure financing of this amount at an early stage.

IV. Punitive Damages

Due to the often exorbitant amounts granted by juries, punitive damages are especially feared by companies sued for product liability offences. In the year 2000, a jury imposed punitive damages amounting to USD 145 billion in the context of a class action against the U.S. tobacco industry⁴. In the end, the total was reduced by a considerable amount only as a result of persistent appeals to court.

From the American legal point of view, the principle of punitive damages is seen to be consistent with the ideas of the civil law, adding

⁴ *Engle v. Reynolds Tobacco Co.*, 672 So. 2d 39 (Fla. 3d DCA 1996).

punitive damages to the actually caused damage in order to punish the respondent and deter it from exhibiting such behavior again. From the German legal point of view, the character of punitive damages seems more to be affected by the idea of a monetary fine under the criminal law. Normally, punitive damages are granted in cases of premediated breach of statutory duty, but they may also be applied on product liability cases.

Throughout the last years, the U.S. Supreme Court developed a more restrictive policy regarding the use of punitive damages. Whereas in 1993 an amount 526-times the amount of the effective damages was granted by the Supreme Court⁵, in 1996, the Court restricted its policy in *BMW v. Gore*. In this case, BMW concealed a decrease in value of USD 4000 to Gore, leading to punitive damages amounting to USD 2 million, i.e. 500-times the amount of the effective damages. The Court pointed out that there is a mere economical damage in the case under consideration, causing an administrative fine not higher than USD 2000 in some states and even no administrative fine in other states. For this reason, even though there might be a public interest to impose punitive damages in certain cases, there is no such interest given in this case. Thus, the amount of the punitive damages was considered “grossly excessive“ here. The Court overruled the judgement and established three guideposts to assess the amount of punitive damages:

- The degree of reprehensibility of the defendant’s misconduct
- The disparity between the actual or potential harm suffered by the plaintiff and the punitive damages awarded, and
- The difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases

In *State Farm Mutual Automobile Insurance Company v. Campbell*, the Court specified its position regarding the second guidepost: though there are no concrete constitutional limits on the ratio between harm, or potential

⁵ *TXO Productions v. Alliance Resources Corp.*, 509 U.S. 443 (1993).

harm, to the plaintiff and the punitive damages awarded, in practice, few awards exceeding a single-digit ratio between punitive and compensatory damages will satisfy due process. Many people hence considered the resulting 9-to-1 ratio to be the fixed limit by the Court. However, this cannot be taken for granted, since the Court has been purposely reluctant to identify concrete constitutional limits on the ratio and keeps on emphasising that there are no rigid benchmarks.

V. Special Characteristics of Lawsuits in the US

1. Jury Trial

The jury is exclusively composed of laypersons. The right to a jury trial is guaranteed by the Seventh Amendment of the US Constitution. Since in the colonial time judges were said to be biased, the jury was installed to protect the individual from arbitrariness.

In a civil lawsuit the plaintiff may choose jury trial in federal courts and most state courts. Whereas the jury decides questions of fact such as that of the credibility of a witness, the judge decides questions of law only, for example the interpretation of statutes or issue of evidence. Jury Trial is granted when the claim is based on Common Law. This is regularly the case when the plaintiff demands relieve in money.

With requesting a jury trial the plaintiff aims to put the defendant under pressure to gain a better settlement; furthermore, damages granted by a jury are usually considerably higher.⁵ Jury trial is most prominent in liability cases. Also individuals that go up against big companies benefit from the trial by jury. Problems arise, though, for juries are more easily swayed by lawyers. This can be either dangerous or the big chance for a party. Complex, for example technical, problems are less likely to be fully comprehended by the members of the jury.

⁵ Fausten VersR 2005, 1502 – 1510 „Die Einbeziehung ausländischer Geschädigter im Zivilverfahren in den USA“.

Even though the defeated party nevertheless has the possibility to appeal, most defendants choose to settle considering the horrendous sums that could be granted by a jury.

2. Pre-Trial Discovery

A peculiarity of the US System is the discovery process. The plaintiff and the defendant have the possibility, before the actual court appearance, to request all relevant information for their case from the respective opponent. The scope of discovery is limited. Only relevant and not-privileged information may be requested. The ultimate aim of a discovery process is to give each party the same scope of information to make a possible settlement fair by providing the parties with all information on the risks.

The production of documents can be abused though, if it is used solely to raise the costs for the opponent so high that he is practically forced to settle. Advantageous is that, for example, a plaintiff can have full insight into the opponent's company making it easier to prove his claim.

3. Costs I: Court Fees

In order to make legal protection easily accessible, court fees in the US are traditionally low. For a civil action before a federal court of first instance, only USD 150 have to be paid. According to Georgia State Law, the party underlying in the lawsuit has to bear these expenses.

4. Costs II: Attorney's Fees - the American Rule

According to the so called American Rule, each party bears its own attorney's fees. Unlike in the German Legal System, the underlying party does not have to pay the fees of the winning party. On the hand, this rule increases the willingness to bring an action against someone. On the other hand, a company being sued in the US, will be left with their attorney's fees even if the action was baseless. Thus it is important for a company to initiate the right legal steps from the beginning and to avoid experiments

that might turn out expensive in the aftermath.

Though there are exceptions from this rule, they are of little practical relevance.

In the US, attorney's fees are not regulated by anything comparable to the fixed scales of charges that are established in Germany. The US Supreme Court considers these scales of charges a prohibited cartel agreement. Instead, attorney's fees usually arise from the hourly rate that was agreed on between lawyer and client.

5. Costs III: Contingency Fees

Other than hourly rates, plaintiffs in the US can agree with their attorneys on a contingency fee. Especially in cases of product liability or during class actions, agreements between plaintiff and attorney are made, according to which no expenses arise for the plaintiff if the case is lost. In case of a successful lawsuit however, the attorney gets 25 - 50% of the awarded sum or the amount garnered from a settlement. Expecting high damage claims, the lawyer also bears the financial burden resulting from the preparation of the lawsuit, i.e. the production of evidence. Thus, putting the plaintiff in a win-win situation, a contingency fee agreement adds to the plaintiff's willingness to file an action.

Bearing in mind these characteristics of US civil procedure, it is important to obtain reliable legal counsel before business engagement in the US.

VI. Extraterritorial Application of US laws

Talking about the extraterritorial use of US laws, it is inevitable to point at US competition and antitrust laws. The US antitrust division and US courts are not very likely to limit the extent of US jurisdiction over foreign companies. Especially the application of the *Sherman Act* follows the principle "If you want to trade with us, you'll have to accept our rules". The affects of extraterritorial use of US laws on foreign companies should not be underestimated: US laws stipulate "treble damages" for offending

against US competition law, which means that the respective company is obliged to pay the triple amount of the incurred damage.

However, the applicability of the *Sherman Act* is restricted by the *Foreign Trade Antitrust Improvement Act*, according to which the *Sherman Act* is not applicable on foreign issues, unless:

- The conduct of the defendant has a marring influence on the US-market and
- Out of this influence arises a claim under the *Sherman Act*.

As an example, the decision in *F. Hoffmann-La Roche, ltd. et al. v. Empagran S.A. et al.* from June 14th, 2004 concerns the extraterritorial usage of US antitrust law. The Supreme Court had to decide if, under the *Sherman Act*, plaintiffs can assert compensation for damages solely deriving from occurrences outside the US market. The court decided that the *Sherman Act* finds no application in cases where the plaintiff's claim is based solely on an independent foreign damage. A foreign damage is considered to be independent, if the effects on the US market did not contribute to its emergence.

Thus, only if an effect on the US market results in damages on the US market, the *Sherman Act* is applied. Additionally, it will also find application in cases where the effect on the US market resulted in damages on a foreign market. Considering today's global economy, the latter scenario is likely to happen. Only in cases where there is no effect on the US market or where the effects on the US market are not connected to foreign damages, the *Sherman Act* doesn't apply.

VII. Conflict of the Laws USA - Germany

As a result of the partly considerable differences between German and US legal proceedings law as well as material law, a so-called conflict of the laws may occur in the following cases.

A. Service of a writ

On July 25th 2003, the German Constitutional Court granted an injunction to the Bertelsmann AG thereby abating the service of a writ in Germany regarding a class action which started in the U.S. by the music industry against “Napster“- amounting to 17 billion USD.

The Court points out that the service of a writ for this type of class action is a prerequisite under US legal proceedings, additionally it serves as a prerequisite for a subsequent acceptance of a foreign judgement in Germany under the German Code of Civil Procedure (ZPO). The Court mentions that in principle, it is impossible to review the context of the service of a writ in regards to its compatibility with German substantive law. Furthermore according to the Court, filing a claim for punitive damages under US law normally does not violate German substantive law since- in principle- German Constitutional Law respects foreign legal systems.

However, this obligation to respect foreign legal systems is limited in instances where:

- The foreign claim has no substantial basis due to its gross monetarial amount, and
- Where the claim is used tactically so that it is clearly abusive to the respondent: by creating pressure and the risk of a sentence in order to force an extrajudicial arrangement.

In this case, Bertelsmann claimed the writ being served to them had such intentions.

Although the respondent has the right to challenge the claims of a lawsuit following the service of the respective writ, this right solely does not justify serving a writ since legal obligations and consequences arise for the respondent from this action. Such consequences harm the respondents constitutional rights by exposing them to the risk of a verdict for punitive damages- which is incompatible with the German Constitution.

Even though such a verdict would not be allowed in Germany, this could not prevent the loss of the respondent's property located in the US and concurrently cause a subsequent loss of reputation for the respondent.

For these reasons, the German Constitutional Court granted the injunction to Bertelsmann, however the constitutional complaint regarding this case has not yet been decided.

B. Acceptance and execution of a claim

In its judgement of June 4th 1992, the 9th Civil Division of the Federal Supreme Court (FSC) argued that- in general- a US judgement granting punitive damages to the complainant is acceptable.⁶ The German court declared the US judgement enforceable in Germany except, upon reviewing each facet of the claim in detail, found that the part of the claim requesting punitive damages cannot be legally enforced in Germany.

The Court states that legally enforcing judgements which grant punitive damages will regularly fail to be consistent with the basic principles of the German legal system.

One of the basic principles of the German legal system is the principle of commensurability developed from the constitution: in general, only the compensation for loss caused by the illegal interference with the financial circumstances of the directly involved persons shall be achieved by civil trial. Sanctions aiming at the punishment and deterrence of the respondent fall under only the jurisdiction of criminal courts.

Such is the consensus of the case under consideration. The amount of the imposed punitive damages is greater than the total of the imposed compensation. Even the attorney's totalled fee constitutes just one third of the imposed punitive damages. Furthermore, there is no given evidence for additional losses which require compensation. Therefore, under these circumstances the enforcement of the claim would be an exorbitant act

⁶ BGHZ 118, 312.

upon the respondent. Consequently the lack of a fixed standard regarding a real loss, means that the amount of the punitive damages imposed is left up to the sole discretion of the courts, thereby leading to a rapidly increasing burden caused by claims for damages- which normally have already reached the limits for a calculable and insurable risk.

By accepting the claim then, the idea of imposing punitive damages as punishment within a civil trial- combined with uncertainty about its amount- would lead to an excessive demand of the German liability system. Executing such a title therefore, would provide foreign creditors with an advantage over a German creditor possessing a German title to take hold of the debtor's assets located in Germany. The German legal system does not provide reasoning for the resulting priority of creditors from countries who practice the idea of punitive damages. In consideration of the above, the execution of a claim for punitive damages would be an intolerable result under the German legal system, wherefore the rather marginal relation of this case to Germany has been pulled up to dismiss the petition.