THE FOREIGN MANUFACTURER
AND THE JURISDICTION OF U.S. COURTS

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Executive Summary

Foreign manufacturers concerned about product liability exposure in the United States market can take a number of effective steps to minimize their risk by structuring their operations and contractual relationships. The goal is to avoid, as far as possible, creating contacts that would subject the foreign company to the jurisdiction of U.S. courts. These steps can include avoiding direct sales to end users, employing third-party distributors, establishing arms’ length subsidiaries and creating licensing arrangements. Foreign companies also can take advantage of differences in various states' laws to limit their contacts to states where punitive damages and class actions lawsuits, two major engines for damages awards to plaintiffs, are limited by law. Finally, the doctrine of forum non conveniens, recently invoked by a New York court to send a high-profile case to Germany, as well as the use of arbitration and choice of forum/choice of law clauses, can close the door to a costly American litigation forum.\(^2\)

Introduction

Whether to try to tap into the vast American consumer market can be a difficult question for many businesses outside the United States. On the one hand, gaining access to the world’s single largest market is appealing. On the other hand, however, there are weighty concerns about the plaintiff-friendly legal environment, particularly in product liability matters. The prospects of class action lawsuits and punitive damages (unknown or at least far more limited in most other court systems) give American plaintiffs unique levers to extract damages. Coupled with the ability to retain counsel paid on a contingent basis and the absence of an obligation to pay costs or fees incurred by a successful defendant, this creates an environment in which a plaintiff faces little downside in pursuing claims. These factors make many foreign manufacturers hesitate about a foray into the U.S. market. The extent to which foreign companies can limit their potential exposure to liability is therefore a crucial matter. While the risk can’t be eliminated entirely, there are effective steps a foreign company can take to substantially reduce its potential exposure to litigation liability in the United States.

A foreign company’s central strategy in this endeavor must be to structure involvement in the American market to minimize the chances of it becoming subject to the jurisdiction of a U.S. court. Only rarely will American plaintiffs seek to sue a foreign manufacturer in its home country. Typically, non-U.S. legal systems do not allow extensive fact discovery; do not permit the award of punitive damages; do not allow group actions to proceed without affirmative consent of the represented individuals; and also may require a losing plaintiff to compensate a defendant for its legal fees. Thus, closing the doors to a court in the United States in practice forecloses most claims. How the foreign entity structures its business relationships — for example, whether it sells directly to the U.S. market, or uses an affiliated entity, or deals through third parties — may make an important difference. So may whether it manufactures its products entirely outside the U.S. or makes them partly or entirely in America. The internet revolution also has affected these determinations, with some courts unwilling to assert jurisdiction over a foreign company merely because its products can be read about on-line.

Equally critically, there are significant variations among the willingness of U.S. states to assert jurisdiction over foreign-based entities, to defer to another jurisdiction for the resolution of disputes between Americans and a foreign company and to award punitive damages, among other things. Even if jurisdiction exists, it may be possible to

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\(^2\) To be clear, the concepts outlined below will not shield a U.S.-based affiliate or business entity from being brought into an American court. However, they can protect a foreign direct or indirect parent from being subject to U.S. jurisdiction.
persuade the U.S. court that arbitration or a foreign judicial forum is the appropriate venue in which to resolve the case, as a recent New York claim against Porsche over its acquisition of shares of Volkswagen demonstrates. Carefully drawn choice of law/choice of forum/arbitration provisions can help achieve this result.

Discussion

I: Assertion of Jurisdiction Over a Nonresident Corporation — A Theoretical Overview

It will be useful to recall at the outset that the United States is a federal nation. Its constituent states exercise much of the governmental power over businesses, and therefore state law governs most jurisdictional and forum non conveniens issues. But states must exercise that power consistently with the requirements of the United States Constitution, most notably, its requirement that the foreign defendant be afforded "due process of law." This places significant limits on the ability of courts to enter damage awards against foreign entities.

Broadly speaking, states exercise two types of personal jurisdiction over corporations. General jurisdiction permits the court to exercise jurisdiction for all purposes. A state in which a corporation is incorporated, or in which it is authorized to do business, or where it has continuous and systematic business contacts, such as a primary place of business where it has offices, employees and bank accounts, will have jurisdiction over any claim against that corporation, even one arising outside the forum state.

Most corporations will be present for purposes of general jurisdiction only in one state or perhaps in a few states, even though their products or services may be in use across the country. This is where the second species of jurisdiction, specific jurisdiction (or "long arm jurisdiction"), comes into play. Specific jurisdiction is confined to the adjudication of issues related to activity in the particular state, deriving from or connected with the "very controversy that establishes jurisdiction." Illustratively, if a foreign corporation with its U.S. headquarters in Utah enters into a contract to be performed in New York, the New York court likely would have jurisdiction over claims against the corporation provided they are related to that contract.

As to any particular claim, it is the plaintiff’s burden to establish that a state has specific jurisdiction over a nonresident defendant. Activities on the basis of which long arm statutes allow specific jurisdiction to be established for claims related to the activity typically include conducting business in the state or with its residents, ownership of property there, or action causing injury in that state.

Specific Jurisdiction and the “Stream of Commerce”

Since the mid-century landmark decision of International Shoe Co. v. Washington, the touchstone for determining whether the assertion of specific jurisdiction comports with Constitutional due process has been whether the defendant’s “minimum contacts” with the forum state would allow a suit to be maintained without offending “traditional notions of fair play and substantial justice.”

At the outset, the plaintiff must show that the nonresident defendant had sufficient contacts with the forum state. If that burden is met, the analysis turns to the reasonableness of asserting jurisdiction under “traditional notions
of fair play.” This analysis almost always favors the plaintiff.\(^6\) It follows that, for foreign corporations, the key is to structure operations and transactions to reduce or eliminate the minimum contacts needed under *International Shoe*. Although continuing to evolve, the case law has developed two tests: purposeful availment and reasonable foreseeability.

In Hanson v. Denckla, the Supreme Court mandated that there must be some act by which a defendant “purposefully avails itself of the privilege of conducting activities” within a state, “thus invoking the benefits and protections of its laws.”\(^7\) In subsequent decisions, the Court’s analysis of purposeful availment has focused on the intentionality of the defendant’s connections with the forum state to determine whether they were sufficient to support a finding of minimum contacts. Examples of purposeful availment have included:

- Entering into a long-term business relationship with a forum resident;
- Seeking to serve customers in the forum state;
- Purposeful direction of goods towards a forum state.

Courts also have considered whether the defendant reasonably could have foreseen being haled into court in a particular state. In a famous concurring opinion based on considerations of fairness and foreseeability, Justice Brennan urged that the defendant’s ability to anticipate suit in a forum, rather than purposeful availment, should be the dispositive factor. If the defendant was aware, or reasonably should have been aware, that its product could be marketed in the forum state, the “possibility of a lawsuit there could not come as a surprise.”\(^8\)

This view has not carried the day in the Supreme Court. In *Asahi*’s plurality opinion, Justice O’Connor was joined by three other justices in holding that a foreign corporation’s mere awareness that a component it sold could travel anywhere in the United States in the “stream of commerce” did not provide sufficient contacts with the forum state to allow its courts to exercise specific jurisdiction.\(^9\) Instead, the court required some form of purposeful direction of commerce toward the forum state and not just the placement of goods into the general stream of commerce without other action targeting the state. The tension between these two approaches has resulted in many courts relying on either foreseeability or purposeful availment in applying the minimum contacts test for specific jurisdiction over nonresident defendants in stream of commerce cases, leaving the law in an uncertain state.

"Stream of Commerce +“ - J. McIntyre’s Focus on Purposeful Availment

The Supreme Court’s most recent teaching in this area, *J. McIntyre*, reiterated the emphasis on purposeful availment but still left some key questions unanswered. *J. McIntyre Machinery, Ltd.* was an English manufacturer of heavy machinery that partnered exclusively with an independent distributor to sell its products throughout the United States. The manufacturer sent officials from its home office to appear with the distributor at trade shows outside the State of New Jersey. It also aided in the direction of the distributor’s marketing and sales efforts, which were targeted at the U.S. market as a whole. The plaintiff, injured in New Jersey using a device purchased from the distributor at a Nevada trade show attended by J. McIntyre’s representatives, sued the English manufacturer. The court held that due process did not permit a New Jersey court to exercise jurisdiction over the English manufacturer because it had not purposefully and voluntarily directed its activities towards the state in a way that would cause it to expect, by virtue

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\(^{7}\) 357 U.S. 235, 253 (1958).

\(^{8}\) *Asahi Metal Indus. Co. v. Superior Court of Cal., Solano Cnty.*, 480 U.S. 102, 117 (1987)

\(^{9}\) Asahi produced valve assemblies which were sold to a Taiwanese motorcycle tire manufacturer. The plaintiff alleged that one of these valves was the cause of a tire failure in a fatal accident in California.
of the benefit received from its relationship with the state, to be subject to its jurisdiction. Another four-justice plurality opinion found that the proper test for minimum contacts was to examine the defendant's purposeful conduct towards the state and determine whether that made the assertion of jurisdiction consistent with "traditional notions of fair play and substantial justice," rejecting the foreseeability standard. The relevant inquiry was J. McIntyre's purposeful contacts with New Jersey, not its entity's purposeful contacts with the nation as a whole.

The court put aside considerations of foreseeability and the defendant's expectations of where its products would go in the stream of commerce in favor of a focus on the defendant's conduct. Because J. McIntyre's only contact with New Jersey was the presence there of (at most) four machines it had made elsewhere (including the one that caused the plaintiff's injury), there was an insufficient basis for jurisdiction. The plaintiff could not establish that J. McIntyre had minimum contacts with New Jersey because its conduct failed to reveal any intent to invoke or benefit from the protection of that particular state's laws.

Justice Breyer, in a concurring opinion, differed with the plurality's analysis dispensing with notions of fairness and foreseeability in its minimum contacts analysis. He felt that the facts of the case did not warrant the plurality's focus on purposeful availment, because it did not take into account modern commercial circumstances that let a foreign corporation target a worldwide market via the internet and ship its products through various intermediaries. How the purposeful availment test would apply in such an online context remains unresolved by the Supreme Court.

Because J. McIntyre also did not produce a majority opinion, state and federal courts continue to follow their respective precedents regarding the analysis of minimum contacts for purposes of specific jurisdiction. The plurality opinion in J. McIntyre has been persuasive in leading many courts to embrace purposeful availment as their standard. Nonetheless, some jurisdictions have continued to apply the reasonable foreseeability standard in accordance with their precedents.

II: Applying Specific Jurisdiction Principles in Actual Practice

These concepts might be of academic interest only if all 50 states had identical laws, but they don’t. There are important differences as to the theories on which and amounts for which defendants can be held liable in different states. Knowing the long arm ground rules lets a foreign manufacturer take steps to avoid or minimize its chances of being subjected to jurisdiction in a given state. If it has identified a given state as particularly unfavorable legally, steps can be taken to avoid being subject to its jurisdiction. For example:

- Do not register to do business in that state;
- Do not maintain a place of business, employees or any bank accounts in that state;
- Do not design, manufacture, or advertise products in that state;
- Do not design state-specific versions of the product;
- Do not solicit business or personally sell or ship goods in that state;
- Do not contract with distributors specifically to sell goods to that state;
- Do not indicate a willingness to defend any suit on the merits in a court, or otherwise waive the defense of personal jurisdiction.

The following paragraphs apply these principles to the various business models available to a foreign manufacturer for the distribution and sale of its products in the United States:

1. Direct Sale by a Foreign Manufacturer to U.S. Consumers

A foreign manufacturer selling its products directly to end users in the United States almost certainly would be subject to specific jurisdiction, thus exposing itself to the highest potential for liability. This outcome likely would be the same whether the minimum contacts issue was analyzed under the purposeful availment or reasonable foreseeability tests. Even a single, isolated sale resulting in injury to a consumer could provide sufficient contact for the exercise of jurisdiction over the foreign manufacturer as to that consumer’s claim of injury.11

However, as discussed in Justice Breyer’s concurring opinion in J. McIntyre, the law remains unclear as to the implications of internet-based commerce for minimum contacts analysis. A website that is seen to reach out to consumers of a specific state—e.g., by offering Illinois residents a 15% discount—is more likely to subject the foreign manufacturer to specific jurisdiction. A passive website, or at least one not reaching out specifically to U.S. buyers, is less likely to subject the foreign manufacturer to U.S. jurisdiction. It is precisely for this reason that foreign manufacturers intent on avoiding the assertion of specific jurisdiction should refrain from conducting direct sales, including those on the internet, to customers in the United States.

2. Sale by a Third-Party Distributor to U.S. Consumers

Rather than sell directly to end-users in the United States, a foreign manufacturer may find it better, from both business and legal perspectives, to engage an independent distributor to sell its products. The manufacturer may choose to import partially or completely finished products, or to license its products for manufacture in their entirety by the distributor. These choices will affect the minimum contacts analysis.

a. Sale by a Third-Party Distributor of Goods Manufactured Abroad

If a foreign manufacturer engages an independent distributor to sell its products throughout the United States, J. McIntyre suggests that, at a minimum, the manufacturer will have sufficient contacts with the state of incorporation or place of principal business of the distributor to be subject to specific jurisdiction there. A court likely would find that in doing business with an entity in that state, the foreign manufacturer “purposefully availed” itself of the benefits of the state’s laws. Likewise, if the reasonable foreseeability standard were applied, a court likely would hold that the foreign manufacturer reasonably should have anticipated being brought before a court in that jurisdiction as a result of the distribution agreement.

The minimum contacts analysis does not differ significantly for a foreign manufacturer that delivers components that subsequently are made into a finished product by the distributor. The foreign manufacturer likely will have sufficient contacts resulting from its contractual relationship and delivery of goods to the distributor’s state to be amenable to jurisdiction there. It bears noting that the presence of the foreign manufacturer’s goods, regardless of the extent to which the product was finished, may result in contacts sufficient to establish specific jurisdiction.12

Whether or not the foreign manufacturer delivers partially or completely finished products to its distributor, the manufacturer’s amenability to suit in states beyond those where its distributor is found will depend upon whether the

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12 In a recent case, a Chinese manufacturer of automotive glass was found to have sufficient contacts with the State of Michigan as a result of its contracts with a distributor and automotive manufacturer in that state. The cause of action arose when the plaintiff was injured by the Chinese manufacturer’s glass prior to its final assembly. McFadden v. Fuyao N. Am. Inc., 10-CV-14457, 2012 WL 1230046 (E.D. Mich. Apr. 12, 2012).
manufacturer purposefully directed activity towards those other states. Courts focus on all of the foreign manufacturer’s activity related to the U.S. market to determine if states were targeted specifically. Examples of this include advertising aimed at a state or product design peculiar to a state, which would indicate purposeful availment of that state's laws. Additionally, in states that apply the reasonable foreseeability standard, courts will analyze whether the manufacturer had reason to know, or should have known, the markets the distributor primarily served. Although this analysis of minimum contacts is applied in a minority of states, it creates a troubling situation for the foreign manufacturer. Depending upon the size of the distributor, the reasonable foreseeability standard may result in the manufacturer being amenable to jurisdiction in multiple locations.

b. Sale by a Third Party Distributor of Goods Manufactured Under License Domestically

A foreign manufacturer’s best chance to avoid jurisdiction in a given state may be to license its product to a third party that proceeds independently to manufacture the licensed goods. Case law suggests that when a licensor has no control over how its licensee markets or sells a licensed product, the mere fact that the licensed product is sold in a given state will not provide a sufficient basis to assert personal jurisdiction over the licensor.\(^1\) If a foreign manufacturer only collects licensing fees or royalties from a product, without doing anything more, it should feel confident in its ability to avoid being brought before a court in the U.S. on that basis alone.

3. Sale by an Affiliate of the Foreign Manufacturer

One obvious way in which foreign manufacturers may seek to minimize their exposure to U.S. jurisdiction is to establish American subsidiary entities. The minimum contacts analysis for a distribution agreement with a subsidiary is likely to track that for a distribution agreement with an independent third party. In other words, at a minimum, the foreign manufacturer will have sufficient contacts with the state of incorporation or place of principal business of the subsidiary distributor to be subject to specific jurisdiction there.

In addition, while it is a deep-seated principle in American corporate law that a parent corporation is not liable for the acts of its subsidiaries, it is an equally fundamental principle that the “corporate veil” will be pierced when a parent company misuses the corporate form for wrongful purposes, as in the creation of a shell company to avoid liability in a given jurisdiction. In such circumstances, courts will ignore the fact that the subsidiary is a different entity and impose liability on the parent beyond the assets of the subsidiary.

The potential trap for the unwary, into which many foreign companies fall, is the failure to maintain a sufficiently separate corporate identity for the subsidiary. That failure leads to the actions of the subsidiary being imputed to the foreign parent for minimum contacts purposes, leaving the foreign parent subject to jurisdiction and defeating the entire purpose.

When a foreign corporation forms a U.S. subsidiary to distribute its products, it is absolutely crucial that it follow good corporate practices to avoid being held liable in place of its subsidiary. The U.S. subsidiary, unlike the foreign parent, may be subject to general jurisdiction in several states, depending upon where it is incorporated, headquartered, or otherwise has systematic and continuous business contacts. It follows that if the corporate veil were to be pierced, a court in any one of these states would be able to exercise jurisdiction over the parent company.

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The decision whether to pierce the corporate veil is very fact intensive, so there are no bright-line rules. However, various factors, varying from state to state, are considered. Generally speaking, in order to pierce the veil, courts require a showing that the parent company exercised complete dominion over the subsidiary, acting in a capacity greater than that of an investor. To avoid a court’s piercing the corporate veil, a foreign corporation should follow the following steps:

- Avoid mirror image board membership of the parent and subsidiary;
- Avoid keeping the subsidiary thinly capitalized;
- Avoid commingling of funds between the parent and subsidiary;
- Avoid holding the subsidiary out to the public as an agent of the parent company;
- Avoid taking active day-to-day control of the subsidiary;
- Establish and follow communication protocols between the parent and subsidiary;
- Follow corporate resolutions and formalities regarding behavior and maintenance of documentation;
- Negotiate contracts between the parent and subsidiary at arms length.

III: “Forum-Shopping” for Defendants: Structuring Transactions to Select Where a Defendant May be Subject to Jurisdiction

A. Select the State

Depending upon the contemplated transaction, a foreign corporation may be unable to avoid being subjected to jurisdiction in a given state. While the preceding discussion outlined useful steps for avoiding the exercise of specific jurisdiction, a foreign corporation also can use this advice to select the state(s) within which it is willing to be amenable to suit. This provides the foreign corporation with a planning advantage, including giving it the opportunity to establish a relationship with local counsel in advance of litigation, while avoiding being caught off-guard by a plaintiff bringing suit in a remote jurisdiction.

In “shopping” for the states where it may choose to partner with a third party distributor or establish a subsidiary, a foreign manufacturer can avoid additional exposure to liability by choosing states that limit class actions and/or punitive damages. For example, the following states either prohibit punitive damages completely, or limit it by statute in product liability cases:

- Louisiana
- New Hampshire
- Washington
- Massachusetts
- Michigan
- Nebraska

The following states prohibit bringing product liability class action lawsuits under their consumer fraud statutes:

- Georgia
- Iowa
- Minnesota
- Pennsylvania
- South Carolina
- Virginia
B. Craft the Contract

A foreign corporation also can do a great deal to control the forum in which it may have to face claims by crafting the contracts into which it enters. For example, a recent U.S. Supreme Court decision upheld the validity of arbitration clauses in consumer agreements that explicitly prohibited class action lawsuits. The simple inclusion of such a provision could transfer claims from a proceeding in court as a class action, to be decided by a jury, with the potential for a punitive damage award, to an individual matter in an arbitral forum where such a punitive damage award might not be permitted and, in any event, the fact-finder might be less open to emotional appeals.

For reasons already noted, product liability plaintiffs generally would prefer to litigate their claims in the United States. Even if jurisdiction exists over a defendant with regard to a claim against it, however, American courts have the power to grant a *forum non conveniens* motion, concluding that it would be better for the particular matter to be resolved in another country’s courts. The legal label for how the foreign corporation moves the claim against it into another court system probably will be of less interest to its management than the result.

In a recent New York State intermediate appellate court decision, various hedge funds had brought suit against Porsche for claims of fraud and unjust enrichment. Plaintiff funds alleged that they had relied on statements by Porsche that it had no present intention to acquire a three-fourths stake in Volkswagen to execute short sales of VW stock. Porsche allegedly then proceeded with a takeover plan, leaving plaintiffs in a “short squeeze.” VW share prices rose and plaintiffs claimed they had been forced to spend a billion dollars to cover their short positions.

The plaintiffs pretty plainly were looking for a way to bring what would have been a securities fraud claim prior to the U.S. Supreme Court’s *Morrison* decision, which restricted the availability of such claims where foreign plaintiffs purchase shares in a foreign entity on a market outside the United States. In *Porsche*, the “only alleged connections between the action and New York are the phone calls between the plaintiffs in New York and a representative of defendant in Germany, and the emails sent to plaintiffs in New York but generally disseminated to parties elsewhere,” in which the alleged misrepresentations were made. Because everything related to the claim was outside New York — the location of the defendant and most of the plaintiffs; that VW stock traded only on foreign markets; the location of many witnesses and documents in Germany — and an adequate alternative forum was available, the defendant’s motion for a *forum non conveniens* transfer was granted. In contractual settings, a similar result may be obtained by including choice of law and choice of forum provisions.

**Conclusion**

Continuing efforts towards tort reform in the United States undoubtedly will make product liability an interesting issue for foreign manufacturers to watch in upcoming years. But in the meantime, there are better ways to manage the risk of product liability claims in the United States than by simply foregoing this potentially lucrative market. Thoughtful design of business arrangements and structures, attention to the variations in state law and careful crafting of protective contractual provisions all can go a long way to protecting foreign businesses.
