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Foreign Trade Zones: "Everything Except the Customs?"

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FOREIGN-TRADE ZONES: "EVERYTHING EXCEPT THE CUSTOMS"?*

> [Foreign Trade Zones] are subject to a little within [sic] adjacent regions to all laws relating to public health, vessel inspection, postal service, labor conditions, immigration, and indeed everything except the customs.
>
> Congressman Emmanuel Celler, 1934.[1]

INTRODUCTION

Foreign-Trade Zones (Zones)[2] are enclosed and sharply delimited areas adjacent to a port of entry and physically within the United States. However, Zones are considered for the purposes of customs laws and related regulations to be outside of the geographic boundaries of this country.[3] A Zone's primary impact is to preclude the requirements of otherwise applicable customs duties and entry formalities upon import merchandise transactions unless and until the goods physically leave the Zone and enter United States customs territory.[4] Although patterned after the ancient free port device,[5] Zones in this country are governed entirely by federal statute.[6] The constitutional authority of the federal government to establish these Zones is premised upon its exclusive and plenary power to regulate foreign commerce.[7]

A Zone has been picturesquely described as "[a] neutral stockaded area

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1. 78 CONG. REC. 9853 (1934). Congressman Celler of New York was the legislator primarily responsible for the enactment of the Foreign-Trade Zone legislation; indeed, the Foreign-Trade Zone Act of 1934 *as amended by* 19 U.S.C. §81a-u (1976) (Act) is popularly known as the "Celler Act." *E.g.*, W. DYMSZA, FOREIGN-TRADE ZONES AND INTERNATIONAL BUSINESS 31 (1964).

The clause "a little within" should be interpreted to mean "equally with." Note, *Foreign-Trade Zones: A Means by Which the Businessman May Avoid Import Duties*, 29 U. PITT. L. REV. 89 (1967). The quoted statement is often cited by courts in construing the Act. *See, e.g.*, G.D. Searle & Co. v. Byron Chemical Co., 223 F. Supp. 172, 174 (E.D.N.Y. 1963) (holding United States patent law applicable to Zone-based transactions). Commentators examining the Act also make frequent reference to the quoted statement. Note, *supra* at 102-03.

2. "Zone(s)" will hereinafter be used in both the text and the footnotes to refer only to Foreign-Trade Zones as established pursuant to the Foreign-Trade Zones Act of 1934 *as amended by* 19 U.S.C. §81a-u (1976). For clarity, these statutory Zones should be kept categorically separate from Free Cities, Free Ports, and Free Zones. These historical antecedents of Zones will be discussed later. See notes 16 and 20 *infra* and accompanying text.

3. *In But Out Foreign-Trade Zones Merit Community Attention Today*, COM. TODAY Dec. 9, 1974 at 4.

4. 19 U.S.C. §81c (1976); the Act provides, "[m]erchandise . . . without being subject to the customs laws . . . [may] be brought into a [Z]one . . . but when such foreign merchandise is sent from a zone into customs territory of the United States it shall be subject to the laws and regulations of the United States affecting imported merchandise." *See also* 15 C.F.R. §400.801 (1978).

5. R. THOMAN, FREE PORTS AND FOREIGN-TRADE ZONES, 6-13 (1956). See notes 15-17 *infra* and accompanying text.

6. 19 U.S.C. §81a-u (1976).

7. U.S. CONST. art. I, §7, cl. 3.

where a shipper can put down his load, catch his breath and decide what to do next."[8] The intent of federal Zone legislation was to provide this opportunity to domestic businesses, and this objective was implemented by the passage of the Foreign-Trade Zone Act of 1934[9] (Act). The stated purpose of the Act was to encourage and expedite foreign trade.[10] By promoting domestic expenditures through foreign trade, Congress hoped to stimulate economic activity.[11]

The Act and its stated purpose, with the exception of a 1950 amendment removing the prohibitions on manufacturing within Zones, have remained congressionally unchanged for forty-five years.[12] Although initial utilization of the Zone privilege was unexpectedly limited,[13] recently, this disinterest has dissipated as the demand for Zone grants has burgeoned.[14] Moreover, this

8. Thompson, *Role of Foreign-Trade Zones in World Trade Significantly Enlarged,* FOREIGN COM. WEEKLY, June 26, 1950, at 1, quoted in R. THOMAN, *supra* note 5, at 6. A Zone is more technically defined as "[a]n isolated, enclosed, and policed area, operated as a public utility, in or adjacent to a port of entry, furnished with facilities for lading, unlading, handling, storing, manipulating, manufacturing and exhibiting goods, and for reshipping them by land, water, or air. Any foreign and domestic merchandise, except such as is prohibited by law or such as the Board may order to be excluded as detrimental to the public interest, health, or safety may be brought into a zone without being subject to the customs laws of the United States governing the entry of goods or the payment of duty thereon; and such merchandise permitted in a zone may be stored, exhibited, manufactured, mixed or manipulated in any manner, except as provided in the act and other applicable laws or regulations. The merchandise may be exported, destroyed, or sent into customs territory from the zone, in the original package or otherwise. It is subject to customs duties if sent into customs territory, but not if reshipped to foreign points." 15 C.F.R. §400.101 (1978).

9. 48 Stat. 998-1003 (1934), *as amended,* 19 U.S.C. §81a-u (1976).

10. H.R. REP. No. 1521, 73d Cong., 2d Sess. 1 (1934) [hereinafter cited as H.R. REPORT]. The report stated that "[t]he wisdom of many governments in setting up these free zones cannot be disregarded by us. It is believed that it would be of material advantage to the commerce of the United States to provide for the creation of such zones so that the benefits which accrue to foreign nations by their establishment may be shared by us." *Id.* at 2. The report also included a letter from the Chamber of Commerce of America which encouraged the enactment of the Bill and indicated that Zones were needed by American businessmen who desired to engage in diversified international trading. The Chamber of Commerce also stated that Zones would bring additional business to America. *Id.* at 3-4.

11. *Id.*

12. *E.g.,* Foutain v. New Orleans Public Service, Inc., 387 F.2d 343, 344 (5th Cir. 1967) ("[p]urpose of Foreign-Trade Zones [to] expedite and encourage foreign commerce").

13. The first Zone, "New York Foreign-Trade Zone No. 1," was not established until 1937, and it was ten years until the next Zone, was established in New Orleans. W. DYMSZA, *supra* note 1, at 43.

14. Seven Zones were operating in 1967 at the following ports of entry: Honolulu, Mausquez (P.R.), New Orleans, New York, San Francisco, Seattle, and Toledo. Note, *supra* note 1, at 97. As of January 12, 1979 the Board had issued forty-four grants for Zone operations and six Zone applications were pending final decision. The pending applications are for Zones in Arizona, Kentucky, Missouri, Ohio (2), and Oregon. Letter from Jean Blocker, Foreign-Trade Zones Board Staff Member, to author (Jan. 26, 1979) [hereinafter cited as F-TZ Board Letter].

This expansion is particularly notable in Florida where three Zones have recently been located: (1) Zone No. 25, Port Everglades, Florida; 30 acre Zone within a 260 acre area of the Port Authority, sponsored by Board of Commissioners of the Port Everglades Authority. (2) Zone No. 32; general purpose three-acre Zone on 13 acre tract west of Miami International Airport sponsored by Greater Miami Foreign Trade Zone, Inc. (3) Zone No. 42, Orlando,

decade has witnessed a distinct transformation in the physical characteristics of Zones.[15] As a consequence of these changes, considerable confusion surrounds Zone operations today.

This note will trace the historical development of Zones culminating with the enactment of Zone legislation in this country. The provisions of the Act will be examined and the business incentives it provides will be analyzed. Emphasis will be given to Zone related litigation and judicial constructions of the Act. The policy implications of the rapidly expanding number of Zones and the metamorphosis of the Zone concept are also considered. Finally, in light of the expanding number of Zones, specific suggestions for improvement in the Act and Zone operations will be made.

HISTORICAL DEVELOPMENT OF FOREIGN-TRADE ZONES

Early traces of the Zone concept can be found in the beginning of commerce itself, when the inhabitants of ancient villages allowed visiting merchants various trading privileges.[16] Although the modern free zone is a relatively small and enclosed area, its antecedent, the free port, was often a complete harbor or occasionally an entire urban unit.[17] In 1189, Frederick I established one of the earliest significant free zones by granting the City of Hamburg a charter which exempted it from the payment of customs duties.[18] The first free zone physically delimited by geographic boundaries appeared in Genoa in the later stages of mercantilism.[19] Protectionistic polices of the Second Reich facilitated the next major development of free zones.[20] The free port cities of Hamburg, Breman, and Lubeck were forced to join the *Zollerin*, the Reich's customs union. These cities reduced the size of their customs exempt

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Florida; 201 acre Zone at the Orlando International Airport, sponsored by Greater Orlando Aviation Authority. F. TZ Board Letter. The cities of Tampa and Jacksonville are also considering procuring Zone grants. Landy & McGinnis, *Foreign-Trade Zones in Florida: Legal Considerations for Foreign Business Interests*, 10 LAW. OF THE AMERICAS 41 (1978).

15. DaPonte, *Foreign-Trade Zones: An Update*, AM. IMPORT EXPORT BULL., April, 1977, at 4 (Mr. DaPonte is Executive Secretary of the Foreign-Trade Zones Board). Zones were previously almost exclusively harbor terminal facilities similar to those at "Foreign-Trade Zone No. 1" in Stapleton, New York. However, many Zones have recently been established at industrial parks adjacent to international airports. *Id.* at 2. These new types of Zones are designed to accommodate production requirements such as the final assembly and testing of merchandise, and similar light industries. These industrial park Zones also provide ready access to transportation necessary for the distributive functions of Zones. An effective distributive design of a Zone must allow for ready access to all means of modern transportation. *Id.*

16. R. THOMAN, *supra* note 5, at 6-20 (containing an extensive history of the development of the free-Zone concept).

17. *Id.* at 11. The rudiments of the free port device, which is nothing more than an enlarged Zone, were present in the ancient cities of Tyre, Carthage and Utica. *Id.*

18. A. LOMAX, THE FOREIGN-TRADE ZONES 8 (1947) (arguing that the genesis of free-Zone began at the City of Hamburg). *See* Note, *supra* note 1, at 93.

19. R. THOMAN, *supra* note 5, at 14. The Genoa Zone was quite similar to United States Zones in that residence in the Zone was basically prohibited, and the major use of the Zone was warehousing foreign goods prior to the liquidation of their customs duties. *Cf.* 19 U.S.C. §81o (1976) (similar provisions).

20. Note, *supra* note 1, at 94.

areas to comport with *Zollerin* policy thereby converting them from free ports into free zones.[21]

Although the free zone has been known to international commerce for centuries, its basic purpose has remained unchanged.[22] This purpose is to encourage foreign trade by expediting the passage of goods from an exporting foreign country through the medium of the free zone, located in the intermediary country, to the importing country.[23] This three-country process, known as transshipment commerce, is encouraged by minimizing the disincentives of customs duties and attendant procedural formalities on goods which are only temporarily in an intermediary country and destined for re-export.[24] Zones, as congressionally developed, differ from their historical predecessors, free ports and cities, in name and size only. Their essential purpose has not been altered.[25]

United States Perspective

Congressional proponents of free zone legislation encountered substantial opposition to the implementation of the Zone concept.[26] Apparently because of deep-seated protectionistic attitudes against any "free" trade concept, it was necessary for such matters "to simmer in our legislative kitchens for some twenty-four years" prior to enactment.[27] Efforts to enact Zone legislation, which began in 1894, reached their zenith in 1919. The questionable motivating force for this effort was an alleged desire to capitalize upon the disruption in German shipping resulting from World War I.[28] Throughout the 1920's the expansionists unsuccessfully continued to debate the free zones concept with their protectionist opponents.[29] At the national level the continued attempt to implement the free zone concept is evidenced by the commissioning of the Army Corps of Engineers to conduct a comprehensive study of the viability of this

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21. *Id. See* note 17 *supra* and accompanying text.

22. See notes 10-12 *supra*.

23. Note, *supra* note 1, at 96. *Cf.* 19 U.S.C. §81c (1976) (a recent amendment to the Act which allows extensive manufacturing in Zones).

24. Note, *Foreign-Trade Zone Manufacturing: The Emergence of a Free Trade Instrument*, 9 VA. J. INT'L L. 444, 448-49 (1969).

25. W. DYMSZA, *supra* note 1, at 28-31.

26. R. THOMAN, *supra* note 5, at 134. Legislative efforts began in 1894 and were directed towards the creation of specific Zones as opposed to the enactment of self perpetuating legislation which would allow for the creation of an unlimited number of Zones. Indicative of the special interest nature of Zones, the proponents of the two original Zones, at Ford Ponds Bay and Point Judith, Rhode Island, were representatives from those same areas. *Id.*

27. *Id.*

28. *Id.* In 1919 nine joint resolutions concerning free Zones were introduced in the Congress and the House and the Senate were each presented with three free Zone bills. *Id.*

29. *Id.* at 135. These early bills were in a large measure defeated by the argument that free Zones in this country would be unconstitutional as violative of the U.S. CONST., art. I, §9, cl. 6, which provides in pertinent part that "No Preference shall be given by any Regulation of Commerce or Revenue to the Ports of One State over those of another . . . ." A. LOMAX, *supra* note 17, at 14-16 (containing a detailed account of the legislative background of the Zone concept).

trade device in the United States.[30] Although the report was favorable,[31] the controversy continued and it was several years before a successful legislative effort could be spearheaded.

Ultimately, in May of 1934, the House Ways and Means Committee reported out a bill authorizing the establishment of Foreign-Trade Zones[32] designed to encourage and revive foreign trade in the United States.[33] The Committee report recommended passage of the bill;[34] however, considerable opposition was voiced by protectionistic legislators desiring to insulate their manufacturing and industrial constituency from foreign competition.[35] Other legislators were particularly concerned with inherent problems in the administration of Zones, the equitable allocation of Zone grants, and the possibility of detrimental effects of Zone operations upon American industry.[36] Also underlying the opposition to the bill was a recognized need to safeguard the neophyte domestic steel industry from competition with foreign steel manufacturers.[37]

The chief advocate of the Zones, Representative Celler,[38] attempted to alleviate these concerns by proclaiming that Zones would not act as a "hole in the tariff wall" because all products entering the United States through a Zone would be subject to normally applicable customs duties.[39] The intensive efforts of Representative Celler,[40] combined with the persuasive arguments of various

30. U.S. CORPS OF ENGINEERS, REPORT ON FOREIGN TRADE ZONES (1926) *as quoted in* W. DYMSZA, *supra* note 1, at 29. The Army Corps of Engineers was commissioned to conduct the study because of its supervisory function over United States ports of entry. See note 47 *infra*.

31. *Id.*

32. H.R. REPORT, *supra* note 10, at 2. The Report specifically denominated the devices Foreign-Trade Zones as opposed to Free-Trade Zones. This was an alleged subtle attempt to placate the protectionists opposed to free trade and any concept or device connected even remotely to it. *Id.*

33. *See generally* Note, *supra* note 1, at 93-99.

34. H.R. REPORT, *supra* note 10, at 1.

35. *See Hearing on H.R. 4726 and H.R. 9206, Before the Subcomm. of the House Comm. on Ways and Means*, 72nd Cong., 2d Sess. 10 (1933) [hereinafter cited as *Hearing on H.R. 4726 and H.R. 9206*].

36. *Id. See generally* Note, *Foreign Trade Zones: International Business Incentives*, 7 GA. J. INT'L & COMP. L. 669 (1977).

37. 78 CONG. REC. 9762, 9767 (1934). The fear was that these foreign steel manufacturers would be able to dump steel on the domestic market and stifle our growing steel producers. Note, *supra* note 36, at 671-72.

38. See note 1 *supra*.

39. *Hearings on H.R. 4726 and H.R. 9206, supra* note 35, at 12. "A free port is not a hole in the tariff wall or an entering wedge for the dumping of foreign products. . . . Every pound of copper, ton of sugar, and barrel of oil landed in such a Zone would be subject to the payment of duties and taxes to the United States *the minute it came through* the customs barriers for sale in this country." (Emphasis added.) *Cf.* Armco Steel Corp. v. Stans, 431 F.2d 779, 784-85 (2d Cir. 1970). In discussing the scope of the manufacturing amendment to the Act the court stated: "If a 'hole' is thereby rent in 'the tariff wall' Congress intended it, for the Foreign-Trade Zone[s] Act clearly contemplates that trade Zone users may take advantage of differing rates in tariff schedules. . . ." The court, therefore, concluded that the mere avoidance of customs duties was permissible within the scope of the Act's purpose. *Id.* at 785.

40. Representative Celler's efforts might be explained by the fact that "Foreign Trade

foreign trade experts such as the United States Chamber of Commerce,[41] should be credited with convincing the protectionists of the merits of the free zone concept,[42] and effecting passage of the Act. Like its passage, the Act itself gave rise to conflicting viewpoints. As originally framed, it limited the alteration of goods within Zones to manipulation.[43] Unfortunately manipulation was not a defined term. Therefore, administrators were faced with the difficult task of drawing the fine line between manipulation and manufacturing.[44] This problem was rectified in 1950 with the passage of the "Boggs Amendment," which expanded the provisions of the Act to allow manufacturing within Zones.[45] However, neither the original Act nor the passage of this manufacturing amendment initially generated substantial interest in the business community.[46]

Indifference within the business community was exacerbated by the prospect of unitary, centralized Zones which would be inutile to firms unwilling to establish operations within the Zone's boundary. In response to this disincentive the Foerign-Trade Zone Board (Board)[47] promulgated a regulation[48]

Zone No. 1" was established in his district at Stapleton, New York, resulting in his constituents receiving its economic benefits.

41. See note 10 *supra*.

42. W. DYMSZA, *supra* note 1, at 29-31. This exhaustive work presents an excellent analysis of the public policy variables in regard to Zone operations. Prepared under a grant by the Small Business Administration, the study provides a model for that which should be conducted into present day Zone operations. See notes 13-15 and accompanying text *supra* for a discussion of the recent changes in Zone operations which indicate the need for an updated study.

43. 48 Stat. 998-1003 (1934), *as amended*, 19 U.S.C. §81a-u (1976).

44. Note, *supra* note 24, at 451. Manipulation was generally considered to be limited to the repacking and adjusting of goods. The problem begins to develop as the adjustment begins to entail putting together two separate products. At the manufacturing end, it would seem certain that the processing of raw products into finished goods would constitute manufacturing. At the Foreign-Trade Zone in New Stanton, Pennsylvania, Volkswagenwerk is *assembling* cars from parts manufactured overseas. Machalaba, *Trimming Tariffs*, WALL ST. J., Dec. 4, 1978, at 30, col. 3. It is questionable whether such activity is the manufacture of automobiles or the manipulation of parts.

45. 64 Stat. 246 (1950), *as amended*, 19 U.S.C. §81c (1976) (presented by Representative Hale Boggs of Louisiana). It should be noted that the first Zone to undertake substantial manufacturing operations was located at New Orleans within Representative Boggs' district. This fact would further confirm the impact of special interests upon Zone legislation. See note 40 *supra* (noting that the first Zone was located in the district of the original legislation's primary proponent). The Act now provides that: "Foreign and domestic merchandise of every description, except such as is prohibited by law, may, without being subject to the customs laws of the United States, except as otherwise provided in this chapter, be brought into a Zone and may be stored, sold, exhibited, broken up, repacked, assembled, distributed, . . . mixed with foreign or domestic merchandise, or otherwise manipulated, or be manufactured except as otherwise provided in this chapter. . . ." 19 U.S.C. §81c (1976).

46. Note, *supra* note 24, at 454.

47. 19 U.S.C. §81a-b (1976); 15 C.F.R. §400.103 (1978). The Board consists of the Secretary of Commerce, who is chairman because of his integral role in the promotion of foreign commerce, the Secretary of the Treasury, who is a member because of his obligations as the supervisor of customs collection, and the Secretary of the Army, who is a member because of his responsibilities in the supervision and development of ports and harbors. W. DYMSZA, *supra* note 1, at 31. Because of the recent growth of Zones at international airports, see note 15 *supra* and accompanying text, consideration should be given to appointing

permitting specialized non-contiguous Zones, called "sub-Zones."[49] These zones are to be established upon a finding by the Board that the existing Zone could not adequately serve the proposed operation. The practical effect of this regulation has been that ongoing business operations may utilize the Zone device without physically moving to a Zone.[50]

Early Zone Operation

Despite concentrated efforts to enact Zone legislation, there was no onslaught of importers or businessmen seeking the advantages of a Zone grant.[51] In fact, it was nearly three years after the passage of the Act before the first grant was issued.[52] The original Zone, as anticipated by Congress,[53] functioned primarily as a pre-import warehouse and transshipment facility. Importers held

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a member with expertise in aviation such as the Director of the FAA. See DaPonte, *Foreign Trade Zones: An Update*, AM. IMPORT EXPORT BULL. April, 1977, at 3-4 for a description of the changes in Zone operations and their evolution in modern industrial parks.

48. 19 U.S.C. §81h (1976) (providing that the Board may promulgate regulations, not inconsistent with the Act, to carry out the Act's purposes).

49. 15 C.F.R. §400.304 (1978). This regulation provides: "The establishment of a Zone, or sub-Zone in an area separate from an existing Zone, for one or more of the specialized purposes of storing, manipulating, manufacturing, or exhibiting goods, may be authorized if the Board finds that existing or authorized zones will not serve adequately the convenience of commerce with respect to the proposed purposes." A sub-Zone conceptually allows an already operating permanently situated business to have the Zone come to its operation as opposed to the normal procedure in which it would move its operations to a Zone. See Armco Steel Corp. v. Stans, 431 F.2d 779 (2d Cir. 1970) for a description of the utilization of the sub-Zone privilege in a shipbuilding operation. In this case the sub-Zone was used because the existing Zone could not accommodate the extensive nature of the shipbuilding operation. *Id.* at 782.

50. DaPonte, *supra* note 15, at 4. "The fact that there are only two subzones presently in operation attests to their extraordinary nature. Approval of these special facilities is contingent upon a convincing case being made of a specific public benefit that the establishment of the subzone will bring about, such as the creation or retention of jobs that would otherwise be overseas." *Id.* As of January 1978, however, there were five sub-Zones in operation with applications pending for two new sub-Zones. F-TZ Board Letter, *supra* note 14. The pending applications are specified as separate sites for Zone No. 46 and are denominated 46(a) and 46(b). Upon this basis they may be characterized as sub-Zones.

It should be noted that the sub-Zone regulation in combination with the manufacturing amendment have coalesced to promote the use of Zones in ways never considered in the original legislative enactment. *See, e.g.*, Hawaiian Independent Refineries v. United States, 460 F. Supp. 1249 (Cust. Ct. 1978) (oil refining in sub-Zone). It would appear that this regulation, by only incidentally expanding operations because of increased profits, does little to effectuate the purposes of the Act. *Cf. Hearings on H.R. 4726 and H.R. 2906, supra* note 35, at 2. The specified purpose of Zones is to expedite and encourage foreign trade. See notes 254 and 256 *infra* and accompanying text.

51. See notes 26-31 *supra* and accompanying text.

52. R. THOMAN, *supra* note 5, at 137. Zone No. 1, involving some 92 acres, was however larger in physical size than Congress had anticipated. This should be compared to the size of some of the more recent grants, such as Zone No. 42, operated by the Greater Orlando Aviation Authority, which is over 200 acres in size. See note 14 *supra*.

53. Note, *supra* note 24, at 448. "[T]he original legislation envisioned foreign-trade zones as storage, transshipment and manipulation centers only." *But see* 114 CONG. REC. 10,011 (1968) (Zones are not intended to be used for goods destined for domestic consumption).

their goods in the Zone until it was economically advantageous to liquidate[54] customs duties by finally importing the merchandise. Almost immediately, however, subtle issues which were not contemplated by the framers of the Act began to arise such as when the recipient of the first Zone grant, New York City, "licensed"[55] a private corporation to operate the Zone.[56] Since this transaction was unexpected the Act did not expressly authorize or forbid it. Consequently, there were no guidelines governing the licensing of private corporations to operate Zones and to date, none have been enacted.[57]

As the number of Zones increased, other operational firsts occurred. "Foreign-Trade Zone No. 2," granted to the Board of Commissioners of the Port of New Orleans, was the first Zone to utilize the manufacturing privilege.[58] The Port Commission of San Francisco was the first grantee to obtain permission to operate a Foreign-Trade sub-Zone.[59] Another first, and still unique, Zone operation was established at McAllen, Texas. This Zone, because of its location at the Mexican/United States border, enables users to participate in international commerce. Thus, businesses located in the McAllen Zone utilize ground transportation for importing goods as opposed to air or sea transportation which must be used at all other Zones.[60]

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54. "Liquidate" as used herein means the assessment and payment of the applicable duties upon the import of the goods into United States Customs territory.

55. R. THOMAN, *supra* note 5, at 140. The license was to New York Foreign Trade Zone Operators, Inc., and was on a yearly renewal basis. This corporation continues to operate the New York Zone. 38 FOREIGN-TRADE ZONES BOARD, ANN. REP. TO CONGRESS at 8 (1976) [hereinafter cited as 38th ANN. REP.].

56. The transfer is problematic because the Act provides that: "[T]he grant shall not be sold, conveyed, transferred, set over or assigned." 19 U.S.C. §81q (1976); 15 C.F.R. §701 (1978). The action of the city in licensing a private corporation to operate a Zone was challenged by the plaintiff in American Dock Co. v. City of New York, 174 Misc. 813, 21 N.Y.S.2d 943 (Sup. Ct. 1940). The court however found the licensing not violative of the Act and further reasoned that the provision could only be asserted to terminate the grant by the United States and not a third party to the grant. 174 Misc. at 821, 21 N.Y.S.2d at 947. The court in Armco Steel Corp. v. Stans, 431 F.2d 779, 789, n.16 (2d Cir. 1970) also reached this conclusion and stated: "That Equitable and Central Gulf thought of the plan and that they requested the Board of Commissioners of the Port of New Orleans to apply for the subzone grant does not make the grant to the Board illegal. There is no evidence that the New Orleans Board is not ultimately responsible for the establishment, operation and maintenance of the subzone and that consequently it is the real grantee. Appellant's contention ignores the practical operation of the Act." Regardless of these problems, the New York Zone continues to be a viable operation. In 1976 it handled more than $66 million dollars worth of goods and paid more than $400,000 in customs duties. The Zone also provided services to 115 businesses and employed 14 full-time persons. 38TH ANN. REP., *supra* note 55, at 12.

57. See notes 126-131 & 190-200 *infra* and accompanying text.

58. W. DYMSZA, *supra* note 1, at 21. Ironically the first manufacturing in the Zone involved the import of bulk foreign metal which was processed to finished goods within the Zone, and thereby avoided otherwise applicable customs duties. 13 FOREIGN-TRADE ZONES BOARD, ANN. REP. TO CONGRESS 7 (1951). *Cf.* 78 CONG. REC. 9762 (1934) (discussing the harms of the dumping of foreign metals upon domestic markets).

59. 38TH ANN. REP., *supra* note 55, at 21.

60. *Id.* at 44-48.

Update of Zone Operations

A commentator in 1969 could fairly state that "Foreign-Trade Zones are not widely used."[61] This, however, is clearly not the current situation, with the number of Zones expanding rapidly.[62] Today, Zones are perceived by local officials as a vehicle to generate additional jobs, increase tax receipts and benefit the community by providing economic stimulation.[63] In fiscal 1976, Zones handled over $507 million worth of goods,[64] and this figure apparently will increase.[65]

Typically, the modern Zone is situated in an industrial park which provides ready access to all major transportation modes.[66] These Zones are engineered to accomodate the needs of technology-intensive operations,[67] whose plants are not a substantial nuisance and do not entail major construction and capital expenditure.[68] Historically, these more mobile operations have taken advantage of production economies and other incentives similar to those offered by Zone-based operations.[69] Such businesses have resulted in the following utilization of space in the forty-plus Zones presently operating: 65 percent for manipulation of goods; 25 percent for storage of merchandise; and 10 percent for manufacturing purposes.[70] Due to industrial changes, Zones, as evidenced by their rapid increase in number, are becoming a significant part of the international trade picture.[71]

FOREIGN-TRADE ZONE ACT

The Act, contrary to initial suggestions,[72] establishes procedures for the creation of Zones rather than itself establishing specific Zones. This approach delegates broad authority to an administrative board to create Zones as they are needed, obviating the necessity for legislative approval of each grant issued. To achieve this result, the Act necessarily contains broad language.[73] The

61. Note, *supra* note 24, at 456.

62. F-TZ Board Letter, *supra* note 14 (44 Zone grants have now been issued).

63. *"In" but "Out" Foreign Trade Zones Merit Community Attention Today*, COM. TODAY, Dec. 9, 1974, at 1. Zones can be characterized as a lure to commericial and industrial development at the local community level. In the economic development of an area a Zone will provide significant attraction to industry and trade. This article states that operating Foreign-Trade Zones "is a reflection of the concern of state and local officials and the service sector of the business community in providing the best possible business climate. . . ." *Id.* at 2.

64. 38TH ANN. REP., *supra* note 55, at 1 (Report of the Executive Secretary).

65. This conclusion is a reflection of the growing number of Zones. See note 14 *supra*.

66. DaPonte, *supra* note 15, at 4.

67. Technologically intensive operations normally proceed with minimal capital expenditure for plant and equipment. Their primary emphasis is upon the application of labor to earlier processed goods. The electronics industry, the final testing of products and the final assembly of cars from component parts exemplify technology intensive industries.

68. DaPonte, *supra* note 15, at 4.

69. *Id.*

70. Machalaba, *Trimming Tariffs*, Wall St. J., Dec. 4, 1978, at 1, col. 7.

71. *Id.* (quoting John DaPonte, executive secretary of the Foreign-Trade Zone Board: "The real significance of [Z]ones is just coming into being.").

72. See note 26 *supra*.

73. R. THOMAN, *supra* note 5, at 136. The self perpetuating legislation approach providing

administrative creation concept is superior to a congressional one because the influx of Zone applications raising technical issues creates the need for decisional processes for which Congress is unsuited.[74] At the same time, this broad delegation of power is somewhat surprising because Congress was unable to predict the impact of Zone availability and therefore surrendered control over a potentially significant aspect of foreign commerce.

Section 81 of the Act creates the Foreign-Trade Zones Board[75] and grants the Board authority to administer[76] and promulgate regulations under[77] the Act. The Board is an interagency body chaired by the Secretary of Commerce, with the primary functions of determining whether a grant for Zone operation will be issued, policing compliance[78] with regulations,[79] and revoking grants of violators of the Act.[80] The Board is also given the power to promulgate administrative regulations which are not inconsistent with the Act.[81] Board regulations charge the District Director of Customs with the local supervision of Zones within his area.[82]

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procedures to create numerous Zones is not universal and many countries such as Denmark create specific Zones by legislation. The Danish legislation is excerpted in R. THOMAN, *supra* note 5, at 170-85.

74. 15 C.F.R. §§400.400-.403 (1978). (Board promulgated regulations delineating extensive and complex criteria for economic, administrative and physical prerequisites to obtaining a Zone grant.)

75. 19 U.S.C. §81a-b (1976).

76. *Id.*; 15 C.F.R. §§400.200-.203 (1978) (jurisdiction and authority of Board).

77. 19 U.S.C. §81b (1976); 15 C.F.R. 400.103 (1978). The Board in the regulations is defined to mean "[t]he Board created by the [A]ct to carry out the provisions thereof. The Board shall consist of the Secretary of Commerce, who shall be chairman and executive officer, the Secretary of the Treasury, and the Secretary of the Army." The Board is required to promulgate an annual report to Congress. 19 U.S.C. §81p(c) (1976). These annual reports, often cited herein, are available from the Superintendent of Documents, and are excellent sources of up-to-date information on the operations of each Zone. A report on the Income and Expenditures for each grantee is included, see 19 U.S.C. §81p(b) (1976), requiring that each grantee report to the Board annually.

78. Grantee is defined as "a corporation to which the privilege of establishing, operating, and maintaining a foreign-trade zone hase been granted." 15 C.F.R. §400.107 (1978).

79. These regulations controlling operations in Zones are very specific and extensive. They are found in 15 C.F.R. §§400.800-.1014 (1978).

80. At the present time the Board has never terminated a grant and all of the Zones that have closed down have voluntarily released their grants. F-TZ Board Letter, *supra* note 14. The Board, however, has the power to revoke any grant after notice and a hearing if the grantee willfully violates any of the Act's provisions. 19 U.S.C. §81r(a) (1976). It appears that such revocation must be based upon violation of the Act's provisions and not violations of the Board's regulations. 38 OP. ATT'Y GEN. 227 (1935). Violation of the regulations may, however, result in the imposition of fines of up to $1,000 per day. 15 C.F.R. §400.200(h) (1978). In any circumstance in which a grant is revoked, the grantee will have a right of appeal to the circuit court of appeals in which the Zone is located. 19 U.S.C. §81r(c) (1976). It is further required that any operation in the Zone conform to the Regulations of the Customs Service as found in 19 C.F.R. §146 (1978).

81. 19 U.S.C. §81h (1976).

82. 15 C.F.R. §400.108 (1978).

Application Procedures

The basic requirements for obtaining a Zone grant and the specific procedures for grant applications are established by regulation.[83] These procedures are designed to ascertain the viability of the proposed Zone and the applicant's qualifications to operate the Zone.[84] The potential grantee corporation must demonstrate that it is permitted by a special act of its state legislature to apply for a Zone grant, and the Board must give preference to public corporations.[85] The number of Zones in a port of entry[86] is potentially unlimited,[87] and each port is entitled to at least one Zone if the application requirements are met.[88] The Board typically appoints an examining committee to evaluate and make recommendations upon pending applications.[89]

Zone Operation and Regulation

The operative provisions of the Act are found in section 81c, which authorizes foreign merchandise to be transported into the Zone exempt from customs laws.[90] Under the Act, the merchandise may be stored, manupulated, subjected to manufacturing procedures or exported from the Zone, unaffected

83. 15 C.F.R. §§400.600-.609 (1978). The application must be accompanied by 13 exhibits, which cover such matters as the status of the property for the proposed Zone, the financing proposed for undertaking the operation of the Zone, the physical facilities proposed for the Zone and the expected impact of the Zone upon local commerce. 15 C.F.R. §400.603 (1978).

84. *Id. See generally,* Note, *Foreign-Trade Zones—International Business Incentives,* 7 GA. J. INT'L & COMP. L. 669, 673-75 (1977).

85. 19 U.S.C. §81b (1976) requires the grant to be given to a corporation. A private corporation is defined in the Act to mean "any corporation (other than a public corporation) which is organized for the purpose of establishing, operating, and maintaining a foreign-trade zone and which is chartered under special Act enacted after June 18, 1934, of the State within which it is to operate such Zone." 19 U.S.C. §81a(f) (1976). Florida has only recently enacted FLA. STAT. §288.36 (1977), which provides: "Any corporation or government agency shall have the power to apply to the proper authorities of the United States for a grant of the privilege of establishing, operating, and maintaining foreign trade zones and foreign trade subzones under the provisions of the Act of Congress and, when the grant is issued, to accept the grant and to establish, operate, and maintain the foreign trade zones and foreign trade subzones and do all things necessary and proper to carry into effect the establishment, operation, and maintenance of such zones, all in accordance with the Act of Congress and other applicable laws and rules and regulations."

Examples of other enabling acts are VA. CODE §§62.1-159 to -162 (1950); LA. REV. STAT. ANN. §§51.61-.66 (1965). Section 81b of the Act mandates a preference for public corporations and Board regulations define public corporation as: "[a] State, political subdivision thereof, a municipality, a public agency of a State, political subdivision thereof, or municipality, or a corporate municipal instrumentality of one or more States." 15 C.F.R. §400.105(a) (1978).

86. See Note, *supra* note 24, at 473 n.189, for a list of various sites granted Ports of Entry status. Zones must be located in Ports of Entry. 19 U.S.C. §81b (1976).

87. 15 C.F.R. §400.303 (1977). This regulation allows the establishment of additional Zones in a Port of Entry if the Board finds that existing Zones will not adequately serve the convenience of commerce. This standard is very similar to the criteria for the establishment of a sub-Zone. 15 C.F.R. §400.304 (1977). See note 49 *supra.*

88. 19 U.S.C. §81b(b) (1976); 15 C.F.R. §400.300 (1978).

89. 15 C.F.R. §§400.1308-.1312 (1978).

90. 19 U.S.C. §81c (1976). See note 45 *supra* (quoting the operative portions of the Act).

by the customs law.[91] In addition, an importer holding within a Zone merchandise which is intended for import may follow a specal procedure to limit his customs duty liability. Under this procedure the customs duties upon the goods are assessed at the present rate but are not payable until import of the goods.[92] Absent this privileged status, the Act requires duties to be assessed and liquidated when goods leave the Zone and are imported into United States customs territory,[93] placing the importer at risk for duty increases during the period the goods are in the Zone. The Act, in recognition of the opportunities for customs fraud in Zone-based operations, assigns customs officials to each Zone to ensure that the operation complies with customs regulations and that the appropriate duties are paid.[94]

Another facet of Zone regulation, provided by section 81n, requires that Zones be operated as public utilities.[95] The rate charged by a Zone grantee for Zone usage must be "reasonable," published, and applied uniformly to all Zone users.[96] The grantee may permit others to erect buildings within the Zone for their own use upon Board approval.[97] Permission to construct does not constitute a vested right against the United States,[98] and may not interfere with the regulation of the Zone, or hinder its operation as a public utility.[99] The lack of specificity in section 81n, combined with the possible penalties for noncompliance,[100] causes understandable concern to those operating within and financing the construction of Zones. Accordingly, clarification of the regulations in this area would be beneficial.

The Act's mandated preference for public corporations[101] and the imposed standards of public utility operation, compel the conclusion that Zones are not designed to be profit-making ventures for their sponsors.[102] Instead, Zones were

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91. 19 U.S.C. §81c (1976).

92. 19 U.S.C. §81c (1976) provides in regard to privileged status that: "[W]henever the privilege shall be requested and there has been no manipulation or manufacture effecting a change in tariff classification, the appropriate customs officer shall take under supervision any lot or part of a lot of foreign merchandise in a zone, cause it to be appraised and taxes determined and duties liquidated thereon."

93. 19 U.S.C. §81c (1976); 15 C.F.R. 400.804 (1978) (status of merchandise in a Zone).

94. 19 U.S.C. §81d (1976).

95. 19 U.S.C. §81n (1976). Public utility operation includes the charging of fair and reasonable rates and the uniform treatment by the operator of all who apply for space in the Zone.

96. *Id.*

97. 15 C.F.R. §400.815 (1978).

98. *Id.* The phrase vested right would appear to be an attempt to prevent any property interest in the Zone grant from accruing to the grantee. *Cf.* 19 U.S.C. §81u (1976) (providing the government's right to alter, amend or repeal the Act).

99. 19 U.S.C. §81m (1976); 15 C.F.R. §400.1003 (1978). *See also* 19 U.S.C. §81z (1976) (requirinig certain adequate facilities, such as docks, warehouses and wharves).

100. 15 C.F.R. §400.1200 (1978) (fines for violation of Act and regulations).

101. See note 85 *supra* and accompanying text.

102. *See* Memorandum, FOREIGN-TRADE ZONES BOARD, SOME COMMENTS ON FOREIGN-TRADE ZONES FOR PROSPECTIVE APPLICANTS (generally circulated memorandum available from the Board). "Zones are not intended to be a profit venture for the sponsor. Their benefits are intended to be public in the sense of stimulating desired economic activity in the community consistent with national policy. One of the purposes of zones is to encourage operations in

planned to provide an economic benefit to the local and national communities by encouraging transshipment trade.[103] However, neither extensive manufacturing in Zones nor sub-Zone regulation generate the direct public benefit apparently contemplated by the statutory scheme. Although Zone manufacturing creates a local benefit by increasing employment demand, such an increase is necessarily motivated by a concomitant desire to avoid customs duties.[104] Also, the sub-Zone regulation would not appear to possess even the redeeming feature of increased business activity. Therefore, sub-Zones and manufacturing are questionable in light of the limited purposes of the Act.[105]

Business Incentives Provided by the Act

The importation of merchandise is expedited in Zone-based operations because goods may be discharged directly from ships or aircraft into the Zone without full customs formalities.[106] The most important direct benefit intended by the Act's provisions is the elimination of duty upon and the inspection of goods that merely enter the Zone for purposes of transshipment.[107] Zone-located businesses will benefit also from the constant Zone supervision provided by customs officials,[108] including the incidental benefits of a reduction in the business' own security measures and insurance rates.[109] An additional direct benefit of the Act which is receiving revitalized attention is the Zone user's ability to use goods imported into the Zone in manufacturing.[110] The incentive to manufacture in a Zone results from the fact that customs duties are determined upon the finished products entering customs territory rather than their component parts.[111] Incidental to the manufacturing privilege, duties will not

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the United States that would otherwise have been conducted abroad for Customs reasons. In other words zones should help create employment, not simply divert it from one region of the country to another." *Id.* at 2.

103. *Id.*

104. See Armco Steel Corp. v. Stans, 431 F.2d 779 (2d Cir. 1970), in which the Zone user was turning dutiable Japanese steel into non-dutiable barges in the Zone and thus completely avoiding the otherwise applicable customs duties.

105. See note 12 *supra.*

106. BUSINESS INTERNATIONAL CORPORATION, WASHINGTON HANDBOOK FOR INTERNATIONAL CORPORATIONS 41 (1975) [hereinafter cited as WASHINGTON HANDBOOK].

107. 19 U.S.C. §81c (1976). This particular transshipment potential produces the situation in which leather may be exported from South America into a Zone, converted into luggage, marked with the prestigious "Made in U.S.A." logo and re-exported to South America with no customs duties ever being paid. Landy & McGinnis, *supra* note 14, at 46 (describing similar procedure utilizing denim with additional transshipment to third country). An additional example of this usage is seen in the New York Zone, which is used as a transshipment point for the distribution of high duty French perfume to Latin American countries. *Id.* at 44. *See* Note, *Foreign Trade Zones: Holes in the Tariff Wall or Incentives for Development?*, 2 L. & POLICY INT'L BUS. 190, 205 (1970).

108. 19 U.S.C. §81d (1976); 15 C.F.R. §§400.808-.815 (1978).

109. WASHINGTON HANDBOOK, *supra* note 106, at 41. Case law establishes that the theft of goods from a Zone-based transaction will generally constitute a Federal offense. United States v. Prock, 105 F. Supp. 263 (S.D. Tex. 1952). See notes 161-168 *infra* and accompanying text.

110. DaPonte, *supra* note 15, at 4.

111. 19 U.S.C. §81c (1976). *See* Note, *supra* note 24, at 470-76.

be assessed on any material wasted in the manufacturing process.[112] Moreover, any raw material consumed in the manufacturing process will not be subject to customs duties.[113]

One of the more important indirect benefits accruing from Zone-based operation is an increase in business' cash flow. This results because capital is not tied up in the payment of customs duties prior to the sale of the importer's goods.[114] Additionally, the businessman will often be able to finalize a product's sale before importation because prospective purchasers can examine products in Zones.[115]

Another incidental benefit to the non-payment of duties on the products imported will be the availibility of lower insurance rates to Zone-based operations because the insurable value of their goods will be reduced due to the non-payment of customs duties. Also, if the goods have been damaged in transit, the importer will be able to salvage the merchandise while holding it in the Zone without paying the applicable customs duties.[116] The culling of bulk shipments prior to importation will also reduce applicable duties, because unsatisfactory items may be eliminated.[117]

Zone-based operations also offer the businessman an opportunity to increase his profits through proper timing. For example, the goods may be stored in the Zone until market conditions improve; if the market does not improve the goods may be transshipped to a more favorable market.[118] The goods could also be held in the Zone in anticipation of a quota elimination or a tariff reduction.[119] Furthermore, the imported goods may be withdrawn from the Zone

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112. Landy & McGinnis, *supra* note 14, at 45.

113. 19 U.S.C. §81c (1976). See note 49 *supra*.

114. WASHINGTON HANDBOOK, *supra* note 103, at 45. The ability of the Zone-based operation to improve its capital flow is one of the significant advantages of the Act over such alternative devices as temporary importation bonds and drawback provisions. *See* 19 U.S.C. §1313 (1970). These other devices require initial capital outlay even though it is ultimately refunded. The Act, however, requires no capital outlay because customs duties are not assessed while the goods remain in the Zone. *See generally* Note, *supra* note 1, at 91-93 (more fully explaining the comparisons of Zones with alternative devices).

115. WASHINGTON HANDBOOK, *supra* note 106, at 41. Retail trade in imported goods still subject to customs duties is not permitted in the Zones. Retail trade may, however, with the permission of the grantee and the Board, be conducted by the permittee in domestic, duty-paid goods. 15 C.F.R. §400.808 (1978). This regulation also provides that: "No goods shall be offered for sale or sold in a [Z]one which are not of the same kind and quality permitted to be offered for sale or sold in the political jurisdiction in which the [Z]one is located."

116. 19 U.S.C. §81c (1976) (permitting the manipulating of goods in a Zone). If the merchandise has been damaged to such an extent that there is no longer a market in the country it could be transshipped to another country or discarded in the Zone without payment of customs duties.

117. W. DYMSZA, *supra* note 1, at 40. Duties on items subject to shrinkage, breakage or spoilage will also be reduced if the items are stored in the Zone when the applicable event occurs.

118. This type of timing advantage would be particularly beneficial to the importer dealing with seasonal or cyclic products.

119. WASHINGTON HANDBOOK, *supra* note 106, at 45. This is due to the fact that normally customs duties are liquidated and determined only when goods enter the customs territory, unless the business, in a reversal of the normal timing advantage procedure, has in anticipa-

in smaller amounts than is possible by direct importation.[120] Finally, goods may be altered or repacked and relabeled to comply with government restrictions, allowing the importer in many cases to avoid a regulatory fine.[121]

ZONES IN LITIGATION

Although there has not been a large amount of litigation concerning Zone operations, troublesome inconsistencies exist even within this paucity of case law.[122] These inconsistencies can be attributed to many diverse factors but they originate predominantly in the interdigitation of the Act and the Commerce Clause.[123] This interaction between statute and Constitution necessarily engenders complex issues regarding the extent of permissible application of state laws to Zone-based operations.[124] This note will review the conflicting cases in light of the Act's purpose and whenever possible these decisions will be reconciled. Where reconciliation does not appear to be possible, this note will suggest

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tion of a tariff increase previously liquidated the applicable duties and obtained a privileged status for his goods. See note 92 *supra*.

120. WASHINGTON HANDBOOK, *supra* note 106, at 41. The businessman involved in a Zone-based operation will also be able to determine the precise duty applicable to his product prior to its importation. Differences of opinion between the businessman and the customs officials can often be worked out because the goods are accessible for examination in the Zone. *Id.*

121. *Id.*

122. *Compare* United States v. Prock, 105 F. Supp. 263 (S.D. Tex. 1952) (interstate gambling device control statute not applicable to Zone-based transactions) *with* United States v. Yaron Laboratories, Inc., 365 F. Supp. 917 (N.D. Cal. 1972) (interstate drug regulation applicable to Zone-based transactions). For a further illustration of inconsistency, *compare* Lefkowitz v. Disbrok Trading Co., 71 Misc. 2d 750, 336 N.Y.S.2d 762 (Sup. Ct. 1972) *with* Idlewild Bon-Voyage Liquor Corp. v. Epstein, 212 F. Supp. 376 (S.D.N.Y. 1962). The court in *Idlewild* found that the plaintiff was engaged in the selling of tax-free liquor to imminently departing foreign-bound passengers. 212 F. Supp. at 378. The customer paid for the liquor in New York but did not receive it until he reached his foreign destination. The New York court contended that the plaintiff/seller must comply with state alcoholic beverage control laws. *Id.* The court, however, stressing the fact that the plaintiff's business would not merely be regulated but terminated by the state laws, because the business was unlicensable, held that the plaintiff's business was within the protection of the Commerce Clause. *Id.* at 382. *See* U.S. CONST. art. I, §8, cl. 3. *Cf.* U.S. CONST. amend. XXI. Therefore because the regulation protected no sufficient local interest the court enjoined the state from further interference with the plaintiff's operation. In Lefkowitz v. Disbrok Trading Co., 71 Misc. 2d 750, 336 N.Y.S.2d 762 (Sup. Ct. 1972) the plaintiff, Attorney General of New York, sought to enjoin the trade of the defendant in crocodile skins, which was, similar to the act of the plaintiffs in *Idlewild*, illegal under New York law. The defendant's business operated as follows: a contact was made through its New York office with potential buyers, the defendant would accept the offer at his office outside of the Zone, and would then order the skins to be shipped from the New York Zone to the foreign purchaser. 71 Misc. 2d at 751, 336 N.Y.S.2d at 763. The court noted that although the prohibited merchandise was never introduced into intrastate commerce, the skins were "held for sale from New York." *Id.* The court, however, with a complete lack of analysis of constitutional principles limiting the state regulation of foreign commerce issued the requested injunction. *Id.* The validity of the decision, particularly in comparison to *Idlewild*, is subject to question. The injunction in point cannot be characterized as protecting any local interest to allow the termination of the foreign trade.

123. *See* U.S. CONST. art. I, §7, cl. 3.

124. *See, e.g.*, During v. Valente, 267 App. Div. 383, 46 N.Y.S.2d 385 (Sup. Ct. 1944). *See generally* Landy & McGinnis, *supra* note 14, at 47-49.

alternative solutions designed to effectuate the public policies underlying the Act.

Jurisdiction

An important threshold issue generated by the Act was whether a Zone was subject to exclusive federal jurisdiction as a federal "enclave".[125] The first case concerning this issue was *American Dock Co. v. City of New York.*[126] *American Dock* involved a taxpayer's action to invalidate a Zone operating contract between the city[127] and a private corporation.[128] The New York state court held, *inter alia,*[129] that neither the Foreign-Trade Zones Board nor the United States was a necessary party to the action.[130] The court reasoned that resolution of the case would not involve any right or interest of the United States and, therefore, found that the Board was not a necessary party.[131] The issue of jurisdiction was not explicitly addressed. However, because the state court reached the merits of the case, *a fortiori,* Zones were determined not to be "federal enclaves" subject to exclusive federal jurisdiction. Early Zone litigation, therefore, established that Zones are subject to concurrent jurisdiction.

A more comprehensive examination of the impact of Zone operation upon jurisdiction is found in *Fountain v. New Orleans Public Service, Inc.*[132] *Fountain* was a wrongful death action in which the only possible basis for federal jurisdiction was the fortuitous fact that the accident occurred in a Zone.[133] The plaintiff contended that the extensive federal regulatory power exercised in the Zone,[134] coupled with the exclusive power of the federal government to regulate foreign commerce, was a sufficient basis upon which to establish federal jurisdiction. The court prefaced its holding by observing that the Act did not specifically or even inferentially confer federal jurisdiction.[135] The court further determined that the United States acquired no possessory rights to property in the Zone[136] and that therefore, the decision in the case

125. *Cf.* Stewart & Co. v. Sadrakula, 309 U.S. 94 (1940) (discussion of "federal enclaves").

126. 174 Misc. 813, 21 N.Y.S.2d 943 (Sup. Ct. 1940), *aff'd,* 286 N.Y. 658, 36 N.E.2d 696 (1941).

127. See note 56 *supra* and accompanying text.

128. 174 Misc. at 815-16, 21 N.Y.S.2d at 948-49.

129. *Id.*

130. *Id.*

131. *Id.* The Board had however submitted a brief as *amicus curiae* and taken the position that the operating contract did not violate the Act. 174 Misc. at 816, 21 N.Y.S.2d at 949. *See also* 19 U.S.C. §81q (1976) (forbidding disposition of the grant).

132. 387 F.2d 343 (5th Cir. 1967).

133. *Id.* at 343. The accident occurred when the boom of a crane touched a high tension wire while the decedent, employed by a private company, was unloading tractors from a railroad flatcar in the New Orleans Zone.

134. *Id.* at 344; *see* 15 C.F.R. §§400.800-.1014 (1978) (providing standards for the operation, administration and facilities in Zones).

135. 387 F.2d at 344. The court stated: "The statute in question nowhere in [its] terms confers jurisdiction upon U.S. District Courts." *Id.* The court also examined the congressional record of the Act and could find no indication of an intent of Congress to confer federal jurisdiction upon the basis of the event occurring within a Zone. *Id.*

136. *Id.* The district court in deciding this case stated: "[from] the provisions of the Act

would not turn upon a construction of the Act. Accordingly, the federal court dismissed the case for a lack of jurisdiction.[137] The trend of case law indicates that litigation incident to Zone-based operations does not necessarily confer federal jurisdiction.[138] Furthermore, it is now patent that Zones are not the subject of exclusive federal jurisdiction.[139]

However, other bases for federal jurisdiction exist aside from mere operation in the Zone. *United States v. Yoppolo*,[140] involving the theft of goods from a Zone, illustrates one such basis. The defendants in *Yoppolo* contended that their convictions in federal district court were invalid because that court lacked jurisdiction.[141] The circuit court upheld the convictions, finding that federal jurisdiction attached because the stolen goods were still in foreign commerce.[142] In view of this holding, it appears that a basis for federal jurisdiction should exist whenever merchandise is stolen from Zones[143] because goods in Zones nearly always remain in foreign commerce.[144]

Applicable Law

The question of which laws may be avoided by the decision to utilize a Zone-based operation is one of primary importance to the businessman. Because the desire for competitive advantage provides impetus for the question, business is concerned with the applicability of federal regulatory controls, such as anti-

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of Congress (Foreign-Trade Zones Act) and the regulations adopted thereunder, it was contemplated that the United States would not acquire by purchase, lease or otherwise the fee or other proprietary interest in the territory in which the Foreign-Trade Zones are located." Fountain v. New Orleans Public Service, Inc., 265 F. Supp. 630, 639 (E.D. La. 1967). The circuit court followed this language in determining that a Zone was not a "federal enclave." 387 F.2d at 344.

137. 387 F.2d at 344. Although it is true that a finding of negligence would not necessarily turn upon a construction of the Act, it appears that a violation by the defendant of any of the extensive regulatory provisions of the Act, 15 C.F.R. §§400.1000-.1014 (1978), would have been a basis upon which a prima facie case of negligence could have been predicated. *See, e.g.*, McKinney v. Adams, 68 Fla. 208, 224-26, 66 So. 988, 992 (1914) (statutory violation as evidence of negligence per se).

138. See notes 140-160 *infra* and accompanying text (discussing other bases for federal jurisdiction over Zone-related litigation).

139. *See* Foster v. R.E. Schanzer, Inc., 350 So. 2d 254 (La. 4th Cir. 1977) (an action for negligence occurring in a Zone, in which the possibility of exclusive federal jurisdiction is not even raised.)

140. 435 F.2d 625 (6th Cir. 1970).

141. *Id.* at 626. The defendants had stolen a tractor trailer load of scotch whiskey which was stored in the Toledo Zone, awaiting delivery to customers.

142. *Id.* The court in support of its reasoning that the liquor was still involved in foreign commerce stated: "An interstate or foreign shipment does not lose its characteristics until it arrives at its final destination and it is there delivered." *Id.*

143. The possible exceptions to goods in a Zone not being in foreign commerce are goods which are in the Zone for the purpose of consumption or goods which are merely being stored and no longer in import transit. See note 145 *infra*.

144. 18 U.S.C. §659 (1976) (theft of goods in foreign commerce). See discussion in United States v. New York Foreign-Trade Zones Operators, Inc., 304 F.2d 792, 795 (2d Cir. 1962), in which federal jurisdiction was based upon an assignment of a claim pursuant to the FELA. 5 U.S.C. §776 (1958).

trust and fair-trade, and the permissible extent of state taxation[145] and state regulation of Zone-based operations.[146] On the surface, the cases assessing pertinent law have not been uniform,[147] although it is possible to harmonize some of the decisions if they are perceived as based on unarticulated extensions of the Commerce Clause.[148] However, it is not possible to extract from the case law a comprehensive statement of the applicable law in Zones. Therefore, the requisite clarity which would expand Zone utilization because of greater business certainty is achievable only by legislative refinement of the Act.

Federal Law

Judicial efforts to delineate federal law applicable to Zone operations have engendered some confusion. In *G.P. Searle & Co. v. Bryon Chemical Co.*,[149] a federal district court examined the applicability of United States patent law to Zone transactions. In *Searle* a patent owner brought an action on the unauthorized sale of patented goods.[150] The plaintiff grounded his reliance upon

145. *See generally* 39 FOREIGN TRADE ZONES BOARD, ANN. REP. TO CONGRESS (1977) [hereinafter cited as 39TH ANN. REP.] in which it is stated: "Some unresolved issues affecting zone operations came into sharper focus during the year. The question of whether state and local inventory taxes apply to merchandise in zones assumed a more urgent note during the year. Attention centered on California, where county assessors began taxing goods in that State's two zones in the wake of the *Michelin* case. Until *Michelin*, goods in zones had generally been considered constitutionally exempt under the commerce clause. The issue was still very much alive at year's end, with some states considering legislation to make the exemption explicit." *Id.* In Michelin Tire Corp. v. Wages, 423 U.S. 276 (1976), *reh. denied*, 424 U.S. 935 (1976), the court determined that only goods still in "import transit" are exempt from state taxation by the Import Clause. U.S. CONST. art. I, §10. *See generally Traders Seeking Relief from Michelin Setback*, COM. AM. March 28, 1977, at 16; Landy & McGinnis, *supra* note 14, at 48-49. The concern is centered upon California because of the case of Lilli-Ann Corp. v. City & County of San Francisco, No. 726, 271 (Super. Ct. of San Francisco County, filed July 29, 1977) *cited in*, Landy & McGinnis, *supra* note 14, at 47, n.36, which is presently being litigated and directly involves the issue of whether Zone-based goods will be subject to a personal property tax. The Internal Revenue Service, similar to state taxation authorities, has also taken the position that revenues derived from the sale of goods in a Zone are not exempt from income tax regardless of the fact that the goods are exempted from customs duties until shipped into United States customs territory. REV. RUL. 76-161, 1976-18, IRB 193.

146. *See, e.g.*, During v. Valente, 267 App. Div. 383, 46 N.Y.S.2d 385 (Sup. Ct. 1944) (in which the court determined that to allow a state to impose liquor licensing requirements on Zone-based operations would impermissibly burden foreign commerce and impede the congressional purpose in the establishment of Zones).

147. See note 122 *supra* and accompanying text.

148. U.S. CONST. art. I, §7, cl. 3. *See generally* Duckworth v. Arkansas, 314 U.S. 390 (1941) (holding state regulation of foreign commerce must be reasonably necessary to protect a local public interest). For an example of a state provision placing constraints upon foreign commerce see FLA. STAT. §288.38 (1976), which provides: "Any application for establishment of a foreign trade [Z]one made pursuant hereto shall include a provision that all laws of this state and rules of the Florida Department of Citrus applicable to citrus fruit and processed citrus products shall equally apply within any foreign trade zone so established." Because this statute is predicated upon the protection for local interests, it should be constitutionally permissible state regulation of foreign commerce.

149. 223 F. Supp. 172 (E.D.N.Y. 1963). *See generally* Note, *supra* note 1, at 103-04.

150. The United States patent infringement statutes are found in 35 U.S.C. §§271-293

federal patent law, since, the title to the goods was transferred within the Zone.[151] The court agreed that United States patent law applied to the transaction.[152] Enjoining the operation,[153] the court stressed that although the chemical which was sold was both covered by a German patent and owned by the defendant — importer's seller, United States patent law still conferred rights upon the plaintiff.[154] The *Searle* decision has the salutary effect of protecting "home grown [congressionally granted] monopolies."[155] However, if the holding of the case is construed narrowly, the decision may be protective of United States patent holders only when title to the merchandise passes in the Zone.[156] If *Searle* is so interpreted, the importer may avoid United States patent laws by delivering the goods to the purchaser in a foreign country. However, if broadly construed, the holding creates a disincentive to foreign trade because of the possibility that parties involved in transactions similar to that in *Searle* will simply conduct their business completely outside of the United States.[157] Such a construction of *Searle* would be contrary to the Act's purposes.

The *Searle* decision could have been reconciled with the purposes of the Act by applying United States patent law only to goods located in Zones destined for United States import, and not upon those goods located in a Zone merely for purposes of transshipment.[158] Such a decision would have provided

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(1976). The patent in this case, No. 2,659,732, was for the chemical propanitheline bromide. 223 F. Supp. at 173.

151. 223 F. Supp. at 173. The operation of the defendant was basically as follows: an assignment contract was executed by the defendant with a German company; the chemicals were then shipped on consignment to the New York Zone, where the goods were stored until they were subsequently shipped via carrier to Japan.

152. *Id.* The *Searle* court used for precedent the unreported case of American Cynamed Co. v. Butane, No. 922-60, slip op. at — (D.N.J. 1962), in which the defendant consented to a judgment enjoining him from further sales of patented goods in a Zone. The *Cynamed* court declared: "[t]he patent laws apply with full force and effect to the Foreign Trade Zone." *Id. See also* FOREIGN TRADE ZONES BOARD, LAWS, REGULATIONS AND OTHER INFORMATION RELATING TO FOREIGN-TRADE ZONES 12 (1965), stating: "[P]atent laws do if otherwise applicable, cover operations within a zone."

153. 223 F. Supp. at 173.

154. *Id.* at 174. "The monopoly grant of the United States Patent Office can not in any way be limited by foreign fiat." *Id. See* Boesch v. Graff, 133 U.S. 697 (1890). The court in *Searle* also made an extensive investigation into the Act and astutely determined that the legislative history of the Act evidenced no intent by Congress "to insulate this patch of U.S. territory from the force of Patent Laws." 223 F. Supp. at 174. ("United States territory" must be read to mean jurisdiction and not ownership). See note 136 *supra.*

155. Note, *supra* note 1, at 104.

156. 223 F.2d at 173. The following language causes this concern: "Title passed to the defendant purchaser when the goods were delivered aboard the outgoing vessel to Japan. Since title passed in the Foreign Trade Zone in New York, pursuant to a contract consummated in Long Island City, New York, the sale which constituted the infringing act, occurred within the territorial limits of this district court." *Id.* See discussion of jurisdiction relative to patents in Bulldog Elec. Prods. Co. v. Cole Elec. Prods. Co., 134 F.2d 545 (2d Cir. 1943) (holding jurisdiction in patent infringment suit may be where defendant has a regular and established place of business).

157. In the *Searle* situation the defendant would merely ship his chemical directly from Germany to Japan and avoid use of the intermediary Zone in the United States.

158. *See* Note, *supra* note 1, at 104.

substantially the same protection from imported goods to the patent holder which prevailed prior to the Act without discouraging transshipment trade. The central problem with this suggested alternative holding is its inconsistency with an express provision of the Act declaring that operations "otherwise prohibited" by law may not be conducted in Zones.[159] The *Searle* decision and the suggested amelioration of its possible adverse effect underscore the need for an express designation of the applicable federal law governing Zone transactions. This refinement will serve to maximaze the purposes of the Act, by further encouraging foreign trade. The needed refinement results from the assumption in the Act that all federal laws should be uniformly applicable to Zone-based operations. As demonstrated by *Searle*, this assumption is not always accurate, moreover, it can serve to discourage foreign trade when no public policy is served. Nevertheless, the Act presently requires that all federal laws be indiscriminately applied in the resolution of Zone related litigation.[160]

The cases of *United States v. Prock*[161] and *United States v. Yaron Laboratories*[162] further demonstrate the confusion that exists when courts attempt to ascertain what law controls Zone-based operations. *Prock* was the first case to consider which laws would be applicable to merchandise traveling through the United States to a Zone. The defendants in *Prock* had been indicted for the interstate transportation of gambling devices, which were being moved from Texas to South America via the New Orleans Zone.[163] The *Prock* court initially noted that the goods in question were in foreign commerce. The court found, however, that the applicable federal law was expressly limited to "interstate shipments" and therefore, did not control the instant foreign shipments.[164] Thus, because the language of the federal law was not broad enough and since the Commerce Clause apparently prevented state control,[165] the anomalous result of the *Prock* decision was that neither state nor federal law was applicable.[166] In *Prock*, constitutional matters inherent in the Commerce Clause which preclude substantial state regulation of foreign commerce, and the language of the relevant federal statute were dispositive. However, the fact of Zone usage was influential although not conclusive in the court's finding that the goods were in foreign commerce.[167]

159. 19 U.S.C. §81c (1976).

160. "There is no mention in the Act of any relief from the application of non-customs law." Note, *supra* note 1, at 104.

161. 105 F. Supp. 263 (S.D. Tex. 1952).

162. 365 F. Supp. 917 (N.D. Cal. 1972).

163. 105 F. Supp. at 264. The defendant was moving four hundred slot machines to the Zone for export because a Texas law making such devices illegal was about to become effective. *See* TEX. STAT. ANN. §642(a) (1952). The machines had already been sold to a purchaser in South America. 105 F. Supp. at 264.

164. In viewing the federal statute, the court indicated that gambling devices may be freely shipped in interstate, intrastate, or foreign commerce unless expressly prohibited by statute. 105 F. Supp. at 264. *Compare* 15 U.S.C. §1172 (1952) *with* 15 U.S.C. §1172 (1976).

165. See note 148 *supra*.

166. 105 F. Supp. at 264.

167. *Id.* This case is typical of the confusing juxtaposition of the Act, with constitutional principles which mandate the exclusive federal control of foreign commerce. See notes 146-148 *supra* and accompanying text.

In *United States v. Yaron Laboratories*[168] the plaintiff, under federal law, sought to enjoin the defendant's Zone-based manufacturing of an unapproved drug.[169] The case was tried upon a stipulation of facts indicating that the defendant was manufacturing the drug wholly within the Zone, that the drug was intended only for foreign export purposes and was in fact directly exported from the defendant's plant to a foreign country.[170] The district court granted a permanent injunction preventing the defendant from introducing the drug into interstate commerce. In light of the *Prock* decision, finding Zone-based goods to be in foreign commerce, it appears that the manufacturer in *Yaron* was not introducing the drug into interstate commerce but into foreign commerce.[171] Because of this reasoning the holding of the *Yaron* court is paradoxical if not totally ineffective. Notably however, the control of the drug in *Yaron*, like the control of the gambling devices in *Prock*, is predicated upon the involvement of the goods in interstate commerce. The inconsistency in these cases points out the need for specific refinements in the Act dealing with the applicability of non-fungible federal laws.

State Law

Confronted by analogous uncertainty in the application of state law, courts have been equally ineffective in alleviating the Act's inadequacies. The first decision[172] on the extent to which state law would control Zone activities was *During v. Valente*.[173] This state court, much like the earlier federal courts, was confronted with a complex juxtaposition of constitutional principles[174] and the provisions of the Act. In *During* the defendant had retained the plaintiff, a broker, to locate purchasers for Portuguese brandy stored in a Zone.[175] The defendant alleged that the contract for the commission was invalid because the plaintiff did not have the requisite state license[176] to conduct a liquor brokerage.[177] The *During* court concluded that the mere fact that the goods were located in a Zone within the state did not establish a sufficient predicate upon which to base state regulation. Because the New York regulatory license

168. 365 F. Supp. 917 (N.D. Cal. 1972).

169. "Pax" was the new drug being manufactured by the defendant and in accordance with federal regulations it must have been approved by the Food and Drug Administration prior to its distribution. 21 U.S.C. §§321(p), 355(a) (1976).

170. 365 F. Supp. at 918. The entire supply of the drug in the Zone was being shipped directly to Saigon where the drug had already been approved for usage.

171. If the injunction was taken at its literal interpretation and the defendant was only enjoined from introducing the drug into interstate commerce his activity could permissibly continue as it is foreign commerce.

172. An earlier case, New York Foreign-Trade Zone Operations, Inc. v. State Liquor Auth., 285 N.Y. 272, 34 N.E.2d 316 (1941) had been filed, however the court did not reach the merits and dismissed the action holding that a declaratory judgment would not be possible as the matter was not yet up for judicial resolution.

173. 267 App. Div. 383, 46 N.Y.S.2d 385 (1944).

174. See note 148 *supra*.

175. 267 App. Div. at 384, 46 N.Y.S.2d at 386.

176. *See* N.Y. Alco. Bev. Cont. Law §§2, 93 sub. 1 (McKinney 1935).

177. 267 App. Div. at 384, 46 N.Y.S.2d at 386.

laws were not applicable, the contract was validated.[178] The *During* decision indicates the possible undesirable results of the total non-applicability of state law to Zone transactions. States faced with the possibility of a complete lack of control over Zones once they are created will be understandably hesitant to allow their creation.

Since a bonded warehouse involves many of the same considerations as Zones, the early case of *McGolderick v. Gulf Oil Co.*[179] provides insight into what may be the permissible extent of state taxation of Zone-based activities.[180] The effect of a bonded warehouse is analogous to that of Zone transshipment because the importer posts a bond for the amount of customs duties payable upon the imported goods; however, the bond is returned when the merchandise is re-exported.[181] Because the importer in *McGolderick* was using the warehouse to store oil for sale to *foreign* ships[182] the court held that state taxation of the oil would violate the Commerce Clause.[183] The Court, examining the provisions of the Bonded Warehouse Act,[184] determined that it was intended to encourage foreign oil import and re-export as is the Foreign-Trade Zones Act. Because the state taxation of the oil was inconsistent with express federal objectives, it would impermissibly interfere with the federal government's exclusive perogative in regulating foreign commerce.[185]

Although no case has dispositively ruled on the issue, using the rationales of both *McGolderick* and *During*, it appears that carefully controlled state taxation of Zone-based activities should be permissible. Fortunately resolution may be at hand as the issue is presently being litigated in *Lilli-Ann Corp. v. City & County of San Francisco.*[186] The municipal authorities in *Lilli-Ann Corp.* contend that the plaintiff's Zone-based goods should be subject to California's personal property tax. Significantly, a personal property tax may pass constitutional muster if the holdings of *During* and *McGolderick* are construed as limited strictly to trans-shipment goods and the state tax is imposed only upon Zone goods ultimately destined for in-state import.[187] Such a tax in regard to Zones would not impermissibly thwart a congressional objective since it would not be a disincentive to foreign trade.[188] Therefore, carefully controlled state

178. *Id.* at 386, 46 N.Y.S.2d at 388. "[T]he imposition of these complicated regulations (New York State Alcoholic Beverage Control Laws) upon foreign commerce in liquor within trade zones would not only interfere with the exclusive control of Congress over this foreign commerce but would seriously impair if not defeat the purpose for which these Zones have been established." *Id.*, 46 N.Y.S.2d at 388. This statement reflects a considered evaluation of the impact of the Act relative to permissible state regulation. See note 122 *supra.*

179. 309 U.S. 414 (1940).

180. *See* Note, *supra* note 1, at 90-91.

181. *See* Landy & McGinnis, *supra* note 14, at 43 (describing alternatives to Zones).

182. 309 U.S. at 420 (emphasis added because oil for sale to foreign shippers still in "import transit"). See note 145 *supra.*

183. 309 U.S. at 428.

184. 19 U.S.C. §1555 (1976).

185. 309 U.S. at 429.

186. No. 726-271 (Super. Ct. of San Francisco, filed July 29, 1977) *cited in* Landy & McGinnis, *supra* note 14, at 47, n.36.

187. Landy & McGinnis, *supra* note 14, at 47.

188. In some circumstances however specific state legislation provides for the non-

taxation of Zone transaction may survive the constitutional qauntlet. However, the uncertainty existing in this situation further indicates the need for more explicit legislative provisions in the Act specifically dealing with state taxation.

JUDICIAL CONSTRUCTIONS OF THE ACT

Due to the previously limited usage of the Zone device, the provisions of the Act have not been subjected to extensive judicial examination. The earliest construction of the Act's provisions is found in the above discussed case of *American Dock.*[189] The court in *American Dock,* despite finding the Zone operating contract between the city and the private corporation invalid on other grounds,[190] held that the contract did not violate section 81q of the Act, which provides *in toto* that "[t]he grant shall not be sold, conveyed, transferred, set over, or assigned." Although the Board also took the position that the operating contract did violate the Act,[191] the "Humpty-Dumpty-like"[192] approach of the court is troublesome. The court, rather than finding that an assignment of the grant had not occurred, found that the grantee had merely leased the Zone premises to the contract operators.[193] The problem with this approach is that such a lease would necessarily entail an assignment of the grant. The court, however, citing *United States v. City & County of San Francisco,*[194] sidestepped the issue by reasoning that only the United States had standing to invoke section 81q of the Act,[195] and therefore it was not a termi-

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applicability of state taxes to goods merely temporarily located in the state. *See, e.g.,* FLA. STAT. §196.0011(1) (1977), which provides that goods from other states and countries bound for destinations other than Florida are exempted from the state's personal property taxes while the goods are in Florida.

189. 174 Misc. 813, 21 N.Y.S.2d 943 (Sup. Ct. 1940), *aff'd,* 286 N.Y. 658, 36 N.E.2d 696 (1941). See notes 126-131 *supra* and accompanying text.

190. 174 Misc. at 830, 21 N.Y.S.2d at 961. *See generally* Comment, *Municipal Corporation — Foreign Trade Zones — Power to Delegate Operation of Private Corporation — Contract or Lease,* 9 GEO. WASH. L. REV. 482 (1940). The *American Dock* case involved many issues collateral to the Act's construction. The plaintiff, bringing the suit in a taxpayer's action, alleged that the contract violated the public trust. The court determined that the United States was not a necessary party to the action even though the Zone was operated under a federal grant. The central issue in the case then became whether New York City, under New York law, the New York City Charter and the Administrative Code of New York City had the authority to delegate the power to operate the Zone to a private contractor. The plaintiff alleged that such contract delegation was an impermissible surrender of public funds to private interests. 174 Misc. at 816, 21 N.Y.S.2d at 949. The court held that a contract, such as the one entered into by the city with the Zone operators, was a lease. Therefore it involved a surrender of control of the public interest resulting in a breach of the trust for which the facilities were being held. *Id.*

191. 174 Misc. at 830, 21 N.Y.S.2d at 961.

192. "When I use a word," Humpty Dumpty said, "it means just what I want it to mean neither more nor less." L. CARROLL, THE ANNOTATED ALICE: ALICE'S ADVENTURES IN WONDERLAND & THROUGH THE LOOKING GLASS 269 (Annotated ed. M. Gardner 1974).

193. 174 Misc. at 823-24, 21 N.Y.S.2d at 954-56.

194. 310 U.S. 16 (1940). The Court in this case held that certain land which the United States had provided to the city of San Francisco to be used as a park and to supply water power for electric generating systems could not be leased to a private corporation.

195. 19 U.S.C. §81q (1976); 15 C.F.R. §400.701 (1978).

nating provision available to a private party.[196] Although the court's reluctance to terminate the contract upon a construction of the provisions of the Act is understandable, particularly in light of the Board's position,[197] the decision remains vexatious even though other courts have inferentially reached the same conclusion.[198] The *American Dock* reasoning is troublesome because explicit provisions of the Act have been emasculated. Moreover, the decision is problematic because the "bright-line" between a permissible license and an invalid assignment is indiscernible. The grantee considering contract operation as well as the operators and users of the Zone are justifiably concerned about the scope of the *American Dock* rationale, and whether an operation is a valid lease or an invalid assignment.[199] Because the licensee/grantee method of Zone operation has been efficient and generally accepted, specific provisions validating the procedure should be added to the Act and the Board should promulgate regulations controlling the process.[200]

Regulatory Construction

Regulatory construction of the Act is another area in which the courts are in need of legislative assistance. Frequently, the Act has been construed in cases in which a particular Zone grant issued by the Board is being judicially challenged. The first such case was *Sinclair Oil Corp. v. Smith.*[201] There, the plaintiff contended that the Board could not issue a Zone grant when an integral part of the Zone operation would otherwise require an oil import license which the potential grantee could not lawfully obtain.[202] However, the plaintiff's case dissipated when the court refused to uphold his promise

196. 174 Misc. at 821-22, 21 N.Y.S.2d at 954.

197. *See generally* Louisiana v. McAdoo, 234 U.S. 627 (1914) (reasoning that the Secretary of the Treasury had wide discretion as to the scope of certain enabling legislation).

198. See note 56 *supra.*

199. *See* 19 U.S.C. §81r (1976) (providing for termination of the grant for willful violation of the Act's provisions).

200. DaPonte, *supra* note 47, at 2. "While public corporations are given preference as Zone licensees (grantees), operation of the facility may be contracted by the licensee to a private qualified company. In these increasingly common cases, the selection process must conform to local legal requirements and should be consistent with the public utility nature of zones." *Id.* "Qualified company," "local legal requirements," and "standards consistent with the public utility nature of zones" provide little specific guidance and present numerous questions to the licensees in trying to determine when the already questionable licensing has been improper. Regardless of the unregulated process of the grantee licensee operation the procedure continues to be utilized by many Zones. *See* 39th ANN. REP., *supra* note 145, at 10 (indicating that approximately one half of the Zone projects use the grantee licensee method of operation).

201. C.R. Smith, the Secretary of Commerce, was chairman of the Board at the time and therefore was the defendant in the action. 293 F. Supp. 1111, 1111 (S.D.N.Y. 1968); *see* 15 C.F.R. §400.103 (1978) (delineating who are members of the Board); *see also* Oklahoma v. Smith, 312 F. Supp. 770 (W.D. Ok. 1970). This action, nearly identical to *Sinclair Oil,* was to enjoin the Board from issuing a grant to Occidental Petroleum Company. *Id.* at 710. The court in language very similar to that in *Sinclair Oil* stated: "It is the general rule that courts will not become involved for obvious reasons in administrative agency proceedings until final action is taken by the agency." *Id.* at 771.

202. 293 F. Supp. at 1114.

that an oil import license could not be granted.[203] Instead, the court used the ripeness doctrine to avoid judicial review until the agency proceeding had concluded.[204] Observing that the administrative outcome was a matter of speculation, and that no egregious violations of either statutory or constitutional authority were evident, the court refused to interfere with the Board's consideration of the application. *Sinclair* evinces judicial recognition of the Board's expertise in fact finding and resolving technical issues arising in the application proceeding.

Unlike the *Sinclair* court, the court in *Armco Steel Corp. v. Stans*,[205] reached the merits of an injunctive action against the Board.[206] *Armco* is a leading case because of its in-depth and exhaustive analysis of the Act.[207] The Board had issued an order granting New Orleans a sub-Zone to be used by Equitable Shipbuilders for manufacturing non-dutiable barges from dutiable Japanese steel. The application for the sub-Zone had been considered by an examiners committee[208] which recommended to the Board that the grant be issued. The Board issued the grant.[209]

The plaintiff's attack upon the Board's decision to issue a sub-Zone grant for the purpose of barge manufacturing was multi-faceted.[210] The plaintiff initially contended that a Zone could not be utilized to avoid customs duties, particularly if this avoidance results in unfair competition between foreign and domestic industries. In addition, the plaintiff argued that the sub-Zone could not be operated as a public utility, as required in the provisions of the Act,[211] because Equitable Shipbuilders would use the entire facility for its own operations to the exclusion of all others.[212] In a somewhat specious argument, Armco Steel also insisted that vessels (barges) were not "articles," a term of art em-

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203. *Id.*

204. *Id.* "We have no idea, at this juncture, what or when the agencies will decide, or what will be the reasons or bases for their decisions. The case, therefore, is not ripe for judicial action. . . ." *Id.* at 1114. The court was also unwilling to reach the merits of the case because even if the application was granted it would be an intermediate agency order as opposed to a final order. *Id.* at 1114-15. See APA §10c, *as codified* 5 U.S.C. §704 (1976). *See also* Sperry & Hutchinson v. F.T.C., 256 F. Supp. 136 (S.D.N.Y. 1966).

205. 431 F.2d 779 (2d Cir. 1970).

206. See note 197 *supra* and accompanying text.

207. 431 F.2d 779-82. *See generally* Recent Decisions, *Foreign-Trade Zones Act — Domestic Steel Manufacturer Has Standing to Challenge Order of Foreign-Trade Zone Board Authorizing Foreign Trade Sub-Zone in Which Imported Duty-Free Steel Can be Used to Manufacture Barges for Sale in United States*, 10 VA. J. INT'L L. 179 (1970).

208. 15 C.F.R. §400.1308 (1978) provides for an Examiners Committee. The Examiner is to be appointed by the Executive Secretary. 15 C.F.R. §400.1301 (1978). The Examiner will oversee the application process to assess if the applicant has complied with prerequisites for the issuance of a grant. See 15 C.F.R. §§400.600-.608 (1978); 15 C.F.R. §1307 (1978) (duties of examining committee). The Regional Commissioner of Customs and the District Engineer in whose territory the proposed Zone is to be located will also serve on the Examiners Committee. 15 C.F.R. §400.1308 (1978).

209. 431 F.2d at 783.

210. *Id.* at 785.

211. 15 C.F.R. §400.1003 (1978).

212. *Id.*

ployed in the Act, and therefore could not be manufactured in a sub-Zone.[213] The plaintiff further alleged that barge construction was never intended by the framers of the Act to occur in a Zone. Finally, the plaintiff asserted that only light manufacturing was contemplated within the scope of the manufacturing amendment to the Act.[214]

After examining the Act's provisions and legislative history, the court, in response to the first contention found that if a " 'hole' is thereby rent in the tariff wall [by the alteration of steel to barges in the Zone], Congress intended it, for the Foreign Trade Zones Act clearly contemplates that [trade zone] users may take advantage of differing rates in tariff schedules . . . ."[215] Importantly, the court also recognized that the Act gave broad discretion to the Board, particularly in determining who shall receive a grant.[216] In ruling upon the plaintiff's second contention, the court reasoned that because the grantee was willing to work with other parties to obtain additional sub-Zones, the instant sub-Zones used exclusively by Armco, did not contravene provisions of the Act requiring Zone operation on public utility principles. The third contention of the plaintiff was dismissed expeditiously, as the court found no "cogent reasons" to distinguish vessels from "articles" as the word is used in the Act.[217] The plaintiff's fourth contention, that Congress intended only "light manufacturing" in a Zone, was rejected after the court scrutinized the explicit provisions of the Act which provided that "[m]erchandise of *every . . . description* . . . may be . . . manufactured [in Zones] except as otherwise prohibited in this chapter."[218] The extensive examination of the Act's provisions in *Armco* is unique among the limited number of cases which have analyzed the Act. Moreover, the decision is important because of its *carte blanche* grant of discretion to the Board regarding the policy matters of Zone grant applications.

Significantly, the court in *Armco* stated that the "multi-faceted assault on the New Orleans Foreign-Trade sub-Zone involved arguments of policy which are better designed for consideration by the Congress than by a court."[219] Nevertheless, the court, ignoring its own advice, explored economic and policy

213. 431 F.2d at 784. The court prior to reaching the merits of the case dealt with the issue of whether the plaintiff had standing to challenge the Board's action. The court, citing to the then recent case of Data Processing Services v. Camp, 397 U.S. 150 (1970), held that Armco had standing because (1) it had alleged economic harm from unlawful competition and (2) tariff laws were demonstrably intended to protect against such harm. *Id. See also* Hardin v. Kentucky Utils. Co., 390 U.S. 1968 (1967).

214. 431 F.2d at 784.

215. *Id.* at 784-85.

216. *Id.* at 785.

217. *Id.* at 788. The plaintiff in the case, however, did not challenge the grant as violative of §81q of the Act which prohibits the disposition of grants by grantees. See notes 126-131 *supra* and accompanying text. The grantee of the Zone was the Board of Commissioners of the Port of New Orleans, which still operates the Zone. See note 45 *supra*.

218. 431 F.2d at 789. The Act provides that "articles" may be manufactured within the Zone. The plaintiff's position was that barges were not "articles" and therefore could not be manufactured in a Zone. This reasoning was based upon early customs cases which had under the customs regulations found that vessels (barges) were non-dutiable as not being articles. *See, e.g.*, The Conqueror, 166 U.S. 110 (1897).

219. 431 F.2d at 790 (citing 19 U.S.C. §81c (1976) (emphasis added by the court).

matters of the Act before arriving at its decision.[220] Although the *Armco* court indicated that these matters are appropriately left to Congress, it appears that because of the complex and speculative economic evaluations in regard to the impact of sub-Zone operation that such matters are more appropriate for an administrative body with the requisite expertise and facilities to make the needed judgments.[221] The administrators should, however, be provided with legislative parameters within which to exercise their discretion.

Tariff Assessment

Much like regulatory matters, the determination of the proper tariff transactions, often involves detailed analyses of the Act's provisions. The federal district court in *Inter-Maritime Forwarding Co. v. United States*[222] was faced with a direct conflict in the provisions of the Foreign-Trade Zone Act and the Trade Agreements Act of 1934.[223] The conflict resulted from provisions of the Foreign-Trade Zone Act which allow an importer to obtain "privileged" status for his merchandise by freezing the duty assessed upon the merchandise[224] while it is being held in the Zone. The plaintiff in *Inter-Maritime* had obtained this privileged status for goods which he had stored in the Zone. However, before the goods were imported, the quota applicable to them was exceeded and in accordance with the Tariff Act of 1934 a higher ad valorem duty on the excess was necessitated.[225] As required by departmental policy,[226] customs officials assessed the higher ad valorem duty when the cotton was ultimately imported from the Zone.[227]

In a complex opinion, the *Inter-Maritime* court concluded that the provisions of the two Acts were in direct conflict.[228] Apparently aware of the significant and inherent practical difficulties which would confront the government if a contrary ruling were given,[229] the court held that the higher assessment was proper.[230] Thus, the need for efficient tariff assessment overcame the privileges granted by the Act. Because the court was unwilling to

220. *Id.* at 784.

221. Titles of subsections of the opinion include "Impact of the Subzone of the Domestic Steel Industry," see notes 34-39 *supra*, and "Balance of Payments." 431 F.2d at 785.

222. See notes 255-256 *infra* and accompanying text.

223. 192 F. Supp. 631 (Cust. Ct. 1961).

224. See TARIFF ACT OF 1930, *as amended by* 19 U.S.C. §1202 (1976).

225. 192 F. Supp. at 631. *Cf.* 19 U.S.C. §81c (1976), providing in relevant part that whenever "[t]he privilege shall be requested . . . foreign merchandise in a zone . . . [shall] be appraised . . . and [the] duties liquidated thereon [and the merchandise] . . . may be sent into customs territory upon the payment of such liquidated duties. . . ."

226. The Customs Bureau had, in anticipation of this problem, circulated a notice indicating that goods which had privileged status would still not be exempt from changes in duties due to the expiration of quota limitations. 192 F. Supp. at 640.

227. *Id.* at 631.

228. *Id.*

229. Note, *supra* note 1, at 106.

230. 192 F. Supp. at 637. The decision was justified as "protecting Government revenue on such merchandise not entered for consumption so as to obtain the benefit of the quota concession (privileged status)." The court reasoned, "[t]he proper interpretation, in our opinion, would be that the impact of the trade agreement with its reservations and depart-

find a middle ground between the two Acts, the plaintiff was denied any of the benefits accruing from the privileged status of his goods. Such a middle ground is described by the dissenting judge in *Inter-Maritime*.[231] The dissent found the Acts reconcilable and reasoned that if the importer had at the time of receiving privileged status agreed to import the goods prior to the expiration of the quota period, the duty should have been assessed at the lower rate as if the goods had actually been imported.[232] The dissent's reasoning seems more palatable because the express provisions of the Foreign-Trade Zone Act are not rendered a nullity and the importer is more equitably treated.[233]

A more recent case construing provisions of the Act in relation to applicable customs duties is *Hawaiian Independent Refinery v. United States*.[234] The issue in *Hawaiian Independent Refinery* was whether customs duties could be charged upon goods consumed in the Zone.[235] The defendant's position was that unless specifically exempted by statute, all goods imported into the customs territory of the United States are subject to import duties, that the Act does not provide a specific exemption for goods consumed in a Zone, and that therefore such goods are subject to import duties.[236] The court acknowledged the validity of this general rule, but noted that it was expressly conditioned upon "the importation of foreign articles 'into the customs territory of the United States . . . .' "[237] Positing that goods consumed in a Zone never enter customs territory,[238] the general rule was held inapplicable.[239] Although the holding in *Hawaiian Independent Refinery* is axiomatic, given the rationale of the court, the case illustrates the need for a congressional reevaluation of the Act. The manner in which the refinery utilized the Zone device in *Hawaiian Independent Refinery* could not have been anticipated by the Congress when

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mental regulations on said section 3 [19 U.S.C. §81c] is to modify the latter to the extent that it is not arbitrarily controlling as to the quota goods in question. . . ." *Id.* at 636. The problem with this reasoning is that no basis is established to reach a conclusion that one Act was intended to be modified by the other. The decision is particularly troubling because the Foreign-Trade Zone Act was the later of the two acts.

231. 192 F. Supp. at 638 (Mollison, J., dissenting).

232. *Id.*

233. Note, *supra* note 1, at 106.

234. Hawaiian Independent Refinery v. United States, 460 F. Supp. 1249 (Cust. Ct. 1978).

235. The plaintiff's oil refinery had been granted sub-Zone status. The refinery processed foreign crude oil into petroleum products, primarily for export. In the process of crude oil fractionalization and distillation a great amount of heat is required. The plaintiff was using its own refined product to supply such energy. It was upon this oil that the customs officials indicated that duties should be paid. 460 F. Supp. at 1252-53.

236. *Id.* at 1253.

237. *Id.* (some emphasis deleted).

238. See 19 U.S.C. §81c (1976) providing in part "when foreign merchandise is so sent from a zone *into customs territory* . . . ." (emphasis supplied) *See also* S. REP. No. 1107, 81st Cong., 1st Sess. (1949) (to the effect that merchandise is subject to all customs laws if and when brought into customs territory).

239. 460 F. Supp. at 1254. The court, however, noted that the decision could in effect be reversed by the Board if it made use of its regulatory prerogatives. *See* 15 C.F.R. §400.807 (1978), which provides "[t]he Board may order the exclusion from the zone of any goods or process of treatment that in its judgment is detrimental to the public interest, health, or safety."

it passed the Foreign-Trade Zone Act.[240] The product consumption validated in *Hawaiian Independent Refinery* permits extensive customs avoidance,[241] an operating technique which has unfortunately seeped into the Zone device without sufficient legislative analysis.

SUGGESTIONS FOR LEGISLATIVE REFINEMENT AND REGULATORY IMPROVEMENT

An evaluation of the Act's success in fulfilling its purpose to expedite and encourage foreign trade[242] must necessarily precede suggestions for its constructive change. If the Act has served purposes other than those for which it was designed, these new usages, regardless of their beneficial nature, mandate a legislative refinement of the Act.[243] Of paramount concern is the scope of customs avoidance permitted by the coalescense of the manufacturing amendment[244] and the sub-Zone regulation.[245] This interaction in conjunction with manufacturing involving extensive product consumption was not contemplated by the framers of the Act. This necessitates a legislative weighing of the detrimental loss of customs revenue against the benefits of expanded Zone usage.[246] If expansion is determined to be desirable, Congress should enact specific provisions to sanction as well as control these operations.

Subsequent to a congressional determination that present Zone functions

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240. See note 50 *supra*.

241. 39TH ANN. REP., *supra* note 145, at 41-43 (describing oil production within the Zone).

242. See notes 10-12 *supra* and accompanying text.

243. See notes 234-242 *supra* and accompanying text.

244. See note 45 *supra* and accompanying text. DaPonte, the executive secretary, however, already has provided a substantial explanation for the expansion of the Zone device. He states in a recent article that: "So, when we count the growing number of port communities with zones or considering them, and note the emergence of the more accommodating contemporary industrial park zone, we are simply witnessing a response to demand brought about by international economic developments." DaPonte, *supra* note 15, at 4. Throughout the congressional debate and hearings there was an implicit belief that the limited space available for Zones would act as an inherent "brake" on manufacturing operations in Zones. See *Hearings on H.R. 4726 and H.R. 9206*, *supra* note 35, at 15, in which a proponent of the Act stated: "[I] do not envisage large plants. Lack of space would make that impossible." The sub-Zone regulation, however, completely emasculated the inherent space limitations in Zone operations. It also appears that the large spaces available at international airports, where a great number of new Zones are being established, will further eliminate this space limitation. See note 14 *supra* (note the 200-acre plus size of the Orlando Zone). The sub-Zone regulation is promulgated by the Board pursuant to the powers conferred upon the Board in the Act. 19 U.S.C. §81h (1976) (providing the Board may promulgate regulations "not inconsistent with the provisions of this chapter"). Although the regulation does not conflict with express provisions of the chapter, colorable arguments can be made that it effectuates purposes outside those intended by the Act. The sub-Zone device is primarily acquired by ongoing operations that do not basically change upon receipt of the sub-Zone grant. See notes 103-105 *supra* and accompanying text. Therefore, because operations are not directly expanded or altered, foreign trade is not expedited or encouraged and the only result is the avoidance of some customs duties by the Zone-based operation.

245. See note 49 *supra* and accompanying text.

246. See Armco Steel Corp. v. Stans, 431 F.2d 779, 783 (2d Cir. 1970), in which the court stated: "In the final analysis the propriety of the Act is a matter that must be addressed to Congress."

are valid, steps should be taken to alleviate problems in the Act. Prior to any legislative action, however, a comprehensive independent survey and study should be conducted to determine the reasons for the recent expansion in Zone numbers and usage.[247] This study should also be directed toward the anticipation of future changes in Zone operations so that many potential problems may be effectively anticipated.

Specific deficiencies are readily ascertainable in the Act. It currently has no provisions controlling the grantee/licensee contract method of Zone operation.[248] Specific sections should be added to provide guidelines for acceptable licensees and operating contracts. Such guidelines should also allow the Board to re-assert its role in providing preference to public corporations as Zone operators.[249] Furthermore, provisions should be added to alleviate existing confusion as to the applicability of state law to Zone transactions. Specific language delineating acceptable parameters for state taxation of Zone operations are particularly needed.[250] In addition to providing clarification, the enactment of sections controlling state law should preclude undesirable polarization in the applicability or non-applicability of state law to Zone operations.[251] Federal laws are demonstrably non-fungible in their effect on Zone operations.[252] Therefore, Congress to prevent *ad hoc* judicial determinations, should examine the problematic federal statutes and specifically determine the applicability of each one.

In conjunction with the needed legislative reevaluation of the Act, it is suggested that new Board-promulgated regulatory controls are neecssary to curtail customs avoidance schemes. The Act was designed to encourage foreign trade by eliminating the hindrances incidental to the collection of customs duties, and customs avoidance was intended only for transshipment goods. However, the Act's manufacturing amendment, permitting the importers to benefit from differential customs rates, and the lack of assertive control by the Board,[253] encourage extensive customs avoidance. Furthermore, the Board-

247. The study by Professor Dymsza under a grant from the Small Business Administration in 1964 is a good example of the type of study which presently needs to be conducted. W. DYMSZA, *supra* note 1.

248. See notes 189-196 *supra* and accompanying text. The most recent report of the Board to Congress states that "In about half of the projects operation of the Zone is contracted to a private firm." 39TH ANN. REP., *supra* note 145, at 10. This type of operation should also be considered in light of the Act's mandated preference for public corporations. *See* 19 U.S.C. §81b(c) (1976).

249. 19 U.S.C. §81b(c) (1976).

250. See notes 179-188 *supra* and accompanying text.

251. See text accompanying notes 145-148 *supra*. Some controls have already been established by the Board in regard to retail sales in Zones. 15 C.F.R. §400.808 (1978) provides in part: "No goods shall be offered for sale or sold in a zone which are not of the same kind and quality permitted to be offered for sale or sold in the political jurisdiction in which the zone is located."

252. See notes 149-160 *supra* and accompanying text.

253. *See* 19 U.S.C. §81h (1976) (giving the Board power to administer the Act). The Board has promulgated a regulation that requires permission to be obtained prior to the commencement of any manufacturing in a Zone. 15 C.F.R. §400.803 (1977). There is no evidence however that this regulation has been used to curtail manufacturing in the Zones.

promulgated regulation creating sub-Zones[254] allows large-scale, immobile manufacturing operations to take advantage of Zones and customs avoidance. Providing these operations with the Zone device encourages only incidental foreign trade while directly permitting business to reduce customs tariffs. Therefore, the Board should promulgate prophylactic regulations delineating standards to control the utilization of sub-Zones for manufacturing purposes. The regulations should mandate a comparative evaluation of the scope of customs avoidance and the amount of increased foreign trade caused by the particular business seeking sub-Zone status.[255] When the public benefits are *de minimis,* the sub-Zone request should be denied.

CONCLUSION

The ultimate propriety of the Zone concept is integrally related to and must be measured in terms of the diverse interests of Zone operators, Zone users and the general public. However, it is clear that the benefits of the Act accruing to any of the parties will not be maximized when substantial legal confusion exists relative to Zone operations. The greatest benefits will occur when the Zone device is utilized for the appropriate purposes.

In the final analysis Zones are important devices for American businessmen seeking to compete in complex international trade. Time and changes in industry, however, make it necessary for the concept to be legislatively scrutinized and improved. With the benefit of hindsight, legislators are presently in position to apply accumulated insight to the Act and make needed improvements. These improvements can provide a legislative answer to the question "Everything except the Customs?"[256]

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See note 50 *supra.*

254. See note 49 *supra.*

255. There appears to be a growing recognition of the impact of the sub-Zone regulation. In the most recent report of the Board to Congress it is stated that: "The fact that sub-[Z]one proposals must stand on their own in showing a significant public benefit tends to limit their number." 39TH ANN. REP., *supra* note 145, at 1. The executive secretary has stated: "In *very special cases,* where a firm can use zone procedures only at its own plant, designation as a 'subzone' adjunct to the general zone facility can be considered." DaPonte, *supra* note 14.

256. See note 1 *supra.*