

THE ACT OF STATE DOCTRINE AND FOREIGN  
SOVEREIGN DEFAULTS ON UNITED STATES BANK  
LOANS: A NEW FOCUS FOR A MUDDLED DOCTRINE

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United States banks have loaned billions of dollars to foreign borrowers,<sup>1</sup> including governments, government instrumentalities, and individuals or entities subject to sovereign coercion. Loan agreements covering these loans have been carefully crafted in an attempt to ensure that in the event of default United States courts will have personal and subject matter jurisdiction, United States law will be applied, and United States courts will be able to enforce any judgment.<sup>2</sup> However, these loan agreements generally have not anticipated application of the act of state doctrine to a sovereign or sovereign-compelled default. In simplest terms the act of state doctrine bars United States courts from examining the lawfulness of an action taken by a foreign sovereign within its own territory.<sup>3</sup> To the extent sovereign loan defaults fall within the scope of the doctrine, United States courts cannot decide actions stemming from those defaults. In such situations, banks have to seek relief in the courts of the defaulting nation or from the executive or legislative branches of the United States government.

The act of state doctrine was introduced to American jurisprudence in 1897 by Chief Justice Fuller in *Underhill v. Hernandez*.<sup>4</sup> In his opinion for the Court, the Chief Justice stated that "the courts of one country will not sit in judgment on the acts of the government of another done within its own territory."<sup>5</sup> This classic formulation was reaffirmed in 1964 by the Supreme Court in *Banco Nacional de Cuba*

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<sup>1</sup> See 71 Fed. Res. Bull. at A62 (Table 3.21) (Jan. 1985) (loans totalled more than \$425 billion at the end of June 1984).

<sup>2</sup> See Ryan, *Defaults and Remedies Under International Bank Loan Agreements with Foreign Sovereign Borrowers—A New York Lawyer's Perspective*, 1982 U. ILL. L. REV. 89, 110-28. Ryan discusses events that result in default and alternative remedies in the event of default. There is no discussion of the applicability of the act of state doctrine, but the article does note that "[i]n its own country, a sovereign borrower is and always should be sovereign." *Id.* at 132.

<sup>3</sup> RESTATEMENT (REVISED) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 428 (Tent. Draft No. 4, 1983).

<sup>4</sup> 168 U.S. 250 (1897).

<sup>5</sup> *Id.* at 252.

*v. Sabbatino*.<sup>6</sup> Yet over the past twenty years courts have inconsistently applied the doctrine, and the purpose, scope, and effect of the doctrine remain unsettled.

The extent to which the doctrine has been muddled was drawn sharply into focus in two recent cases involving defaults on loans made to several Costa Rican banks. In cases arising from action taken by the Costa Rican government, one judge in the United States District Court for the Southern District of New York held that the act of state doctrine applied to the default and dismissed the bank's suit;<sup>7</sup> several weeks later another judge in the same district held that the act of state doctrine did not apply to the Costa Rican default and permitted the suit to proceed.<sup>8</sup>

As this Comment will show, the general confusion in the act of state area is largely a result of judicial unwillingness to accept the consequences of the broad doctrine set out by Chief Justice Fuller in *Underhill*. For a variety of reasons, courts have narrowed the doctrine's application by carving out numerous exceptions to it. These exceptions, however, are both unnecessary and unprincipled. By creating exceptions to fit the fact patterns of particular cases, courts have neglected two natural limitations on the scope of act of state analysis: the doctrine's purpose and judicial ability to grant effective relief.

The act of state doctrine has at its core a concern about judicial offense to foreign sovereigns and the resulting effects of such offense on United States foreign policy. Act of state analysis, therefore, must seek to determine when judicial actions will offend foreign sovereigns. This Comment suggests that offense to sovereigns is at risk only where a foreign sovereign's action has been made "substantially effective." When, for example, a sovereign action affects goods or property situ-

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<sup>6</sup> 376 U.S. 398, 416 (1964) ("None of this Court's subsequent cases in which the act of state doctrine was directly or peripherally involved manifest any retreat from *Underhill*.").

<sup>7</sup> See *Allied Bank Int'l v. Banco Credito Agricola de Cartago*, 566 F. Supp. 1440 (S.D.N.Y. 1983), *aff'd on other grounds*, 733 F.2d 23 (2d Cir. 1984), *rev'd and remanded*, No. 83-7714 (2d Cir. March 18, 1985) (en banc).

As this issue went to press, the Second Circuit vacated its initial decision in *Allied* and reversed the district court's denial of Allied Bank's motion for summary judgment. The court held that the act of state doctrine did not apply to the Costa Rican loan defaults because the situs of the banks' obligation to repay was in New York. The court further held, following the suggestion of an amicus brief filed by the Department of State, that Costa Rica's unilateral renunciation of its debt was inconsistent with United States policy favoring international cooperation and negotiation in debt resolution and United States contract law.

The Second Circuit's resolution of the act of state issue illustrates the need for a principled test capable of determining the situs of intangibles for act of state purposes.

<sup>8</sup> See *Libra Bank Ltd. v. Banco Nacional de Costa Rica*, 570 F. Supp. 870 (S.D.N.Y. 1983).

ated in the foreign country, such action will be substantially effective with respect to those goods or property and thus will fall within the act of state doctrine. In cases where the goods or property upon which the sovereign purports to act are not clearly located within territorial boundaries of the sovereign nation, however, the effectiveness of the sovereign act may be uncertain. In such cases, this Comment suggests that a United States court's ability to grant meaningful relief becomes the crucial consideration in determining whether the doctrine applies since that ability is a dispositive indication of the ineffectiveness of the sovereign's action.

## I. DEVELOPMENT OF THE ACT OF STATE DOCTRINE

The act of state doctrine arises out of the deceptively simple principle that some acts done by foreign sovereigns are inappropriate for judicial review in the United States. The doctrine's development, however, has been marked by inconsistent litigation results. In part this may reflect changing times; it is not unreasonable that a doctrine arising from a tort action against a foreign government official in 1897 and developed in expropriation cases during the 1960's and 1970's requires a careful rethinking to resolve the sovereign loan defaults of the 1980's. A review of the doctrine's development reveals its underlying purpose of avoiding affront to foreign sovereigns and the elements to be considered to achieve that purpose.

### A. *The Landmark Cases*

#### 1. *Underhill v. Hernandez*

Although the origins of the act of state doctrine can be traced as far back as 1674 in British law,<sup>9</sup> the doctrine was not recognized in the United States until the 1897 case of *Underhill v. Hernandez*.<sup>10</sup> Underhill was an American citizen who operated a waterworks and machinery repair business in Venezuela. When revolution swept that country in 1892, Underhill was detained by General Hernandez, a revolutionary supporter, and forced to operate the waterworks and machine repair business for the new government. After his release, Underhill brought an action against Hernandez to recover damages for his detention; the Supreme Court rejected his claim.

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<sup>9</sup> See *Blad v. Bamfield*, 36 Eng. Rep. 992 (Ch. 1674). For a discussion of the act of state doctrine in English law, see Holdsworth, *The History of Acts of State in English Law*, 41 COLUM. L. REV. 1313 (1941).

<sup>10</sup> 168 U.S. 250 (1897).

Chief Justice Fuller's statement that "the courts of one country will not sit in judgment on the acts of the government of another done within its own territory"<sup>11</sup> may have been unnecessarily broad, given the factual context of the case.<sup>12</sup> Nevertheless, the expression is still regarded as the classic formulation of the American act of state doctrine.<sup>13</sup> This breadth, however, is the source of much of the doctrine's present confusion as it has led to the creation of numerous unprincipled exceptions by courts unwilling to accept the doctrine's expansive reach.

*Underhill* requires that two questions be asked in evaluating act of state claims. First, is the act in question one of "the acts of the government"?<sup>14</sup> Second, if it is a government act, is it "done within its own territory"?<sup>15</sup> In addressing these seemingly straightforward inquiries, however, litigants and courts have developed at least thirteen grounds on which to argue that the act of state doctrine does not apply.<sup>16</sup>

The general unwillingness of courts to apply the broadly stated doctrine may be partially attributable to Chief Justice Fuller's failure

<sup>11</sup> *Id.* at 252.

<sup>12</sup> Many commentators have suggested narrower grounds upon which the decision could have been reached. *See, e.g., Zander, The Act of State Doctrine*, 53 AM. J. INT'L L. 826, 830 (1959) (characterizing Chief Justice Fuller's language as dictum and suggesting better basis for decision was personal immunity of defendant Hernandez as agent of the foreign government performing acts within his official capacity); Note, *Rehabilitation and Exoneration of the Act of State Doctrine*, 12 N.Y.U. J. INT'L L. & POL. 599, 603 (1980) (describing Chief Justice Fuller's statement as an "eloquently superfluous exposition" and suggesting decision was based on Court's determination that a military commander of a de facto government subsequently recognized by the United States should be given the same immunity from civil suit that the military forces of a de jure recognized government traditionally receive).

<sup>13</sup> Though one commentator has referred to the statement as "Fuller's Curse." *See* Note, *supra* note 12, at 605.

<sup>14</sup> *Underhill*, 168 U.S. at 252.

<sup>15</sup> *Id.*

<sup>16</sup> *See International Law—Act of State Doctrine—First National City Bank v. Banco Nacional de Cuba*, 406 U.S. 759 (1972), 49 WASH. L. REV. 213 (1973). The article asserts,

Support exists in varying degrees for assertions that the doctrine should not apply when (1) the foreign state is at war with the United States, (2) the foreign state is not recognized by the United States, (3) the suit is brought to enforce a foreign state's penal or revenue laws, (4) the act was not performed within the territory of the foreign state, (5) the foreign government is not in existence at the time of suit, (6) the act was not fully executed, (7) the act is illegal under the law of the foreign state, (8) a treaty or other unambiguous agreement covers the controversy or (9) there is a "clear" violation of international law.

*Id.* at 223-24 (footnotes omitted). The Hickenlooper Amendment, *see infra* notes 47-51 and accompanying text, is also mentioned. Other instances in which the doctrine may not apply include counterclaims, commercial acts, executive suggestions, and acts by government functionaries without express sovereign authority. *See infra* text accompanying notes 47-84.

to place the doctrine on solid ground; his classic formulation was issued without reference to a single authority. However, the lower court's opinion<sup>17</sup> is far more helpful in this regard. Although the United States Court of Appeals for the Second Circuit decided the case for Hernandez on more limited grounds than did the Supreme Court,<sup>18</sup> it is the lower court's language that has been quoted in later Supreme Court cases<sup>19</sup> as the doctrine's rationale:

Considerations of comity, and of the highest expediency, require that the conduct of states . . . should not be called in question by the legal tribunals of another jurisdiction. The citizens of a state have an adequate redress for any grievances at its hands by an appeal to . . . the other departments of their own government. . . . [I]t would imperil the amicable relations between governments, and vex the peace of nations, to permit the sovereign acts or political transactions of states to be subjected to the examinations of the legal tribunals of other states.<sup>20</sup>

It is thus apparent that in its early stages of development the act of state doctrine was centrally concerned with avoiding judicial affront to foreign sovereigns. And in the years following *Underhill* the act of state doctrine was given the broad application Chief Justice Fuller appeared<sup>21</sup> to have contemplated.<sup>22</sup> However, the Supreme Court did not

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<sup>17</sup> *Underhill v. Hernandez*, 65 F. 577 (2d Cir. 1895), *aff'd*, 168 U.S. 250 (1897).

<sup>18</sup> The Second Circuit determined that Hernandez, as military commander of the de facto Venezuelan government, was immune from suit for the acts he had done in the performance of his duties to the government. *See id.* at 579.

<sup>19</sup> *See United States v. Belmont*, 301 U.S. 324, 328 (1937); *Oetjen v. Central Leather Co.*, 246 U.S. 297, 304 (1918).

<sup>20</sup> *Underhill v. Hernandez*, 65 F. 577, 579 (2d Cir. 1895), *aff'd*, 168 U.S. 250 (1897).

<sup>21</sup> The Chief Justice's view on the expansiveness of the act of state doctrine may have been considerably narrower than the language of *Underhill* indicates. In particular, he seemed to support judicial acquiescence to the executive branch in areas touching upon foreign affairs. *See Hilton v. Guyot*, 159 U.S. 113, 229 (1895) (Fuller, C.J., dissenting).

<sup>22</sup> *See United States v. Pink*, 315 U.S. 203 (1941) (holding that an act of Soviet government nationalizing insurance companies' assets both at home and abroad was not reviewable by an American court trying to dispose of New York assets of Soviet insurance company); *United States v. Belmont*, 301 U.S. 324 (1937) (ruling that actions of Soviet government nationalizing foreign and local assets of a dissolved corporation were not reviewable by American courts, even after Soviet claims to the money were released and assigned to the United States. Such settlement was found to be within the competency of the President and not a matter for judicial review.); *Ricaud v. American Metal Co.*, 246 U.S. 304 (1918) (holding that seizure of bullion by Mexican government was not reviewable by American courts when bullion was later shipped to United States); *Oetjen v. Central Leather Co.*, 246 U.S. 297 (1918) (holding seizure of animal hides by Mexican government not reviewable by American courts when hides were later shipped

discuss extensively the source and purpose behind the act of state doctrine until the 1964 case of *Banco Nacional de Cuba v. Sabbatino*<sup>23</sup>. As it is also the last Supreme Court act of state decision to command the support of more than a bare majority of the Court,<sup>24</sup> *Sabbatino* is a necessary starting point for a discussion of the modern act of state doctrine.<sup>25</sup>

## 2. *Banco Nacional de Cuba v. Sabbatino*

On August 6, 1960 the Cuban President and Prime Minister, acting pursuant to Law No. 851 passed by the Cuban Council of Ministers, expropriated the property of certain companies owned wholly or principally by American nationals. One of those companies was *Compania Azucarera Vertientes-Camaguey de Cuba (CAV)*. CAV had previously contracted to sell sugar to Farr, Whitlock & Co., an American commodities broker. The agreement stated that Farr, Whitlock was to pay for the sugar in New York upon presentation of the shipping documents and a sight draft. On the date of the expropriation CAV's sugar was being loaded onto a ship at a Cuban port. The expropriation decree required that before a ship carrying sugar of a named company could leave Cuban waters, the consent of the Cuban government had to

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to United States); *American Banana Co. v. United Fruit Co.*, 213 U.S. 347 (1909) (holding that actions of Costa Rican soldiers in seizing the railroad and plantation of an American corporation upon the prompting of a competing American corporation were not subject to review by American courts even though the conspiracy to do such acts was designed in the United States).

The only major exception to this broad interpretation appears in *Bernstein v. Van Heyghen Freres Societe Anonyme*, 163 F.2d 246 (2d Cir.), cert. denied, 332 U.S. 772 (1947), in which the Second Circuit, in an opinion by Learned Hand, held that the application of the act of state doctrine could, in a case involving acts of Nazi Germany, be waived at the suggestion of the executive. See also *Bernstein v. N.V. Nederlandsche-Amerikaansche Stoomvaart-Maatschappij*, 210 F.2d 375 (2d Cir. 1954); *Bernstein v. N.V. Nederlandsche-Amerikaansche Stoomvaart-Maatschappij*, 173 F.2d 71 (2d Cir. 1949). The Second Circuit's creation of the Bernstein or executive suggestion exception foreshadowed further breaches in the scope of the act of state doctrine that occurred after the Supreme Court's decision in *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398 (1964). See *infra* notes 47-84 and accompanying text.

<sup>23</sup> 376 U.S. 398 (1964).

<sup>24</sup> The *Sabbatino* decision, written by Justice Harlan, was endorsed by eight Justices. Only Justice White dissented.

<sup>25</sup> Because of its importance in the area, *Sabbatino* has been much written about. See, e.g., Goldie, *The Sabbatino Case: International Law Versus the Act of State*, 12 UCLA L. REV. 107 (1964); Henkin, *The Foreign Affairs Power of the Federal Courts: Sabbatino*, 64 COLUM. L. REV. 805 (1964); Mann, *The Legal Consequences of Sabbatino*, 51 VA. L. REV. 604 (1965); Reeves, *The Sabbatino Case and the Sabbatino Amendment: Comedy—or Tragedy—of Errors*, 20 VAND. L. REV. 429 (1967); Comment, *The Act of State Doctrine After Sabbatino*, 63 MICH. L. REV. 528 (1965); Recent Developments, *International Law: Congressional Abrogation of the Act of State Doctrine*, 65 COLUM. L. REV. 530 (1965).

be obtained. To secure permission for the ship to depart, Farr, Whitlock was required to enter into contracts, identical to those it had made with CAV, with an instrumentality of the Cuban government.

The Cuban instrumentality assigned the bills of lading to Banco Nacional de Cuba, which tendered the documents to Farr, Whitlock in New York for payment. Farr, Whitlock refused to pay Banco Nacional, and the Cuban instrumentality brought suit to recover on its bills of lading.<sup>26</sup>

The principal issue before the Supreme Court in *Sabbatino* was whether the the act of state doctrine applied to acts the United States considered to be in violation of international law.<sup>27</sup> It was also argued that the doctrine applied only at the executive branch's specific suggestion<sup>28</sup> and that it could not be applied when the foreign government is a plaintiff in United States courts.<sup>29</sup> The Court rejected these arguments and held that the lower courts were barred from examining the validity of the Cuban expropriation decrees:

[T]he Judicial Branch will not examine the validity of a taking of property within its own territory by a foreign sovereign government, extant and recognized by this country at the time of suit, in the absence of a treaty or other unambiguous agreement regarding controlling legal principles, even if the complaint alleges that the taking violates customary international law.<sup>30</sup>

This reformulation of the act of state doctrine is the law today, and subsequent decisions restricting its scope have attempted to do so within the framework of this decision. Like that in *Underhill*, this formulation restricts the doctrine most clearly to acts done within the state's territory and requires that the action be taken by a sovereign government. Unlike *Underhill*, however, *Sabbatino* requires that the

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<sup>26</sup> These facts are set forth in *Sabbatino*, 376 U.S. at 401-06.

<sup>27</sup> Not all countries consider expropriations to be violations of international law. "There are few if any issues in international law today on which opinion seems to be so divided as the limitations on a state's power to expropriate the property of aliens." *Id.* at 428 (footnote omitted).

<sup>28</sup> This argument is the converse of the Bernstein or executive suggestion, exception that the Second Circuit adopted in *Bernstein v. Van Heyghen Freres Societe Anonyme*, 163 F.2d 246 (2d Cir.), *cert. denied*, 332 U.S. 772 (1947). *See supra* note 22. While the Supreme Court rejected this extension of the exception in *Sabbatino*, it expressly refused to pass on its validity. *See Sabbatino*, 376 U.S. at 436. In *First National City Bank v. Banco Nacional de Cuba*, 406 U.S. 759 (1972), however, six members of the Court, in three separate opinions, rejected such an exception. *See infra* text accompanying note 56.

<sup>29</sup> *See Sabbatino*, 376 U.S. at 420.

<sup>30</sup> *Id.* at 428.

government be extant and recognized at the time of the suit,<sup>31</sup> and it expressly requires that a court apply the doctrine even to takings in violation of customary international law so long as no treaty or other unambiguous agreement has been breached. More importantly, *Sabbatino* includes an extensive discussion of the doctrine's basis and purpose.

## B. Doctrinal Underpinnings

### 1. Basis of the Doctrine

Unlike *Underhill*, the *Sabbatino* opinion clearly establishes that the purpose of the American act of state doctrine is to avoid affront to foreign sovereigns in situations where judicial interference might create foreign policy problems for the executive branch. The Court stated that judicial review of acts of state was neither constitutionally prohibited nor required but noted that the doctrine had "'constitutional' underpinnings" arising "out of the basic relationships between branches of government in a system of separation of powers."<sup>32</sup> The doctrine "concerns the competency of dissimilar institutions to make and implement particular kinds of decisions in the area of international relations."<sup>33</sup>

The decision permits—indeed, perhaps requires—that a court faced with an act of state issue carefully consider whether resolution of the issue could be more effectively left to the political branches of government. An emphasis on the judicial branch's inability to grant relief permeates the opinion: "When one considers the variety of means possessed by this country to make secure foreign investment, the persuasive or coercive effect of judicial invalidation of acts of expropriation dwindles in comparison."<sup>34</sup> The Court noted the diplomatic and coercive avenues available to the executive and compared them to judicial determinations of title that "have only an occasional impact, since they depend on the fortuitous circumstance of the property in question being

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<sup>31</sup> *Sabbatino* thus expands on *Underhill* to make application of the doctrine retroactive to acts performed before the United States recognized the government in power at the time of the suit. It further provides a rationale for the Bernstein/executive suggestion exception, *see supra* note 22, independent of the requirement of judicial acquiescence to executive requests. The Court apparently believed that the risks inherent in reviewing the acts of a government no longer in existence do not justify automatic dismissal on act of state grounds.

<sup>32</sup> *Sabbatino*, 376 U.S. at 423.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.* at 435. The means noted by the Court included a country's self-interest in maintaining a climate conducive to foreign investment, the discretionary distribution of foreign aid, the sanctioning of economic embargo, and the freezing of assets in this country. *See id.* at 435-36.



brought into this country.”<sup>35</sup> The Court further noted that “[i]f the political branches are unwilling to exercise their ample powers to effect compensation, this reflects a judgment of the national interest which the judiciary would be ill-advised to undermine indirectly.”<sup>36</sup>

However, the Court was clear that in deciding whether to apply the act of state doctrine to a particular act, a court must also consider the extent to which the foreign sovereign would actually be offended by judicial interference. The opinion noted that “some aspects of international law touch more sharply on national nerves than do others; the less important the implications for our foreign relations, the weaker the justification for exclusivity in the political branches.”<sup>37</sup>

In grounding the act of state doctrine on our government’s separation of powers, the Court explicitly rejected sovereign immunity as the basis for the doctrine.<sup>38</sup> While this rejection has been characterized as the “most unfortunate aspect of the *Sabbatino* opinion,”<sup>39</sup> moving away from sovereign immunity was a useful advance. It focuses attention on what should be the crucial element in judicial review of an act of state—the extent to which such review will actually offend a foreign sovereign—rather than on abstract considerations relating to the nature of sovereignty.<sup>40</sup>

## 2. Application of the Doctrine

Although *Sabbatino* helped to clarify the purpose behind the act of state doctrine, the opinion did not provide clear guidance to lower courts on how to apply the doctrine in a manner consistent with that purpose. While reaffirming the broad scope first articulated in *Un-*

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<sup>35</sup> *Id.* at 431.

<sup>36</sup> *Id.* at 436.

<sup>37</sup> *Id.* at 428.

<sup>38</sup> The Court said that it did not believe that the doctrine was “compelled either by the inherent nature of sovereign authority . . . or by some principal of international law. . . . While historic notions of sovereign authority do bear upon the wisdom of employing the act of state doctrine, they do not dictate its existence.” *Id.* at 421.

<sup>39</sup> Note, *supra* note 12, at 611.

<sup>40</sup> “[A]ct of state” refers to the principle that the courts of one nation will not judge the validity of the acts of a foreign government committed within that foreign government’s territory. Transnationally, sovereign immunity means that no sovereign will be subject to suit without its consent.” Cooper, *Act of State and Sovereign Immunity: A Further Inquiry*, 11 *LOV. U. CHI. L.J.* 193, 194 (1980) (footnotes omitted). The act of state doctrine shields the sovereign’s acts from judicial examination, while sovereign immunity exempts the sovereign itself from suit by virtue of its status as a sovereign. Thus, while a third party can assert the act of state doctrine as a defense, only the sovereign itself can claim sovereign immunity protection. The parameters of sovereign immunity are currently governed by the Foreign Sovereign Immunities Act of 1976, Pub. L. No. 94-583, 90 Stat. 2891 (codified at 28 U.S.C. §§ 1330, 1332(a), 1391(f), 1441(d), 1602 to 1611 (1982)).

*derhill*,<sup>41</sup> the opinion failed to delineate the meaning of the requirements that an act be done by a "foreign sovereign government"<sup>42</sup> "within its own territory."<sup>43</sup>

*Sabbatino* has been characterized as requiring a "balancing of interests"<sup>44</sup> on a case-by-case approach, but the opinion itself provides few clues as to precisely what interests must be balanced. Separation of powers was one of the Court's concerns. The *Sabbatino* decision asserted that the act of state doctrine's "continuing vitality depends on its capacity to reflect the proper distribution of functions between the judicial and political branches of the Government on matters bearing upon foreign affairs."<sup>45</sup> The Court further asserted that courts might better render decisions on acts of state if they were to "focus on the application of an agreed principle to circumstances of fact rather than on the sensitive task of establishing a principle not inconsistent with the national interest . . . ."<sup>46</sup>

But in a world where agreed principles are few, courts need a straightforward description of those circumstances of fact that require application of the act of state doctrine and those that do not. On the continuum of sovereign government acts that might fall under review by United States courts, standards must be established to determine at what point acts become so intertwined with sovereign interests as to preclude judicial review. It is important that courts have some method for determining when judicial review will be ineffective or will interfere with the foreign policy responsibilities of the political branches of government. In the absence of clear guidance from the Supreme Court, post-*Sabbatino* court decisions have created numerous exceptions to the doctrine without due regard for its underlying purpose.

### C. *Retreat from Underhill and Sabbatino*

The act of state doctrine survived relatively intact during the sixty-seven years between *Underhill* and *Sabbatino*. The twenty years since *Sabbatino*, however, have been marked by a continuing retreat from its broad scope.

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<sup>41</sup> "None of this Court's subsequent cases in which the act of state doctrine was directly or peripherally involved manifest any retreat from *Underhill*." *Sabbatino*, 376 U.S. at 416.

<sup>42</sup> *Id.* at 428.

<sup>43</sup> *Id.*

<sup>44</sup> See *First Nat'l City Bank v. Banco Nacional de Cuba*, 406 U.S. 759, 774 (1972) (Powell, J., concurring).

<sup>45</sup> *Sabbatino*, 376 U.S. at 427-28.

<sup>46</sup> *Id.* at 428.

## 1. Hickenlooper Amendment

Shortly after the decision in *Sabbatino* holding that the act of state doctrine applied even to acts alleged to be in violation of international law, Congress enacted the Hickenlooper Amendment to the Foreign Assistance Act of 1964.<sup>47</sup> The Hickenlooper Amendment requires that United States courts apply principles of international law to determine expropriation cases on their merits, unless the President requests that no such determination be made.<sup>48</sup> The Amendment has withstood a constitutional challenge,<sup>49</sup> but that is the only instance in which a court has applied it.<sup>50</sup> Litigants have raised the Amendment in act of state cases, but courts have always interpreted it narrowly and found it inapplicable.<sup>51</sup> Nevertheless, the Amendment exists as a potential exception to be applied by the courts, and its enactment reflects legislative discomfort with the breadth of the doctrine set forth in *Underhill* and *Sabbatino*.

## 2. Counterclaim Exception

The second limitation on the broad act of state doctrine evolved from the 1972 case of *First National City Bank v. Banco Nacional de Cuba*,<sup>52</sup> where a sharply divided Supreme Court permitted an American bank being sued by a Cuban national bank to assert a counterclaim for damages resulting from the Cuban militia's seizure of the American bank's Cuban branches.<sup>53</sup>

Although only one Justice in *City Bank* unequivocally supported an exception to the act of state doctrine for counterclaims, the three-

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<sup>47</sup> 22 U.S.C. § 2370(e)(2) (1982). For a detailed discussion of the amendment, see Dellapenna, *Suing Foreign Governments and Their Corporations: Choice of Law Part V*, 87 COM. L.J. 8, 11-15 (1982).

<sup>48</sup> See 22 U.S.C. § 2370 (e)(2) (1982); see also S. REP. NO. 1188, 88th Cong., 2d Sess. 24 (1964), reprinted in 1964 U.S. CODE CONG. & AD. NEWS 3829, 3852.

<sup>49</sup> See *Banco Nacional de Cuba v. Farr*, 383 F.2d 166 (2d Cir. 1967), cert. denied, 390 U.S. 956 (1968).

<sup>50</sup> See *id.*; see also Mathias, *Restructuring the Act of State Doctrine: A Blueprint for Legislative Reform*, 12 LAW & POL'Y INT'L BUS. 369, 407 (1980).

<sup>51</sup> For a discussion of the various narrow interpretations that courts have placed on the Hickenlooper Amendment, see Dellapenna, *supra* note 47, at 12-15.

<sup>52</sup> 406 U.S. 759 (1972) (plurality decision).

<sup>53</sup> *City Bank* had made a secured loan to the pre-Castro Cuban government. After the establishment of Castro's government, the Cuban militia seized *City Bank's* Cuban branches. *City Bank* used the collateral to repay the loan and attempted to keep \$ 1.8 million in excess proceeds. When the Cuban national bank sued to recover this \$ 1.8 million, *City Bank* asserted the right to counterclaim and set off for damages resulting from the expropriation of its bank branches. The district court held for *City Bank*, but the Second Circuit reversed on the ground that *Sabbatino* barred the assertion of a counterclaim. *Id.* at 760-62.

one-one-four decision has nonetheless come to be understood as adopting such a position. Justice Rehnquist, in a plurality opinion that was joined by Justice White and Chief Justice Burger, asserted that because the executive had expressly stated that application of the act of state doctrine to this case would not advance American foreign policy interests, the doctrine should not be applied.<sup>54</sup> However, this endorsement of an "executive suggestion exception" was squarely rejected by six members of the Court.<sup>55</sup> Justices Powell and Douglas concurred in the result, but both relied upon entirely different reasoning.<sup>56</sup>

Only Justice Douglas wrote unequivocally in favor of a counterclaim exception, but the plurality noted that their result was "consonant" with Justice Douglas's approach.<sup>57</sup> Despite this lukewarm endorsement of the exception, a subsequent dissent by the *City Bank* dissenters conceded that in *City Bank* "a bare majority of the Court allowed prosecution of the counterclaim."<sup>58</sup>

Lower court cases applying the counterclaim exception are rare. And in those cases in which it has been applied the courts have acted inconsistently. In *Menendez v. Saks & Co.*<sup>59</sup> the Second Circuit permitted counterclaims by importers against Cuba up to the limits of the respective claims lodged against them by the Cuban intervenors.<sup>60</sup> However, in a more recent Second Circuit opinion,<sup>61</sup> authored by the same judge who wrote the *Menendez* opinion, the court rejected a counterclaim exception, holding that "*Sabbatino* disposes of any objection to our application of the act of state doctrine to counterclaims . . . ."<sup>62</sup>

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<sup>54</sup> *Id.* at 768.

<sup>55</sup> *See id.* at 772 (Douglas, J., concurring in the result); *id.* at 773 (Powell, J., concurring in the judgment); *id.* at 777-78 (Brennan, J., dissenting, joined by Justices Stewart, Marshall, and Blackmun).

<sup>56</sup> Justice Douglas believed a sovereign immunity case, *National City Bank v. Republic of China*, 348 U.S. 356 (1955), was controlling. That case held that sovereign claims may be reduced by a counterclaim or setoff, when fair dealing so requires, up to the amount of the claim on which the suit is brought. *See City Bank*, 406 U.S. at 771-73. Justice Powell believed that the Court's holding in *Sabbatino* was too broad and concluded that absent evidence that review would interfere with delicate foreign relations, the courts have an obligation to decide cases before them on the merits. *See id.* at 774-76.

<sup>57</sup> *See City Bank*, 406 U.S. at 768.

<sup>58</sup> *Alfred Dunhill, Inc. v. Republic of Cuba*, 425 U.S. 682, 733 (1976) (Marshall, Brennan, Stewart and Blackmun, JJ., dissenting).

<sup>59</sup> 485 F.2d 1355 (2d Cir. 1973), *rev'd sub nom.* *Alfred Dunhill of London, Inc. v. Republic of Cuba*, 425 U.S. 682 (1976).

<sup>60</sup> *See id.* at 1373.

<sup>61</sup> *Empresa Cubana Exportadora de Azucar y Sus Derivados v. Lamborn & Co.*, 652 F.2d 231 (2d Cir. 1981) (opinion by Mansfield, C.J.).

<sup>62</sup> *Id.* at 238.

The creation of a counterclaim exception illustrates several problems in the act of state doctrine's recent development: a sharply fragmented Supreme Court, a refusal to mesh the facts of the case with the principles of the doctrine, and the inability of lower courts to apply the doctrine consistently.

### 3. Act Exception

The Supreme Court further restricted application of the act of state doctrine in *Alfred Dunhill, Inc. v. Republic of Cuba*<sup>63</sup> by permitting courts to call into question the sovereign authority of the actor claiming act of state protection and by seeming to insist that only government acts taken through formal "gold seal" decrees warrant act of state protection.<sup>64</sup> *Alfred Dunhill* involved the expropriation of Cuban cigar companies that were placed under the control of "interventors."<sup>65</sup> The former owners of the companies sued the American importers for trademark infringement and for the purchase price of the cigars that had been shipped to the importers from the seized Cuban plants both before and after the intervention. The importers, assuming the interventors were entitled to payment, had already paid for the preintervention shipments.<sup>66</sup>

The district court held that the 1960 intervention constituted an act of state and thus that the United States courts could not examine its validity.<sup>67</sup> As a result, the interventors were entitled to payment for the shipments that had been made after the intervention. The Cuban act of state, however, was not effective with respect to the preintervention accounts receivable that, the court held, had their situs in the United States.<sup>68</sup> The former owners were thus entitled to payment for the preintervention shipments, even though the importers had already mistakenly paid the interventors.

The court held that the interventors' refusal to repay the amounts mistakenly paid to them for the preintervention shipment did not constitute an act of state, and thus the importers were permitted to set off

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<sup>63</sup> 425 U.S. 682 (1976).

<sup>64</sup> This exception is inconsistent, however, with the first American act of state case. In *Underhill v. Hernandez*, 168 U.S. 250 (1897), the defendant had been a revolutionary military officer acting without formal government decree.

<sup>65</sup> See *Alfred Dunhill*, 425 U.S. at 685.

<sup>66</sup> See *id.* at 685-86.

<sup>67</sup> See *Menendez v. Faber, Coe & Gregg, Inc.*, 345 F. Supp. 527, 537 (S.D.N.Y.), *aff'd in part and rev'd in part*, *Menendez v. Saks & Co.*, 485 F.2d 1355, 1364 (2d Cir. 1973), *rev'd sub nom. Alfred Dunhill, Inc. v. Republic of Cuba*, 425 U.S. 682 (1976).

<sup>68</sup> See *id.* at 538.

their mistaken payments for preintervention shipments against the amounts due for postintervention shipments.<sup>69</sup> Dunhill, one of the importers, was owed more for preintervention shipments than it owed for postintervention shipments, and the district court granted a judgment against Cuba for the full amount of Dunhill's claim.<sup>70</sup>

The court of appeals agreed with the district court that the Cuban act of state was not effective as to the preintervention accounts receivable.<sup>71</sup> However, it believed that the intervenors' repudiation of their obligation to return the mistakenly paid funds constituted an act of state that precluded the grant of an affirmative judgment to Dunhill.<sup>72</sup>

The Supreme Court reversed the court of appeals on this point, with five Justices holding that the intervenors' refusal to return the monies mistakenly paid to them was not an act of state.<sup>73</sup> Instead, the Court characterized the refusal to repay as an exercise of only "commercial authority,"<sup>74</sup> and noted that "no statute, decree, order, or resolution of the Cuban Government itself was offered in evidence indicating that Cuba had repudiated its obligations in general of any class thereof or that it had as a sovereign matter determined to confiscate the amounts due three foreign importers."<sup>75</sup>

The majority's opinion appears less to reflect a principled reduction in the scope of the act of state doctrine than it does an ad hoc solution to an individual American company's act of state problem. As the dissent recognized, a foreign state need not formally ratify its conduct in order to exercise its sovereign authority.<sup>76</sup> In any case, the im-

<sup>69</sup> To say that the refusal of the intervenors to honor their obligations to repay the amounts by which they were unjustly enriched under the circumstances of these cases constituted a foreign act of state which must be given effect in our courts, would extend the act of state doctrine to unprecedented and unconscionable lengths.

*Id.* at 545.

<sup>70</sup> *See id.* at 564.

<sup>71</sup> *See Menendez v. Saks & Co.*, 485 F.2d 1355, 1364 (2d Cir. 1973), *rev'd sub nom.* *Alfred Dunhill, Inc. v. Republic of Cuba*, 425 U.S. 682 (1976).

<sup>72</sup> *See id.* at 1369-71.

<sup>73</sup> *See Alfred Dunhill*, 425 U.S. at 691-94. The five were Chief Justice Burger and Justices White, Powell, Rehnquist and Stevens.

<sup>74</sup> *Id.* at 694.

<sup>75</sup> *Id.* at 695.

<sup>76</sup> Justice Marshall, in a dissent joined by Justices Brennan, Stewart, and Blackmun, argued,

While it is true that an act of state generally takes the form of an executive or legislative step formalized in a decree or measure, that is only because duly constituted governments generally act through formal means. When they do not, their acts are no less the acts of a State, and the doctrine, being a practical one, is no less applicable.

*Id.* at 718-19 (citations omitted).

pact of the act exception may be insignificant since foreign governments can avoid the problems by post-facto formal ratification of the acts of interventors and similar government agents. What is significant about the decision is the signal it sends to lower courts that loopholes may be created in the act of state doctrine without substantial regard for the doctrine's underlying principles and purpose.

#### 4. Commercial Act Exception

A more serious limitation on the scope of the act of state doctrine was the suggestion by four of the five majority Justices in *Alfred Dunhill* that "the concept of an act of state should not be extended to include the repudiation of a purely commercial obligation owed by a foreign sovereign or by one of its commercial instrumentalities."<sup>77</sup> These Justices felt that in order to avoid embarrassment to the executive branch,<sup>78</sup> application of the doctrine should be consistent with the application of sovereign immunity. Since the current theory of sovereign immunity adopted by the United States did not extend protection to the commercial acts of foreign sovereigns, these Justices felt that an exception must also be made to the act of state doctrine.<sup>79</sup>

The dissenters in *Alfred Dunhill* recognized the breadth of the exception carved out by the majority and objected to it as "fundamentally at odds with the careful case-by-case approach adopted in *Sabbatino*."<sup>80</sup> They attempted to clarify the distinctions between sovereign immunity and the act of state doctrine, noting that the two doctrines

differ fundamentally in their focus and in their operation. Sovereign immunity accords a defendant exemption from suit by virtue of its status. By contrast, the act of state doctrine exempts no one from the process of the court. Equally applicable whether a sovereign nation is a party or not, the act of state doctrine merely tells a court what law to apply to a case . . . .<sup>81</sup>

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<sup>77</sup> *Id.* at 695. Justice White wrote for Chief Justice Burger and Justices Powell and Rehnquist. Justice Stevens provided the fifth vote for the majority on the ground that no act of state was involved, but did not join in Part III of the opinion advocating the creation of a commercial act exception.

<sup>78</sup> *See id.* at 697.

<sup>79</sup> *See id.* at 698-99. The Justices felt that any other result would undermine the policy behind the restrictive view of immunity to "assure those engaging in commercial transactions with foreign sovereignties that their rights will be determined in the courts whenever possible." *See id.* at 699.

<sup>80</sup> *Id.* at 728 (Marshall, J., dissenting).

<sup>81</sup> *Id.* at 725-26.

The dissenters saw the doctrine of sovereign immunity as "simply not designed to be responsive to the particular considerations underlying the act of state doctrine."<sup>82</sup> These differences, they argued, preclude automatic application of the exceptions to sovereign immunity to the act of state doctrine.

Despite this vigorous dissent, the commercial act exception has been adopted by many lower courts,<sup>83</sup> and it represents a substantial diminution in the scope of the act of state doctrine.<sup>84</sup>

#### D. Summary

These exceptions to the act of state doctrine reflect the discomfort of the legislative, executive, and judicial branches of government with a doctrine that seemingly denies a wronged plaintiff a forum. The exceptions also reveal a misunderstanding on the part of the courts of the purpose behind the doctrine as articulated by the Supreme Court in *Sabbatino*.

As *Sabbatino* made clear, the act of state doctrine seeks to avoid court actions that might offend foreign sovereigns in a way that would disrupt the foreign policy of the executive branch. If judicial review of a

<sup>82</sup> *Id.* at 728.

<sup>83</sup> See Dellapenna, *Suing Foreign Governments and Their Corporations: Choice of Law Part IV*, 86 COM. L.J. 486, 490 n.65 (1981) (collecting cases).

<sup>84</sup> The existence of a commercial exception to the act of state doctrine is further confused by the failure of its proponents in *Alfred Dunhill* to define the scope of such an exception. See *Alfred Dunhill*, 425 U.S. at 728 n.14 ("Indeed it is difficult to discern the precise scope of the 'commercial act' exception . . ."). At the time *Alfred Dunhill* was decided, the leading case in defining the scope of the restrictive view of sovereign immunity noted that sovereigns have traditionally been sensitive about political or public acts in the following categories: "(1) internal administrative acts, such as the expulsion of an alien. (2) legislative acts, such as nationalization. (3) acts concerning the armed forces. (4) acts concerning diplomatic activity. (5) public loans." *Victory Transport Inc. v. Comisaria General de Abastecimientos y Transportes*, 336 F.2d 354, 360 (2d Cir. 1964) (footnote omitted). However, these parameters for the scope of the restrictive view of foreign sovereign immunity were superseded by the Foreign Sovereign Immunities Act of 1976, Pub. L. No. 94-583, 90 Stat. 2891 (codified at 28 U.S.C. §§ 1330, 1332(a), 1391(f), 1441(d), 1602 to 1611 (1982)) (FSIA). This statutory codification of the restrictive theory of sovereign immunity included a very broad definition of commercial activity. See 28 U.S.C. § 1603(d). The committee report accompanying the FSIA said that the legislation did not affect the existing act of state doctrine because "decisions such as that in the *Alfred Dunhill* case demonstrate that our courts already have considerable guidance enabling them to reject improper assertions of the act of state doctrine." H.R. REP. NO. 1487, 94th Cong., 2d Sess., 20 n.1, reprinted in 1976 U.S. CODE CONG. & AD. NEWS 6604, 6619 n.1. If, as the Justices supporting a commercial exception in *Alfred Dunhill* argued, the act of state commercial act exception should be consistent with the sovereign immunity commercial act exception, the legislative expansion of the commercial act exception in the sovereign immunity area will have further eroded the scope of the act of state doctrine, and the courts will find few instances in which the doctrine will apply.



sovereign act will not offend the sovereign, it will not interfere with the conduct of foreign relations, and the act in question should fall outside the scope of the act of state doctrine. In those situations, however, where judicial review might create foreign relations problems, the judicial branch should refrain from examining the validity of the foreign state's act. Although such results might appear unfair, the act of state doctrine is intended to identify precisely those situations where redress is better left to the political channels of government.

The recent exceptions to the act of state doctrine upset this careful balance between the various branches of government that the Supreme Court outlined in *Sabbatino*. Each exception circumvents the careful case-by-case analysis that *Sabbatino* requires by labeling acts without examining the extent to which judicial review will affront the sovereign state and interfere with the conduct of foreign relations. To the extent that act of state questions are being answered without regard for these considerations, the doctrine is no longer serving the purpose for which it was intended.

## II. ACT OF STATE DOCTRINE TODAY

As the previous section implies, the Supreme Court's act of state decisions since *Banco Nacional de Cuba v. Sabbatino*<sup>85</sup> divided the Court, with four Justices<sup>86</sup> favoring a narrow scope for the doctrine and four Justices<sup>87</sup> seeking to preserve the broad scope that *Underhill v. Hernandez*<sup>88</sup> and *Sabbatino* set forth. This division has not provided the stable guidance the lower courts need to apply the doctrine consistently and has resulted in confusion over virtually every aspect of the doctrine.<sup>89</sup>

### A. *The Costa Rican Loan Defaults*

The confusion created by the Supreme Court's decisions on the act of state doctrine can best be seen by comparing two cases, *Libra Bank Ltd. v. Banco Nacional de Costa Rica*<sup>90</sup> and *Allied Bank Interna-*

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<sup>85</sup> 376 U.S. 398 (1964).

<sup>86</sup> Chief Justice Burger, and Justices White, Powell, and Rehnquist.

<sup>87</sup> Justices Brennan, Stewart, Marshall, and Blackmun.

<sup>88</sup> 168 U.S. 250 (1897).

<sup>89</sup> A discussion of the numerous lower court decisions since *Alfred Dunhill, Inc. v. Republic of Cuba*, 425 U.S. 682 (1976), falls outside the scope and space of this Comment. For an incisive discussion of such cases, see Dellapenna, *Suing Foreign Governments and Their Corporations: Choice of Law* (pts. III-VI) 86 Com. L.J. 438, 486 (1981), 87 Com. L.J. 8, 129 (1982).

<sup>90</sup> 570 F. Supp. 870 (S.D.N.Y. 1983).

*tional v. Banco Credito Agricola de Cartago*,<sup>91</sup> both of which arise out of defaults by Costa Rican banks on loans made by two commercial banking syndicates. On August 27, 1981 the Central Bank of Costa Rica adopted a resolution prohibiting the Costa Rican banks from paying interest or principal on debts denominated in foreign currency to foreign creditors.<sup>92</sup> Costa Rica was in the midst of a serious debt crisis, and it passed the resolution in an effort to resolve its debt problems.<sup>93</sup>

In November 1981 Costa Rica's President and Finance Minister issued a decree requiring that no payments on foreign debt be made without prior approval from the Central Bank.<sup>94</sup> The central bank notified the Costa Rican banks "that they would not be permitted to make external debt repayments pending resolution of the entire Costa Rican external debt situation."<sup>95</sup>

At the time the Costa Rican government halted the payments the balance due the Allied syndicate was approximately \$4.5 million,<sup>96</sup> while the amount owed the Libra syndicate was approximately \$35 million.<sup>97</sup> Both syndicates sued the Costa Rican banks in the United States District Court for the Southern District of New York. The act of state doctrine was the only defense raised in the *Allied* case<sup>98</sup> and was the principal defense raised in *Libra*.<sup>99</sup> Despite the fact that both cases arose from similar fact situations and were decided in the same district court within five weeks of each other, the decisions in the cases arrived at opposite conclusions as to the applicability of the act of state doctrine to the Costa Rican banks' defaults. The district court in *Allied* applied the doctrine;<sup>100</sup> the district court in *Libra* found it inapplicable.<sup>101</sup>

Attempting to apply the act of state doctrine to situations outside the context of an expropriation reveals the extent to which the expropriation cases have colored the recent development of the doctrine and the inadequacy of expropriation reasoning in other act of state situations. Considering the applicability of the act of state doctrine to sover-

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<sup>91</sup> 566 F. Supp. 1440 (S.D.N.Y. 1983), *aff'd on other grounds*, 733 F.2d 23 (2d Cir. 1984), *rev'd and remanded*, No. 83-7714 (2d Cir. March 18, 1985) (en banc) (see *supra* note 7).

<sup>92</sup> *Allied*, 566 F. Supp. at 1442.

<sup>93</sup> *Libra*, 570 F. Supp. at 875.

<sup>94</sup> *Allied*, 566 F. Supp. at 1442; *Libra*, 570 F. Supp. at 875. (The *Allied* court put the date at November 6, but the *Libra* court put the date at November 24.)

<sup>95</sup> *Allied*, 566 F. Supp. at 1442.

<sup>96</sup> Banco Cartago owed about \$3.8 million, Banco Anglo \$500,000, and Banco Nacional \$186,000. *Allied*, 570 F. Supp. at 1442.

<sup>97</sup> *Libra*, 570 F. Supp. at 874; *see also id.* at 887.

<sup>98</sup> *See Allied*, 566 F. Supp. at 1440.

<sup>99</sup> *See Libra*, 570 F. Supp. at 870.

<sup>100</sup> *See Allied*, 566 F. Supp. at 1444.

<sup>101</sup> *See Libra*, 570 F. Supp. at 884.

eign loan defaults is particularly helpful because such consideration requires a thoughtful examination of precisely what sovereign interests should be protected as acts of state. Furthermore, because sovereign loan defaults involve intangible property interests, a principled approach for determining when the sovereign action merits protection is necessary. As the reasoning in *Libra* and *Allied* illustrate, however, the courts have yet to articulate such a principled approach.

### B. *The Muddled Reasoning of the Costa Rican Cases*

As the conflicting results of the two cases suggest, the *Allied* and *Libra* courts approached the act of state issue very differently. The *Allied* court reasoned that although the execution of the promissory notes was a commercial activity, the government proclamations prohibiting foreign loan repayments were separable from the underlying commercial agreement and would themselves constitute an act of state.<sup>102</sup> The court decided that because the conduct of Costa Rica's President and Finance Minister was intended to alleviate a national economic crisis, it was "clearly an exercise of a governmental function."<sup>103</sup> The court concluded,

A judgment in favor of *Allied* in this case would constitute a judicial determination that defendants must make payments contrary to the directives of their government. . . . Such an act by this court risks embarrassment to the relations between the executive branch of the United States and the government of Costa Rica.<sup>104</sup>

In focusing on the governmental order barring repayment of foreign loans without considering the underlying negotiations and agreements giving rise to those loans, the court effectively sidestepped the *Underhill* requirements that a court determine the situs of the debt and

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<sup>102</sup> See *Allied*, 566 F. Supp. at 1443.

<sup>103</sup> *Id.* In reaching its decision, the court said it was applying what the Second Circuit had identified as principal factors justifying application of the act of state doctrine:

[W]here a court is asked to judge a foreign government's conduct under ambiguous principles of international law; where the challenged governmental conduct was public rather than commercial in nature, and where its purpose was to serve an integral governmental function; and where the executive branch of the United States Government has stated its view regarding the propriety of applying the act of state doctrine or regarding the validity of the foreign governmental act in question.

*Id.* (footnote omitted) (citing *Texas Trading & Milling Corp. v. Federal Republic of Nigeria*, 647 F.2d 300, 316 n.38 (2d Cir. 1981), cert. denied, 454 U.S. 1148 (1982)).

<sup>104</sup> *Id.* at 1444.

whether the banking syndicate's right to repayment was affected by an act done within Costa Rica. Since all governmental decrees are issued from the government's territory, all decrees, no matter how far-reaching, would merit act of state protection. The doctrine, however, is and should be limited to actions or declarations affecting the rights of property situated in foreign states. In failing to recognize the many property rights involved in the Costa Rican debt situation, the *Allied* approach toward application of the act of state doctrine is somewhat limited.<sup>105</sup>

The *Libra* court directly confronted the issue of the situs of the debt, determining the situs to be the United States and thus not granting act of state protection to the Costa Rican decree. It applied the two-step reasoning the Second Circuit had developed in a prior case addressing the validity of the attempted confiscation of the former King of Iraq's New York bank accounts by his successor government.<sup>106</sup> According to that reasoning, a court must first determine the situs of the property at the time of the attempted confiscation. Second, a court should apply the law and policy of the country where the property was located.<sup>107</sup> Thus, if the property were located in the United States, as was the case with the King's bank accounts, the act of state doctrine would be inapplicable, and United States law against takings without compensation would apply. If the property were located in the foreign state, the act of state doctrine would apply, and that state's laws and policies would govern. Under this test, the situs of the property becomes virtually dispositive of act of state questions.

This test is adequate when the property in question is tangible, as in an expropriation case. However, when the property in question is debt, there is no clear situs. Moreover, the test, at least as applied in *Libra*, fails to address what should be the central inquiry in an act of state case—the extent to which a judicial determination of rights will offend the foreign sovereign and impair the conduct of United States foreign policy.

The *Libra* court concluded that the situs of Banco Nacional's debt was in the United States for several reasons: Banco Nacional had con-

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<sup>105</sup> It is worth noting that the three Costa Rican banks involved in the *Allied* case were wholly owned by the Costa Rican government. *Allied*, 566 F. Supp. at 1441. If, as the court's opinion suggests, governmental decrees barring loan repayments are unreviewable in United States courts, foreign sovereigns might become inclined to issue such orders. When foreign state banks are involved, the foreign government benefits both from whatever economic stability ensues from halting the outflow of currency payments and from the value of the unpaid outstanding debt.

<sup>106</sup> See *Libra*, 570 F. Supp. at 877-82 (applying *Republic of Iraq v. First Nat'l City Bank*, 353 F.2d 47 (2d Cir. 1965), *cert. denied*, 382 U.S. 1027 (1966)).

<sup>107</sup> See *Republic of Iraq v. First Nat'l City Bank*, 353 F.2d 47, 51 (2d Cir. 1965), *cert. denied*, 382 U.S. 1027 (1966).

sented in the loan agreements to the jurisdiction of American courts; the letter agreement was to be construed in accordance with New York law; all payments were due in New York; all payments were to be made free and clear from other charges and withholdings; Banco Nacional had \$2.5 million on deposit at various New York banks; and Banco Nacional had substantial assets located in the United States.<sup>108</sup> None of these factors, however, considers the extent of the offense to Costa Rica that might result from judicial review of its acts.

Under the Second Circuit's two-part test, once a determination is made that the situs of the property that is the subject of the attempted confiscation is in the United States, American courts may apply domestic law and public policy in passing on the merits of the act. Since governmental takings of property without compensation are unlawful, the *Libra* court refused to recognize the Costa Rican proclamations as acts of state.<sup>109</sup>

It was only after the court had concluded that the act of state doctrine was inapplicable that it considered the act of state doctrine's underlying rationale—the effect of its judgment on the Costa Rican government and United States foreign relations—and the relationship between territorial limitations and the act of state doctrine.<sup>110</sup> The court's failure to give adequate consideration to such factors is symptomatic of the muddled condition of the act of state doctrine. A new approach emphasizing these factors must be developed to restore the balance between the need for court administered justice and the reality that the administration of such justice is often ineffective in practice and can create or exacerbate foreign policy problems for the political branches.

### III. ACT OF STATE: A FRESH APPROACH

The experience of the last twenty years has demonstrated the importance of establishing clear standards for lower courts to follow when applying the act of state doctrine. Such standards would lend predictability to the doctrine and would reduce the chances of judicial offense to sovereign governments. In developing a fresh approach to act of state analysis, this section examines the policies behind the doctrine, sets forth the factors that should and should not have a place in act of state analysis, and explains why this fresh approach renders exceptions to the doctrine obsolete.

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<sup>108</sup> See *Libra*, 570 F. Supp. at 881-82.

<sup>109</sup> See *id.* at 882.

<sup>110</sup> See *id.* at 882-84.

### A. Policies

At the heart of the *Banco Nacional de Cuba v. Sabbatino*<sup>111</sup> opinion was the essence of the act of state doctrine: courts may not examine a sovereign's taking of property where (1) the taking occurs within the sovereign's territory and (2) the government is extant and recognized at the time of suit.<sup>112</sup> The Court thus made clear that an important purpose underlying the doctrine was to avoid actions that would "imperil the amicable relations between governments and vex the peace of nations."<sup>113</sup> A related policy articulated by the Court in *Sabbatino* was recognition of the fact that the political branches of government are in many cases better at protecting the interests of Americans than are the courts.<sup>114</sup> The doctrine arises "out of the basic relationships between branches of government in a system of separation of powers,"<sup>115</sup> and thus the future "vitality" of the act of state doctrine depends upon the maintenance of a proper balance between the judicial and political branches of governments.<sup>116</sup>

Developing a fresh approach in the context of a sovereign default on United States bank loans is useful for several reasons. First, a sovereign's refusal to repay a loan is most likely to occur in response to a serious national economic crisis or following a change in government. Any United States court action refusing to give effect to the act of state will conflict with what the foreign sovereign government perceives as a vital national interest. Any valid approach should recognize these interests because they are an important measure of the extent to which review will "vex the peace of nations."

Second, act of state analysis requiring a determination of the situs of property breaks down when a clear situs does not exist. Much of the trouble courts have experienced in applying the doctrine has arisen in situations in which "a situs of the property" is not readily determinable. An approach comprehensive enough to cover intangible as well as tangible property interests would go far to alleviate the confusion courts

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<sup>111</sup> 376 U.S. 398 (1964).

<sup>112</sup> *Id.* at 428.

<sup>113</sup> *Id.* at 417-18 (quoting *Oetjen v. Central Leather Co.*, 246 U.S. 297, 303-04 (1918)).

<sup>114</sup> "The freezing of Cuban assets exemplifies the capacity of the political branches to assure, through a variety of techniques . . . , that the national interest is protected against a country which is thought to be improperly denying the rights of U.S. citizens." *Id.* at 412. "Judicial determinations of invalidity of title can, on the other hand, have only an occasional impact, since they depend on the fortuitous circumstance of the property in question being brought into this country." *Id.* at 431.

<sup>115</sup> *Id.* at 423.

<sup>116</sup> *See id.* at 427-28.

have experience in applying the doctrine.

Finally, because the dollar magnitude of these defaults, or potential defaults, is so great, United States courts will simply be unable to grant a remedy even roughly comparable to the losses banks could experience.<sup>117</sup> In the context of sovereign loan defaults, therefore, act of state principles will be applied, at least in economic terms, to extreme situations. Clarification of the doctrine so as to handle the most difficult and important act of state problems should help to resolve less difficult act of state problems.

## B. *Appropriate Factors for Review*

### 1. Sovereign Interests

The contraction in the scope of the act of state doctrine has significantly narrowed the scope of sovereign interests considered sufficiently serious to merit act of state protection. The Hickenlooper Amendment<sup>118</sup> and the exceptions to the doctrine, particularly the commercial act exception, have all eroded the concept of sovereign interest that was a central focus of *Sabbatino*.<sup>119</sup>

*Sabbatino* recognized that "some aspects of international law touch much more sharply on national nerves than do others; the less important the implications of an issue are for our foreign relations, the weaker the justification for exclusivity in the political branches."<sup>120</sup> In one of the Costa Rican default cases, *Libra Bank Ltd. v. Banco Nacional de Costa Rica*,<sup>121</sup> the court asserted that a United States court judgment against Costa Rica was unlikely to vex the peace of nations and that deference was therefore not required.<sup>122</sup> Given the court's awareness that the effect of its judgment would be to reverse the Costa Rican decrees issued in response to a national economic crisis,<sup>123</sup> such an assertion is indefensible. It is difficult to conceive of an act more intimately related to the advancement of a critical governmental inter-

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<sup>117</sup> Although *Libra* sought \$35 million from Banco Nacional, Banco Nacional had only about \$2.5 million in New York bank accounts, of which only \$800,000 had been successfully attached. *Libra*, 570 F. Supp. at 882; see also *supra* note 1 and accompanying text.

<sup>118</sup> 22 U.S.C. § 2370(e)(2) (1982).

<sup>119</sup> Sovereign interest is a central focus even of a doctrine grounded in separation of powers since the judicial and political branches conflict only when a sovereign has been offended. This is most likely to occur when a substantial sovereign interest is at stake.

<sup>120</sup> *Sabbatino*, 376 U.S. at 428.

<sup>121</sup> 570 F. Supp. 870 (S.D.N.Y. 1983).

<sup>122</sup> See *id.* at 882.

<sup>123</sup> See *id.*

est, and the court's judgment could clearly be expected to create or exacerbate diplomatic tension between Costa Rica and the United States.

The emerging commercial act exception to the act of state doctrine is an egregious example of foregoing the careful analysis anticipated by *Sabbatino* in favor of simply tacking a label onto a governmental act. The commercial exception is intuitively appealing because it places governments participating in business transactions on the same footing as individual entrepreneurs. And certainly in some cases governmental commercial acts should be denied the benefit of act of state treatment. But just as certainly there is a range of governmental acts that might be characterized as commercial and yet involve serious noncommercial sovereign interests. Labeling the purchase of a weapons system, for example, as commercial ignores the central question of the extent to which a United States court's review of that act will offend a foreign government. Courts reviewing sovereign acts of a commercial nature must avoid basing decisions on convenient labels; rather, they should examine the transaction in light of the governmental interest in it.<sup>124</sup>

There should be no commercial act, counterclaim, or narrow act exceptions to the act of state doctrine. Such exceptions divert judicial attention from the goal of the doctrine—consideration of the foreign state's real interest in the act in question. The key is to identify when foreign sovereigns might be offended by judicial review of legitimate acts of state.

## 2. Territorial Limitations

It is necessary to recognize a territorial limitation on the scope of the act of state doctrine. Sovereign acts that affect rights to property that is located entirely within the territorial boundaries of a foreign state should be considered effective acts of state and nonreviewable by American courts. Conversely, acts that purport to affect rights to property situated in the United States should be considered ineffective and reviewable by the courts in this country.<sup>125</sup>

Many sovereign acts, however, affect property rights that defy such simple categorization. Governmental decrees like those at issue in the Costa Rican cases are examples of such acts. The decrees were completely effective within Costa Rica and had the effect in the United

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<sup>124</sup> Analogous cases in the sovereign immunity area can be used for guidance in evaluating the governmental interest involved. See *supra* note 84.

<sup>125</sup> Current act of state doctrine deals with these situations adequately. See *Mendez v. Saks & Co.*, 485 F.2d 1355 (2d Cir. 1973), *rev'd sub nom.* *Alfred Dunhill of London, Inc. v. Republic of Cuba*, 425 U.S. 682 (1976); *Republic of Iraq v. First Nat'l City Bank*, 353 F.2d 47 (2d Cir. 1965), *cert. denied*, 382 U.S. 1027 (1966).



States of substantially precluding repayment of the outstanding loans.<sup>126</sup>

This Comment proposes that an act be considered "done" within the territory of a foreign sovereign when that sovereign has the power to make the action substantially effective. Such action should be deemed substantially effective if American courts are unable to grant adequate relief to a plaintiff who brings suit against a party claiming the act of state doctrine as a defense. This proposed approach recognizes that the foreign state is likely to expect that United States courts will respect its dominion over property within its control.

When a state has expropriated tangible property located within its borders, it has done a substantially effective act—it has affected the property in such a way as to alter the legal relationship of all those parties who previously had a legal interest in the property. A judgment by a United States court cannot alter this fact unless by chance the expropriated property is later transported to the United States. Since the expropriation has already been made substantially effective, however, United States courts, under this analysis, should refrain from examining the act's validity.<sup>127</sup> When the expropriated property is tangible, therefore, the "substantially effective" analysis arrives at the same result as standard theories for determining the applicability of the act of state doctrine—the situs of the property at the time of the expropriation is dispositive.<sup>128</sup>

When a case involves intangible property, this approach in effect places the property in the country that can most significantly affect legal interests in that property. In the context of a sovereign loan default, this analysis dictates that, unless American lenders have negotiated a security interest in property located in the United States or are able to attach assets that afford them recovery of a significant percentage of the default amount, the foreign government has done an act effective within its own territory. In such cases lenders will be required to seek redress through political branches of government.

Under this proposal, in both *Libra* and *Allied Bank International*

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<sup>126</sup> *Libra*, 570 F. Supp. at 882.

<sup>127</sup> Current doctrine recognizes this result. See, e.g., *United Bank Ltd. v. Cosmic Int'l, Inc.*, 542 F.2d 868, 874 (2d Cir. 1976) ("[T]he act of state doctrine reflects . . . the realization that in most cases there is nothing that an American court can do to rectify a foreign seizure which has been fully effected within the territory of the expropriating state . . ."); *Tabacalera Severiano Jorge, S.A. v. Standard Cigar Co.*, 392 F.2d 706, 715 (5th Cir.), cert. denied, 393 U.S. 924 (1968) ("[W]hen a foreign government performs an act of state which is an accomplished fact, that is when it has the parties and the *res* before it and acts in such a manner as to change the relationship between the parties touching the *res*, it would be an affront to such foreign governments for courts of the United States to hold that such an act was a nullity.").

<sup>128</sup> See *supra* text accompanying and following note 110.

*v. Banco Credito Agricola de Cartago*,<sup>129</sup> the primary concern should have been the extent to which the court would have been able to grant substantial relief to the plaintiff banks. The courts easily could have done this by comparing the amount due on the loans to the amount of assets then attachable in the United States. In *Libra* it is clear that the court was unable to grant substantial relief. While the *Libra* syndicate sought approximately \$35 million from Banco Nacional, it was estimated that Banco Nacional had \$2.5 million in New York bank accounts, only \$800,000 of which had been successfully attached. This amounted to less than three percent of the amount due.<sup>130</sup> Thus the *Libra* court should have refrained from examining the validity of the Costa Rican loan defaults. Since any judgment entered against the defaulting banks probably could only have been satisfied by assets located within Costa Rica at the time of the default, such a judgment would certainly have risked offense to Costa Rica by attempting to alter the legal ownership of property located within its territorial boundaries.

The *Allied* case is somewhat more difficult to analyze because the amount of the loan default was only \$4.5 million.<sup>131</sup> In this situation a court might consider a \$2.5 million recovery to be substantial relief. Since the approach to the act of state doctrine proposed by this Comment seeks to avoid judgments that can only be satisfied by assets located within the foreign state's territorial boundaries, a court should refrain from examining the validity of the foreign state's act unless the plaintiff is willing to accept the amount of relief that the court is able to grant as full satisfaction of its claim.

This proposed approach recognizes a foreign state's reasonable expectation of dominion over property substantially within its control.<sup>132</sup> It attempts to respect this expectation by precluding a court from entering any judgment against a foreign sovereign that cannot be satisfied by assets located within the United States. While on the surface it may appear arbitrary to allow the banking syndicate that is owed the lesser amount of money to recover, the purpose of this theory is to identify those situations where strong sovereign interests would be affected by a

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<sup>129</sup> 566 F. Supp. 1440 (S.D.N.Y. 1983), *aff'd on other grounds*, 733 F.2d 23 (2d Cir. 1984), *rev'd and remanded*, No. 83-7714 (2d Cir. March 18, 1985) (en banc) (see *supra* note 7).

<sup>130</sup> *Libra*, 570 F. Supp. at 882.

<sup>131</sup> *Allied*, 566 F. Supp. at 1442.

<sup>132</sup> See *Libra*, 570 F. Supp. at 883 ("Within its territorial boundaries, the foreign state has reasonable expectations of complete dominion over property and acts by courts of this nation declaring confiscation decrees invalid would 'often be likely to give offense to the expropriating country . . . .'"; quoting *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 432 (1964)).

judgment against the party claiming the act of state doctrine as a defense. When a domestic bank makes an unsecured loan to an entity potentially subject to sovereign coercion, the bank should recognize the risk that the sovereign will exercise its authority over the entity. In such a case the bank must be aware that domestic courts are incapable of granting the relief sought and should be encouraged to seek redress through the political channels of government.

### 3. Practical Considerations

Those seeking relief through the courts should recognize that an important consideration in act of state determinations is the ability of the judicial, as compared to the political, branch to grant effective relief.<sup>133</sup> If the foreign government's act has been made substantially effective within its borders, United States courts will be unable to grant meaningful relief. In such a situation the party injured by the act of state can only attain meaningful recovery with the help of the political branches. And if the political branches are reluctant to act, such a decision "reflects a judgment of the national interest which the judiciary would be ill-advised to undermine indirectly."<sup>134</sup>

A vigorous act of state doctrine should not unduly alarm those engaging in international financing. Certainly the political branches of government are in a better position to secure compensation from foreign governments than is the judiciary. Banks that suffer a sovereign default will, if the political branches deem it wise to intervene, attain more meaningful recovery than would be possible through the courts. In such cases it is sound policy for courts to require that banks seek redress through the branches of government best suited to examine the impact of those claims on foreign policy.

### CONCLUSION

This Comment's proposed approach to act of state analysis serves the doctrine's basic purpose of not offending foreign states and does so in a manner capable of consistent and predictable application by the courts. By refocusing judicial inquiry on the extent to which a particular adjudication will offend a foreign sovereign, it makes obsolete the many exceptions carved out of the doctrine in the last twenty years. It further defines that inquiry by proposing that American courts are most likely to offend a foreign sovereign when they review actions that

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<sup>133</sup> See *supra* notes 34-36 and accompanying text.

<sup>134</sup> *Sabbatino*, 376 U.S. at 436.

the sovereign has made effective within its territory. Specifically, if the sovereign is able to make the act substantially effective within its own territory, the act of state doctrine should be applied and the plaintiff forced to seek relief through the other channels. An act would be considered substantially effective, or done, within a foreign sovereign's territory if an American court were unable to grant effective relief to the party seeking recovery based on the act. Although developed around cases involving sovereign defaults on bank loans, this new approach should be generally applicable to all act of state contexts. It thus provides a much needed element of predictability in this highly sensitive area.