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The Act of State Doctrine: A Shield For Bribery And Corruption

Clayco Petroleum Corporation v. Occidental Petroleum Corporation, 712 F.2d 404 (9th Cir. 1983)

In 1979, the Board of Directors of Occidental Petroleum Corporation (Occidental) published a report admitting that Occidental had made a number of illegal overseas payments.¹ Clayco Petroleum Corporation (Clayco) subsequently filed an antitrust action in the United States District Court for the Central District of California against Occidental Petroleum Corporation, Occidental of Umm Al Qaywayn, Inc. and Armand Hammer. Clayco alleged that by making secret payments to Sheikh Sultan bin Ahmed Muallah, the Petroleum Minister and son of the ruler Umm Al Qaywayn,² Occidental had unlawfully secured an off-shore oil concession previously promised to Clayco.³ The district court granted Occidental's motion to dismiss on the ground that an adjudication of the case was barred by the act of state doctrine. The court reasoned that if Clayco were allowed to sustain the proof of its claim, a review of the sovereign's involvement in the granting of the oil concession would have been required. In the court's view, this would have resulted in unwarranted judicial interference with United States foreign policy. The court also refused to apply a commercial exception to the act of state doctrine.

Clayco's appeal to the United States Court of Appeals for the Ninth Circuit asserted that the district court erred in dismissing the complaint because of the act of state doctrine. On appeal, the

1. The report had been prepared upon the directive of the Securities Exchange Commission following commencement of an action alleging violations of the Securities Exchange Act of 1934. *Securities and Exchange Commission v. Occidental Petroleum Corp.*, No. 77-0751 (D.D.C. filed May 3, 1977). The report revealed that a questionable \$200,000 payment had been made in Switzerland and inaccurately entered on Occidental's books.

2. This former sheikdom now constitutes part of the United Arab Emirates. In *Occidental Petroleum Corporation v. Buttes Gas & Oil Company*, 331 F. Supp. 92 (C.D. Cal. 1971), the court concluded that Umm Al Qaywayn was a state for purposes of the act of state doctrine.

3. Clayco claimed violations of section 1 of the Sherman Act, 15 U.S.C. § 1, section 2(e) of the Robinson-Patman Act, 15 U.S.C. § 13(c), section 16720 and 17046 of the California Business and Professions Code, and the common law.

Court of Appeals *held*, affirmed: Where allegations of bribery and conspiracy implicated the exercise of power peculiar to a sovereign, the act of state doctrine required dismissal of the complaint; no exceptions based on the commercial activity of the sovereign or the Foreign Corrupt Practices Act of 1977 could be invoked. *Clayco Petroleum Corporation v. Occidental Petroleum Corporation*, 712 F.2d 404 (9th Cir. 1983).

The act of state doctrine is a principle of self-imposed judicial restraint in the adjudication of cases involving politically-sensitive foreign policy. Its underlying purpose is to preclude judicial pronouncements that might embarrass the Executive branch or a foreign sovereign and undermine favorable United States relations with foreign governments.

Ever since *Underhill v. Hernandez*,⁴ courts have been grappling, oftentimes unsatisfactorily, with both analysis and application of the act of the state doctrine. In *Banco Nacional de Cuba v. Sabbatino*,⁵ a case involving the expropriation of American property in Cuba by the Castro government, the Supreme Court recognized that the doctrine had "constitutional underpinnings," but rejected the argument that it was constitutionally mandated by the principle of separation of powers.⁶ Instead, the Court advocated use of a balancing test to determine whether a foreign affairs issue was so politically sensitive that judicial abstention was warranted.⁷ In *Sabbatino*, however, the Court failed to identify which factors should be balanced, thereby providing little guidance for the adjudication of future litigation involving the act of state doctrine.

The problem has been further exacerbated by the burgeoning incursion of the doctrine into the antitrust action domain. In *Hunt v. Mobil Oil Corporation*,⁸ for example, the doctrine was applied as a jurisdictional bar to adjudication of an antitrust claim. Although the foreign sovereign was neither named as a defendant nor implicated in the alleged conspiracy, the court noted that any adjudication would have required an inquiry into the activities of the foreign sovereign which could only be "fissiparous, hindering or

4. 168 U.S. 250 (1897). In *Underhill*, the Supreme Court stated that: "Every sovereign state is bound to respect the independence of every other sovereign state, and the courts of one country will not sit in judgment on the acts of the government of another, done within its own territory." *Id.* at 252.

5. 376 U.S. 398 (1964).

6. *Id.* at 423.

7. *Id.* at 428.

8. 550 F.2d 68 (2d Cir. 1977).

embarrassing to the conduct of foreign relations which [was] the very reason underlying the policy of judicial abstention expressed in the doctrine."⁹ The court failed to observe, however, that the act of state doctrine is a defense relating to the subject matter of a dispute, to be invoked only after a determination has been made that the court should exercise extraterritorial jurisdiction under the United States antitrust laws.

Early antitrust litigation was confined almost exclusively to a territorial jurisdictional analysis. One of the first antitrust cases, *American Banana Co. v. United Fruit Co.*,¹⁰ established the rule that the Sherman Act would not apply to acts performed exclusively outside of the United States. Shortly thereafter, however, in *Thomsen v. Cayser*,¹¹ the Supreme Court liberalized this rule of strict territoriality by holding that a combination of common carriers, although formed abroad, came within the purview of the Sherman Act, since "the combination affected the foreign commerce of this country and was put into operation here."¹²

The concept of extraterritorial application of the antitrust laws was firmly established in *United States v. Aluminum Co. of America*,¹³ where Judge Learned Hand adopted the "effects" test. A finding of both an intent to affect and an effect on American commerce brings extraterritorial activities within the ambit of the Sherman Act.¹⁴

In *Timberlane Lumber Co. v. Bank of America*,¹⁵ the Ninth Circuit Court of Appeals expanded the *Alcoa* "effects" test, advocating the use of a balancing approach in determining the extent of the extraterritorial jurisdiction under the antitrust laws.¹⁶ The court noted that "[t]he act of state doctrine . . . demonstrates that the judiciary is sometimes cognizant of the possible foreign implications of its actions," and that a "[s]imilar awareness should be extended to the general problems of extraterritoriality."¹⁷ The court then identified the following considerations that should be balanced in determining whether extraterritorial jurisdiction

9. *Id.* at 77.

10. 213 U.S. 347 (1909).

11. 243 U.S. 66 (1917).

12. *Id.* at 88.

13. 148 F.2d 416 (2d Cir. 1945).

14. *Id.* at 444.

15. 549 F.2d 597 (9th Cir. 1976).

16. *Id.* at 614.

17. *Id.* at 613.

exists:

The degree of conflict with foreign law or policy, the nationality or allegiance of the parties and the locations or principal places of business of corporations, the extent to which enforcement by either state can be expected to achieve compliance, the relative significance of effects on the United States as compared with those elsewhere, the extent to which there is explicit purpose to harm or affect American commerce, the foreseeability of such effect, and the relative importance to the violations charged of conduct within the United States as compared with conduct abroad.¹⁸

These factors were adopted in substantially the same form in *Mannington Mills, Inc. v. Congoleum Corporation*,¹⁹ which involved a claim that a competitor had violated the antitrust laws by fraudulently procuring foreign patents. The district court dismissed the complaint filed by one U.S. corporation against another U.S. corporation on the ground that the "validity of the foreign patents was to be determined by the courts of the respective issuing nations," and that enjoining the plaintiff would violate the act of state doctrine.²⁰ The Third Circuit Court of Appeals rejected the district court's application of the act of state doctrine and remanded the case to determine whether, based on the factors set forth by the court in *Timberlane*, extraterritorial jurisdiction should be exercised.²¹ The circuit court concluded that "the granting of the patents *per se*, . . . is not the kind of governmental action contemplated by the act of state doctrine, or its correlative, foreign compulsion."²²

In both *Timberlane* and *Mannington Mills*, judicial abstention from adjudicating politically-sensitive disputes was addressed as an extraterritorial jurisdiction issue rather than an act of state doctrine issue. Nevertheless, the considerations involved in applying the act of state doctrine are quite similar to those involved in determining whether to exercise extraterritorial jurisdiction under the antitrust laws.²³

18. *Id.* at 614.

19. 595 F.2d 1287 (3d Cir. 1979). One significant factor which the *Mannington Mills* court added to those enumerated in *Timberlane*, was the "possible effect upon foreign relations if the court exercises jurisdiction and grants relief." *Id.* at 1297-98.

20. *Id.* at 1290.

21. *Id.* at 1297.

22. *Id.* at 1294.

23. "[T]he availability of the act of state defense hinges on policy considerations that

Although the balancing test in *Timberlane* and *Mannington Mills* was adopted in response to the growing awareness of the potential and actual conflict of American antitrust laws with the laws and policies of nations whose economic philosophies are frequently drastically opposed to those of the United States, the test also encompasses act of state policy considerations. Indeed, one commentator has suggested that when a determination is made under the *Timberlane* test that the United States' interest in exercising antitrust jurisdiction outweighs foreign economic regulatory interests, the act of state doctrine should not preclude application of United States antitrust laws.²⁴ In distinguishing between disputes involving the validity of foreign expropriation decrees, where judicial involvement might interfere with the executive branch's efforts to secure compensation, and private antitrust actions, this commentator pointed out that "fears of affront carry less weight if imposition of liability on a private defendant who has chosen to disobey American antitrust law rather than command of a foreign sovereign is at issue."²⁵

The Ninth Circuit Court of Appeals in *Clayco* recognized that *Sabbatino* called for a flexible balancing approach to the act of state doctrine.²⁶ Nevertheless, except for stating in conclusion that "judicial scrutiny of sovereign decisions allocating the benefits of oil development would embarrass the political branches of our government in the conduct of foreign policy,"²⁷ the court failed to follow the *Sabbatino* directive. It also made no attempt to substantiate this assertion. Indeed, it is doubtful that a convincing argument could have been made that judicial scrutiny would have caused embarrassment, since all the facts surrounding the alleged violations had already been publicized, and the acts of a United States corporation, not those of the ruler of Umm Al Qaywayn,

are best accounted for by attention to the kinds of factors identified in *Timberlane* and *Mannington Mills*." *Sage International Ltd. v. Cadillac Gage Co.*, 435 F. Supp. 896, 905 (E.D. Mich. 1981). The court also noted that such an approach would be "in keeping with *Sabbatino's* caution that there is no 'inflexible and all-encompassing rule.'" *Id.* at 905-06 (citing *Sabbatino*, 376 U.S. at 428).

24. Note, *Foreign Sovereign Compulsion in American Antitrust Law*, 33 STAN. L. REV. 131, 136 (1980).

25. *Id.*

26. 712 F.2d at 406. The court, citing *Sabbatino*, 379 U.S. at 428, declared that since "the critical element is the potential for interference with our foreign relations, 'the less important the implications of an issue are for our foreign relations, the weaker the justification for exclusivity in the political branches.'"

27. 712 F.2d at 407.

were under attack. Instead, relying heavily on *International Association of Machinists and Aerospace Workers (IAM) v. OPEC*,²⁸ the court chose to concentrate its analysis on a public/private interest distinction—a distinction more firmly grounded in the theory of sovereign immunity than in the act of state doctrine.²⁹ This is contrary to *Sabbatino* where the Supreme Court stated that the “[act of state] doctrine is not compelled . . . by the inherent nature of sovereign authority, as some of the earlier decisions seem to imply, see *Underhill* . . . and *American Banana*.”³⁰

The court in *IAM v. OPEC* refrained from actually applying the doctrine of sovereign immunity. Had it done so, IAM could have prevailed by showing that OPEC’s price-fixing practices fell within the commercial exception to the Foreign Sovereign Immunities Act of 1976.³¹ To prevent such a result, the court artfully invoked the act of state doctrine, which “remain[ed] available . . . regardless of any commercial component of the activity involved.”³² Similarly, the court in *Clayco* skirted the argument that a commercial exception should apply in the case before it. While acknowledging that the Supreme Court had recognized an exception to an act of state defense for a sovereign’s commercial activity,³³ the *Clayco* court refused to apply the exception because it characterized the granting of a concession to exploit natural resources as an activity that “entails an exercise of powers peculiar to a sovereign.”³⁴

28. 649 F.2d 1354 (9th Cir. 1981).

29. 712 F.2d at 406.

30. 376 U.S. at 421.

31. Foreign Sovereign Immunities Act of 1976 [hereinafter FSIA], 28 U.S.C. §§ 1603, 1605 (1976). Section 1605 of the FSIA states that:

(a) A foreign state shall not be immune from the jurisdiction of courts of the United States or of the States in any case—

* * *

(2) in which the action is based upon a commercial activity carried on in the United States by the foreign state, or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere, or upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States.

Section 1603(d) defines a commercial activity as: [E]ither a regular course of commercial conduct or a particular commercial transaction or act. The commercial character of an activity shall be determined by reference to the nature of the course of conduct or particular transaction or act, rather than by reference to its purpose.

32. 649 F.2d at 1360.

33. *Alfred Dunhill of London, Inc. v. Republic of Cuba*, 425 U.S. 682 (1976).

34. 712 F.2d at 408.

The court also rejected Clayco's argument that, because (1) the actions involved in this case did not "include a sovereign policy decision,"³⁵ and (2) examination of the motivation behind the sovereign's act was less intrusive than an examination of its legal validity,³⁶ Occidental should not be shielded by the act of state doctrine. The court maintained that a sovereign policy decision was involved based on the fact that the dispute here, as in *Occidental Petroleum Corp. v. Buttes Gas & Oil Co.*³⁷ and *Hunt v. Mobil Oil Corporation*, concerned a "sovereign decision authorizing exploitation of important national resources."³⁸ The court also distinguished cases where an act of state defense did not preclude adjudication, such as *Timberlane*, *Mannington Mills* and *Industrial Investment Development Corp. v. Mitsui & Co. Ltd.*,³⁹ by classifying them as cases in which "sovereign activity merely formed the background to the dispute or in which the only governmental actions were the neutral application of the laws."⁴⁰

The *Clayco* court, thus, concluded that it was precluded by the act of state doctrine from scrutinizing any sovereign decision involving natural resources.⁴¹ While this decision was, no doubt, based on well-founded concerns for the sensitive nature of United States foreign relations with oil producing nations, it also has the adverse effect of "immunizing the conduct of private oil companies who are able to implicate a foreign sovereign in their anticompetitive schemes."⁴²

The court also rejected Clayco's argument that the act of state doctrine did not preclude judicial scrutiny of the sovereign's motivation. The court acknowledged that in the case of *Mitsui* the motivation of the sovereign act had been subject to examination, but it maintained that this was limited to an assessment of the plaintiff's damages and that adjudication in that case "would result in no embarrassment to executive department action."⁴³ In *Clayco*,

35. *Id.* at 406.

36. *Id.* at 407.

37. 331 F. Supp. 92 (C.D. Cal. 1971).

38. 712 F.2d at 407.

39. 594 F.2d 48 (5th Cir. 1979).

40. 712 F.2d at 406.

41. See, e.g., *International Association of Machinists and Aerospace Workers v. OPEC*, 649 F.2d 1354 (9th Cir. 1981); *Hunt v. Mobil Oil Corporation*, 550 F.2d 68 (2d Cir. 1977); *Occidental Petroleum Corporation v. Buttes Gas & Oil Co.*, 331 F. Supp. 92 (C.D. Cal. 1971).

42. Backer, *Sherman Act Jurisdiction and the Acts of Foreign Sovereigns*, 77 COLUM. L. REV. 1247, 1248 (1977).

43. 712 F.2d at 407.

however, the basis of the claim was bribery of a government official. Thus, the court reasoned, any inquiry into the sovereign's motivation would result in embarrassment.⁴⁴

The court failed to recognize, however, that such embarrassment to a foreign sovereign or state is a proper judicial concern only insofar as such embarrassment could "seriously interfere with negotiations being carried on by the Executive Branch [which] might prevent or render less favorable the terms of an agreement that could otherwise be reached."⁴⁵ In sum, the act of state doctrine commands judicial self-restraint when adjudication would lead to any serious intermeddling by the judiciary with the executive branch's conduct of foreign policy.

Since the Securities and Exchange Commission (SEC), an agency of the Executive, had already brought an action against Occidental alleging that it had violated the Securities Exchange Act of 1934⁴⁶ by making illegal payments to the Petroleum Minister of Umm Al Qaywayn,⁴⁷ there was no particular reason for the court to have been concerned about embarrassing the Executive. Where the Executive has exercised its prosecutorial discretion to bring an enforcement proceeding, any subsequent court action should not be regarded as judicial interference with United States foreign policy. The court's attempt to dismiss Clayco's arguments by indicating that "the Payments Report and Source Memorandum disclose[d] only some of the underlying facts and only raise[d] a question as to the legality of some of the payments under Umm Al Qaywayn law,"⁴⁸ is unconvincing. As the court in *Sage Intern., Ltd. v. Cadillac Gage Co.* pointed out:

[S]ince the Act imposes criminal sanctions for bribery "for the purpose of" improper influence or inducement, it is inconceivable that a trial would proceed without some inquiry into whether the alleged improper activity could have the intended effect, an examination that will call into question the operations of the foreign entity to which the bribe was allegedly directed. The standards of proof in a criminal action, particularly with respect to intent, would seem to require no less. Thus, in spirit and in practice, the Act supports the notion that act of state

44. *Id.*

45. 376 U.S. at 432.

46. 15 U.S.C. § 78 (1983).

47. See *supra* note 1.

48. 712 F.2d at 409 n.6.

concerns are subjugated to interests in stemming foreign corrupt practices.⁴⁹

Finally, the court in *Clayco* rejected Clayco's argument that the Foreign Corrupt Practices Act of 1977⁵⁰ (FCPA) created an exception to the act of state doctrine. The court reasoned that enforcement action under the FCPA was intended as solely a public action, with prosecutorial responsibility shared by the Justice Department and the SEC, whose activities would be coordinated with, and screened by, the State Department.⁵¹ It concluded that the act of state doctrine remained necessary in private suits "to protect the proper conduct of national foreign policy."⁵²

The *Clayco* decision is wrong and should not be followed by

49. 534 F. Supp. 896, at 910 n.26 (E.D. Mich. 1981). Also, as one commentator noted: Clearly, any prosecution under the Act risks embarrassment of any foreign governments involved, and may incur resentment for the imposition of American moral judgments on their methods of doing business. However, Congress and the President, by passing and signing the law, have determined, as a policy matter that such risks are less troublesome than the practices prohibited. . . . It would seem that where the branches responsible for formulation of foreign policy have subordinated the sensitivity of foreign governments to having their acts of a particular sort explored in American courts that, at least after a successful prosecution of the American concern, the act of state doctrine should not stand in the way of the injured competitor's antitrust claim.

Becker, *supra* note 42, at 1261.

50. 15 U.S.C. §§ 78 dd-1 *et. seq.* (1983). Section 78 dd-2, in pertinent part, states:

(a) It shall be unlawful for any domestic concern, other than an issuer which is subject to section 78dd-1 of this title, or any officer, director, employee, or agent of such domestic concern or any stockholder thereof acting on behalf of such domestic concern, to make use of the mails or any means or instrumentality of interstate commerce corruptly in furtherance of an offer, payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value to—

(1) any foreign official for purposes of—

(A) influencing any act or decision of such foreign official in his official capacity, including a decision to fail to perform his official functions; or

(B) inducing such foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality;

in order to assist such domestic concern in obtaining or retaining business for or with, or directing business to, any person.

Section 78dd-2(d)(3) states that:

The term "interstate commerce" means trade, commerce, transportation, or communication among the several States, or between any foreign country and any State or between any State and any place or ship outside thereof. Such term includes the intrastate use of (A) a telephone or other interstate means of communication or (B) any other interstate instrumentality.

51. 712 F.2d at 409.

52. *Id.*

other courts. Conspicuously absent from the court's opinion was any discussion of the extremely important policies underlying the act of state doctrine and the extraterritorial application of the antitrust laws. The court disregarded *Sabbatino's* mandate that a balancing test should be applied to determine whether the act of state doctrine required judicial abstention. As a result, the court provided a blanket immunization for Occidental's activities and extended an open invitation to American corporations with international operations to disregard laws designed to curb corrupt practices overseas. If reliance had been placed on the *Timberlane* and *Mannington Mills* flexible jurisdictional test, a different, and more logical, result would have been reached. Under a balancing test, the United States' strong historic policy and interest favoring antitrust enforcement, coupled with Congress's explicit condemnation of overseas corrupt business practices, would have been accorded significantly more weight than deference to a nation's self interest in perpetuating anticompetitive and illicit behavior. It is even unclear whether these activities were indeed condoned by the rule of *Umm Al Qaywayn* or whether they were legitimately recognized practices in that state.

Although the court's argument that the prosecution under the FCPA is strictly reserved to the executive branch may be valid, that should not have precluded the court from giving due deference to the Act's intent and purpose which views corporate bribery as a threat to the "very stability of overseas business"⁵³ and to the "public confidence in the integrity of the American business system."⁵⁴

Once the executive branch, charged with responsibility for foreign policy, has demonstrated that it is willing to subject a foreign state to possible embarrassment, the courts should feel free to grant relief, otherwise unavailable, to an aggrieved party. Indeed, it could be argued that the court's refusal to do so is, in and of itself, an unwarranted judicial interference with the political branches' foreign policy interests.

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53. S. REP. NO. 114, 95th CONG. 1ST SESS. 3, reprinted in 1977 U.S. CODE CONG. & AD. NEWS 4098, 4101.

54. *Id.*