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Holding Foreign Government Corporations Liable for the Wrongs of the Government: A Clash Among Competing Policies

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CASE COMMENT

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I. INTRODUCTION

After years of fomenting revolution, Fidel Castro seized control of Cuba on January 1, 1959.¹ Adopting a banner of anti-Yankeeism, Castro moved Cuba into a close relationship with the Soviet Union.² Relations with the United States deteriorated rapidly.³ By July, 1960, the Eisenhower Administration reacted to the growing economic and military ties between Cuba and the Soviet Union by abandoning its "wait-and-see" policy and suspending all Cuban sugar imports.⁴ In that same month, the Cuban government enacted a law authorizing the expropriation of all Cuban properties of United States citizens.⁵ One enduring effect of these events has been years of litigation in United States courts

1. C. FRANQUI, *DIARY OF THE CUBAN REVOLUTION* 482-88 (1980).

2. F.G. GIL, *LATIN AMERICAN-UNITED STATES RELATIONS* 230 (1971).

3. *Id.*

4. *Id.* at 230-31.

5. Joint Appendix on Writ of Certiorari to the United States Court of Appeals for the Second Circuit at 57-61, *First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba*, 103 S. Ct. 2591 (1983) (translating Cuban Law No. 851 of July 6, 1960):

concerning these expropriations.⁶ *First National City Bank v. Banco Para El Comercio Exterior de Cuba*⁷ (*Banco Para El Comercio*) is the most recent addition to a long line of cases involving Cuban expropriations.

In *Banco Para El Comercio*, the issue before the Supreme Court of the United States was whether Banco Para El Comercio Exterior de Cuba (BANCEC), a state-owned Cuban bank established as a separate juridical entity but since dissolved, could be considered one and the same with the Republic of Cuba for the purpose of a counterclaim.⁸ Specifically, First National City Bank (now "Citibank"⁹) sought to set off the value of its expropriated Cuban branches against any recovery by BANCEC in an action against Citibank on an unpaid letter of credit.¹⁰ In deciding the question, the Court grappled with a number of competing values that have come in the wake of both increasing state involvement in the commercial field through government corporations and recurring expropriations and nationalizations of foreign-owned private property.

One of the values at stake was the recognition of the separate legal status of government corporations.¹¹ In this respect, government corporations resemble private law corporations.¹² Hence, one question that necessarily arises is whether the courts should treat a government corporation as a private corporation in all respects.

6. See, e.g., *First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba*, 103 S. Ct. 2591 (1983); *Alfred Dunhill of London, Inc. v. Republic of Cuba*, 425 U.S. 682 (1976); *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398 (1964); *Banco Nacional de Cuba v. Chase Manhattan Bank*, 658 F.2d 875 (2d Cir. 1981); *Banco Nacional de Cuba v. Chemical Bank N.Y. Trust Co.*, 658 F.2d 903 (2d Cir. 1981); *Banco Nacional de Cuba v. First Nat'l City Bank*, 478 F.2d 191 (2d Cir. 1973).

7. 103 S. Ct. 2591 (1983).

8. *Id.* at 2593.

9. *Id.*

10. This author uses the term, "setoff," in its common law sense, whereby a defendant is permitted to set off claims from unrelated transactions against a plaintiff's claim, if the claims are liquidated or easily determinable, up to the amount of the plaintiff's claim. J.M. LANDERS & J.A. MARTIN, *CIVIL PROCEDURE* 459 (1981). In its stricter sense, setoff refers to the "legal right of a financial institution to appropriate the deposit of its customer upon the customer's default" on a loan obligation. The banker's right of setoff operates extrajudicially. Clark, *Bank Exercise of Setoff: Avoiding the Pitfalls*, 98 *BANKING L.J.* 196, 196 (1981).

11. See *id.* at 2599-601; Becker, *The Rolimpex Exit from International Contract Responsibility*, 10 *N.Y.U. J. INT'L L. & POL.* 447, 453-61 (1978); Friedmann, *Government Enterprise: A Comparative Analysis in GOVERNMENT ENTERPRISE: A COMPARATIVE STUDY* 303, 314-15 (W. Friedmann and J.F. Garner eds. 1970); Lasok, *Government Intervention and State Trading*, 44 *MOD. L. REV.* 249, 255-58, 268-69 (1981); Supranowitz, *The Law of State-Owned Enterprises in a Socialist State*, 26 *LAW & CONTEMP. PROBS.* 794, 800-01 (1961).

12. See *infra* notes 86, 87 and accompanying text.

Specifically, should courts recognize the principle of limited liability,¹³ considered by many as the hallmark of the corporate form,¹⁴ when government corporations are concerned? Even if the vitality of limited liability to private corporations is assumed,¹⁵ the reasons for according limited liability to private corporations do not directly apply to government corporations.¹⁶ One must, however, consider the interests that will be undermined if American courts pierce the veil of government corporations too readily or, worse, arbitrarily. Among these interests are the avoidance of unnecessary and untimely disputes with foreign states¹⁷ and the preservation of respect abroad for the juridical divisions between American multinational corporations and their independent subsidiaries.¹⁸ These considerations necessarily raise the question of what is the courts' proper institutional role in American society: Should courts consider in their decision-making process American foreign policy and economic interests abroad?¹⁹

The concerns that favor treating government corporations as separate legal entities compete with the vindication of traditional American opposition to expropriation of property in violation of international law.²⁰ In *Banco Para El Comercio*, the Court's decision to allow Citibank's counterclaim against BANCEC had much to do with the fact that the Cuban government had expropriated Citibank's Cuban branches and that Citibank might not be able to obtain compensation otherwise.²¹ Although the decision was not

13. The concept of limited liability provides that "shareholders of a corporation are under no obligation to the corporation or its creditors other than to pay full consideration for shares." Meiners, Mofsky & Tollison, *Piercing the Veil of Limited Liability*, 4 DEL. J. CORP. L. 351, 353 (1979) (footnote omitted). The theoretical foundation for limited liability is that the law considers a corporation to be an entity separate from its shareholders. Comment, *The Alter Ego Doctrine: Alternative Challenges to the Corporate Form*, 30 UCLA L. REV. 129, 129 (1982).

14. Meiners, Mofsky & Tollison, *supra* note 13, at 352 (quoting H. SOWARDS, CORPORATION LAW 2-2 (1974)).

15. Scholars strongly disagree about the economic and historic importance of limited liability to the corporate form. Compare Meiners, Mofsky & Tollison, *supra* note 13, at 352 (questioning whether the rule of limited liability has had any significant impact at all) with Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 499, 505-07 (1976) (arguing that the rule of limited liability saves transaction costs and facilitates the extension of credit by providing an implied contractual term without the necessity of negotiation).

16. See *infra* notes 140-52 and accompanying text.

17. See *infra* notes 173-79 and accompanying text.

18. *Id.*

19. See *infra* notes 170-71 and accompanying text.

20. See *infra* notes 112, 124-32 and accompanying text.

21. *Banco Para El Comercio*, 103 S. Ct. at 2603; see *infra* notes 124-32 and accompany-

necessarily an undesirable solution to the problem of providing compensation to Americans whose property has been illegally expropriated, the Court's doctrinal justification for its decision—BANCEC's dissolution—could work against the very interests that the Court sought to protect.²²

II. FACTUAL SETTING AND COURT PROCEEDINGS

The Cuban government established BANCEC on April 25, 1960, as "[a]n official autonomous credit institution for foreign trade . . . with full juridical capacity . . . of its own . . ."²³ BANCEC's purpose was to "contribute to, and collaborate with, the international trade policy of the Government and the application of the measures concerning foreign trade adopted by the 'Banco Nacional de Cuba'" (hereinafter "Banco Nacional"), Cuba's central bank.²⁴ In accordance with its stated purpose, BANCEC's duties included maintaining Cuba's balance of payments equilibrium,²⁵ increasing exports without negatively affecting domestic supplies of raw materials and essential articles,²⁶ rationing foreign exchange,²⁷ and stimulating Cuba's foreign trade.²⁸

The Cuban government capitalized BANCEC at 6,000,000 Cuban pesos, subject to increase by national law, and subscribed to all of its stock.²⁹ Every six months, BANCEC's profits, considered fiscal revenue, went into the General Treasury after the Governing Council decided whether to set aside any amounts for capital reserves.³⁰

BANCEC's governing board consisted of delegates from Cuban governmental ministries,³¹ and its president was Ernesto "Ché" Guevara, Cuba's Minister of State and president of Banco

ing text.

22. See *infra* paragraph in text following note 166.

23. Joint Appendix on Writ of Certiorari to the United States Court of Appeals for the Second Circuit at 37, *First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba*, 103 S. Ct. 2591 (1983) (translating Cuban Law No. 793 of April 25, 1960, Art. I).

24. *Id.* at 39 (translating Cuban Law No. 793 of April 25, 1960, Art. I, By-Law VIII).

25. *Id.* (translating Cuban Law No. 793 of April 25, 1960, Art. I, By-Law VIII(a)).

26. *Id.* (translating Cuban Law No. 793 of April 25, 1960, Art. I, By-Law VIII(b)).

27. *Id.* at 40 (translating Cuban Law No. 793 of April 25, 1960, Art. I, By-Law VIII(f)).

28. *Id.* at 41 (translating Cuban Law No. 793 of April 25, 1960, Art. I, By-Law VIII(k)).

29. *Id.* at 38 (translating Cuban Law No. 793 of April 25, 1960, Art. I, By-Law IV).

30. *Id.* at 39 (translating Cuban Law No. 793 of April 25, 1960, Art. I, By-Law V).

31. *Id.* at 46 (translating Cuban Law No. 793 of April 25, 1960, Art. I, By-Law XI). The delegates represented the Minister of Commerce, the Minister of Economy, the National Agrarian Reform Institute (INRA), and the Department of Mines and Petroleum of the Ministry of Agriculture. *Id.*

Nacional.³² The board had the authority to appoint, remove, and replace the general manager,³³ who directed the bank's day-to-day operations.³⁴

In accordance with its duties, BANCEC sold a quantity of sugar to a buyer in the United States.³⁵ An irrevocable letter of credit that Citibank issued in favor of BANCEC supported the sale agreement.³⁶ BANCEC assigned the letter to Banco Nacional for collection,³⁷ and on September 12, 1960, Banco Nacional presented the sight draft for \$217,249.50.³⁸ The documents, however, did not comply with the terms of the letter of credit, because they showed a shortfall of several thousand pounds of sugar.³⁹ After notice of the shortfall, Banco Nacional waived payment of \$23,969.20 to compensate for the discrepancy in the delivery. The new amount due equalled \$193,280.30.⁴⁰ On the following day, September 17, 1960, the Cuban government expropriated all Cuban property belonging to three American banks, including Citibank.⁴¹ On September 22, 1960, Citibank credited the new draft amount to Banco Nacional's account and applied the balance in the account as a setoff against the value of its Cuban branches.⁴²

On February 1, 1961, BANCEC sued Citibank in the United States District Court for the Southern District of New York to recover on the unpaid letter of credit.⁴³ On February 23, 1961, before Citibank could serve its answer, the Cuban government dissolved BANCEC and divided its capital between Banco Nacional and the foreign trade enterprises of the Ministry of Foreign Trade,⁴⁴ which

32. *Banco Para El Comercio*, 103 S. Ct. at 2593.

33. Joint Appendix on Writ of Certiorari to the United States Court of Appeals for the Second Circuit at 46, *First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba*, 103 S. Ct. 2591 (1983) (translating Cuban Law No. 793 of April 25, 1960, Art. I, By-Law XI).

34. *Banco Para El Comercio*, 103 S. Ct. at 2593.

35. *Id.*

36. *Id.* at 2493-94.

37. *Id.* at 2594.

38. Joint Appendix on Writ of Certiorari to the United States Court of Appeals for the Second Circuit at 78, 79, *First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba*, 103 S. Ct. 2591, 2594 (1983).

39. *Id.* at 117.

40. *Id.* at 118.

41. *Id.* at 70-73 (translating Cuban Resolution No. 2 of September 17, 1960). The other two banks were Chase Manhattan Bank and The First National Bank of Boston. *Id.*

42. *Id.* at 119.

43. *Banco Nacional de Cuba v. Chase Manhattan Bank*, 505 F. Supp. 412, 418 (S.D.N.Y. 1980).

44. *Banco Para El Comercio*, 103 S. Ct. at 2594. Banco Nacional received all rights, claims and assets "peculiar to the banking business." The Trade Ministry assumed all of BANCEC's trading functions. Within one week of BANCEC's dissolution, the Ministry as-

was established on the same day.⁴⁵

On March 8, 1961, Citibank filed its answer and counterclaim, asserting its right to set off the value of its seized branches against any recovery BANCEC might realize.⁴⁶ The case lay dormant until 1975, when BANCEC moved for a substitution of parties.⁴⁷ The district court denied the motion and, in 1977, held a bench trial on the merits.⁴⁸

The district court immediately rejected Citibank's claim that Banco Nacional was the real party in interest because the draft against the letter of credit was deposited with Banco Nacional as agent for collection.⁴⁹ Citing section 350-a of the New York Negotiable Instruments Law,⁵⁰ which was still in force in 1961, the court held that Citibank could not discharge its obligation to BANCEC by setting off against funds collected by Banco Nacional as agent for BANCEC.⁵¹ Unless Banco Nacional, as collecting bank, had al-

signed 300,000 of 2,000,000 *pesos* that it received to the newly created Empresa Cubana de Exportaciones (Cuban Enterprise for Exports) (hereinafter referred to as "Empresa"), which remained subrogated to all the rights and obligations pertaining to BANCEC's export activities. The government then dissolved Empresa by the end of the year and assigned BANCEC's rights relating to trade in sugar to Empresa Cubana Exportadora de Azucar y sus Derivados (Cuban Enterprise for Sugar Exports) (hereinafter referred to as "Cuba Zucar"). *Id.*

45. *Id.*

46. *Id.* On July 7, 1961, BANCEC filed a stipulation stating that BANCEC had been dissolved and that the Ministry of Foreign Trade held its claim. Although the district court approved the naming of the Republic of Cuba as plaintiff, no amended complaint showing the change was ever filed. *Id.*

47. 103 S. Ct. at 2595. BANCEC now wanted to name Cuba Zucar as plaintiff. *Id.*

48. *Id.*

49. *Banco Nacional de Cuba v. Chase Manhattan Bank*, 505 F. Supp. 412, 425 (S.D.N.Y. 1980).

50. N.Y. NEG. INSTR. LAW § 350-a (McKinney 1943), *repealed by* N.Y. U.C.C. § 4-201 (McKinney 1964). Section 350-a provided, in pertinent part:

Except as otherwise provided by agreement and except as to subsequent holders of a negotiable instrument payable to bearer or indorsed specially or in blank, where an item is deposited or received for collection, the bank of deposit shall be agent of the depositor for its collection and each subsequent collecting bank shall be sub-agent of the depositor but shall be authorized to follow the instructions of its immediate forwarding bank and any credit given by any such agent or sub-agent bank therefore shall be revocable until such time as the proceeds are received in actual money or an unconditional credit given on the books of another bank, which such agent has requested or accepted. Where any such bank allows any revocable credit for an item to be withdrawn, such agency relation shall nevertheless continue except the banks shall have all the rights of an owner thereof against prior and subsequent parties to the extent of the amount withdrawn.

N.Y. NEG. INSTR. LAW, § 350-a (McKinney 1943).

51. *Chase Manhattan Bank*, 505 F. Supp. at 427.

ready paid the proceeds of the sight draft to BANCEC, those funds in Banco Nacional's account that corresponded to the draft amount were held in trust for BANCEC.⁵² Because "one dealing with an agent for a disclosed principal may not set-off the agent's personal indebtedness against amounts due the principal,"⁵³ Citibank could not set off its claim against Banco Nacional against the proceeds of the draft.⁵⁴

The district court nevertheless held that Citibank could properly counterclaim against BANCEC to set off the value of its seized assets against any recovery BANCEC might obtain.⁵⁵ It found no basis for distinguishing among BANCEC, Banco Nacional, and Cuba for the purpose of determining whether Citibank's counterclaim was proper.⁵⁶ In rejecting arguments based on BANCEC's independent juridical status, the court reasoned that "[w]here the equities are so strong in favor of the counter-claiming defendants, as they are in this case, the Court should recognize the practicalities of the transactions."⁵⁷ It further declared that "the devolution of [BANCEC's] claim, however viewed, brings it into the hands of the Ministry, or Banco Nacional, each an *alter ego* of the Cuban Government."⁵⁸ Finding that the Cuban government had supplied all of BANCEC's capital and that BANCEC's only function was to manage commodity exports for the government, the district court concluded that BANCEC was engaged in a state function and declared BANCEC itself an "alter ego" of the Cuban government.⁵⁹ As a result, the court dismissed BANCEC's complaint.⁶⁰

The court of appeals reversed the district court's judgment and remanded the case for dismissal of the counterclaim and entry of judgment in favor of BANCEC for \$193,280.30.⁶¹ Because the Cuban government created and operated BANCEC as a separate

52. *Id.* at 426-27.

53. *Id.* at 427 (quoting *Fuller v. Fasig-Tipton Co.*, 587 F.2d 103, 106 (2d Cir. 1978)).

54. *Id.* Noting that there was no evidence that Citibank knew of the agency relationship, the court stated that such knowledge could be inferred from the facts or, alternatively, that Citibank "was aware of the statutory presumption and had no factual knowledge indicating otherwise." *Id.*

55. *Id.* at 430.

56. *Id.* at 427. Counterclaims, of course, can only be asserted against "opposing parties." FED. R. CIV. P. 13.

57. *Chase Manhattan Bank*, 505 F. Supp. at 428.

58. *Id.* at 425.

59. *Id.* at 425, 428.

60. *Id.* at 425.

61. *Banco Para El Comercio Exterior de Cuba v. First Nat'l City Bank*, 658 F.2d 913, 920 (2d Cir. 1981).

juridical entity and because BANCEC had taken no part in the expropriations, the court of appeals held that Citibank could not properly assert a counterclaim against BANCEC for the value of its expropriated assets in a suit arising from a purely commercial transaction between Citibank and BANCEC.⁶² On certiorari, the Supreme Court of the United States *held*, reversed and remanded.⁶³ Under equitable principles recognized by both international law and federal common law, Citibank may properly assert a counterclaim to set off the value of its assets seized by the Cuban government against the amount sought by BANCEC. Although the normal presumption should be that government instrumentalities are entities distinct from their government, the presumption is outweighed when, due to the dissolution of the suing instrumentality, the only beneficiaries of recovery would be the government and those entities that could be considered its alter egos and liable to the counterclaiming defendant on their own account. *First National City Bank v. Banco Para El Comercio Exterior de Cuba*, 103 S. Ct. 2591 (1983).

III. THE ROLE OF GOVERNMENT CORPORATIONS: AN OVERVIEW

Government's increasing involvement in society has led almost all states to establish state instrumentalities.⁶⁴ In a comparative study of government corporations throughout the world, Professor Wolfgang Friedmann identified two principal motives for increasing governmental involvement in society: practical economic neces-

62. *Id.* at 919-20. The court of appeals recognized that BANCEC was principally engaged in promoting foreign trade. *Id.* It distinguished *Banco Para El Comercio* from *Banco Nacional de Cuba v. First National City Bank*, 478 F.2d 191 (2d Cir. 1973), a case in which Citibank was able to assert a similar counterclaim against Banco Nacional, on the ground that Banco Nacional had played an active role in the bank expropriations, whereas no evidence suggested that BANCEC had played such a role. *Banco Para El Comercio Exterior de Cuba v. First Nat'l City Bank*, 658 F.2d 913, 918-19 (2d Cir. 1981).

63. The purpose of the remand was for the court of appeals to consider BANCEC's alternative argument on appeal that the district court had erred in determining that the value of Citibank's Cuban assets exceeded BANCEC's claim. *Banco Para El Comercio*, 103 S. Ct. at 2604. Because it held that Citibank could not counterclaim at all, the court of appeals never reached the question. *Banco Para El Comercio de Cuba*, 658 F.2d at 914-15. On remand, the court of appeals sustained the district court's decision. It held that (1) the district court properly considered the going concern value of the branches an allowable item of loss; (2) the net value of the Cuban branches properly included the claimed loss of \$772, 331 for loans made to United States corporations and that Citibank did not have to attempt collecting from those corporations directly; and (3) the statute of limitations did not bar a claim for Citibank's liabilities at its head offices because of the expropriations. *First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba*, 744 F.2d 237, 240-43 (2d Cir. 1984).

64. Friedmann, *supra* note 11, at 303-07.

sity and political ideology.⁶⁵

Underdeveloped countries need capital in order to spur economic development.⁶⁶ Because of the high risks of investing in these countries, private capital is either unwilling or unable to launch development ventures.⁶⁷ Thus, the burden falls on government to promote development through state enterprise.⁶⁸ Even industrialized countries with significant private sectors, such as the United States and Canada, have found it necessary to place the responsibility for certain undertakings squarely on the shoulders of public corporations.⁶⁹ In European countries, such as Great Britain and Italy, the state controls certain basic industries.⁷⁰ Despite their ideology, states that follow the Soviet "brand" of socialism have modified their philosophy of state ownership of the means of production in view of the economic and administrative need to decentralize management through the use of relatively autonomous state enterprises.⁷¹ Indeed, the pervasive presence of government corporations on the modern commercial scene⁷² led Professor Friedmann to suggest that "the establishment of public enterprises of a more or less autonomous character . . . should be judged on its merits, as a legitimate instrument of modern government."⁷³

One of the primary reasons for channeling state involvement into various economic sectors through government corporations is the desire to remove such operations from potentially negative political and bureaucratic influences.⁷⁴ Thus, as Professor Friedmann suggested, it is generally agreed that a minister or his representative should not form part of the management of the corporation.⁷⁵

True independence, however, is illusory. First, ministers in

65. *Id.* at 303.

66. *Id.* at 303-04.

67. *Id.* at 303.

68. *Id.* at 303-04.

69. *Id.* at 306-07. The Tennessee Valley Authority in the United States is but one example. *Id.* at 306.

70. *Id.* Margaret Thatcher's Conservative government may have changed things a bit in Great Britain.

71. *Id.* at 307.

72. I Congreso del Partido, [1981] 2 All E.R. 1064, 1067 (opinion of Lord Wilberforce).

73. Friedmann, *supra* note 11, at 306-07.

74. *Id.* at 304, 307, 316-21; Fabrikant, *Developing Country State Enterprises: Performance and Control*, 15 COLUM. J. TRANSNAT'L L. 40, 42 (1976).

75. Friedmann, *supra* note 11, at 316. Professor Friedmann wrote: "On this point, countries whose legal and political systems are otherwise as divergent as those of Britain, Germany, France, the USSR, the United States, India, Italy, and Australia are unanimous." *Id.* In 1960, Cuba obviously disagreed. See *supra* notes 31-34 and accompanying text.

some countries do sit on governing boards.⁷⁶ Second, even if they do not sit on the board, they can still make their influence felt by threatening to replace independent managers with more compliant personnel.⁷⁷ Third, to the extent that government corporations are not provided with permanent capital assets,⁷⁸ they depend on periodic appropriations from the national budget.⁷⁹ Politics inevitably intrudes into the operation of any entity that depends upon periodic appropriations from the government.⁸⁰ The lack of financial independence thus defeats political independence—one of the primary reasons for the establishment of government corporations.⁸¹ Fourth, no matter how one looks at it, the basic function of government corporations is to carry out governmental policies, whether those policies are directed at industrial, commercial, or agricultural sectors of the economy.⁸² In some cases, the public corporation merely replaces free enterprise where private capital dare not go;⁸³ in others, the public corporation acts as a device to decentralize management in a planned economy, where the state owns the means of production.⁸⁴

As a general rule, whatever the particular function of an individual government corporation may be, the state that creates it,⁸⁵ endows it with separate legal personality to enable it to accomplish state objectives.⁸⁶ Legal personality allows the public corporation

76. *Id.* at 316-17.

77. Fabrikant, *supra* note 74, at 43.

78. "There is little doubt that any genuine freedom of management and initiative requires that the public corporations, at least those of a revenue-earning character, should have permanent assets freely at their disposal and not be dependent on periodical political battles in Parliament or other instruments of Government." Friedmann, *supra* note 11, at 320.

79. *Id.* at 319.

80. *Id.* at 320.

81. *See id.* at 304, 320-21. Predictably, most public corporations must remit to the government whatever profits they do not apply to their own development. *Id.* at 321.

82. *See id.* at 303-07. Professor Friedmann concluded emphatically: "[N]owhere is the public corporation completely independent in its financial status and operation. Nor indeed could it be as long as it forms in some respects a part of Governmental responsibilities." *Id.* at 320.

83. *See supra* notes 66-70 and accompanying text.

84. *See supra* note 71 and accompanying text; Lasok, *supra* note 11, at 264-67.

85. Most government "corporations are created either by special statute or by Government ordinance." Friedmann, *supra* note 11, at 313. The government corporation is to be distinguished from what Professor Friedmann called the "joint stock company controlled completely or partly by public authority." *Id.* at 307, 310-13. Such joint stock companies are often mixed public-private undertakings, *see id.* at 310-12, removing them somewhat from the realm of "true" government corporations.

86. *Id.* at 314; *see Supranowitz, supra* note 11, at 800.

to sue and be sued in its own name, to conclude contracts, and to hold and dispose of property.⁸⁷

Because of the important role that the government corporation plays in economic development, Professor Friedmann suggested that a government corporation should approximate a private legal person as much as political responsibility allows.⁸⁸ It should enjoy no tax advantages or priorities in debt collection.⁸⁹ The government should keep its assets and liabilities apart from the government's general funds.⁹⁰

IV. THE "ACTIVE ROLE" CRITERION FOR ALLOWING COUNTERCLAIMS AGAINST GOVERNMENT CORPORATIONS FOR THE WRONGS OF THE GOVERNMENT

Until *Banco Para El Comercio*, the Supreme Court of the United States, by its own admission, had never considered the separate status of a foreign government corporation.⁹¹ Most of the reported decisions in the United States that deal with the status of foreign government corporations have dealt only with the issue of whether those corporations enjoy the same benefits of sovereign immunity that states themselves enjoy.⁹² Aside from *Banco Para El Comercio*, only two other American cases have dealt with the issue of whether a counterclaim based on the wrongful acts of the government may be asserted against its instrumentality. It is not surprising that both cases involve Cuba's expropriation of assets belonging to American banks.⁹³

87. Friedmann, *supra* note 11, at 313-15; Supranowitz, *supra* note 11, at 800.

88. Friedmann, *supra* note 11, at 333-36.

89. *Id.* at 336.

90. *See id.* at 334.

91. *Banco Para El Comercio*, 103 S. Ct. at 2598 n.12. The Court, however, has in the past considered the legal status of United States instrumentalities under federal law. *See, e.g.,* Keifer & Keifer v. Reconstruction Fin. Corp., 306 U.S. 381 (1939); United States Grain Corp. v. Phillips, 261 U.S. 106 (1923); Sloan Shipyards Corp. v. United States Board Emergency Fleet Corp., 258 U.S. 549 (1922); Bank of United States v. Planter's Bank of Ga., 22 U.S. (9 Wheat.) 904 (1824).

92. *See, e.g.,* *In re Rio Grande Transport, Inc.*, 516 F. Supp. 1155 (S.D.N.Y. 1981); United Euram Corp. v. U.S.S.R., 461 F. Supp. 609 (S.D.N.Y. 1978); Yessenin-Volpin v. Novosti Press Agency, 443 F. Supp. 849 (S.D.N.Y. 1978); Edlow Int'l Co. v. Nuklearna Elek-trarna Krsko, 441 F. Supp. 827 (D.D.C. 1977). For comprehensive treatment of sovereign immunity issues, see Dellapenna, *Suing Foreign Governments and Their Corporations: Sovereign Immunity* (pts. 1-5), 85 COMM. L.J. 167, 228, 298, 364, 497 (1980).

93. *See* Banco Nacional de Cuba v. Chemical Bank N.Y. Trust Co., 658 F.2d 903 (2d Cir. 1981) (companion case to Banco Para El Comercio Exterior de Cuba v. First Nat'l City Bank, 658 F.2d 913 (2d Cir. 1981)); Banco Nacional de Cuba v. First Nat'l City Bank, 478 F.2d 191 (2d Cir. 1973).

In the first decision, *Banco Nacional de Cuba v. First National City Bank*,⁹⁴ (hereinafter "*Banco I*"), the Court of Appeals for the Second Circuit held that although Banco Nacional was organized as a separate juridical entity, Citibank could set off the value of its expropriated Cuban branches against the excess realized on the sale of collateral for a loan made to Banco Nacional.⁹⁵ The court concluded that for the purposes of the litigation, Banco Nacional was an alter ego of the Cuban government, because the bank had actively collaborated with the government in the expropriation of Citibank's branches by taking over the operations of the branches pursuant to government order.⁹⁶

The second case, *Banco Nacional de Cuba v. Chemical Bank N.Y. Trust Co.*⁹⁷ (hereinafter "*Banco II*") presented the court of appeals with a somewhat more complex problem. In that case, Banco Nacional sued Chemical Bank and two other New York banks to recover the deposits of private Cuban banks that the Cuban government had expropriated.⁹⁸ Banco Nacional also sought release of its own deposit, which Chemical Bank had withheld.⁹⁹ Chemical Bank and the two other banks counterclaimed against Banco Nacional in order to set off the balance due on loans made to the Cuban Electric Company, a Florida corporation whose Cuban assets Cuba expropriated.¹⁰⁰ The banks argued that Cuba had assumed the obligation to pay Cuban Electric's overdue loans by virtue of its having expropriated Cuban Electric's assets.¹⁰¹ The court of appeals disallowed the counterclaim insofar as recovery of Banco Nacional's own deposit was concerned.¹⁰² Finding that Banco Nacional had neither collaborated in the expropriation of Cuban Electric's assets nor benefited from it in any way, the court of appeals held that there was no reason for imputing to Banco Nacional the acts of the Cuban government.¹⁰³ Nor was there any reason for imputing to the Cuban government the ownership of deposits that Banco Nacional was claiming for itself, because the bank had been established as a separate and distinct juridical en-

94. 478 F.2d 191 (2d Cir. 1973).

95. *Id.* at 193-94.

96. *Id.*

97. 658 F.2d 903 (2d Cir. 1981).

98. *Id.* at 905, 906.

99. *Id.* at 905.

100. *Id.* at 905-07.

101. *Id.* at 907.

102. *Id.* at 910.

103. *Id.*

tity.¹⁰⁴ In contrast, the court allowed the counterclaim asserted against Banco Nacional in its capacity as successor to the private banks. The court reasoned that Banco Nacional was acting as an agent of the Cuban government by virtue of its having received the expropriated banks.¹⁰⁵

The rule of law that emerged from the court of appeals's decisions in *Banco I*¹⁰⁶ and *Banco II*¹⁰⁷ is that a government instrumentality organized as an independent juridical entity is not liable for the obligations incurred by its government when the instrumentality neither participated in nor benefited from the act that gave rise to the obligation. Instead, the Second Circuit has predicated liability upon a finding that the instrumentality was acting on behalf of the government either in the performance of the act that gave rise to the obligation¹⁰⁸ or in the prosecution of a claim based upon the wrongful act of the government.¹⁰⁹ The Second Circuit in *Banco Para El Comercio* relied on the same distinctions to deny Citibank's claim against BANCEC.¹¹⁰ Thus, the "active role" test applied in *Banco I* and *Banco II* is dispositive in a judicial determination on the issue of the liability of a government corporation for the wrongs of the government—at the least, this is the test that the Second Circuit chose to apply.

V. THE SUPREME COURT'S FORMULATION: IS THE PRESUMPTION OF INDEPENDENCE OUTWEIGHED?

Once the case reached the Supreme Court, judicial focus changed. If Citibank were to succeed in its counterclaim, the court of appeals's "active role" test would have to be expanded to include other criteria that would justify disregarding BANCEC's sep-

104. *Id.*

105. *Id.* at 910-11. Interestingly, the court allowed Chemical Bank's counterclaim even though it was not based on an expropriation of Chemical Bank assets by the Cuban government but arose merely from a loan default. In *Banco II*, the court characterized its decision as one based on a conclusion that the Cuban government was the "real party in interest" in the prosecution of the claim to recover the private banks' deposits. *Id.* at 911.

106. 478 F.2d 191 (2d Cir. 1973).

107. 658 F.2d 903 (2d Cir. 1981).

108. The application of the "active role" test to *Banco I* is discussed in Ryan, *Defaults and Remedies under International Bank Loan Agreements with Foreign Sovereign Borrowers—A New York Lawyer's Perspective*, 1982 ILL. L. REV. 89, 108-09. The author also identifies the factors considered by courts in the context of loan defaults by foreign governments or their instrumentalities. *Id.*

109. *Id.* at 109.

110. *Banco Para El Comercio Exterior de Cuba v. First Nat'l City Bank*, 658 F.2d 913, 919 (2d Cir. 1981).

arate juridical status.

The Court immediately rejected BANCEC's argument that conflict of law principles required that the law of the state of incorporation, Cuba, determine whether a government corporation could be held liable for the actions of its sovereign.¹¹¹ Drawing a distinction between the internal affairs of a corporation and the rights of third parties external to the corporation, the Court stated:

To give conclusive effect to the law of the chartering state in determining whether the separate juridical status of its instrumentality should be respected would permit the state to violate with impunity the rights of third parties under international law while effectively insulating itself from liability in foreign courts. We decline to permit such a result.¹¹²

The Court, nevertheless, adopted a presumption in favor of the separate status of government corporations: "[G]overnment instrumentalities established as separate juridical entities distinct and independent from their sovereign should normally be treated as such."¹¹³ Among the reasons that the Court cited for adhering to this presumption is the role that instrumentalities play in securing much needed financing for developing countries by assuring prospective creditors that they will be able to seek judicial relief.¹¹⁴ To this end, the juridical and fiscal independence of instrumentalities should be respected.¹¹⁵ Furthermore, principles of comity among nations mandate respect by the courts of one nation for the divisions established by the government of another.¹¹⁶ Finally, the Court interpreted the legislative history of the Foreign Sovereign Immunities Act of 1976 (hereinafter "FSIA"), as a directive from Congress to respect the independent status of state instrumentalities.¹¹⁷

Refusing to adopt what it called a "mechanical formula," the Court rejected the standard that the district court had adopted and that Citibank and the United States, as *amicus curiae*, urged

111. *Banco Para Comercio*, 103 S. Ct. at 2597.

112. *Id.* (footnotes omitted).

113. *Id.* at 2600.

114. *Id.* at 2600; see also *supra* text accompanying notes 64-73, 87.

115. 103 S. Ct. at 2600.

116. *Id.* at 2600.

117. *Id.* at 2600-01 (citing H.R. Rep. No. 1487, 94th Cong., 2nd Sess. 29-30, reprinted in 1976 U.S. CODE CONG. & AD. NEWS 6604, 6628-29) [hereinafter cited as HOUSE REPORT]; Foreign Sovereign Immunities Act of 1976, 28 U.S.C. §§ 1330, 1602-1611 (1982) (amending 28 U.S.C. §§ 1332, 1391, 1441 (1976)).

it to adopt.¹¹⁸ Under that standard, whether the court recognized the separate status of a government instrumentality would turn, in part, on whether the instrumentality in question performed a "government function."¹¹⁹ The Court rejected this standard because it perceived that the "concept of a 'usual' or a 'proper' governmental function changes over time and varies from nation to nation."¹²⁰ In view of the role instrumentalities play in giving effect to governmental policies,¹²¹ mechanical application of the suggested standard would result in the automatic "piercing of the veil" whenever a party sued a government corporation. Although it may not make sense for the court to apply to a government corporation the same principles of limited liability that apply to a private law corporation,¹²² if a court pierces the corporate veil, it should do so for more substantive reasons than its perception that a public corporation performs governmental functions. The Court wisely rejected that standard.

The Court, instead, purported to adopt a considerably more flexible approach by asking whether the equities of the case merited disregard of the instrumentality's independent status.¹²³ The Court decided that the equities so favored Citibank that they overcame the presumption in favor of BANCEC's independent status.¹²⁴ In reaching this conclusion, the Court noted that because of "considerations of fair dealing," a foreign sovereign asserting a claim in a United States court could not plead sovereign immunity as a bar to a counterclaim.¹²⁵ Had Cuba itself brought the action against Citibank to recover on the unpaid letter of credit, Citibank could have properly asserted a counterclaim to set off the value of its expropriated assets in Cuba.¹²⁶

118. 103 S. Ct. at 2603 & n.27; see *Banco Nacional de Cuba v. Chase Manhattan Bank*, 505 F. Supp. 412, 425, 428 (S.D.N.Y. 1980).

119. 103 S. Ct. at 2603 & n.27.

120. *Id.*

121. See *supra* notes 82-85 and accompanying text.

122. See *infra* notes 136-52 and accompanying text.

123. 103 S. Ct. at 2601-03.

124. See *id.* at 2603.

125. *Id.* at 2602 (quoting *National City Bank v. Republic of China*, 348 U.S. 356, 365 (1955)). Justice Frankfurter authored *Republic of China*, which held that the Republic of China could not interpose sovereign immunity as a defense to a counterclaim by National City Bank in an action brought by the Chinese government to recover an amount deposited by one of its agencies in the bank, when the counterclaim arose from a general course of business. The *Republic of China* holding is now codified at 28 U.S.C. § 1607(c) (1982). HOUSE REPORT, *supra* note 117, at 6622.

126. See 103 S. Ct. at 2602.

Notwithstanding the Court's rather broad language, the specific facts of *Banco Para El Comercio* make the basis for the Court's holding quite narrow.¹²⁷ BANCEC, because of its dissolution, was nothing more than a nominal party to the action.¹²⁸ The Court concluded that the Cuban government and Banco Nacional would have been the real beneficiaries of any recovery by BANCEC.¹²⁹ In the Court's view, the reason for this conclusion was simple: BANCEC's assets had been divided between Banco Nacional, on the one hand, and the Ministry of Foreign Trade, on the other.¹³⁰ Even though the Trade Ministry's share of the assets ultimately came to rest with other instrumentalities,¹³¹ the Court declined to allow this fact to change its holding, stating: "To hold otherwise would permit governments to avoid the requirements of international law simply by creating juridical entities whenever the need arises."¹³²

The Court was so preoccupied with BANCEC's dissolution that it gave only the most cursory treatment¹³³ to the fact that by denying recovery to BANCEC, it was actually depriving other victims of the Cuban expropriations of their ratable portions of Cuban funds frozen in the United States.¹³⁴ Had it been truly concerned with the specific equities of this case, the Court might well have reached the same conclusion advanced in the minority opinion:

Petitioner is only one of many American citizens whose property was nationalized by the Cuban Government. It seeks to minimize its losses by retaining \$193,280.30 that a purchaser of Cuban sugar had deposited with it for the purpose of paying for the merchandise, which was delivered in due course. Having won this lawsuit, petitioner will simply retain the money. If petitioner's contentions in this case had been rejected, the money would be placed in a fund comprised of frozen Cuban assets, to be distributed equitably among all the American victims of Cuban nationalizations. . . . Even though petitioner has suffered a serious injustice at the hands of the Cuban Government, no spe-

127. See K.N. LLEWELLYN, *THE BRAMBLE BUSH* 40 (1960) ("The court can decide only the particular dispute which is before it.").

128. See 103 S. Ct. at 2602-03.

129. *Id.* at 2602.

130. *Id.* at 2602 & n.22; see *supra* note 44 and accompanying text.

131. See *supra* note 44.

132. 103 S. Ct. at 2603.

133. See *id.* at 2602 n.24.

134. See Cuban Assets Control Regulations, 31 C.F.R. § 515 (1982); Ryan, *supra* note 108, at 109.

cial equities militate in favor of giving this petitioner a preference over all other victims simply because of its participation in a discrete, completed, commercial transaction involving the sale of a load of Cuban sugar.¹³⁵

A close reading of the majority opinion reveals that the Court was looking beyond the specific facts of the case before it to the general problem of dealing with the separate juridical status of government corporations, on the one hand, and the foreign expropriation of American property, on the other. Although the Court gave due regard to important policy considerations, it failed to articulate a satisfactory doctrinal reason for its holding.

VI. DOCTRINAL FOUNDATIONS OF THE SUPREME COURT'S DECISION IN *Banco Para El Comercio*

A. *A Misguided Presumption*

The Supreme Court's fundamental assumption was that separate legal personality and its corollary, limited liability, are as vital to public corporations as they are supposed to be to private law corporations.¹³⁶ The Court consequently adopted a presumption in favor of a government corporation's independent status.¹³⁷ This presumption was misguided.

General corporation laws accord separate legal personality to the private law corporation in order to endow it with the capacity to sue and be sued as a firm, to conclude contracts, and to hold property in the firm name.¹³⁸ The government corporation may nevertheless enjoy these attributes without specific legislation providing for the full status of legal personality.¹³⁹

The concept of limited liability is likewise inapplicable to government corporations. One commonly cited reason for recognizing

135. 103 S. Ct. at 2605 n.2 (Stevens, J., concurring in part and dissenting in part). Justices Brennan and Blackmun joined in Justice Stevens's opinion.

136. See *id.* at 2599. The Court declared: "[W]hat the Court stated with respect to private corporations in *Anderson v. Abbott*, . . . is true also for governmental corporations: 'Limited liability is the rule, not the exception; and on that assumption large undertakings are rested, vast enterprises are launched, and huge sums of capital attracted.'" *Id.* at 2599-600 (quoting *Anderson v. Abbott*, 321 U.S. 349, 362 (1944)).

137. *Id.* at 2601.

138. See Sowards & Mofsky, *Factors Affecting the Development of Corporation Law*, 23 U. MIAMI L. REV. 476, 479 (1969).

139. Friedmann, *supra* note 11, at 315. In Australia, for example, the South Australian Dried Fruits Board is noted to have carried out "a multitude of transactions which presuppose legal personality," even though no legislative or administrative document conferred legal personality upon it. *Id.* at 314.

the limited liability of shareholders is to encourage investment in business ventures by many individuals who would otherwise be unable to invest without the risk of suffering disastrous losses should the venture fail.¹⁴⁰ The diversification of risk, as it is called, makes the selling of shares easier and allows the market for corporate control to eliminate inefficient management.¹⁴¹ Except in the case of mixed public-private undertakings, it is immediately apparent that diversification of risk is hardly the moving force behind the use of government corporations. The desire for freedom from political and bureaucratic influences is probably the primary motivation behind their establishment.¹⁴² Moreover, with the government as sole shareholder, broadly based participation and ease of transferability of shares are not pertinent considerations.¹⁴³

Sole government ownership of government corporations also makes inapposite the rationale that supports conferring limited liability upon private law corporations. The rationale is that limited liability reduces transaction costs, because it is easier for a prospective voluntary creditor to evaluate the credit-worthiness of a single corporation than it is for the small investor to monitor not only the financial position of the corporations whose shares he owns but that of his fellow shareholders as well.¹⁴⁴

Notwithstanding the above doctrinal shortcomings, the Court made a somewhat persuasive *a priori* argument in favor of treating the assets and liabilities of instrumentalities as distinct from those of the government.¹⁴⁵ According to the Court, credit transactions with government instrumentalities would be jeopardized if third parties were allowed recovery against the instrumentalities as compensation for the acts of the government.¹⁴⁶ The proposition, however, loses its force in view of the realities of the banking world. Consider two hypothetical scenarios.

First is the case of a development loan to a third world country. If the World Bank extends a loan to a state entity that is not the government of a member country, it is required to obtain the

140. See, e.g., Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 262 (1967); Comment, *supra* note 13, at 135. *Contra* Meiners, Mofsky & Tollison, *supra* note 13, at 362-63.

141. See Manne, *supra* note 140, at 262-65.

142. See *supra* text accompanying note 74.

143. See Friedmann, *supra* note 11, at 311-12.

144. Manne, *supra* note 136, at 262-63. *Contra* Meiners, Mofsky & Tollison, *supra* note 13, at 363.

145. See *Banco Para El Comercio*, 103 S. Ct. at 2599.

146. *Id.*

guarantee of the member country in whose territory the project is to be financed.¹⁴⁷ A private bank is likely to negotiate for similar guarantees from the entity's government.¹⁴⁸ Both are protected, even if a third party were to obtain affirmative recovery against the government corporation and deprive it of all of its assets—a most unlikely scenario.

Second, consider the commercial credit transaction tied to the sale of goods; several options are open to the creditor. Once again, a creditor might require a guarantee from the entity's government. The creditor's own state may have instituted a program of export credit insurance covering short- and medium-term credits.¹⁴⁹ If the creditor is a bank, it can require the instrumentality to keep deposits with it and provide for a formal setoff clause in the loan agreement.¹⁵⁰ Alternatively, the creditor could require the borrowing entity to pledge certificates of deposit held at some bank and proceed to perfect its interest and notify the bank of the pledge so as to defeat any possible right of setoff the bank might have.¹⁵¹ Irrespective of which rule of law controlled, creditors would soon adapt to it and find new ways of doing business.¹⁵²

147. Silkenat, *The Role of International Development Institutions in International Project Financing: IBRD, IFC and Co-Financing Techniques*, 17 INT'L LAW. 615, 617 (1983).

148. Silkenat, *Eurodollar Borrowings by Developing States: Terms and Negotiating Problems*, 20 HARV. INT'L L.J. 89, 100-01 (1979).

149. L. HENKIN, R.C. PUGH, O. SCHACHTER & H. SMIT, INTERNATIONAL LAW: CASES AND MATERIALS 796 (1980) [hereinafter cited as INTERNATIONAL LAW].

150. Findlay, *Setoff Under International Loan Agreements: Danger Spots and Detours*, 99 BANKING L.J. 447, 453 (1982).

151. See Clark, *supra* note 9, at 222-24. A bank with notice of a third party's interest in funds deposited by its customer cannot set off against those funds. *Id.* at 215.

152. Cf. Meiners, Mofsky & Tollison, *supra* note 13, at 360-61 (a creditor offering a loan to a corporation could insist that the assets of both the corporation and the sole shareholder collateralize the transaction). Restricting disregard of the government instrumentality's separateness to setoff by way of counterclaim, the procedural context of *Banco Para El Comercio*, *Banco I*, and *Banco II*, arguably eliminates the risks to third party creditors who are not diligent enough to take precautions like those outlined above. Because no affirmative recovery is involved, the instrumentality's assets are not depleted. For a discussion of setoff, see J.M. LANDERS & J.A. MARTIN, *supra* note 9, at 459. Note, however, that the only reason Citibank was able to assert a setoff by way of counterclaim against BANCEC was because BANCEC sued it to recover the draft proceeds that Citibank kept when it exercised its banker's right of setoff against Banco Nacional. See *supra* notes 42-46 and accompanying text. Citing Section 350-a of the New York Negotiable Instruments Law, the district court held that the setoff was improper. *Chase Manhattan Bank*, 505 F. Supp. at 425; see *supra* notes 49-54 and accompanying text. Only the counterclaim issue reached the Supreme Court of the United States. See *Banco Para El Comercio*, 103 S. Ct. at 2593. Although allowance of the counterclaim seems to give judicial sanction to the original setoff, it is still an open question whether a bank, finding its assets expropriated, may obtain the same results without resort to a counterclaim. See generally Clark, *supra* note 9, at 197 (In addition to other

B. *Presumption Overcome*

Despite its professed respect for the separate status of government instrumentalities, the Court found the presumption of independent status overcome in BANCEC's case.¹⁵³ As previously discussed, the Court relied on the fact that BANCEC had been dissolved and that, one way or the other, the Cuban government would be the "real beneficiary" of any judgment in BANCEC's favor.¹⁵⁴

In deciding that Cuba lost either way, the Court avoided having to pass on the district court's neat characterization of the letter of credit as "the sort of asset, right and claim peculiar to the banking business," that probably should be regarded as belonging to Banco Nacional because of BANCEC's dissolution.¹⁵⁵ Otherwise, the Court may have had to decide whether the instrumentalities that took over BANCEC's trading functions, Empresa and Cuba Zucar,¹⁵⁶ were also alter egos of the Cuban government.

According to the minority opinion, that was precisely one of the issues left unanswered.¹⁵⁷ The minority found that BANCEC's dissolution, the Trade Ministry's holding of the assets, and the assets' subsequent transfer to the independent trade enterprises could have just as easily been viewed as a "single integrated plan of corporate reorganization."¹⁵⁸ As BANCEC argued, the Ministry's role may have been nothing more than that of a trustee.¹⁵⁹ Although the minority concurred with the majority's refusal to always "pierce the veil" of government corporations as well as with the majority's rejection of the "governmental function" standard, it recommended that the judgment be vacated and the case remanded to the court of appeals for further findings concerning BANCEC's legal status and operational autonomy.¹⁶⁰

BANCEC's operational autonomy is now a moot point because

requirements of maturity of the debt and mutuality of obligation, there must be a debt owing to the bank by the depositor to justify setoff.).

153. *Banco Para El Comercio de Cuba*, 103 S. Ct. at 2602-03.

154. *See supra* notes 128-32 and accompanying text.

155. *Chase Manhattan Bank*, 505 F. Supp. at 424.

156. *See supra* note 44.

157. *See* 103 S. Ct. at 2604-05.

158. *Id.* at 2604.

159. *Id.* at 2604-05.

160. *Id.* at 2605. The minority further noted that only one witness had testified on these matters and that the record contained many pertinent documents whose legal significance had yet to be interpreted by an expert. These evidentiary deficiencies precluded the Court from correctly and accurately applying the principles it had enunciated. *Id.* at 2604.

of its dissolution. Nevertheless, the objections the minority raised have some merit. For example, what if the Ministry of Trade never had anything to do with BANCEC's assets, and the assets had been transferred directly to other instrumentalities that had played no role in the expropriation? This possibility suggests that the Court should have at least inquired into the independent status of Empresa and Cuba Zucar, as it did with BANCEC.

It is apparent that one of the objectives that the majority sought to achieve was to broaden the court of appeals's narrow formulation of the alter ego doctrine.¹⁶¹ By focusing on who the "real beneficiaries" of any recovery would be, instead of on the "active role" distinction to which the court of appeals adhered, the Supreme Court corrected one of shortcomings in the court of appeals's "active role" standard. That shortcoming, highlighted by the United States in its *amicus curiae* brief, was that "governments contemplating expropriation may protect themselves from liability in American courts simply by ensuring that their instrumentalities with assets or claims in the United States do not play a 'key role' in the expropriation."¹⁶²

The Supreme Court's reliance on the alter ego doctrine in cases where there is a dissolution of an entity claiming separate legal status is not without a modicum of support in international jurisprudence. In the case of *In re Barcelona Traction, Light & Power Co. (Belg. v. Spain)*,¹⁶³ the International Court of Justice noted that international law refers "to rules generally accepted by municipal legal systems which recognize the limited company whose capital is represented by shares, and not to the municipal law of a particular State . . ."¹⁶⁴ The International Court acknowledged two situations that merited disregard of the corporate form. One was the familiar "abuse of corporate privilege"¹⁶⁵ upon which American courts rely when invoking the alter ego doctrine in private corporate law. The other was the corporation's ceasing to exist as a legal entity.¹⁶⁶

161. See *supra* notes 108-10 and accompanying text.

162. Brief for the United States as Amicus Curiae, on Certiorari to the United States Court of Appeals for the Second Circuit at 8, *First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba*, 103 S. Ct. 2591 (1983).

163. 1970 I.C.J. 3 (Judgment of Feb. 5).

164. *Id.* at 37.

165. *Id.* at 38-39.

166. *Id.* at 40-41. In *Barcelona Traction*, the International Court denied Belgium standing to assert against Spain the claims of Belgian nationals who were shareholders of a defunct Canadian corporation whose assets Spain had expropriated. *Id.* at 50. One of the

The Supreme Court's doctrinal solution to *Banco Para El Comercio*, whether or not supported in law, may not help claimants like Citibank in the future. Difficult questions will arise when the named instrumentality has not been dissolved and has not played an active role in the acts that gave rise to its government's obligations. A government facing a similar situation may wait until after it has obtained a judgment to dissolve the instrumentality. Alternatively, if the instrumentality has been dissolved before judgment, its assets may be transferred directly to other "innocent" entities, bypassing the government coffers altogether. The ease with which a government may circumvent the rule of *Banco Para El Comercio* suggests the need for a more effective rule of law.

VII. FOUR ALTERNATIVES TO THE RULE OF *Banco Para El Comercio*

The first and obvious alternative to the rule in *Banco Para El Comercio* is judicial adoption of a rule that the courts shall treat the government corporation as if it were the government itself, regardless of the instrumentality's juridical status under its domestic law. The doctrinal basis for this alternative rule is that the reasons that support the rule of limited liability for private corporations do not apply to the public corporation.¹⁶⁷ A rule of unlimited liability destroys the presumption that the Supreme Court adopted in favor of separate status.¹⁶⁸

The benefits of this alternative rule are that it is predictable and neutral—two important values to be sought in law.¹⁶⁹ One of the problems with the Supreme Court's reasoning in *Banco Para El Comercio* is that it has neither of these qualities. Its lack of predictability destroys its value to Americans who invest abroad. Under the *Banco Para El Comercio* decision, no government whose wholly-owned corporation had assets in the United States could be certain of the outcome of future litigation and might therefore risk an expropriation. *Banco Para El Comercio* would pose no deterrent whatsoever. No potential private litigant would know how best to ensure some compensation in the event that a foreign gov-

reasons for the court's decision was that the corporation had not ceased to exist as a legal entity. *Id.* at 41.

167. See *supra* notes 136-48 and accompanying text.

168. See *supra* notes 109-13 and accompanying text.

169. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6 comment i (1967) (on predictability); B.N. CARDOZO, *The Nature of the Judicial Process*, in SELECTED WRITINGS OF BENJAMIN NATHAN CARDOZO 107, 153 (M. Hall ed. 1980).

ernment expropriated its assets.¹⁷⁰ Moreover, the Supreme Court's own decision might have differed if the expropriating country had been a country less antagonistic to the United States than Cuba.¹⁷¹ Although such distinctions may be necessary on a political level, their use by the courts undermines the position of courts as neutral arbiters of legal rights. A rule based only on the inapplicability of the limited liability rule would not recognize political distinctions among countries, and thus would preserve the courts' institutional role.

A second alternative is a rule allowing for different judicial treatment of government instrumentalities based on the character of the entity involved in the litigation. This is no longer a blanket

170. See generally Comment, *American Oil Investors' Access to Domestic Courts in Foreign Nationalization Disputes*, 123 U. PA. L. REV. 610, 636 (1975) (The author suggests that "one goal of the oil investor should be to posture himself in relationships in which property of various Arab oil producing states is in the legal possession of the investor or parties friendly to him" so that such property can be converted in response to nationalization. The conversion forces the nationalizing state to litigate in American courts and allows the investor to use the possible counterclaim exception to the act of state doctrine in *First Nat'l City Bank v. Banco Nacional de Cuba*, 406 U.S. 759 (1972)).

171. If the "offending" state were important enough to American interests, the President might invoke the act of state doctrine, pursuant to the Hickenlooper Amendment, 22 U.S.C. § 2370(e)(2) (1982).

In the seminal case of *Underhill v. Hernandez*, 168 U.S. 250 (1897), Chief Justice Fuller stated the doctrine:

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. Redress of grievances by reason of such acts must be obtained through the means open to be availed of by sovereign powers as between themselves.

Id. at 252.

In *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 431-32 (1964), the Supreme Court extended the act of state doctrine to hold that American courts would not pass on the legality of foreign expropriations of property under international law. The *Sabbatino* Court stated that the doctrine rests upon the "distribution of functions between the judicial and political branches of government on matters bearing upon foreign affairs." *Id.* at 427-28. The Court also pointed out that:

The doctrine . . . expresses the strong sense of the Judicial Branch that its engagement in the task of passing on the validity of foreign acts of state may hinder rather than further this country's pursuit of goals both for itself and for the community of nations as a whole in the international sphere.

Id. at 423.

Recently, however, federal legislation has made inroads into the act of state doctrine insofar as it applies to expropriations that violate international law:

[N]o court in the United States shall decline on the ground of the federal act of state doctrine to make a determination on the merits giving effect to the principles of international law in a case in which a claim of title or other rights to property is asserted by any party including a foreign state (or a party claiming through such state) based upon . . . a confiscation or other taking

22 U.S.C. § 2370(e)(2) (1982).

rule of unlimited liability but merely a reversal of the presumption that the Court espoused in *Banco Para El Comercio*. Whereas *Banco Para El Comercio* presumed the independent status of a government corporation unless the circumstances required otherwise,¹⁷² a modified unlimited liability rule would presume that no government corporation was independent unless proven otherwise. Factors that a court might consider in determining the instrumentality's degree of independence would include whether the entity had permanent capital assets, whether it had revenue-earning capacity, and whether it was a mixed public-private undertaking.¹⁷³ The closer a government-owned public corporation came to resembling a private corporation, the stronger the case for its entitlement to limited liability.

Although this alternative rule may not be as easy for courts to apply as the bright-line rule of unlimited liability, it allows for differences in organization among different states and among government corporations within a single state. It is possible that in order to get a business underway, a state would be willing to underwrite the initial capital investment in a corporation in exchange for stock and leave management decisions to a group of aspiring entrepreneurs. At some future time, the government might assign its shares to the managers and employees in exchange for their services, changing the corporation's status to that of a privately owned company. In such a case, neither the rationale of unlimited liability nor the cognizable differences between a soon-to-be private corporation that happens to be government-owned and a full fledged government corporation support the holding that the entity is liable for the wrongful acts of the government.

A third alternative, which has little to do with pure doctrine, is to adopt a rule of reciprocity. Because of the United States's limited or non-existent use of government corporations abroad, true reciprocity is impossible. Instead, the United States might base its recognition of the separate status of government corporations on the concerned state's recognition of the separate status of foreign subsidiaries and affiliates of private American corporations.

In all likelihood, not all states have yet had the opportunity to consider the separate status of American-owned subsidiaries, it might be desirable to incorporate a rule of reciprocity in a bilateral

172. See *supra* text accompanying notes 136-37.

173. The factors are similar to current standards used in piercing the veil of American private corporations. Of course, the lack of these characteristics could be used to overcome a presumption in favor of limited liability.

treaty,¹⁷⁴ perhaps in a Treaty of Friendship, Commerce and Navigation. Under the supremacy clause of the United States Constitution,¹⁷⁵ the courts in the United States would be required to apply the rule of reciprocity whenever an action concerning the other state's government corporations was brought in the United States.

Treaty-based reciprocity would give full vindication to the policies underlying the Congressional intent that the FSIA prohibit execution against the property of one foreign agency or instrumentality to satisfy a judgment against another unrelated agency or instrumentality.¹⁷⁶ In enacting section 1610(b) of the FSIA, Congress feared that "[i]f U.S. law did not respect the separate juridical identities of different agencies or instrumentalities, it might encourage foreign jurisdictions to disregard the juridical divisions between different U.S. corporations or between a U.S. corporation and its independent subsidiary."¹⁷⁷

At present, there appears to be no rule of customary international law requiring the recognition by the courts of one state of a company incorporated under the laws of another state.¹⁷⁸ Even

174. For example, the Agreement on Trade Relations, Apr. 2, 1975, United States-Romania, Annex 3, para. 1, 26 U.S.T. 2305, 2322, T.I.A.S. No. 8159, encompassed both private and government corporations:

1. In this Agreement "firms, companies and economic organizations" of the United States of America shall include corporations, partnerships, sole proprietorships, companies and other economic associations constituted under the laws and regulations applicable in the United States of America, and "firms, companies and economic organizations" of the Socialist Republic of Romania shall include state enterprises, industrial centrals, enterprises with the status of centrals and other enterprises which carry out foreign trade activities in accordance with laws and regulations applicable in the Socialist Republic of Romania.

Id.

175. U.S. CONST. art. VI, cl. 2.

176. HOUSE REPORT, *supra* note 117, at 6628; see 28 U.S.C. § 1610(b) (1982).

177. HOUSE REPORT, *supra* note 117, at 6628-29. Courts may decide whether property held by one agency is really the property of the other. *Id.* at 6629.

178. Drucker, *Companies in Private International Law*, 17 INT'L & COMP. L.Q. 28, 42 (1968). As a matter of course, the United States includes a clause in its friendship, commerce and navigation treaties providing for the recognition of the juridical status of companies of each party in the territory of the other party. See, e.g., Treaty of Amity, Economic Relations, and Consular Rights, Aug. 15, 1955, United States-Iran, art. III, para. 1, 8 U.S.T. 899, 902, T.I.A.S. No. 3853; Treaty of Friendship, Commerce and Navigation, Oct. 29, 1954, United States-Federal Republic of Germany, art. XXV, para. 5, 7 U.S.T. 1839, 1866, T.I.A.S. No. 3593; Treaty of Friendship, Commerce and Navigation, Feb. 2, 1948, United States-Italy, art. II, para. 2, 63 Stat. 2255, 2258, T.I.A.S. No. 1965.

There is considerable scholarly debate on the question whether treaties, bilateral or multilateral in character, can establish customary international law, binding on all nations. See INTERNATIONAL LAW, *supra* note 149, at 69-74 and the essays collected therein. In the strictest formulation of the doctrine, a principle cannot become a customary rule of international law unless there is widespread state practice with regard to the principle, accompa-

when states choose to recognize the juridical capacity of foreign corporations, their courts are free, as American courts are, to pierce the veils of subsidiary corporations doing business within their territories.¹⁷⁹ A large number of bilateral or multilateral treaties on the subject could relieve the current instability in the law.¹⁸⁰ The reciprocity rule might be of assistance in this endeavor.

Finally, as a fourth alternative, it is possible to go to the opposite extreme of the unlimited liability rule and adopt an irrebuttable presumption whereby a court will always respect the independent legal status of a government corporation. Under this rule, not even the equitable considerations that the Court in *Banco Para El Comercio* espoused could rebut this presumption. Like the unlimited liability rule, the irrebuttable presumption of independence serves the values of uniformity, predictability, and neutrality. It also precludes the occurrence of untimely disputes that may arise between the United States and foreign nations under continued application of the principles announced in *Banco Para El Comercio*. The courts would not inquire into the juridical divisions that a state established beyond the initial inquiry made to determine that the entity was made juridically separate from the government. If the President so determined, any vindication of American policies against expropriations in violation of international law would take place on a political, rather than judicial, level. The freezing of foreign assets in the United States followed by a negotiated lump-sum settlement from those assets and ratable distribution to expropriation victims might be one solution.¹⁸¹ Note, however, the inherent doctrinal contradiction presented by creating an

nied by a belief by the states that they are acting under a legal obligation. *North Sea Continental Shelf Cases* (Fed. Rep. Ger. v. Den.) (Fed. Rep. Ger. v. Neth.), 1969 I.C.J. 4, 43-44. The belief that a state is acting under a legal obligation is known as "*opinio juris*." *Id.* at 44. Disagreement about the need for *opinio juris* in addition to state practice gives rise to the debate about treaties' acting as a source of customary international law. See INTERNATIONAL LAW, *supra* note 149, at 69-74. If one adopts the strict formulation of the doctrine, numerous treaties that deal with matters within the discretion of states would never, by themselves, lead to a rule of customary international law concerning those matters, because they would lack the necessary *opinio juris*. *Id.* at 73-74. Arguably, this would be the result in the case of treaties wherein states agree to recognize the juridical capacity of foreign corporations. See Drucker, *supra* note 178, at 42.

179. See Griffin, *The Power of Host Countries Over the Multinational: Lifting the Veil in the European Economic Community and the United States*, 6 LAW & POL'Y INT'L BUS. 375, 387-435 (1974). A foreign court may also pierce the veil of the parent corporation to obtain jurisdiction of a subsidiary that does not do business in its territory. *Id.*

180. *Id.* at 434-35.

181. See I F.V. GARCIA-AMADOR, *THE CHANGING LAW OF INTERNATIONAL CLAIMS* 312 (1984).

irrebuttable presumption of a government corporation's separate legal status and then blocking the corporation's own assets together with those assets indisputably belonging to the government. This contradiction may be resolved on a policy level by pointing out that the reason for the irrebuttable presumption is to place the question of disregarding a foreign government corporation's separateness in the hands of the President for foreign policy purposes.

In view of the assaults on the act of state doctrine,¹⁸² a doctrine that appears to vindicate the policies outlined above, it is unlikely that Congress would adopt the irrebuttable presumption in favor of separateness without carving a few exceptions into it.¹⁸³ The Supreme Court almost certainly would not do so.¹⁸⁴

VIII. THE RULE OF LAW: A CHOICE AMONG COMPETING POLICIES

The law cannot remain where *Banco Para El Comercio* has left it.¹⁸⁵ Its holding is too narrow;¹⁸⁶ its rule is undefined.¹⁸⁷ The Supreme Court, however, is not totally to blame. The question before it, although legal in nature, had important policy underpinnings the careless resolution of which could have had negative effects on American interests abroad.¹⁸⁸ This dilemma led the Court to compromise.¹⁸⁹

The Court's failure to articulate a satisfactory rule of law underscores the need for executive and legislative action in this area. Four alternatives are set forth above—there may be others. It is important that the rule that the United States government ultimately chooses reflect American interests and, if possible, afford

182. See *supra* note 171.

183. Of course, the presumption would no longer be considered irrebuttable.

184. The Court has riddled the act of state doctrine with exceptions. See, e.g., *Alfred Dunhill of London, Inc. v. Republic of Cuba*, 425 U.S. 682 (1976) (distinguishes commercial act from act of state); *First Nat'l City Bank v. Banco Nacional de Cuba*, 406 U.S. 759 (1972) (Justice Douglas's concurring opinion may have created a counterclaim exception to the act of state doctrine); see *INTERNATIONAL LAW*, *supra* note 149, at 132-35; Swan, *Act of State at Bay: A Plea on Behalf of the Elusive Doctrine*, 1976 *DUKE L.J.* 807; Comment, *Rationalizing the Federal Act of State Doctrine and Evolving Judicial Exceptions*, 46 *FORDHAM L. REV.* 295 (1977). In *Banco Para El Comercio*, the Court, in a footnote, disposed of any suggestion that the act of state doctrine precluded it from determining the setoff issue. 103 S. Ct. at 2604 n.28.

185. Becker, *supra* note 11, at 460 (saying the same about *C. Czarnikow Ltd. v. Centrala Handlo Zagranicznego "Rolimpex,"* [1977] A.C. 351).

186. See *supra* text accompanying notes 127-32 and paragraph in text following note 166.

187. See *supra* paragraph in text following note 166.

188. See *supra* notes 176-80 and accompanying text.

189. See *supra* text accompanying notes 111-34.

predictability and uniformity of result.

From the standpoint of these values, the unlimited liability rule is the best alternative. Not only does it have a sound doctrinal foundation, but its even-handed application, without regard to momentary political considerations, serves American interests as well. Because a blanket rule of unlimited liability does not distinguish among countries that litigate in the United States, a state finding the veil of its government corporations pierced could hardly complain of prejudice against it. At the same time, some Americans whose foreign assets have been expropriated could obtain some measure of relief that did not depend on the vagaries of international politics.¹⁹⁰

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190. Even if the United States froze the offending state's assets, claimants could not be sure of when they would see some compensation, if ever. *Cf. Dames & Moore v. Regan*, 453 U.S. 654 (1981) (upholding presidential power to suspend American claims against Iran and transfer \$2.2 billion in frozen Iranian assets from United States banks to the Bank of England and the Federal Reserve Bank pending resolution of the claims by the Iran-United States Claim Tribunal).