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Birth of a Nation: The Republic of Palau is Recognized as a Foreign Sovereign Under the Foreign Sovereign Immunities Act of 1976-Morgan Guaranty Trust v. Republic of Palau, 639 F. Supp. 706 (S.D.N.Y. 1986)

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CASENOTE

Birth of a Nation: The Republic of Palau is Recognized as a Foreign Sovereign Under the Foreign Sovereign Immunities Act of 1976—*Morgan Guaranty Trust v. Republic of Palau*, 639 F. Supp. 706 (S.D.N.Y. 1986)

I. INTRODUCTION

The Foreign Sovereign Immunities Act (FSIA)[1] establishes a comprehensive and exclusive federal regime for solving disputes with recognized foreign sovereign parties.[2] In a 1986 decision, *Morgan Guaranty Trust v. Republic of Palau*,[3] the district court enunciated a test for determining whether a governmental entity is a "foreign state," and applied the test to conclude that the Republic of Palau, a strategic trust administered by the United States as part of the Trust Territory of the Pacific Islands, is a "foreign state" entitled under the FSIA to jurisdiction in a federal forum.[4] By virtue of the court's decision, a new "foreign state" was legally recognized, thereby granting the government of Palau the privilege of claiming governmental immunity from suit under the provisions of the FSIA.

II. HISTORICAL BACKGROUND

Between World Wars I and II, the islands and atolls comprising Micronesia, including Palau, were governed by Japan pursuant to a League of Nations mandate.[5] In 1947, the United States and the United Nations Security Council entered into a

1. Foreign Sovereign Immunities Act of 1976, 28 U.S.C. §§ 1602-11 (1982).

2. Feldman, *The United States Foreign Sovereign Immunities Act of 1976 in Perspective: A Founder's View*, 35 INT'L & COMP. L.Q. 302, 305 (1986).

3. 639 F. Supp. 706 (S.D.N.Y. 1986).

4. *Id.* at 716.

5. Treaty on Pacific Islands Under Mandate, Feb. 11, 1922, United States-Japan, 42 Stat. 2149, T.S. No. 664.

Trusteeship Agreement[6] designating Palau as a "strategic area"[7] to be administered by the United States[8] as part of the Trust Territory of the Pacific Islands. The Trusteeship Agreement vested in the United States administrative, legislative and judicial authority over Palau.[9] The Trusteeship also obligated the United States to "foster the development of such political institutions as are suited to the trust territory and [to] promote the development of the inhabitants of the trust territory toward self-government or independence . . . ."[10]

While the United Nations Security Council retained oversight of the islands,[11] direct administrative authority was delegated by Congress to the President[12] and, ultimately, to the Department of the Interior.[13] In 1968, the Secretary of the Interior established a local government for the Trust Territories.[14] Executive power was vested in a High Commissioner who was appointed by the President with the advice and consent of the Senate. The Commissioner was given authority to appoint executive officials and to submit proposed legislation to Congress.[15] The 1968 order also established a bicameral legislative branch empowered to pass laws consistent with treaties or other international agreements of the United States, applicable laws of the United States, and Executive Orders.[16]

Pursuant to an order of the Secretary of the Interior,[17] Pa-

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6. Trusteeship Agreement for the Former Japanese Mandated Islands, July 18, 1947, 61 Stat. 3301, T.I.A.S. No. 1665 [hereinafter "Trusteeship Agreement"].

7. A "strategic area" is an area created by agreement that is to be administered by a trustee nation, with special rights of military power to maintain peace and security vested in the trustee nation. *See id.* at art. 1.

8. *Id.* at art. 2.

9. *Id.* at art. 3.

10. *Id.* at art. 6(1).

11. The United Nations Security Council retains the power to establish and modify by subsequent agreement an international trusteeship system under Article 75 of the Charter of the United Nations. *See id.* at preamble.

12. 48 U.S.C. § 1681(a) (1982).

13. Exec. Order No. 11,021, 3 C.F.R. 600 (1959-1963), *reprinted in* 48 U.S.C. § 1681 (1982).

14. Secretarial Order No. 2918, 34 Fed. Reg. 157 (1968).

15. *Id.*

16. *Id.* The Commissioner retained a legislative veto power; but, if overridden by a two-thirds majority, ultimate veto power was vested in the United States' Secretary of State. For a more complete discussion of the trust territory governmental structure, see Gale v. Andrus, 643 F.2d 826, 828-30 (D.C. Cir. 1980).

17. "Recognition of Governmental Entities under Locally-Ratified Constitutions in the Trust Territories of the Pacific Islands," Secretarial Order No. 3039, 44 Fed. Reg. 28,116 (1978).

lau adopted a constitutional form of government, which became effective January 1, 1981. The Palauan Constitution provides for an executive branch with a popularly elected president and vice-president, a bicameral legislature, and a unified judiciary. Palau also established a relationship of independent "free association" with the United States as defined in the United Nations' General Assembly Resolution 1541.[18] Under "free association," Palauans exercise their own sovereignty and are not United States citizens.[19] On January 10, 1986, Palau and the United States signed a Final Compact of Free Association[20] ("the Compact") which was approved in a Palauan plebiscite on February 21, 1986.[21] The terms of the Compact establish Palau's independent sovereignty and equal diplomatic status in the international community.[22] The Compact was approved by both the President[23] and Congress.[24]

III. THE ACTION

In December of 1985, a consortium of international banks[25] brought suit in the Supreme Court of New York seeking to recover for an alleged $35 million default by the Republic of Palau in connection with the financing of an electrical power plant on the island of Palau. In January of 1986, Palau removed the action to federal court pursuant to 28 U.S.C. § 1441(d) on the

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18. G.A. Res. 1541, 15 U.N. GAOR Supp. (No. 21) at 38, U.N. Doc. A/4684 (1960).

19. *See* Bowoon Sangsa Co. v. Micronesian Indus. Corp., 720 F.2d 595, 600 (9th Cir. 1983).

20. 48 U.S.C. § 1681 (Supp. III 1985).

21. A United States congressional report reveals the following:

> On February 21, 1986, Palau held another U.N. observed plebiscite and approved the modified compact by a vote of 72.2 percent. The report of the United Nations visiting mission observing this plebiscite in Palau concluded: ". . . the plebiscite . . . represented yet another valid act of self-determination by the people of Palau in which all eligible voters had the opportunity to participate of their own free will. . . . It testifies to the political awareness of the Palauan people and the importance they attach to their future constitutional status."

S. REP. No. 403, 99th Cong., 2d Sess. 25, *reprinted in* 1986 U.S. CODE CONG. & ADMIN. NEWS 6207, 6209-10.

22. 48 U.S.C. § 1681 (Supp. III 1985).

23. Exec. Order No. 12,569, 51 Fed. Reg. 37,171 (1986).

24. 48 U.S.C. § 1681 (Supp. III 1985).

25. Morgan Guaranty Trust Co., Morgan Grenfell & Co., Ltd., Bank of Tokyo, Ltd., Governor and Company of the Bank of Scotland and Orion Royal Bank, Ltd.

grounds that Palau is a "foreign state" and therefore entitled to removal jurisdiction in the federal court.[26]

In March of 1986, the banks filed a motion to remand the proceedings to the Supreme Court of New York. The banks' motion opposed removal by claiming that Palau's status as a trust territory deprived it of the status of a "foreign state." The banks cited *World Communications Corp. v. Micronesian Telecommunications Corp.*,[27] where the court dismissed for lack of diversity an action between an Hawaiian corporation and a corporation of the Trust Territory, explicitly holding that a trust territory is not a foreign state.[28] The court in *World Communications* had reiterated its earlier rationale recorded in *Saipan v. United States Department of the Interior*[29] which was that "the United States exercises a maximum degree of control which is inconsistent with the assertion that the Trust Territory is a foreign country."[30] The banks also cited *Sablan Construction Co. v. Government of Trust Territory*,[31] a case wherein the government of the Northern Mariana Islands was sued by a construction company for illegally assessing and collecting taxes on imported construction materials.[32] The government asserted that it

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26. 28 U.S.C. § 1330 (1982), governing original jurisdiction, provides for federal district court jurisdiction regardless of amount in a non-jury civil action against a foreign state as defined by 28 U.S.C. § 1603(a). Section 1441(d) of 28 U.S.C. governs removal jurisdiction on the same grounds and also incorporates § 1603 as the definitional referent. Section 1603 provides in pertinent part:

> a) A "foreign state", except as used in section 1608 of this title, includes a political subdivision of a foreign state or an agency or instrumentality of a foreign state as defined in subsection (b).
>
> b) An "agency or instrumentality of a foreign state" means any entity:
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> 1) which is a separate legal person, corporate or otherwise, and
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> 2) which is an organ of a foreign state or political subdivision thereof, or a majority of whose shares or other ownership interest is owned by a foreign state or political subdivision thereof, and
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> 3) which is neither a citizen of a state of the United States as defined in section 1332(c) and (d) of this title nor created under the laws of any third country.
>
> c) The "United States" includes all territory and waters, continental or insular, subject to the jurisdiction of the United States.

28 U.S.C. § 1603 (1982).

27. 456 F. Supp. 1122 (D. Haw. 1978).

28. *Id.* at 1124.

29. 356 F. Supp. 645 (D. Haw. 1973), *modified*, 502 F.2d 90 (9th Cir. 1974), *cert. denied*, 420 U.S. 1003 (1975).

30. *Id.* at 655.

31. 526 F. Supp. 135 (D.N. Mariana I. App. Div. 1981).

32. *Id.* at 136.

was immune from suit under the FSIA.[33] The district court, however, held that the Trust Territory was not a "foreign state" and therefore the FSIA was inapplicable.[34] The banks also pointed out that recently, in *Bowoon Sangsa Co. v. Micronesian Industrial Corp.*,[35] the Ninth Circuit rejected the contention that the adoption of a constitution rendered Palau an independent sovereign, and held that Palauan courts must honor an injunction issued by a United States federal district court.[36]

IV. The Court's Rationale

While the court conceded that the cases cited by the banks "shed light on the complexity of the issue before the court," the court added that the cases "do not . . . necessarily determine the question of whether the current political autonomy of Palau renders it a 'foreign state'. . . ."[37] The court distinguished *Saipan* and *World Communications* as cases evaluating the status of the Trust Territories in the early 1970's—subsequent advances towards independence had rendered their evaluation obsolete.[38] The court also rejected the application of the *Sablan* decision declaring: "The *Sablan* court thus rested squarely on *People of Saipan* with a brief discourse on the attributes of sovereignty which existed . . . in 1973."[39] Lastly, the court noted that in *Bowoon*:

> The Ninth Circuit had to determine the existence [of] one attribute of sovereignty which Palau did not yet possess, namely a judiciary completely independent from oversight by United States courts, a determination which does not preclude this court's examination of the larger question of whether Palau now possesses enough of the other (and perhaps collectively more significant) attributes of sovereignty to be considered a 'foreign state.'[40]

The court also rejected the banks' assertion that it should

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33. *Id.* at 137.

34. *Id.* at 140.

35. 720 F.2d 595 (9th Cir. 1983).

36. *Id.* at 600.

37. Morgan Guaranty Trust v. Republic of Palau, 639 F. Supp. 706, 710 (S.D.N.Y. 1986).

38. Specifically, the adoption of a constitutional form of government and the Compact of Free Association, both described *supra*, notes 17-24 and accompanying text.

39. 639 F. Supp. at 711.

40. *Id.*

narrowly construe the political status of Palau at the moment the action was filed, which was approximately two months prior to the adoption of the Compact.[41] The Court observed that "courts of the United States have long recognized that sovereignty is an ephemeral concept, which in this court's view if [sic] not susceptible to reduction into a jurisdictional 'moment'."[42]

Rather than following the "narrowly construed" analysis suggested by the banks, which would establish theoretical limits to Palau's independence by virtue of the existence of the Trusteeship, the court chose to evaluate Palau's "*de facto* independence." This approach, the court maintained, has often been used by federal courts "to evaluate their jurisdiction over nations in political transition."[43] The court cited *Murarka v. Bachrack Bros.*,[44] a suit between a New York corporation and a citizen of India, that was initiated prior to India's independence from Great Britain. The *Murarka* court observed that although "our government had not yet given India *de jure* recognition, . . . [the exchange of ambassadors] certainly amounted at least to a *de facto* recognition, if not more."[45] The court also cited *Betancourt v. Mutual Reserve Fund Life Association*,[46] wherein the district court had affirmed the independent sovereignty of the provisional government of occupied Cuba after the Spanish-American War.[47]

In applying the *de facto* sovereignty test, the district court

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41. *Id.* at 712.

42. *Id.*

43. *Id.* at 713. The United States Supreme Court has attempted to define sovereignty by listing its attributes, or the powers which indicate that a nation is recognized as foreign and independent. *See* United States v. Curtiss-Wright Export Corp., 299 U.S. 304, 318-19 (1936) (among the factors listed by the Supreme Court are the power to wage and declare war, to conclude peace, to maintain diplomatic ties, to acquire territory, and to make international agreements and treaties); Chae Chan Ping v. United States, 130 U.S. 581 (1889) (listed general administrative tasks of self-governance such as patents, copyrights, coinage, and postal systems, as well as the power to admit or exclude aliens); United States v. Ferguson, 302 F. Supp. 1111 (N.D. Cal. 1969) (conceptualized non-enumerated powers of sovereignty).

44. 215 F.2d 547 (2d Cir. 1954).

45. *Id.* at 552. In *Palau*, "the United States recognized the diplomatic credentials of Palau's President Lazarus E. Salii when he served as Palau's Ambassador for Status Negotiations and Trade Relations, and accorded President Salii's United States counterpart, Fred M. Zeder II, Ambassadorial status." 639 F. Supp. at 713 n.6.

46. 101 F. 305 (C.C.S.D.N.Y. 1900).

47. Spain had signed a treaty whereby it relinquished all claims of sovereignty over Cuba. Although the United States occupied the island and agreed to protect life and property in Cuba from unexpected consequences of the occupation, the district court found diversity of citizenship between a New York corporation and a citizen of Cuba.

recognized that Palau has negotiated commercial and diplomatic treaties with several nations on a government to government basis, has joined several international organizations, has a national postal system and has a national flag.[48] Furthermore, Palau's constitution gives the government jurisdiction over bankruptcies, immigration, patents, copyrights, and public lands.[49] The court determined that by "[e]xercising its constitutional mechanisms, Palau has demonstrated attributes of sovereignty both before and after adopting the Compact."[50] The court also noted that the role of the United States was never intended to be that of sovereign and opined that steady progress had been made toward a self-governing Palau.[51] The court remarked:

> Viewed in the proper historical context, it appears that although the dismantling of the structure of the trusteeship can be accomplished only with United Nations' approval, Palau's *de facto* political independence demonstrates that the United States and Palau are embarking on a consensual relationship external to the Trusteeship, while the dissolution of the Trusteeship lags behind.[52]

With such a determination, the district court recognized Palau as a "foreign state" which was immune from suit under the provisions of the FSIA and therefore denied the motion to remand.[53]

V. Implications and Conclusions

The decision in *Palau* not only affects the legal status of the island republic, but it also establishes a judicial test for evaluating sovereignty. The implications of each of these two aspects merit some discussion.

A. The Effect of the Decision on Relations with Palau

Now that determinations of sovereign immunity have been transferred from the Executive Office, State Department and

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48. Morgan Guaranty Trust v. Republic of Palau, 639 F. Supp. 706, 708 (S.D.N.Y. 1986).
49. *Id.* at 708-09.
50. *Id.* at 708.
51. *Id.* at 715.
52. *Id.* at 716.
53. *Id.*

Department of the Interior to the court system,[54] there is a new element of certainty in conducting relations with the government of Palau.

Prior to the adoption of the FSIA, "[t]he United States traditionally followed the absolute theory of sovereign immunity, under which sovereign states are immune from jurisdiction in all circumstances."[55] After World War II, however, the State Department, adopted a "restrictive theory of immunity as it was being practised in Europe."[56] Under this theory, immunity could be granted either in the courts or by petition to the State Department.[57] The Executive Branch could also present suggestions of immunity.[58] Consequently, the granting of sovereign immunity became a tool of foreign policy.[59] The adoption of the FSIA eliminated the discretionary nature of sovereign immunity by depoliticizing the process by which immunity was granted.[60]

Even though the FSIA may have fulfilled its depoliticizing purpose, it was unclear just when, how, or if the FSIA would affect Palau. Hence, there was an extra complication in dealing with the provisional government of Palau. Now, following the *Palau* decision, those maintaining relationships with the independent government can rely on the FSIA provisions to serve as the legal parameters within which to conduct their affairs.[61]

Several areas that might fall within the scope of the immunity to which Palau is now entitled should be noted. As indi-

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54. The purpose of the FSIA is declared in § 1602:

> The Congress finds that the determination by the courts of the claims of foreign states to immunity from the jurisdiction of such courts would serve the interests of justice and would protect the rights of both foreign states and litigants in United States courts. . . . Claims of foreign states to immunity should henceforth be decided by courts of the United States and of the States in conformity with the principles set forth in this chapter.

28 U.S.C. § 1602 (1982).

55. Lane, *Sovereign Immunity-FSIA-Foreign Nation Subject to Federal Jurisdiction Under Foreign Sovereign Immunity Act of 1976*, Ministry of Supply, Cairo v. Universe Tankships, Inc., 8 SUFFOLK TRANSNAT'L L.J. 199, 202 (1984).

56. *Id.* According to one scholar, "the growing role of state agencies in international trade led to the re-examination of this approach." *See* Feldman, *supra* note 2, at 303.

57. *Id.*

58. *Id.* at 304.

59. *Id.*

60. *Id. See also* H.R. REP. No. 1487, 94th Cong., 2d Sess. 7, 8, *reprinted in* 1976 U.S. CODE CONG. & ADMIN. NEWS 6604, 6606.

61. While a comprehensive analysis of the actual parameters prescribed by the FSIA is beyond the scope of this article, it can be stated, generally, that the Palauan government is now immune from the jurisdiction of United States' courts in all areas except those outlined by the FSIA.

cated by *Palau*, questions or disputes regarding foreign sovereign debt cannot be litigated in courts of the United States, absent a "commercial activity".[62] A commercial enterprise or corporation in which the majority of shares are held by a "foreign state" may be considered an instrumentality of that state, and therefore eligible for immunity.[63] Governmental agencies which have frequent contact with the citizenry of the United States such as a ministry of tourism[64] or a foreign military procurement agency[65] have been held to be immune. "Acts of State" or other governmental activities that involve sovereign discretion such as nationalization[66] or human rights[67] also present areas of potential immunity. Lastly, the establishment of terms and conditions for removal of natural resources from its territory has been held to be an area of sovereign activity immune from the jurisdiction of United States courts.[68]

B. The De Facto Sovereignty Test

A second notable aspect of the *Palau* decision is the application of the *de facto* sovereignty test. This test represents an equitable evaluation of the practical aspects of government rather than a strict adherence to some theoretical limitation to independence. If an entity other than the established government is independently exercising all the rights and responsibilities of a government, with the approval of both the populace governed and the established government, then to deny recognizing that entity as a "sovereign state" is a pragmatic futility. The recognition of sovereignty merely reflects the volition of the

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62. *See generally* Larson, *Default on Foreign Sovereign Debt: A Question for the Courts?*, 18 IND. L. REV. 959 (1985); Reisner, *Default by Foreign Sovereign Debtors: An Introductory Perspective*, 1982 U. ILL. L. REV. 1.

63. *See, e.g.*, O'Connell Machinery Co. v. M.V. Americana, 734 F.2d 115 (2d Cir.), *cert. denied*, 469 U.S. 1086 (1984); Bailey v. Grand Trunk Lines New England, 609 F. Supp. 48 (D. Vt. 1984), *modified*, 805 F.2d 1097 (2d Cir. 1986), *cert. denied*, 106 S. Ct. 94 (1987); Herman v. El Al Israeli Airlines, 502 F. Supp. 277 (S.D.N.Y. 1980).

64. *See* Tucker v. Whitaker Travel, 620 F. Supp. 578 (E.D. Pa. 1985), *aff'd*, 800 F.2d 1140 (3d Cir.), *cert. denied*, 107 S. Ct. 578 (1986).

65. *See* Unidyne Corp. v. Aeorlineas Argentinas, 590 F. Supp. 398 (E.D. Va. 1984).

66. *See* Alberti v. Empresa Nicaraguense de la Carne, 705 F.2d 250 (7th Cir. 1983).

67. *See generally* Bayzler, *Litigating the International Law of Human Rights: A "How To" Approach*, 7 WHITTIER L. REV. 713 (1985).

68. MOL, Inc. v. Peoples Republic of Bangladesh, 736 F.2d 1326 (9th Cir.), *cert. denied*, 469 U.S. 1037 (1984); International Ass'n of Machinists and Aerospace Workers v. OPEC, 477 F. Supp. 553 (C.D. Cal. 1979), *aff'd*, 649 F.2d 1354 (9th Cir. 1981), *cert. denied*, 454 U.S. 1163 (1982).

parties concerned. Thus, the *de facto* sovereignty test is particularly laudable in the context of promoting democratic processes.

The test, however, is not free from dangers if liberally applied. In a situation such as that in *Palau* or *Murarka*,[69] where there was a relatively amicable transfer of power and a majority of popular support, the *de facto* sovereignty test is a convenient instrument for granting official recognition of sovereignty. However, if there was a violent revolution or a civil conflict involving competing interests with roughly equivalent governmental influence, then it may be difficult to accurately determine who is, *de facto*, the sovereign entity. A judicial ruling may then become a statement in international politics because of the official government support that it may imply. Thus, the *de facto* sovereignty test has the potential to re-politicize the question of sovereign immunity which the FSIA was designed to eliminate.

Therefore, even though the *Palau* decision has established that Palau is a foreign sovereign, the inherent ambiguities in both the FSIA and the *de facto* sovereignty test may give rise to more questions than were answered.

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69. *See supra* note 44 and accompanying text.