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Litigating Claims over Foreign Government-Owned Corporations under the Commercial Activities Exception to the Foreign Sovereign Immunities Act

*Sunil R. Harjani**

I. INTRODUCTION

In the United States, the Foreign Sovereign Immunities Act (“FSIA” or “Act”) is the sole basis for federal subject matter jurisdiction in civil actions against foreign states.¹ The FSIA grants sovereign immunity to foreign states from suits in United States courts unless they fall under one of the exceptions to the Act. Included in the definition of a foreign state under the Act is “an agency or instrumentality of a foreign state.”² This definition of an agency or instrumentality of a foreign state encompasses foreign government-owned corporations (“FGOC”), a corporation of whose shares or ownership interest is owned by a foreign state’s government or political subdivision.

Sovereign immunity is a principle in international law under which domestic courts must refrain from exercising jurisdiction against a foreign state.³ Sovereign immunity is normally thought of as applying against the state itself, but under the FSIA, a corporation owned by the government can

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¹ 28 U.S.C. § 1604 (1976) [hereinafter “FSIA” or “the Act”]; see also *Argentine Republic v. Amerada Hess Shipping Corp.*, 488 U.S. 428 (1989).

² *Id.* at § 1603(b).

³ *Jurisdiction of U.S. Courts in Suits Against Foreign States: Hearings H.R. 11315 Before the Subcomm. on Admin. Law and Governmental Relations of the House Comm. on Judiciary*, 94th Congress, 2d 25 (1976) [hereinafter *Hearings*] (testimony of Monroe Leigh, Legal Advisor, Department of State).

also claim sovereign immunity from suit. Imagine a scenario where a U.S. business is engaged in a transaction with a foreign corporation whose shares are 90 percent owned by the government of the foreign state. If a breach of contract occurs, the U.S. suit would be initially barred from federal court unless the plaintiff can prove that one of the exceptions to the FSIA applies. The FSIA creates a presumption that a FGOC is engaged in sovereign activity and the burden then shifts to the plaintiff to establish an exception to the FSIA.

The Commercial Activities Exception is the most frequently invoked exception by plaintiffs. The exception allows a court to lift the sovereign immunity of the FGOC and exert subject matter jurisdiction over the defendant. This paper examines the commercial activities exception as applied to a FGOC. Specifically, this article will argue that even though subject matter jurisdiction is relatively easy to obtain over FGOCs under this exception, the FSIA should be changed so that the definition of a foreign state in the FSIA no longer includes FGOCs.

First, this article will examine the way courts have dealt with suits against FGOCs claiming immunity under the FSIA. Second, this article will argue that obtaining jurisdiction over a FGOC has become relatively easy under the FSIA due to the way courts have applied the commercial activities exception in recent decisions. Third, this article will suggest methods for United States and foreign businesses to avoid difficulties in obtaining jurisdiction over FGOCs. Finally, this article will advocate that FGOCs should no longer be provided sovereign immunity under U.S. law.

Part II provides a brief introduction into the history of the FSIA. Part III looks at how FGOCs are defined as "foreign states" under the FSIA. Part IV looks at the commercial activities exception to the FSIA. Part V examines recent decisions of the application of the commercial activities exception to FGOCs and the effect it has for jurisdiction in U.S. Courts. Part VI demonstrates the negative effects the FSIA has for U.S. businesses in their business transactions. Finally, Part VII advocates the elimination of FGOCs from the definition of a foreign state. FGOCs should be discarded from the FSIA because of the ease of obtaining jurisdiction over an FGOC, the problems it causes for U.S. businesses in doing transactions, and its inconsistency with the basic rationale of the FSIA.

II. SHORT HISTORY OF THE FSIA

A. Absolute Immunity

The theory of absolute immunity for foreign sovereigns provides that "a state enjoys complete immunity from the adjudicatory jurisdiction of

other states.”⁴ Its application in U.S. courts is generally traced to *The Schooner Exchange v. McFadden*.⁵ In *The Schooner Exchange*, Chief Justice Marshall stated that the “jurisdiction of (a) nation within its own territory, is necessarily exclusive and absolute; it is susceptible of no limitation, not imposed by itself.”⁶ Courts and scholars have agreed that *The Schooner Exchange* established the principle of absolute sovereign immunity.⁷ During the first fifty years of the twentieth century, the absolute theory came under increasing attack from both American and British commentators because of the broad scope of immunity. In 1952, the United States adopted another theory of sovereign immunity -- the restrictive theory of sovereign immunity.⁸

B. Restrictive Immunity

The restrictive theory of sovereign immunity differs from the absolute theory by recognizing that governments often act in a commercial rather than a governmental capacity. Theoretically, when a government acts in a commercial capacity, a foreign government should stand in the same position as that of any other commercial actor in the international marketplace.⁹ In 1952, the Tate Letter formally announced the U.S. State Department’s adoption of the restrictive theory of sovereign immunity with respect to private acts of foreign governments.¹⁰

By enacting the Foreign Sovereign Immunities Act of 1976, Congress codified the doctrine of restrictive sovereign immunity.¹¹ Restrictive sovereign immunity under the FSIA holds that the immunity of the sovereign is recognized with respect to sovereign or public acts but not with respect to private acts.¹² The FSIA was intended to ensure the application of the doctrine of restrictive sovereign immunity in litigation before U.S. courts but Congress also intended to restrict any immunity when foreign states en-

⁴Joan E. Donoghue, *Taking the “Sovereign” Out of the Foreign Sovereign Immunities Act: A Functional Approach to the Commercial Activity Exception*, 17 YALE J. INT’L L. 489, 490 (1992).

⁵*The Schooner Exchange v. McFadden*, 11 U.S. (7 Cranch) 116 (1812).

⁶*Id.* at 136.

⁷David E. Gohlke, *Clearing the Air or Muddying the Waters? Defining a “Direct effect in the United States” under the Foreign Sovereign Immunities Act After Republic of Argentina v. Weltover*, 18 Hous. J. INT’L L. 261 (1995).

⁸*Hearings*, *supra* note 3, at 26.

⁹*Id.* at 30 (testimony of Bruno A. Ristau, Chief, Foreign Litigation Section, Civil Division, Department of Justice).

¹⁰*Id.* at 54.

¹¹H.R. REP. No. 94-1487, at 7 (1976).

¹²Letter from Jack B. Tate, Acting Legal Advisor, Department of State, to Philip B. Perlman, Acting Attorney General (May 19th, 1952), *reprinted in* Alfred Dunhill of London v. Republic of Cuba, 425 U.S. 682 (1976).

gaged in commercial activities.¹³ Before passage of the Act, FGOs were treated as private entities and denied sovereign immunity unless they could show that their activities were of a strictly public nature.¹⁴ The consequence of enacting the FSIA on FGOs is that FGOs are afforded all the immunities enjoyed by a foreign sovereign unless one of the exceptions to the FSIA can be met.

C. International Practice

The United States is the only country in the world that has adopted state ownership of an entity as a basis for conferring sovereign immunity. Since 1976, most countries that have enacted legislation codifying the restrictive theory have expressly rejected the idea.¹⁵ None of the international law organizations that have published draft conventions codifying the restrictive theory have based foreign sovereign status on ownership.¹⁶ Thus, although the FSIA's first objective is international alignment, the failure of FSIA in this regard is apparent. While the commercial activities exception was intended to align the United States with the restrictive theory, as discussed in Part VII, the initial grant of sovereign immunity to FGOs is where the major problem lies. In fact, the FSIA runs contrary to the very purpose of restrictive sovereign immunity. The public commercial sector has diversified so widely that most state-owned corporations are engaged in commercial activities. Thus, conferring foreign state status on FGOs undermines the restrictive theory and the goal of the FSIA.

III. FOREIGN GOVERNMENT-OWNED CORPORATIONS UNDER THE FSIA

The FSIA provides sovereign immunity to foreign government-owned corporations under Section 1603 of the Act.¹⁷ Nowhere in the Act are FGOs specifically mentioned. However, under Section 1603(a), a foreign state is defined to include "a political subdivision of a foreign state or an agency or instrumentality of a foreign state." An agency or instrumentality

¹³H.R. Rep. No. 1487, *supra* note 10.

¹⁴*See* *Oliver American Trading Co. v. United States of Mex.*, 5 F.2d 659, 665 (2d Cir. 1924) (holding that the Mexican railroad enjoyed sovereign immunity on the basis that in Mexico running a railroad was strictly a public function); Danny Abir, *Foreign Sovereign Immunities Act: The Right to Jury Trial in Suits against foreign government-owned corporations*, 32 STAN. L. INT'L L. 159 (1996).

¹⁵William C. Hoffman, *The Separate Entity Rule in International Perspective: Should State Ownership of Corporate Shares Confer Sovereign Status For Immunity Purposes?*, 65 TUL. L. REV. 535, 565-66 (1991).

¹⁶*See* United Nations: International Law Commission Draft Articles on Jurisdictional Immunities of States and Their Property, 26 I.L.M. 292 (1983); International Law Association: Draft Articles for a Convention on State Immunity, 22 I.L.M. 287 (1983).

¹⁷28 U.S.C. §1603 (1976).

is further defined in subsection 1603(b), where a FGOC would be included under the FSIA.¹⁸

Section 1603(b) provides three requirements that an entity must meet before it falls under the definition of an agency or instrumentality of a foreign state: (1) the entity must be a separate legal person, (2) the entity must be an organ of a foreign state or a political subdivision thereof, or a majority of whose shares or other ownership interest is owned by a foreign state or political subdivision thereof, and (3) the entity must not be a citizen of the United States nor created under the laws of any third country.¹⁹ Section 1603(b) is the immunity defense of any state-owned organization. In any case with a FGOC, the key to immunity, and thus to the absence of subject matter jurisdiction and to dismissal, is to show that the entity falls within the Section 1603(b) definition of "agency or instrumentality" and thus should be treated as a "foreign state".

In the House Report accompanying the FSIA, Congress explained the definition of "agency or instrumentality" was "intended to include a corporation, association, foundation, or any other entity which, under the law of the foreign state where it was created, can sue or be sued in its own name, contract in its own name or hold property in its own name."²⁰ These entities can be in a variety of forms including a transport organization such as a shipping line, airline, steel company, foreign bank, state trading corporation, or an export association.²¹ By including FGOCs into the definition of a foreign state, Congress granted the same immunities that it provided to foreign governments to a corporation.

Generally, it is easy for a U.S. court to determine whether a FGOC meets the definition of a foreign state under Section 1603. This is because most FGOCs are owned by one state government which owns more than 50 percent of the shares of that corporation. The difficulty arises when the FGOC is owned by several foreign governments or when the foreign government does not directly own the corporation but rather one of its agencies or instrumentalities is involved in the chain of ownership. The federal courts have deemed these two situations as *pooling* and *tiering* respectively. Although there remains a split in the circuits over the latter issue, a large number of courts have stretched far under these two doctrines to encompass FGOCs under the definition of a foreign state.

A. Pooling of Ownership Interests

Most federal courts have allowed several states to "pool" together their ownership interests in a corporation to foster a majority of ownership for

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ H. R. Rep., *supra* note 11, at 15.

²¹ *Id.* at 15-16.

that corporation.²² Although the FSIA does not expressly allow pooling, most courts do permit it though they do not typically explain how pooling affects the purposes of the FSIA.²³

In *In re Aircraft Disaster near Roselawn, Indiana*, the Seventh Circuit found that the ownership interests of France and Italy in an aircraft manufacturer named Avions de Transport Regional, G.I.E. ("ATR") may be pooled under the FSIA to establish ATR as a foreign state under the FSIA.²⁴ The Court noted that in almost all cases, pooling of several states with ownership interests in a corporation has been allowed under the FSIA.²⁵ In *LeDonne v. Gulf Air*, the court allowed a treaty-created airline owned by four Persian Gulf states to pool its ownership interests to meet the FSIA's majority-ownership provisions²⁶

In *Credit Lyonnais v. Getty Square Associates*, the district court allowed France to pool its ownership interests together to form a 57.17 percent ownership in Credit Lyonnais where France owned 48.5 percent of Credit Lyonnais outstanding shares and in addition, owned 99.97 percent of SPBI SNC, another French Corporation which in turn owned 8.675 percent of Credit Lyonnais.²⁷ The court held that if several states could pool their ownership interests together, then one state could pool its own ownership interest through more than one agency or instrumentality so that the entity may be defined as a "foreign state" under Section 1603(b)(2).²⁸

The effect of allowing pooling of ownership interests is to provide an easy method for FGOs to be deemed an agency of a foreign state under the FSIA and to receive the protections of sovereign immunity. The result of pooling for the purposes of the FSIA is that it broadens the scope of sovereign immunity because an entity may receive immunity even though it is owned by many sovereigns.

²² See, e.g., *Mangattu v. M/V IBN Hayyan*, 35 F.3d 205, 208 (5th Cir. 1994) (holding that entity 100 percent owned by foreign states and created by agreement of all participating states satisfied "majority" requirement; FSIA does not require that majority interest be owned by a single foreign state).

²³ See *In re Air Craft Disaster near Roselawn, Indiana* on October 31, 1994, 96 F.3d 932, 929 (7th Cir. 1996) [hereinafter *In re Aircraft*]. But see *Gardiner Stone v. Iberia Lineas Aereas de Espana*, 896 F. Supp. 125, 131 (S.D.N.Y. 1995) (holding that pooling was not allowed by Spain and Argentina since the corporation was not created by treaty or by a multinational joint venture); *Linton v. Airbus Industrie*, 794 F.Supp. 650, 652 (S.D. Tex. 1992) ("[I]t is far from clear that pooling is allowed under FSIA.").

²⁴ See *In re Air Crash*, 96 F.3d at 939.

²⁵ *Id.*

²⁶ See *LeDonne v. Gulf Air, Inc.*, 700 F. Supp. 1400, 1406 (E.D. Va. 1988); see also Joseph W. Hardy Jr., *Wipe Away the Tiers: Determining Agency or Instrumentality Status under the Foreign Sovereign Immunities Act*, 31 GA. L. REV. 1121 (1997).

²⁷ *Credit Lyonnais v. Getty Square Associates*, 876 F. Supp. 517 (S.D.N.Y. 1995).

²⁸ *Id.* at 520.

B. Tiering of Ownership Interests

Tiering of ownership interests under the FSIA allows classifying an entity as an agency or instrumentality of a foreign state when the entity is not directly owned by any foreign government. There is a split in the circuits over whether tiering should be allowed under the FSIA for FGOs.

In *In re Aircraft Disaster near Roselawn, Indiana*, the Seventh Circuit held that France and Italy may “tier” their ownership interests through corporate intermediaries SNIA and Alenia and still fall within the definition of a foreign state under the FSIA.²⁹ Thus, the Seventh Circuit decision would allow an infinite loop of ownership where corporations owned by agencies or instrumentalities of foreign states themselves become a “foreign state” under the Act and any subsequent majority-owned corporation would also fall within the Act.³⁰

This reasoning was rejected by the Ninth Circuit in *Gates v. Victor Finer Foods, Inc.*, where the court held that Fletcher Finer Foods (“FFF”), which was 100 percent owned by Alberta Pork, an agency or instrumentality of a foreign state (Canada), was not a “foreign state” itself under the FSIA.³¹ The court stated that to add to the list of entities that are owned by an agency or instrumentality would expand the potential immunity for every subsidiary in a corporate chain, no matter how far down the line.³² The district court in *Hyatt Corp. v. Stanton* agreed with the Ninth Circuit’s decision in *Gates*, but a large number of other courts have rejected this decision.³³

Thus, with a combination of pooling and tiering along with direct majority ownership of a corporation, a majority of the FGOs that are sued in U.S. courts have the option of invoking sovereign immunity under the FSIA since they can easily fall under the definition of a foreign state. Courts have interpreted the “majority ownership” provisions in Section 1603(b) liberally to encompass different scenarios of ownership. The effect is that the burden then shifts to the plaintiff to prove an exception to the grant of sovereign immunity in order for the suit to continue.

IV. THE COMMERCIAL ACTIVITIES EXCEPTION

Under the FSIA, a court can only assert jurisdiction over a sovereign state when that state action comes under one of the enumerated exceptions to the FSIA. The most frequently invoked exception is the commercial activities exception.

²⁹ *In Re Aircraft*, 96 F.3d at 939.

³⁰ *Id.*

³¹ *Gates v. Victor Fine Foods*, 54 F.3d 1457, 1466 (9th Cir. 1995).

³² *Id.* at 1463.

³³ *Hyatt Corp. v. Stanton*, 945 F. Supp. 675, 686-87 (S.D.N.Y. 1996).

Section 1605(a)(2) provides that a foreign state shall not be immune from the jurisdiction of a U.S. court

“in which the action is based upon a commercial activity carried out in the United States by the foreign state; or upon an act performed in the United States in connection with a commercial activity of a foreign state elsewhere; or upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States.”³⁴

This section is collectively known as the commercial activities exception and the Supreme Court has referred to Section 1605(a)(2) as “(t)he most significant of the FSIA’s exceptions.”³⁵

There are three parts to the commercial activities exception. The first clause deals with a commercial activity in the United States, the second clause deals with an act in the United States in connection with a commercial activity in a foreign country, and the third clause deals with both acts and commercial activities outside the U.S.

A. Definition of Commercial Activity

Section 1603(d) of the FSIA defines a commercial activity:

“A commercial activity means either a regular course of commercial conduct or a particular commercial transaction or act. The commercial character of an activity shall be determined by reference to the nature of the course of conduct or particular transaction or act, rather than by reference to its purpose.”³⁶

In *Republic of Argentina v. Weltover*, the Supreme Court defined a commercial activity by establishing a “private person” test.³⁷ The Court held that “when a foreign government acts, not as a regulator of a market, but in the manner of a private player within it, the foreign sovereign’s actions are “commercial” within the meaning of the FSIA.”³⁸ The Court also explained that the determination of a commercial activity must be made by reference to its nature and not its purpose, according to the Act, by looking at “whether the particular actions that the foreign state performs (whatever the motive behind them) are the types of actions by which a private party engages in “trade and traffic or commerce”.”³⁹ The Court then provided an example:

“[A] foreign government’s issuance of regulations limiting foreign currency exchange is a sovereign activity, because such authoritative control of commerce cannot be exercised by a private party; whereas a contract to buy

³⁴28 U.S.C. §1605(a)(2).

³⁵*Republic of Argentina v. Weltover*, 504 U.S. 607, 611 (1992).

³⁶28 U.S.C. § 1603(d).

³⁷*Weltover*, *supra* note 35.

³⁸*Id.* at 614.

³⁹*Id.*

army boots or even bullets is a 'commercial activity' because private companies can similarly use sales contracts to acquire goods."⁴⁰

Thus, the court in *Weltover* held that the issuance of bonds by Argentina was a commercial activity since private parties can easily issue bonds.⁴¹

The "private party" test operates with relative ease in the context of FGOs since almost all transactions that are carried out by FGOs could be carried out by private parties. The irony of this test as applied to FGOs is that since most FGOs are engaging in commerce as corporations and not as sovereigns, without the foreign government majority ownership, a FGO would be like any other corporation -- essentially a private party. Thus, the test is almost always fulfilled when a suit is brought on a FGO claiming sovereign immunity.

B. Jurisdictional Nexus Requirements

The commercial activities exception is broken down into three clauses, each identifying an act that is sufficiently connected to the U.S. to fulfill the jurisdictional nexus requirement.⁴² All three clauses require that the cause of action be "based upon" a certain act or activity of a foreign state, in other words the act or activity must form the basis of at least some element of the cause of action.⁴³

The first clause allows jurisdiction when the cause of action is based upon a foreign state's commercial activity carried on in the United States. The FSIA defines the phrase "commercial activity carried on in the United States" as "commercial activity carried on by a (foreign) state and having substantial contact with the United States." Jurisdiction under this clause may be based on an activity carried on only partially in the United States.

The second clause provides for jurisdiction based on "an act performed in the United States in connection with a commercial activity elsewhere." Congress intended a situation involving "conduct of the foreign state in the United States which relates either to a regular course of commercial conduct elsewhere or to a particular commercial transaction concluded or carried out in part elsewhere." Since the second clause is very similar to the first clause, it is rarely used as the basis of subject matter jurisdiction under the FSIA.

⁴⁰*Id.* at 614-15.

⁴¹*Id.* at 615-16.

⁴²The FSIA only establishes subject matter jurisdiction. A plaintiff must still satisfy the "minimum contacts" test to establish personal jurisdiction. The Supreme Court has declined to hold that the "direct effects" requirement of the third clause of the commercial activities exception incorporates the "minimum contacts" test. *See Weltover*, 504 U.S. at 619-20. In some cases, personal jurisdiction and subject matter jurisdiction are easily found together. *See Haniil Bank v. P.T. Negara*, 148 F.3d 127 (2d Cir. 1998).

⁴³*Saudi Arabia v. Nelson*, 507 U.S. 349, 356-58 (1993).

The third clause allows U.S. courts to assert jurisdiction over a foreign state when the cause of action is based "upon an act outside...the United States in connection with a commercial activity...(that) causes a direct effect in the United States." Thus, both the act and the commercial activity can be outside the United States as long as there is a direct effect in the United States. The direct effect provision is addressed in the next subsection.

In *Saudi Arabia v. Nelson*, the U.S. Supreme Court defined the limits of the commercial activities exception. In 1983, agents of Saudi Arabia recruited and hired plaintiff Scott Nelson in the United States to monitor the safety of facilities and equipment at the King Faisal Specialist Hospital in Saudi Arabia.⁴⁴ Nelson alleged that in performing his duties at the hospital, he reported safety violations to a Saudi Arabian investigative commission, and that in retaliation, Saudi officials imprisoned him for thirty-nine days and tortured him. Nelson brought suit in the United States. The district court dismissed the case for lack of subject matter jurisdiction concluding that Nelson's claims were not based upon Saudi Arabia's commercial activities within the United States. The Eleventh Circuit reversed but the Supreme Court affirmed the decision of the district court.

The Supreme Court held that the torture acts committed by Saudi Arabia were not based upon a commercial activity -- the recruitment and employment of Nelson.⁴⁵ The court held that the "based upon" test required something "more than a mere connection with, or relation to, commercial activity."⁴⁶ Courts have interpreted this "based upon" test as those elements of a claim that if proven, would entitle a plaintiff a relief under that claim. Thus, a court has subject-matter jurisdiction over any claims made by a plaintiff in which the elements of the claim require proof of an FGOC's commercial activity in the United States.⁴⁷ For example in *Nazarian v. Compagnie Nationale Air France*, two Iranian passengers on an Air France flight were subjected to severe mistreatment by French authorities during a stopover in Paris, France. The passengers sued Air France under theories of negligence, false imprisonment, false arrest and intentional infliction of emotional distress. Air France is a "foreign state" under the FSIA because the majority of its shares are owned by the Republic of France. The court held that a claim of negligence would require proof of a cognizable duty of care.⁴⁸ By selling its tickets in New York, Air France created a duty of reasonable care in providing safe passage. Thus, the court held that only the negligence action may sustain subject-matter jurisdiction under the FSIA

⁴⁴*Id.* at 351.

⁴⁵*Id.* at 358.

⁴⁶*Id.*

⁴⁷*Nazarian v. Compagnie Nationale Air France*, 989 F. Supp. 504 (S.D.N.Y. 1998).

⁴⁸*Nazarian*, 989 F. Supp. at 509.

because it requires proof of an element that is based upon a commercial activity in the United States.⁴⁹

Thus, with its decision in *Nelson*, the Supreme Court narrowed the application of the first clause of the commercial activities exception.⁵⁰ Despite this limitation, the circuit courts have liberally interpreted other language of the commercial activities exception as discussed in the next section.

C. Direct Effect Under the Third Clause

The Supreme Court's decision in *Republic of Argentina v. Weltover* had a profound effect on the definition of the "direct effect in the United States" language of the third clause of the commercial activities exception. Before *Weltover*, courts applied a "substantial and foreseeable" effect test to interpret the direct effect language.⁵¹ In *Weltover*, the Court resolved any dispute remaining by holding that the FSIA does not contain any requirement of "substantial effect" or "foreseeability."⁵²

In the Court's opinion, "an effect is 'direct' if it follows as an [inevitable and] immediate consequence of the defendant's...activity."⁵³ In *Weltover*, several bondholders sued Argentina and its central bank in the Southern District of New York for breach of contract. The district court denied the motion, and the Second Circuit affirmed. The Supreme Court held that Argentina's unilateral rescheduling of the bond's maturity dates had caused a direct effect in the United States.⁵⁴ The Court stated that because New York was the place of performance for defendants contractual obligations – the payment of funds to a New York bank account – the rescheduling of bonds necessarily had a direct effect in the United States.⁵⁵ Since the *Weltover* decision, federal courts have liberally interpreted the direct effect provision such that the third clause has become the most litigated clause of the commercial activities exception and also the most easily obtainable for lifting sovereign immunity.

⁴⁹ *Id.*

⁵⁰ *But see* *Elliot v. British Tourist Authority*, No. 96 Civ. 9154(HB), 1997 WL 724768 (S.D.N.Y. Nov. 18, 1997) (holding that the hiring and firing of a marketing executive in the United States that works for the British Tourist Authority, an agency of the U.K., is an action based upon a commercial activity in the United States).

⁵¹ *Weltover*, 504 U.S. at 617.

⁵² *Id.* at 618.

⁵³ *Id.*

⁵⁴ *Id.* at 619.

⁵⁵ *But see* *Transatlantic Shiffarrtskontor v. Shanghai Foreign Trade Corp.*, 996 F. Supp. 326, 333 (S.D.N.Y. 1998) (holding that absent contractual obligations for the payment of funds in the United States, no direct effect in the United States is caused).

V. FGOCS UNDER THE COMMERCIAL ACTIVITIES EXCEPTION

This section looks at the way courts have recently applied the commercial activities exception to foreign government-owned corporations seeking immunity in federal court. A number of recent decisions since the Supreme Court's decision in *Weltover* have made the commercial activities exception a much easier exception to achieve. This section looks at four recent decisions by the federal courts on the commercial activities exception on FGOCS and then argues that given these decisions, FGOCS really no longer enjoy the sovereign immunity that it may have once had.

A. Recent Decisions on the Commercial Activities Exception for FGOCS

1. *Voest-Alpine v. Bank of China*, (5th Cir. 1998)

In *Voest-Alpine v. Bank of China*, the Fifth Circuit ruled on the applicability of the commercial activities exception to the Bank of China.⁵⁶ The Bank of China is an instrumentality of the People's Republic of China because a majority of its ownership interest is held by the Chinese government. The Bank of China issued a letter of credit in the amount of US\$1.2 million in which Voest-Alpine was the beneficiary.⁵⁷ Due to alleged discrepancies in the documents, the Bank of China refused to remit funds due or claimed by Voest-Alpine to a designated U.S. bank account.⁵⁸ Voest-Alpine filed suit in U.S. court and the Bank of China argued that it was immune as a "foreign state" under the FSIA.⁵⁹

The Fifth Circuit held that the third clause of the commercial activities exception was applicable. The cause of action was based upon an act outside the United States in connection with the Bank of China's commercial activity outside the United States that caused a direct effect in the United States.⁶⁰ The court held that had the Bank of China not found it necessary to refuse payment, it would have wired money directly to Voest-Alpine's Texas bank account. Thus, the court held that Voest-Alpine's non-receipt of funds in its bank account caused a direct effect in the United States.⁶¹ Essentially, the court's holding stands for the notion that a financial loss endured in the U.S. by an American plaintiff is sufficient to cause a direct effect in the United States.

⁵⁶ *Voest-Alpine Trading USA Corp. v. Bank of China*, 142 F.3d 887 (5th Cir. 1998).

⁵⁷ *Id.* at 890.

⁵⁸ *Id.*

⁵⁹ *Id.* at 891.

⁶⁰ *Id.*

⁶¹ *Id.* at 897.

2. *Hanil Bank v. P.T. Negara Indonesia*, (2d Cir. 1998)

In *Hanil Bank v. P.T. Negara Indonesia*, Hanil Bank was a Korean bank doing business in Indonesia.⁶² The defendant, BNI, issued a letter of credit to Kodeco, an Indonesian manufacturer of car radios. Hanil Bank served as the negotiating bank and it was expected that BNI would remit the funds for the letter of credit to Hanil Bank.⁶³ The designated place of payment was a New York bank account. BNI refused to pay the funds and Hanil Bank filed suit in the New York State Supreme Court. After removing the action to federal court, BNI contended that it was immune from suit under the FSIA.

The court found that BNI was a “foreign state” by virtue of the fact that it was owned by the Indonesian government.⁶⁴ The Second Circuit held that the third clause of the commercial activities exception applied and that Hanil Bank’s failure to pay on a letter of credit in a New York bank account caused a direct effect in the United States.⁶⁵ The court eventually held that the commercial activities exception applied to BNI and that Hanil Bank had jurisdiction in the breach of contract claim.⁶⁶ Thus, in *Hanil Bank*, a breach of contract between a Korean Bank and an Indonesian FGOC, where the only connection to the United States was the funds of a letter of credit that were to be deposited in a New York bank account, satisfied the jurisdictional nexus requirement for the commercial activities exception.⁶⁷

3. *Adler v. Federal Republic of Nigeria*, (9th Cir. 1997)

A United States citizen, Adler, contracted with the Republic of Nigeria, the Nigerian National Petroleum Corporation (“NNPC”) and the Central Bank of Nigeria.⁶⁸ Both NNPC and the Central Bank qualified as “foreign states” under the FSIA as they are owned by the Nigerian government. The contract provided that Adler would denote a non-Nigerian bank account into which the money owed to him would be transferred. When Nigeria failed to pay, *Adler* filed suit in the United States asserting that Nigeria’s failure to pay had caused a direct effect under *Weltover*.⁶⁹

The court ruled that Nigeria had engaged in a commercial activity by entering into an agreement for the assignment of a contract in exchange for

⁶² *Hanil Bank v. P.T. Negara Indonesia*, 148 F.3d 127, 129 (2d Cir. 1998).

⁶³ *Id.* at 130.

⁶⁴ *Id.*

⁶⁵ *Id.* at 133.

⁶⁶ *Id.* at 134.

⁶⁷ *See also* *Commercial Bank of Kuwait v. Rafidain Bank*, 15 F.3d 238, 241 (2d Cir. 1994) (holding that Iraqi banks’ “failure to remit funds in New York, as they were contractually bound to do, had a direct effect in the United States under *Weltover*”).

⁶⁸ *Adler v. Federal Republic of Nigeria*, 107 F.3d 720, 722 (9th Cir. 1997).

⁶⁹ *Id.* at 723.

consideration.⁷⁰ The court rejected the Nigerian government's argument that the contract made was of a sovereign nature -- the right to distribute government funds and collect government revenue.⁷¹ The court stated that this rationale would make all government contracts sovereign in nature and that the correct test was the "private person" test in *Weltover*. Furthermore, the Court held that Nigeria's failure to make payments in a New York bank account caused a direct effect in the United States.⁷² Thus, *Adler* shows that even a contract that potentially involved some sovereign activity could still be classified as a commercial activity as long as a private party could perform that activity.

4. *Aldy v. Valmet Paper Machinery, (5th Cir. 1996)*

Charles Aldy was crushed to death while working in a paper machine at the Stone Container Corporation's paper mill in Louisiana.⁷³ Aldy's wife and daughter brought suit against Valmet Paper Machinery, the manufacturer of the paper machine. Valmet is a FGOE owned by the government of Finland and operating in Finland. Valmet Machinery alleged that it was immune from suit under the Foreign Sovereign Immunities Act.⁷⁴

The Fifth Circuit held that the third clause of the FSIA applied to Valmet. The Aldys' suit was based upon acts that occurred outside the United States. Furthermore, the Fifth Circuit agreed with the Aldys' claim that they satisfied the "in connection" requirements since Valmet Paper is in the business of designing and manufacturing paper machines, and the paper machine that killed Mr. Aldy was one manufactured by Valmet.⁷⁵ Finally, the Fifth Circuit concluded that a direct effect had been caused in the U.S. since Aldy's death occurred as an immediate consequence of the defendant's activity.⁷⁶ Essentially, the court held that a death in the U.S. caused by a product manufactured abroad was enough to satisfy the third clause of the commercial activities exception. *Aldy* is different from other cases because it involves a tort claim rather than a contract claim. Furthermore under *Aldy*, a direct effect in the United States does not have to be a financial loss but can be expanded to include any harm on persons in the United States.

⁷⁰ *Id.* at 726.

⁷¹ *Id.* at 725.

⁷² *Id.* at 727.

⁷³ *Aldy v. Valmet Paper Machinery*, 74 F.3d 72, 73-74 (5th Cir. 1996).

⁷⁴ *Id.* at 74.

⁷⁵ *Id.*

⁷⁶ *Id.* at 74-75.

B. The Effect of the Commercial Activities Exception on FGOCs

As stated in Part II, it is generally easy for a FGOC to claim sovereign immunity under the FSIA. All FGOCs will meet the definition of a "foreign state" if more than 50 percent of their shares are owned by a foreign government. Furthermore, ownership of a corporation can be pooled together to achieve a majority ownership interest and a "foreign state" status. Finally, indirect ownership by a country or several countries through agencies or instrumentalities still allow sovereign immunity to apply. It would seem that all FGOCs then would be immune from suits in U.S. courts given the ease in which courts have allowed "foreign state" status to be conferred. Also, by virtue of obtaining a foreign state recognition, the burden then shifts to the plaintiff to establish an exception to the immunity.

However, the general trend seems to be that suits are not barred against FGOCs because of the ease in obtaining jurisdiction under the commercial activities exception. As stated in Part IV, there are three clauses to the exception that can be applied to a FGOC: (1) where a commercial activity has been carried out in the U.S.; (2) where the act in the U.S. is in connection with a commercial activity of a foreign state elsewhere; (3) where the act and commercial activity are outside the United States but the act causes a direct effect in the U.S.

A "commercial activity" is defined as virtually anything a private party can accomplish on its own -- corporations almost always fit this description. There are very few activities a corporation can do that involve sovereign governmental activities. Where FGOCs have attempted to invoke that argument it has failed, as in *Adler*. Most transactions carried out by a FGOC can easily be done by a corporation that is not owned by a foreign government. In fact, one can argue that the inherent purpose of a corporation is to carry out a commercial activity.

The "in connection with" requirement has also been liberally defined to involve any causal connection between an act and a commercial activity in most cases. Finally, under the third clause of the commercial activities exception, a "direct effect" caused in the United States is anything of immediate consequence of the commercial activity. Thus, in *Voest-Alpine*, failure to remit funds to a U.S. bank account was enough.⁷⁷ In *Hanil Bank*, the entire act and commercial activity was outside the U.S., but since funds were to be deposited in a New York bank account, that proved enough for the court even though New York may not have been the final destination of the funds. In *Aldy*, a paper machine manufactured in Finland but which caused a death in the U.S. was also enough to satisfy the direct effect provision.⁷⁸

⁷⁷ *Voest-Alpine*, 142 F.3d at 894.

⁷⁸ *Aldy*, 74 F.3d at 75.

Thus, after the rejection in *Weltover* of a "substantial and foreseeable" test by the Supreme Court, the circuit courts have liberally interpreted the direct effect requirement as essentially any remote harm that may occur in the United States even if it involves the non-deposit of funds in a U.S. bank account. The effect of this ease in obtaining the commercial activities exception on U.S. businesses will be discussed later.

It should be noted that there are decisions where courts have decided that the application of the commercial activities exception is so far remote that they have denied jurisdiction over FGOCS. Although it has been argued that the exception is easy to obtain, granting the exception in some cases would be absurd and some courts have recognized this fact. In *Nordmann v. Thai Airways Int'l., Ltd.*, the Ninth Circuit rejected the argument that Thai Airways, a FGOCS, fell within the commercial activities exception.⁷⁹ The appellants argued that Thai Airways' acceptance of payment through use of a credit card which was issued by a bank located in the United States and claim for payment against the bank constituted a direct effect of the Thai Airways' crash.⁸⁰

The court held that Thai Airways' acceptance of payment was not a direct effect of the plane crash but rather the acceptance of payment was a direct effect of the purchase.⁸¹ Thus, the court found, under *Nelson*, that the act upon which the action was based did not cause a direct effect in the United States.

Furthermore, in *Randolph v. Budget Rent-A-Car*, a student trainee on a scholarship from Saudi Arabia took a trip away from his Texas school to California at his own expense.⁸² While there, he negligently drove a privately-rented vehicle and injured a motorcyclist. The Ninth Circuit held that "the specific acts of which the plaintiff complains did not arise out of Saudi's commercial activity (providing a scholarship) in the United States."⁸³

Finally, in *Pere v. Nuovo Pignone, Inc.*, Nuovo Pignone was an Italian government-owned corporation (through tiering) that designed and manufactured turbine systems.⁸⁴ The turbines were sent to a corporation in the United States for testing, and Pere was killed during this testing.⁸⁵ Pere's survivors sued and Nuovo claimed sovereign immunity. The Fifth Circuit refused to apply the commercial activities exception to Nuovo finding that there was no material connection between Nuovo's commercial activity and the wrongful death of Pere. Unlike *Aldy*, the important prong in *Pere* was

⁷⁹*Nordmann v. Thai Airways Int'l., Ltd.*, 112 F.3d 517 (9th Cir. 1997).

⁸⁰*Id.*

⁸¹*Id.* at 518.

⁸²*Randolph v. Budget Rent-a-Car*, 97 F.3d 319, 323 (9th Cir. 1996).

⁸³*Id.* at 324.

⁸⁴*Pere v. Nuovo Pignone, Inc.*, 150 F.3d 477, 479 (5th Cir. 1998).

⁸⁵*Id.*

the “in connection with” language of the FSIA. The court found that once the components were delivered in the United States, consultation between Nuovo and the U.S. corporation doing the testing ceased.⁸⁶ Thus, the court held that the “in connection with” requirement of the second clause did not apply.

Although there has been a liberal application of the elements of the commercial activities exception, courts have drawn lines to prevent suits with remote connection with the United States from being litigated in federal court as in *Nordmann, Randolph* and *Pere*.⁸⁷ However, there are only a limited number of cases where the commercial activities exception has not been applied in U.S. case law.

VI. THE EFFECTS OF THE FSIA FOR U.S. BUSINESSES

A. Uncertainty in Transactions

While this paper argues that the commercial activities exception in most cases easily lifts the sovereign immunity of a FGOC, the initial grant of immunity on FGOCs can cause some uncertainty for U.S. businesses. Plaintiffs often find out too late that the corporation with whom they have transacted enjoys a special status.⁸⁸ Usually, the identity of the corporation as a “foreign state” is unknown to a U.S. business dealing with a foreign corporation, especially if the foreign state status is conferred by majority ownership.⁸⁹ American businesses may not have access to a foreign corporation’s corporate ownership shareholder information. Also, the foreign corporation may not wish to reveal to a U.S. business its corporate ownership structure. A corporation’s name, such as Valmet Paper Machinery, does not reflect that the corporation is owned by a foreign state. Moreover, many U.S. businesses may not be aware of the FSIA and the fact that a FGOC could be immune from suit in the U.S. if a breach of contract occurs.

B. Procedural Burdens of the FSIA

There are a number of cumbersome procedural burdens that the FSIA and the commercial exceptions confers upon the plaintiff and defendant.

⁸⁶ *Id.* at 482.

⁸⁷ See also *Montanez v. Banco Progresso Int’l de Puerto Rico*, 973 F. Supp. 89, 94 (D.P.R. 1997) (holding that the acquisition of private banking corporations by a semi-autonomous governmental agency pursuant to emergency efforts to alleviate a nationwide banking crisis is not a commercial activity under the Foreign Sovereign Immunities Act).

⁸⁸ See, e.g., *O’Connell Mach., Co. v. M.V. “Americana”*, 566 F. Supp. 1381, 1383 (S.D.N.Y. 1983) (fact that Italian Line was a shipping company “indirectly owned” by Italian state enterprise FINMARE was disclosed to plaintiff several weeks after complaint was filed).

⁸⁹ See Hoffman, *supra* note 15, at 567.

The FSIA provides for a shifting burden of proof on the establishment of immunity.

The entity sued must first show that it is a "foreign state" under Section 1603.⁹⁰ The burden then shifts to the plaintiff to show an applicable exception to the general rule of immunity. Thus, the plaintiff has the burden to show that the commercial activities exception is applicable. However, the ultimate burden is on the state to prove that the exception is inapplicable.⁹¹ Thus, the plaintiff and defendant are thrust into a labyrinth of shifting burdens of proof under the FSIA. This forces a plaintiff to prove an exception to the sovereign immunity of a FGOC which can cause a great degree of uncertainty for U.S. businesses. Furthermore, in most cases, there is no debate about whether a corporation is foreign government-owned since all that is required is a majority (over 50 percent) of ownership by the foreign government. Thus, the presumption remains strong that a FGOC will have sovereign immunity and the burden is on the plaintiff to prove an exception.

C. Precautions for U.S. Businesses

There are a number of precautions that U.S. businesses can take to avoid being faced with a sovereign immunity defense from a FGOC and having to argue an exception to the FSIA. These exceptions require that the U.S. business have knowledge that (a) the foreign corporation involved in the transaction is owned by a foreign government, and (b) that an FGOC is entitled to immunity under the FSIA. As stated above, the former will pose a difficulty in some circumstances while the latter just requires good lawyering.

A U.S. business should specifically ask for the identity of the owners of the corporation. More preferable is to ask for the ownership hierarchy given the fact that pooling is allowed between several states. However, even with knowledge of the owners of the shares of the foreign corporation, a U.S. business should investigate further back into the chain of ownership given that tiering is allowed in some circuits.

A U.S. business involved in a transaction with a FGOC should structure that transaction so that it has some connection with the United States to satisfy the "in connection with" requirement of the second clause. As stated in Part IV, a non-U.S. business should structure a transaction so that the remittance of funds occurs in a United States bank account. This factor satisfies the jurisdictional nexus of the "direct effect" test of the third clause of the commercial activities exception. This is true even if the U.S. bank account is not the final destination of the funds. The deposit of funds in the

⁹⁰ *Id.*; see also *Joseph v. Office of the Consulate Gen. of Nig.*, 830 F.2d 1018, 1021 (9th Cir. 1987); *Meadows v. Dominican Republic*, 817 F.2d 517, 522 (9th Cir. 1987); *Alberti v. Empresa Nicaraguense de la Carne*, 705 F.2d 250, 255-56 (7th Cir. 1983).

⁹¹ *Hoffman*, *supra* note 15.

United States seems to be the safest way of structuring a transaction so that the commercial activities exception will be satisfied.

U.S. businesses may also ask for an explicit waiver of the immunity of a foreign state by a specific provision in the contract during the negotiation of a transaction. The FSIA provides for this explicit waiver of immunity and explicit waivers have never been the subject of judicial scrutiny.⁹² A FGOC may also impliedly have waived its sovereign immunity although this has been the source of much debate. Most courts have construed the implied waiver exception narrowly and have generally declined to go beyond Congress's list of examples of implied waiver in the Act's legislative history. These examples include: (1) cases in which foreign states agree to arbitration in the United States, (2) cases in which foreign states agree that the law of the United States should govern and (3) cases in which a foreign state has filed a responsive pleading in an action without raising the defense of sovereign immunity. Courts have usually required some evidence that the foreign state has intended to waive its immunity under the FSIA before they find that the foreign state has impliedly done so.⁹³

VII. GETTING RID OF SOVEREIGN IMMUNITY FOR FGOCS.

No other country in the world has adopted state ownership as a basis for conferring sovereign legal status on commercial corporations.⁹⁴ Since 1976, most jurisdictions that have codified the restrictive theory have expressly rejected the idea, choosing to codify the separate entity rule.⁹⁵ Section 1603(b) is directly contrary to the international practice of conferring sovereign immunity.

Under current law, entities with separate legal personality enjoy a "presumption of independent status" for purposes of liability.⁹⁶ Separate entities cannot be held liable for obligations of a foreign state (or another separate entity) unless the court finds an alter ego relationship exists between the two.⁹⁷ For immunity purposes, Section 1603(b) confers sover-

⁹² *Id.*

⁹³ *See* *Pere*, 150 F.3d at 482 (holding that *Nuovo Pigone* did not impliedly waive its sovereign immunity when it agreed in the contract that the laws of Texas would govern the performance or execution of the contract; implied waiver must be construed narrowly).

⁹⁴ *Hoffman*, *supra* note 15.

⁹⁵ *Id.*

⁹⁶ *See* *First Nat'l Bank v. Banco Para El Comercio Exterior de Cuba* (*Bancec*), 462 U.S. 611, 629 (1983).

⁹⁷ *See id.* (stating that the elements of an "alter ego" doctrine is "where a corporate entity is so extensively controlled by its owner that a relationship of principle and agent is created, we have held that one may be held liable for the actions of the other. In addition, our cases have long recognized 'the broader equitable principle that the doctrine of corporate entity, recognized generally and for most purposes, will not be regarded when to do so would work fraud or injustice.'"); *see also* *Hester Int'l Corp. v. Federal Republic of Nigeria*, 879 F.2d 170, 181 (5th Cir. 1989).

eign immunity over an FGOC as it was the state itself. However, for liability purposes, that same entity can claim it is separate from the state to such a degree that it cannot be identified with the state. Thus, there is a great inconsistency associated with Section 1603(b) in relation to the separate entity rule.

The purpose of the restrictive theory of sovereign immunity as stated in Part II is to prevent conferring sovereign immunity on a foreign state for their commercial activities. However, even the initial grant of sovereign immunity to a FGOC, which by nature, as a corporation, is almost always engaged in commercial activities, runs contrary to the very purpose of restrictive sovereign immunity. Thus, there is an inherent contradiction in granting an FGOC sovereign immunity.

Furthermore, current FSIA case law runs contrary to the very purpose of sovereign immunity. A number of circuits allow pooling and tiering of the ownership structure. Under pooling, a corporation owned by numerous countries can satisfy the presumption of immunity. However, the very purpose of sovereign immunity is to prevent jurisdiction over one country and its entities in U.S. courts. Allowing pooling of corporations has opened up sovereign immunity to a large number of multinational corporations and countries. Ten countries could own a 5 percent share in a corporation with the eleventh country owning a 1 percent share, and that corporation would be presumed immune from suit until an exception is invoked. Under tiering, a corporation could be owned by an agency of a state government. As the Ninth Circuit pointed out in *Aldy*, this could lead to immunity for every subsidiary in a corporate chain. Granting immunity even when the government is separated by five links in the chain of ownership also destroys the very purpose of sovereign immunity. Thus, pooling and tiering lead to absurd conclusions and both doctrines should be discarded.

As stated above, the granting of immunity under the FSIA causes a great deal of confusion and contradiction. However, that confusion is heightened by the fact that sovereign immunity is almost never sustained on a FGOC because the commercial activities exception is almost always applicable. The definition of a commercial activity in *Weltover* is anything a private person can accomplish. Thus, corporations fall nicely within this definition. The "direct effect" test in the third clause of the FSIA has a broad definition that is easy to meet as evidenced in *Voest-Alpine*, *Hanil Bank*, *Adler*, and *Aldy*. Thus, even though a FGOC initially gets immunity, it soon loses it under the commercial activities exception.

Moreover, the very potential of immunity from suit on a FGOC causes a great degree of uncertainty for U.S. and foreign businesses, and requires them to take extra precautions. The FSIA hurls them into a labyrinth of shifting burdens when suit has been filed. Also, the FSIA grants jurisdiction to FGOCs with very remote connections to the United States. FGOCs structuring their transactions to involve the deposit of funds in a U.S. bank

account could very well find themselves sued in a U.S. court. U.S. federal courts could become a forum for foreign countries to litigate their claims. This could lead to a great burden on many federal court dockets.

Given the confusion and absurdity caused by the FSIA, FGOs should be removed from the definition of a foreign state under Section 1603(b). Before the FSIA was enacted, FGOs were not granted sovereign immunity and this policy should have been maintained. There is no reason why a commercial entity owned by a government but engaging in private commercial transactions should be initially granted immunity. Furthermore, there is no reason why a plaintiff in a lawsuit should bear the burden of proving an exception. At the very least, if there should be a FGO that is involved in sovereign activities, U.S. law should allow the defendant to have the option of proving that it is engaged in a sovereign function and require the defendant to bear the burden of proof. The defendant will thus bear the burden of showing a non-commercial function and of proving that its acts are within the scope of a sovereign function. In this case, the "private party" test from *Weltover* can still be used because FGOs involved in private person activities will not be able to meet the burden of showing sovereign activities. This option will be more in line with the doctrine of restrictive immunity, it will rid the procedural burden shifting that a U.S. business must bear and it will provide a degree of confidence to U.S. businesses that their claims can be adjudicated in U.S. courts.

