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**AN AGENCY OR INSTRUMENTALITY
IN THE UNITED STATES FOREIGN SOVEREIGN IMMUNITIES ACT OF 1976:
AN UNAUTHORIZED CHINESE VIEW**

Weimin Wang

**Thesis submitted to
the School of Graduate Studies and Research
in partial fulfilment of the requirement for
LL.M. degree**

University of Ottawa



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All the deficiencies of this piece are those of the writer's himself, and shall by no means be attributed to the persons above.

Weimin Wang

September 1990

Dedicated to
all from whom I learned

AN AGENCY OR INSTRUMENTALITY
IN THE UNITED STATES FOREIGN SOVEREIGN IMMUNITIES ACT OF 1976:
AN UNAUTHORIZED CHINESE VIEW

Legal theories are the creation of the human mind. The jurist who proposes a new theory wants us to believe that the facts of social and economic life correspond to his abstractions. Unfortunately this is not always the case. Sometimes these attempts at systematization break down on the harsh realities of life.
---Clive M. Schmitthoff¹

INTRODUCTION

Foreign sovereign immunity is the doctrine² of international

¹. C.M. Schmitthoff, *Agency in International Trade: A Study in Comparative Law*, in CLIVE M. SCHMITTHOFF'S SELECT ESSAYS ON INTERNATIONAL TRADE LAW, 306, 308 (Chia-Jui Cheng ed. 1988).

². Nations have not agreed on the doctrine of sovereign immunity. The courts of every country differ in their application of it. Some grant absolute immunity; others grant limited immunity, with each defining the limits differently. There is no consensus whatsoever. Yet this does not mean that there is not a rule of international law on the subject. It only means that we differ as to what the rule is. Each country delimits for itself the bounds of sovereign immunity. Each creates for itself the exceptions from it. It is, I think, for the courts of each country to define the rule as best as they can, seeking guidance from the decisions of the courts of other countries, from the jurists who have studied the problem, from treaties and conventions and, above all, defining the rule in terms which are consistent with justice rather than adverse to it.

Taslim O. Elias, as Judge and President International Court of Justice. T. Elias, *THE INTERNATIONAL COURT OF JUSTICE AND SOME CONTEMPORARY PROBLEMS* 172 (1983).

There is no international consensus on the doctrine of sovereign immunity so far. The International Law Commission [hereinafter ILC] of the United Nations has been considering setting down internationally recognized rules in this respect. See

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law under which foreign states are deemed not susceptible to the jurisdiction of domestic courts.³ It has long been an area of controversy in international law to determine the appropriate circumstances under which this immunity should be granted.⁴ This determination is rendered more difficult as international trade comes into play between states with differing views of government's role.⁵

The United States Foreign Sovereign Immunities Act⁶ was the

Report of the International Law Commission on the Work of its Thirty-sixth Session, 39 U.N. GAOR Supp. (No. 10), U.N. Doc. A/39/10 (1984) [hereinafter *U.N. 1984 Report*]; Report of the International Law Commission to the General Assembly, 41 U.N. GAOR Supp. (No. 10), U.N. Doc. A/41/10 (1986) [hereinafter *U.N. 1986 Report*]; see also McCaffrey, *Current Developments: The Thirty-sixth Session of the International Law Commission*, 79 AM. J. INT'L L. 755, 762 (1985). Comment, *International Law Commission's Draft Convention on the Jurisdictional Immunities of States and Their Property*, 17 DEN. J. INT'L L & POL'Y 395 (1989) (authored by V. Morris) [hereinafter *Draft Convention*].

³. H. R. REP. No. 94-1487, 94th Cong., 2d Sess., at 8, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS 6604, 6606 [hereinafter *HOUSE REPORT*]. See also 2 D. O'Connell, *INTERNATIONAL LAW* 913 (1965); 1 L. Oppenheim, *INTERNATIONAL LAW* §115a(8th ed. H. Lauterpacht ed. 1952).

⁴. Recent Developments, 5 BROOKLYN J. INT'L L. 191, 191 (1979) [hereinafter *Recent Developments*]; 1 H. Lauterpacht, *INTERNATIONAL LAW* 484, 486 (1970); 2 D O'Connell, *id.*, at 913 et seq.

⁵. McCormick, *The Commercial Activity Exception to Foreign Sovereign Immunity and the Act of State Doctrine*, 16 LAW & POL'Y INT'L BUS. 477, 477 (1984).

⁶. Pub. L. No. 94-583, 90 Stat. 2891 (1976), codified at 28 U.S.C. §§1330, 1332(a)(2)-(4), 1391(f), 1441(d), 1602-1611 (1982) [hereinafter *U.S. FSIA, FSIA, 1976 Act, or Act*].

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first national attempt to codify the rules of foreign sovereign immunity⁷. The Act extends to foreign states (including their agencies or instrumentalities)⁸ immunity from jurisdiction⁹, the property of foreign states immunity from attachment and execution¹⁰, subject to various exceptions and qualifications.¹¹ After thirteen years of application since its enactment,¹² the U.S. Congress is considering amendments "to enhance its operation".¹³

⁷. See Feldman, *The United States Foreign Sovereign Immunities Act of 1976 in Perspective: A Founder's View*, 35 INT'L & COMP. L. Q. 302, 303 (1986).

Canada adopted its State Immunity Act in July, 1982. For general introduction, see Molot & Jewett, *The State Immunity Act of Canada*, 20 CAN. Y.B. INT'L L. 79 (1982).

⁸. 28 U.S.C. §1603(a).

⁹. 28 U.S.C. §1604.

¹⁰. 28 U.S.C. §1609.

¹¹. 28 U.S.C. §§1605, 1610.

¹². The FSIA was enacted on October 21, 1976 and became effective on January 19, 1977. von Mehren, *The Foreign Sovereign Immunities Act of 1976*, 17 COLUM. J. TRANSNAT'L L. 33, 33 n.1 (1978).

¹³. Note, *Amending the Foreign Sovereign Immunities Act of 1976 to Better Accommodate Non-Market Economies*, 8 MICH. Y.B. INT'L LEGAL STUD. 159, 160 n9 (1987)[hereinafter *Non-Market Economies*].

The amendments, proposed by Senator Charles McC. Mathias (R., Md.), deal with

"the effect of arbitration agreements on sovereign immunity, limitations on the defense of act of state in expropriation and breach of contracts cases, prejudgment attachments of foreign governmental agency property, execution of judgments on commercial property of foreign governments and their agencies, admiralty claims against foreign governmental shipping, and treatment of governmental loan transactions as commercial activity not entitled to sovereign immunity under the Act."

Atkeson & Ramsey, *Proposed Amendment of the Foreign Sovereign Immunities Act*, 79 AM. J. INT'L L. 770, 771 (1985). For the proposed

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Although the proposed amendments seek further limitations of immunity enjoyed by foreign states under the FSIA,¹⁴ some writers commenting on the Act's impact on different economic structures have been arguing that it fails to correct the Act's greatest deficiency, i.e. its inadequacy in cases involving non-market economies,¹⁵ that the resulting ambiguities work to the disadvantage of U.S. firms in litigable disputes with Socialist States.¹⁶

This article seconds the view that the Act fails to account for the ideological and economic differences between market and

amendments, see S. 1071, 99th Cong., 1st Sess., 131 Cong. Rec. S5363 (daily ed. May 3, 1985).

¹⁴. See generally, *id.*.

¹⁵. *Non-Market Economies*, *supra* note 13, at 160 and general. Non-market economy here refers to an economy in which the major means of production are owned by the state, individual property and contract rights are secondary to the dictates of the national economy, and economic decisions are made according to a government plan that may or may not be profit-oriented, as opposed to a market economy, in which a high regard for the exercise of free economic competition persists, and the government basically preserves and encourages competitive pricing, profit based decision-making, and individual or corporate rights to own productive property and to contract freely. See Note, *Breaking Out of Capitalist Paradigm: The Significance of Ideology in Determining the Sovereign Immunity of Soviet and Eastern-Bloc Commercial Entities*, 2 *Hous. J. INT'L L.* 425, 426 (1980) [hereinafter *Capitalist Paradigm*].

¹⁶. *Capitalist Paradigm*, *id.*, at 434 and general.

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non-market economies;¹⁷ As a result, the Act, with its provision of the definition of agencies and instrumentalities, has generated two major defects with regard to socialist economies under reform. One well discussed defect is the fact that almost all the foreign trade corporations from the socialist economies will be categorized under the Act as agencies or instrumentalities of the state for the purpose of sovereign immunity. The second defect, which has not attracted sufficient attention, arises from the proximity of the term "agencies or instrumentalities" in the jurisdiction stage to the factual identification of the relationship of the corporation with the government in the substantive stage, and the resulting likelihood that the term's influence be brought into the liability distribution stage. These two defects reflect a failure of the Act to appreciate the subtle differences between state-owned corporations from non-market economies and government-owned corporations from market economies, a failure which has also worked to the disadvantage of enterprises and governments of non-market economies.¹⁸

¹⁷. *Non-Market Economies*, supra note 13, at 160; see also *Capitalist Paradigm*, supra note 15, at 426; Recent Developments, *Foreign Sovereign Immunity - Communist and Socialist Organizations - Effect of State's System of Property Ownership on Determination of Agency or Instrumentality Status under the Foreign Sovereign Immunities Act of 1976*, 9 GA. J. INT'L & COMP. L. 111, 121-22 (1979) [hereinafter *Property Ownership*].

¹⁸. *Scott v. People's Republic of China*, No. CA3-79-0836-D (N.D. Tex. filed June 29, 1979); for brief introduction, see Comment, *China's Stance on Sovereign Immunity: A Critical Perspective on Jackson v. People's Republic of China*, 22 COLUM. J. TRANSNAT'L L. 101, 127-28 (1983) [hereinafter *China's Stance*]; *First*

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While the Act manifested a desire to discontinue the allegedly competitive advantages often gained through immunity from lawsuits, by sovereigns engaged in state trading or other commercial activities,¹⁹ to simply label foreign state-owned enterprises from large non-market economies as agencies or instrumentalities of the foreign state on the basis of U.S. concepts of economic structures without a proper understanding of the target economy, is far from commendable practice in framing the standard for foreign sovereign immunity practice; the effects of such a standard in identifying the beneficiaries of immunity are definitely felt beyond the national boundary. What is more serious is the harassment of state-owned enterprises and of the state, and the inequity of opening up the possibility of holding the foreign government liable for the wrongs of its state-owned enterprises, or vice versa.²⁰

This is the problem that this article seeks to tackle. It first examines the FSIA and the development of foreign sovereign

National City Bank v. Banco Para El Comercio Exterio de Cuba, 103 S. Ct. 2591 (1983) [hereinafter *Bancec*].

¹⁹. *Capitalist Paradigm*, *supra* note 15, at 426.

"In a modern world whose foreign state enterprises are every day participants in commercial activities, H.R. 11315 [FSIA] is urgently needed legislation." HOUSE REPORT at 7, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS, *supra* note 3, at 6605.

²⁰. The Canadian Act uses the term "agency", yet avoids any market economy terms in interpreting the concept. For comparative analysis of U.S., Canadian and other national legislations and international conventions, see *infra* notes 374-399 and accompanying text.

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immunity in general, and then turns to elaboration and analysis of the definition of "agency or instrumentality" and submits some theoretical questions about its application to entities from non-market economies, especially those from a non-market economy under reform, using China during 1979-1989 as an example. Chapter Three lays out the differences of business and economic entities between the market and non-market economies in the attempt to illustrate the conceptual disparity about the nature and function of public enterprises. Chapter Four discusses the practical inapplicability of the majority ownership definition of "agencies or instrumentalities" and its possible association with the piercing of the corporate veil. The paper ends with the suggestion that the U.S. Congressional introduction of the concept of agency or instrumentality into the FSIA is detrimental to promoting business with non-market economies and that the British modality of defining the foreign sovereign is closer to the economic and business reality with respect to non-market economies.

The whole piece is devoted to suggesting an alternative to eradicating the defects of the Act and bringing about a realistic standard in identifying state organs from non-market economies. It is sincerely hoped that the discussion could draw more attention to the issue of foreign sovereign immunity, which, if properly addressed and managed, could contribute to facilitating international trade for a better world.

CHAPTER ONE: THE US FOREIGN SOVEREIGN IMMUNITIES ACT OF 1976:
THE GENERAL LEGAL REGIME

I. The Historical Background to Sovereign Immunity in the U.S.²¹

The doctrine of sovereign immunity dictates that nations grant immunity from suit to sister nations in certain aspects of their relationships.²² It originated in an era when Kings could do no wrong²³ and when the exercise of authority by one state over another was regarded as an affront to the dignity of the sovereign.²⁴ The doctrine is grounded in the notions of sovereign infallibility and independence; the equality and dignity of all nations;²⁵ international comity, reciprocity, and privilege.²⁶ Much of the doctrinal development took place during the nineteenth

²¹. For more eloquent history, see R. Klein, SOVEREIGN EQUALITY AMONG STATES--THE HISTORY OF AN IDEA (1974).

²². BLACK'S LAW DICTIONARY 1188 (5th ed. 1979).

²³. *Rex non potest peccare, id.*

²⁴. 1 H. Lauterpacht, *supra* note 4, at 483;

²⁵. The concept of sovereign immunity was given expression by the Latin maxim *par in parem non habet imperium* - no state can claim jurisdiction over the other. See 1 L. Oppenheim, *supra* note 3.

²⁶. The fact that bringing a foreign sovereign into court hampers the conduct of foreign relations is another justification advanced for the sovereign immunity. Fensterwald, *Sovereign Immunity and Soviet State Trading*, 63 HARV. L. REV. 614, 616-17 (1950).

century, when sovereign involvement in international trade was minimal.²⁷

The doctrine was first defined in U.S. courts in the landmark case of *The Schooner Exchange v. McFadden*.²⁸ Chief Justice Marshall, in granting immunity to a French warship docked in Philadelphia, upheld the absolute or classical theory that sovereign States can in no instance be subjected to the jurisdiction of foreign courts without their consent.²⁹ Courts,

²⁷. Fenstenwald, *id.*; G.M. Badr, STATE IMMUNITY, AN ANALYTICAL AND PROGNOSTIC VIEW, 73-78 and general (1984).

²⁸. 11 U.S. (7 Branch) 116 (1812). Although one might find antecedents in decisions of English or U.S. courts before 1880, or in the writings of well-known authorities on international law of that time, it has been argued that U.S. courts were the first to announce a theory of immunity for foreign states and their agents - foreign sovereign immunity in its modern sense, as opposed to the earlier personal immunity of foreign sovereigns and their ambassadors. The central case was *The Schooner Exchange v. McFadden*.

²⁹. One sovereign being in no respect amenable to another; and being bound by obligations of the highest character not to degrade the dignity of his nation, by placing himself or its sovereign rights within the jurisdiction of another, can be supposed to enter a foreign territory only under an express license, or in the confidence that the immunities belonging to his independent sovereign station, though not expressly stipulated are reserved by implication, and will be extended to him.

This perfect equality and absolute independence of sovereigns, and this common interest impelling them to mutual intercourse, and an interchange of good offices with each other, have given rise to a class of cases in which every sovereign is understood to waive the exercise of a part of that complete exclusive territorial jurisdiction, which has been stated to be the attribute of every nation.

Id. at 137.

without much to refer to about state trading activities, regarded such words as "absolute" and "exclusive" in the *Exchange* opinion as announcing a theory of absolute immunity for foreign states before U.S. courts.³⁰ Thus until the beginning of the twentieth century the United States, among others³¹, were committed to absolute immunity from suit for foreign states.³²

The decision of the *Schooner Exchange*, nevertheless, also foreshadowed the later development of the restrictive theory of sovereign immunity under which a court will differentiate between a sovereign's public or governmental acts as opposed to acts of a private nature.³³ Immunity is recognized in the case of the former

³⁰. See J.W. Dellapenna, *SUING FOREIGN GOVERNMENTS AND THEIR CORPORATIONS*, 3 n12 (1988).

³¹. Letter from Acting Legal Advisor, Department of State, Jack B. Tate, to Acting Attorney-General, Philip B. Perlman (May 19, 1952), reprinted in 26 DEP'T STATE BULL. 984 (1952) [hereinafter *Tate Letter*].

³². Dellapenna, *supra* note 30, at 3.

For a definition of the absolute theory, see text accompanying *supra* note 29. See also *Tate Letter*, *supra* note 30.

³³. [T]here is a manifest distinction between the private

property of the person who happens to be a prince, and that military force which supports the sovereign power, and maintains the dignity and the independence of a nation. A prince, by acquiring private property in a foreign country, may possibly be considered as subjecting that property to the territorial jurisdiction; he may be considered as so far laying down the prince, and assuming the character of a private individual; but this he cannot be presumed to do with respect to any portion of that armed force, which upholds his crown, and the nation he is entrusted to govern.

(*jure imperii*) but not in the latter (*jure gestionis*),³⁴ a view that is now generally recognised in most of the developed economies³⁵.

In 1952, in what later became known as the "Tate Letter"³⁶, the U.S. State Department announced explicitly that it would thereafter adhere exclusively to the restrictive theory of foreign sovereign immunity³⁷. Despite this proclamation, the State Department continued to issue recommendations to the judiciary

11 U.S. at 145. For analysis, see Dellapenna, *supra* note 30, at 2-3.

³⁴. The rationale behind this distinction is that if a state engages in business with private persons or corporations, it would be unfair if it was immune from the jurisdiction of the courts of the state where the transaction was concluded.

³⁵. See generally, Sucharitkul, *Immunities of Foreign States Before National Authorities*, 149 RECUEIL DES COURS 87 (1976); Lauterpacht, *The Problem of Jurisdictional Immunity of Foreign States*, 28 BRIT. Y.B. INT'L L. 228 (1951). McCormick, *supra* note 3, at 483-84.

³⁶. *Supra* note 31.

³⁷. *Tate Letter*, *supra* note 31. The decision was based upon a desire to seek consistency "with the action of the Government of the United States in subjecting itself to suit" in domestic courts, and with the long-established policy of the United States in not claiming immunity in foreign jurisdictions for its merchant vessels since "the Department feels that the wide spread and increasing practice on the part of governments of engaging in commercial activities makes necessary a practice which will enable persons doing business with them to have their rights determined in the courts". *Id.*.

regarding the grants of sovereign immunity.³⁸ Because of incompatibility between the policy change and "informal practice" of the State Department, and the problems that ensued,³⁹ there came the desire to facilitate and depoliticize litigations against foreign states.⁴⁰

³⁸. See, e.g., *Pan American Tankers Corp. v. Republic of Vietnam*, 291 F. Supp. 49, 51-52 (S.D.N.Y. 1968); *Hellenic Lines, Ltd. v. Embassy of South Vietnam, Commercial Division*, 275 F. Supp. 860, 860 (S.D.N.Y. 1967).

For details, see von Mehren, *supra* note 12, at 40, 41 (1978).

³⁹. The problems included lack of guidelines in aiding the courts, confusing procedures for foreign sovereigns to assert immunity, unpredictability of litigation, difficulty of enforcing judgements, and the political character of the judicial process. *Recent Developments*, *supra* note 4, at 195.

⁴⁰. Letter from Robert S. Ingersoll, Deputy Secretary of State and Harold R. Tyler, Jr., Deputy Attorney-General to the President, United States Senate (Oct. 31, 1975), reprinted in 15 INT'L LEGAL MATS. 88 (1976).

II The U.S. Foreign Sovereign Immunities Act of 1976

The Foreign Sovereign Immunities Act of 1976⁴¹ represents U.S. Congress's attempt to standardize U.S. law governing sovereign immunity by providing federal and state courts with a comprehensive framework to resolve the above-mentioned issues of foreign sovereign immunity.⁴²

It sought to transfer the determination of sovereign immunity from the State Department to the courts⁴³, thereby placing the

⁴¹. The structure of the FSIA's major sections in Title 28 of the United States Code is as follows:

- § 1330: Actions against foreign states (jurisdiction)
 - § 1602: Findings and declaration of purpose
 - § 1603: Definitions
 - § 1604: Immunity of a foreign state from jurisdiction
 - § 1605: General exceptions to the jurisdictional immunity of a foreign state
 - § 1606: Extent of liability
 - § 1607: Counterclaims
 - § 1608: Service; time to answer; default
 - § 1609: Immunity from attachment and execution of property of a foreign state
 - § 1610: Exceptions to the immunity from attachment and execution
 - § 1611: Certain types of property immune from execution
- See Annex.

⁴². The FSIA sets forth the "sole and exclusive standards to be used in resolving questions of sovereign immunity raised by foreign states before Federal and State courts in the United States". HOUSE REPORT at 12, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS, *supra* note 3, at 6610.

⁴³. HOUSE REPORT at 7, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS, *supra* note 3, at 6605-06.

28 U.S.C. §1602. In transferring sovereign immunity determinations from the political branch of the government to the courts, the Act "bring[s] U.S. practice into conformity with that

issues on legal grounds and affording due process guarantees to the litigants.⁴⁴ Furthermore, the Act eliminates the possibility of attaching property of foreign states for obtaining quasi in rem jurisdiction, by providing means of local service of process.⁴⁵ Finally, foreign state's absolute immunity from execution has been qualified to be more compatible with the restrictive theory.⁴⁶

What is significant to countries like the Soviet Union and the People's Republic of China is the fact that the Act codified the basic policy as pronounced in Tate Letter of the restrictive view of foreign sovereign immunity,⁴⁷ in a bid to discontinue the alleged competitive advantages often gained through immunity from law suits, by sovereigns engaged in state trading or other commercial activities.⁴⁸

of most other nations." HOUSE REPORT at 12, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS, *supra* note 3, at 6610.

⁴⁴. HOUSE REPORT at 7, reprinted in 1976 U.S. CODE. CONG. & ADMIN. NEWS, *supra* note 3, at 6606.

⁴⁵. 28 U.S.C. §1608.

⁴⁶. HOUSE REPORT at 8, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS, *supra* note 3, at 6606.

⁴⁷. Letter from Deputy Secretary of State, Robert S. Ingersoll, and Deputy Attorney-General, Harold R. Tyler, Jr., to the Speaker of the House of Representatives, Carl O. Albert (Oct. 31, 1975), HOUSE REPORT at 44, reprinted in 1976 U.S. CODE. CONG. & ADMIN. NEWS, *supra* note 3, at 6634.

⁴⁸. See *supra* note 19 and the accompanying text.

In practice, for the purpose of carrying on international business and trade, the two countries have been realistic to the change towards restricting foreign sovereign immunity in the developed countries including the U.S.⁴⁹ Recently, in a speech delivered to the Sixth Committee of the UN General Assembly, the PRC has conceded that it is instrumental for the development of international contacts and cooperation to provide for exceptions to the doctrine of sovereign immunity in order to maintain a necessary equilibrium between the need to reduce and prevent abuses of domestic judicial procedures against sovereign states and to furnish a reasonable and just dispute resolution mechanism.⁵⁰

⁴⁹. Some business entities in the PRC were obliged to enter into commercial agreements containing sovereign immunity waivers. See *China's Stance*, *supra* note 18, at 125. The PRC is also willing to avail itself of all possible benefits under the foreign domestic codifications of restrictive theory, e.g. by appearing as parties before U.S. courts. *Id.* at 125-29. And the PRC government is also trying to exert all possible influence on the formulation of international rules on foreign sovereign immunity. See *infra* note 50 and accompanying text.

The Soviet Union has been following a practice of entering bilateral treaties in which it consents to subject its state trading enterprises to the jurisdiction of municipal courts in disputes arising out of their commercial activities. See Singer, *Abandoning Restrictive Sovereign Immunity: An Analysis in Terms of Jurisdiction to Prescribe*, 26 HARV. INT'L L. J. (1985) at 6-7.

⁵⁰. The Chinese Delegation has consistently maintained that it is with the aim of reaffirming and strengthening the validity of the international law doctrine of sovereign immunity that the countries are involved in the effort to work out an international law regime for the immunity of states and their property and on this basis, and to proceed from the actual need for international interaction in providing for the exceptions to the doctrine in order to maintain a necessary equilibrium between the need of reducing and preventing abuses of domestic judicial procedures against sovereign states and that of furnishing a reasonable and just dispute resolution

However, this policy ambiguity does not imply that the PRC or U.S.S.R. have not come across any problems in their encounters with the Act. Without these problems, they would not have contended officially that, in theory, the principle of sovereign equality in international law requires that foreign sovereigns be accorded absolute immunity from judicial process in foreign states.⁵¹ In

mechanism.

Address by PRC Representative, Mr. Zhuo Xiaolin, Concerning the Jurisdictional Immunities of States and Their Properties at the Sixth Committee of General Assembly, 44th Sess. Gen. Assemb. UN (Nov. 7, 1989), in Chinese, at 1 [hereinafter PRC Speech]. Judged in comparison to the traditional Chinese approach, the PRC has revealed a willingness to recognise the actuality of "exceptions" to the doctrine of sovereign immunity for the convenience of international business and trade.

⁵¹. Singer, *supra* note 49, at 6.

The Soviet Union used to argue that in socialist states there is no distinction between acts of a socialist state that are of a public nature and acts that are of a private or commercial nature. Osakwe, *A Soviet Perspective on Foreign Sovereign Immunity: Law and Practice*, 23 VA. J. INT'L L. 13, 14 (1982). According to Soviet theory, activities in a socialist country, political as well as economic, are all endowed with the same degree of sovereignty. *Id.*; see also Boguslavsky, *Foreign State Immunity: Soviet Doctrine and Practice*, 10 NETH. Y.B. INT'L L. 167, 169-70 (1979).

China's adherence to the principle of absolute foreign sovereign immunity is based, in part, on reasons similar to those advanced by the Soviet Union. *China's Stance*, *supra* note 18, at 121-22. In addition, the Chinese leadership has a traditional distaste for litigation as a means of dispute settlement. Arbitration is much preferred to adversary judicial proceedings. *China's Stance*, *supra* note 18, at 120-21. Moreover, by holding to absolute immunity as the bottom line in dealing with foreign assertions of jurisdiction, China has, arguably, a stronger foreign policy argument with it hopes to influence foreign governments to intervene in judicial proceedings.

For general discussion of China's position on sovereign immunity and the reasons thereof, see *China's Stance*, *supra* note 18, at 119-22; Recent Developments, *Government Shipping Company of the People's Republic of China is an "Agency or Instrumentality" for the Purpose of the Foreign Sovereign Immunities Act of 1976*, 14 VAND. J. TRANSNAT'L L. 637, 650 n.67 (1981).

practice, they also have worries. China has reported several major concerns in the international codification of the restrictive trend.⁵² The reason for this could be found in the fourteen years of practice of the United States Foreign Sovereign Immunities Act.

Amongst the Chinese concerns, the purpose or nature criteria for commercial activities has received years of heated rhetoric.⁵³ Now that the dust has settled, the emphasis has shifted to the practical issue of defining the state.⁵⁴ The question then is, why

⁵². Since 1978, the ILC has been preparing an international convention on the jurisdictional immunities of states and their property. During its 1986 session, the Commission completed the first reading of its draft articles. Member States were asked to provide comments on the draft by Jan. 1, 1988, before the Commission gives its final approval during the second reading. Since the final draft should be reviewed both by the General Assembly and the Sixth Committee, and because the issue has been controversial, the ILC articles will most probably face an uncertain future. See *Draft Convention*, supra note 2, at 399-400. For the ILC's work, see supra note 2. The main concerns that the PRC has are: (1) the definition of state; (2) the criteria for commercial activity or contract; (3) the existence of general principles of international law concerning sovereign immunity. *PRC Speech*, supra note 50, at 1-3.

⁵³. Aside from the traditional resentment of perceived encroachment on the customary sovereign rights of independent states, the Marxist ideology buttressed Chinese support for the absolute immunity in compounding the difficulty of drawing the distinction between "commercial" and "public" acts of government. See *China's Stance*, supra note 18, at 121. With China turning more and more practical, the ideological intricacy ceases to show its calibre on the international scene. See *PRC Speech generally*, supra note 50.

⁵⁴. While covering four pages in elaborating the Chinese stance on the draft international convention on state immunity and their properties, the Chinese representative devoted more than one half of his speech to the issue of defining states. See *generally PRC Speech*, supra note 50.

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are the large non-market economies, especially the PRC uncomfortable with the definition of "state" in the US Foreign Sovereign Immunities Act of 1976?

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CHAPTER TWO: THE DEFINITION AND IMPLICATIONS OF "AGENCY OR INSTRUMENTALITY" UNDER THE U.S. FSIA

The FSIA vests courts with exclusive jurisdiction over lawsuits involving a foreign state, its agencies and its instrumentalities.⁵⁵ Under the Act, a foreign state, or an agency or instrumentality of a foreign state, is immune from the jurisdiction of the courts of the United States,⁵⁶ with the important exception of actions relating to the foreign party's commercial activities.⁵⁷ The Act provides three criteria, to define

⁵⁵. "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 (1976). See generally 2 G. Delaume, *TRANSNATIONAL CONTRACTS APPLICABLE LAW AND SETTLEMENT OF DISPUTES* §11.01 (1978).

⁵⁶. Jurisdiction is obtained under 28 U.S.C. §1330 (a) (1976), which provides:
The district court shall have original jurisdiction without regard to amount in controversy of any nonjury civil action against a foreign state as defined in section 1603 (a) of this title as to any claim for relief in personam with respect to which the foreign state is not entitled or under any applicable international agreement.

⁵⁷. 28 U.S.C. §1605 (a) (2) provides:

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

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

General exceptions to the jurisdictional immunity of a foreign states can be found in 28 U.S.C. §§ 1605-07.

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an agency or instrumentality. It

- (1) is a separate legal person, corporate or otherwise⁵⁸, and
- (2) 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,⁵⁹ and
- (3) is neither a citizen of a State of the United States... nor created under the laws of any third country.⁶⁰

A foreign entity, claiming the defence of sovereign immunity, must satisfy all three criteria to be deemed an agency or instrumentality of a foreign state. If these requirements are met, immunity will be granted,⁶¹ subject to any international agreements to which the United States is a party⁶² and unless none of the

⁵⁸. It is 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.

HOUSE REPORT at 16, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS, supra note 3, at 6614.

⁵⁹. If such entities are entirely owned by a foreign state, they would of course be included within the definition. Where ownership is divided between a foreign state and private interests, the entity will be deemed to be an agency or instrumentality of a foreign state only if a majority of the ownership interests (shares of stocks or otherwise) is owned by a foreign state or by a foreign state's political subdivision.

Id.

⁶⁰. The rationale behind these exclusions is that if a foreign state acquires or establishes a company or other legal entity in a foreign country, such entity is presumptively engaging in activities that are either commercial or private in nature.

Id.

28 U.S.C. §1603(b)(1-3) (1976) (emphasis added).

⁶¹. 28 U.S.C. §1604 (1976).

⁶². *Id.*; House Report, at 10, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS, supra note 3, at 6608.

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enumerated exceptions apply.⁶³

The first criterion, that the agency or instrumentality must be a legal person,⁶⁴ nullifies previous court decisions that refused to grant immunity to foreign government corporations because they were incorporated and legally independent.⁶⁵ U.S. Congress stated that an agency or instrumentality of a foreign state can:

assume a variety of forms, including a state trading corporation, a mining enterprise, a transport organization such as a shipping line or airline, a steel company, a central bank, an export association, a governmental procurement agency or a department or ministry which acts and is suable in its own name.⁶⁶

The second criterion established by the FSIA requires that the designated agency or instrumentality be either an organ of the foreign state or primarily owned by the foreign state.⁶⁷ According

⁶³. See U.S.C. 28 §§1605-1607 (1976).

⁶⁴. *Supra* note 57 and accompanying text.

⁶⁵. "United States courts have tended to solve the question of immunity of foreign instrumentalities by inquiring whether they are incorporated or not, and granting immunity only when they are unincorporated." *Bradford v. Director-General of Railroads of Mexico*, 278 S.W.R. 251 (1925); *Telkes v. Hungarian National Museum No. II*, 38 N.Y.S. 2d 419 (1942); *Piasek v. British Ministry of War Transport*, 54 F. Supp. 487 (1943); *De Simone v. Transportes Maritimes do Estado*, 199 App. Div. (N.Y.) 602 (1922). See 2 D. O'Connell, *INTERNATIONAL LAW* 875 (2d ed. 1970).

⁶⁶. HOUSE REPORT, *supra* note 3, at 15-16, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS, at 6614.

⁶⁷. See *supra* notes 58, 59 and accompanying text.

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to the legislative history, the foreign state must have majority ownership of the entity.⁶⁸ Neither the Act nor the legislative history, however, clearly defines what is an organ of a state. Problems arise when applying this ownership criterion to non-market economies, as illustrated in the three much quoted U.S. decisions,⁶⁹ which will be discussed later.

The last of these criteria requires the establishment of the agency or instrumentality to have occurred in the foreign state which is pleading for sovereign immunity and, therefore, it cannot be a citizen of the United States or any other third country. The rationale behind this requirement is that if a foreign state acquires or establishes a company or other legal entity in a foreign country, such entity is presumptively engaging in

⁶⁸. HOUSE REPORT, at 15, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS, *supra* note 3, at 6614.

⁶⁹. *Yessin-Volpin v. Novosti Press Agency*, 443 F. Supp. 849 (S.D.N.Y. 1978) and *Edlow International Co. v. N.E.K.*, 441 F. Supp. 827 (D.D.C. 1977). See Recent Development, *Foreign Sovereign Immunity - The Status of Legal Entities in Socialist Countries as Defendants Under the Foreign Sovereign Immunities Act of 1976*, 12 VAND. J. TRANS L. 165 (1979) [hereinafter *Legal Entities*]; see also *Property Ownership*, *supra* note 17.

Bancec, *supra* note 18. See also Note, *Piercing the Corporate Veil Between Foreign Governments and State Enterprises: A Comparison of Judicial Resolutions in Great Britain and the United States*, 25 VA. J. INT'L L. 451 (1985) [hereinafter *Piercing the Veil*]; Comment, *Holding Foreign Government Corporations Liable for the Wrongs of the Government: A Clash Among Competing Policies*, 39 U. MIAMI L. REV. 341 (1985); Note, *Piercing the Veil of Foreign Trade Organizations*, 23 COLUM. J. TRANSNAT'L L. 483 (1985).

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activities that are either commercial or private in nature."⁷⁰

In many of the debates that followed the enactment of the Act, the majority view held by the U.S. commentators tend to treat criterion two as detrimental to the U.S. interest.⁷¹ They argue that because of the Socialist principle that all productive property is owned by the state or the people, the term "ownership" is meaningless in the Socialist context,⁷² and that accordingly every organization, in effect under the Act, is an agency or instrumentality possessing the opportunity to attain sovereign immunity.⁷³ So it seems that the Act has created a class of foreign states -- foreign state-owned or government-owned corporations (FSOCs or FGOCS)⁷⁴ that are automatically protected by foreign sovereign immunity.

This is the case if one considers this criterion exclusive of the other provisions of the Act, one of which that should not be

⁷⁰. HOUSE REPORT at 15, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS, *supra* note 3, at 6614.

⁷¹. *Non-Market Economies*, *supra* note 13; *Capitalist Paradigm*, *supra* note 15; *Recent Development & Recent Developments*, *supra* note 68.

⁷². *Capitalist Paradigm*, *supra* note 15, at 438.

⁷³. *Recent Developments*, *supra* note 69, at 116.

⁷⁴. See *supra* note 58 and accompanying text.

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neglected is the commercial exception provision.⁷⁵ This exception to immunity includes almost any act a FSOC or FGOC would perform, thus making it almost impossible to accord FSOCs or FGOCs immunity, which is the basis of the Immunities Act.⁷⁶ The second element that the Act and the commentators failed or refused to observe objectively is the nominal ownership relations of the enterprises and business associations of large non-market economies with the State. By so doing, the Act has created a potentiality that the doctrine of "piercing the corporate veil" is almost always threatening to edge its way into suits against FGOCs or FSOCs on the basis of a mistakenly-conceived notion of the property relationship.⁷⁷

To fully understand the problems of §1603(b)(2) of the Act toward state-owned corporations from non-market economies, it is necessary to go into the business proper of both market and non-market economies and analyze the different environment in which they operate.

⁷⁵. *Supra* note 57.

⁷⁶. Note, *Foreign Government-Owned Corporations, The Foreign Sovereign Immunities Act, And The Right To Jury Trial*, 6 DUKE L. J. 1076 (1982).

⁷⁷. See *infra*.

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CHAPTER THREE: GOVERNMENT-OWNED CORPORATIONS IN MARKET ECONOMIES
AND STATE-OWNED CORPORATIONS FROM THE PEOPLE'S
REPUBLIC OF CHINA: THE DIFFERENCES.

The two most powerful institutions in society today are business and government. Where they meet on common ground--amicably or otherwise--together they determine public policy,⁷⁸ among which law is a part. Indeed, in history, they were so close in the operations of production and distribution that it was not until the end of the eighteenth century with the rise of the first industrial revolution, that they began to be considered separate institutions.⁷⁹ Since then, both of them have grown to operate with distinct and separate functions until modern times when again they have moved towards each other. This functional combination of the two helped establish a new form of business, government-owned corporations (GOCs).

In the present world, the GOCs operate in market and non-market societies which have radically different notions of the structure and authority of the state.⁸⁰ Such differences are not

⁷⁸. Marshall E. Dimock, *BUSINESS AND GOVERNMENT* 3 (1961).

⁷⁹. *Id.* at 15.

⁸⁰. See generally R. David & J. Brierley, *MAJOR LEGAL SYSTEMS IN THE WORLD* 155-66, 268-83 (2d ed. 1978).

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only seen in the divergent concepts of property ownership held by each of these societies, but are also reflected in the different roles played by governments.⁸¹ Needless to say, the GOCs or even SOCs cannot exist irrespective of their respective economic environments.

I. GOVERNMENT OWNED CORPORATIONS IN MARKET ECONOMIES.

(i). The State and The Business

In almost all the constitutions of market economies, the principle of private property has made the most notable appearance and has attained a high degree of inviolability.⁸² This principle

⁸¹. See *Capitalist Paradigm*, supra note 15, at 438.

⁸². Art. 17. - La propriété étant un droit inviolable et sacré, nul ne peut en être privé, si ce n'est lorsque la nécessité publique, légalement constatée, l'exige évidemment, et sous la condition d'une juste et préalable indemnité.
Déclaration des Droits de L'Homme et du Citoyen du 26 août 1789 (placée ensuite en tête de la Constitution de 1791), reprinted in Maurice Duverger ed., *CONSTITUTIONS ET DOCUMENTS POLITIQUES* 18 (1986).

Art. 5. ..., nor [shall any person] be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public case without just compensation.

Articles In Addition To, And Amendments Of, The Constitution Of The United States Of America, Proposed By Congress, And Ratified By The Legislature Of The Several States Pursuant To The Fifth Article Of The Original Constitution, 1791, reprinted in 4 Peaslee ed., *CONSTITUTIONS OF NATIONS*, 1206 (1970).

Art. 14. The rights of ownership and of inheritance are

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is almost always the most substantive constitutional provision of all, and it represents the basic earmark to differentiate market and non-market economies.⁸³

This principle is also the premise upon which the notion of a market economy is based and has developed. The right to private property sanctioned by this principle, is not one endowed by constitutions,⁸⁴ but one recognized by the constitutions as the

guaranteed.

Basic Law Of The Federal Republic Of Germany, 1949, reprinted in 3 Peaslee ed., id., 364 (1970).

Art. 29. The right to own or hold property is inviolable. Property rights shall be defined by law, in conformity with the public welfare. Private property may be taken for public use upon just compensation therefore.

The Constitution Of Japan, 1946, reprinted in 2 Peaslee ed., id., at 414 (1974).

⁸³. Xiangrui Gong, *BIJIAO XIANFA YÜ XINGZHENFA* (COMPARATIVE CONSTITUTIONS AND ADMINISTRATIVE LAWS), 46 (1985) (in Chinese).

⁸⁴. The institution of private property had existed long before its protection in the constitutions. As remarked by one commentator:

It is all the more remarkable that the institution of private property could have endured so long without any apparent necessity for a legal or constitutional theory or principle to justify its existence.

Calvin B. Hoover, *THE ECONOMIC LIBERTY AND THE STATE* 13 (1961). The U.S. Supreme Court did sometimes attempt a philosophical defense of property. Thus, in the minority opinion in the first Slaughterhouse Case in 1873, which became the majority opinion in the second Slaughterhouse Case eleven years later, the doctrine of John Locke and Adam Smith of the origin of property in labour was used as a justification for the protection of private property against governmental regulations. *Id.*, n1. at 13. *The Slaughterhouse Cases*, cited as 16 Wall. 36, 73 on 5 S. Ct. 45 (1884).

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natural and the inalienable right for human beings⁸⁵ and a means to stabilize the society.⁸⁶ It is believed that human experience has shown that this right is both important for individual autonomy within the community and for the efficient exploitation of resources⁸⁷.

Despite the fact that this principle is widely found in the constitutions of various market economies, the forms it takes vary, ranging from individual proprietorship, partnerships, joint ventures, to joint-stock companies (or association), business trusts, and business (or stock) corporations.⁸⁸ They occupy the bulk of the total economic force.

⁸⁵. According to John Lock, the right to property derives from the right to physical existence. See Lord Lloyd of Hampstead, Q.C., LLOYD'S INTRODUCTION TO JURISPRUDENCE 120 (1985).

⁸⁶. He who is permitted by law to have no property of his own, can with difficulty conceive that property is founded in anything but force....
Thomas Jefferson, *To E. Bancroft, 1789*, S.K. Padover ed., DEMOCRACY BY THOMAS JEFFERSON 154 (1969).

⁸⁷. According to Finnes, J.M., whose book *Natural Law and Natural Rights* is one of today's most authoritative assessment of Natural Law theory, there are two reasons for maintaining a régime of private property. First, "the good of personal autonomy in community" suggests private ownership as a requirement of justice. Finnes, J.M., *NATURAL LAW AND NATURAL RIGHTS* 169 (1980). Secondly, a "rule of human experience indicates that resources are more productively exploited by private enterprise." See Lord Lloyd of Hampstead, Q.C., *supra* note 85, at 140.

⁸⁸. Henn, Harry G., *HANDBOOK OF THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES*, 2nd ed., at XIX (1970).

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The relationship of private businesses with the government has undergone an evolution through different historical times, from old-style capitalism, to modified capitalism,⁸⁹ in which the governmental role in business has grown from purely non-interventionist to a supervisory and an extremely interventionist one.

In the early days of the old-style capitalism during the seventeenth and eighteenth centuries - the age of "mercantilism", most European governments became involved in regulating, sometimes in very great detail, both industry and trade.⁹⁰ Under the circumstances, private enterprise had to pursue governmental protection.⁹¹ At the end of the seventeenth century, all

⁸⁹. See generally C.B. Hoover, *supra* note 84.

⁹⁰. Roger Backhouse, *ECONOMISTS AND THE ECONOMY, THE EVOLUTION OF ECONOMIC IDEAS, 1600 TO THE PRESENT DAY* 45 (1988).

According to the author, in England before the Civil War, government regulation involved the creation of monopolies through the royal patent system, restriction of industry and the development of a capitalist economy, regulations on the market for labour, and foreign trade company regulations for the restriction of foreign trade. *Id.*, at 46-48. After the Civil War, with the passing of the Navigation Act of 1651, amended in 1660, England's foreign trade was monopolized by English shipping under the supervision of the Parliament, and the powerful British Navy was used to promote English trading interests. During this period, the basis for government regulation switched from an economy centred on the crown to one centred on the nation as a whole. *Id.*, at 48-49. In France, a system of industrial foreign regulations was established by 1661 to 1683, surpassing anything attempted across Europe and England, as detailed as to laying down the specification and the exact method of production for products. *Id.*, at 52-53.

⁹¹. Xiangrui Gong, *supra* note 83, at 48.

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philosophers except a few were taking for granted the state's intervention in the process of production.⁹² Even so, there was never any form of government ownership to enforce governmental regulation.

This philosophy then took a drastic turn at the end of the eighteenth century,⁹³ when developed institutionalization of private property led to the belief in the separation of the exercise of political power from the exercise of economic power.⁹⁴ This belief then developed into the theory of "laissez faire" arguing that production, distribution, exchange and consumption can be best served with little government interference.⁹⁵ The theory attained its prevalence with Prof. Adam Smith as the school of the classical economists.⁹⁶

⁹². *Id.*

⁹³. *Id.*

⁹⁴. See C.B. Hoover, *supra* note 84, at 13. See also Roger Backhouse, *supra* note 90, at 49-51 (Arguments for economic freedom in England), at 53-55 (Boisguilbert and The Physiocrats in France).

⁹⁵. According to this school, represented by English economist Adam Smith with his book *INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* (1776), the rule of economics is an invisible hand that best plays its role in pursuing the best interest of society when there was encouragement of the drive for wealth and the dismantling of the structure of social and economic rules and regulations. See Robert L. Heilbroner ed., *THE ESSENTIAL ADAM SMITH* 151 (1986). For brief introduction, see Roger Backhouse, *supra* note 90, at 56-58.

⁹⁶. Xiangrui Gong, *supra* note 83, at 48.

As commented by Prof. Gregory, this pure idea of capitalism depends, in every society, upon the operation of the two principles of "free enterprise" and the "right of the individual to economic

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The separation of political and economic power could only be achieved by reducing greatly the power of the sovereign, and the scope and the arbitrary character of all forms of state power.⁹⁷ Once the authority of government is excluded from control of and responsibility for the operation of the economy, then "[t]he executive of a modern state is but a committee for managing the common affairs of the whole bourgeoisie."⁹⁸ Indeed, it was assumed that the functions of the state were primarily negative: it had only to refrain from acting itself and to prohibit acts which would interfere with the freedom of individuals to carry on economic activities. So long as the state had only the function of "holding the ring" within which individuals were engaged in the economic struggle, it did not matter in peacetime how greatly the restrictions placed upon its powers interfered with the ability of government to take and carry out decisions quickly and efficiently.⁹⁹ In keeping with this theory, the state surrendered control over the economy and production became implicitly the responsibility of countless competing producers.¹⁰⁰

self-expression". THE INDEPENDENT, Aug. 11, 1934, at 28, quoted in Harold J. Laski, THE STATE IN THEORY AND PRACTICE 150 (1960).

⁹⁷. See C.B. Hoover, *supra* note 84, at 13.

⁹⁸. Karl Marx & Friedrich Engels, COMMUNIST MANIFESTO, reprinted in Harold J. Laski, COMMUNIST MANIFESTO, SOCIALIST LANDMARK 122 (1961).

⁹⁹. See C.B. Hoover, *supra* note 84, at 14.

¹⁰⁰. *Id.*, at 16. According to Roger Backhouse, the move towards business and trade freer from government intervention in England came with the abrogation of income tax in 1841, abolition of

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It is only upon the presumption that the responsibilities of the state for the economic welfare of the people could be kept at a minimum that this limitation of state power was practicable.¹⁰¹ Implementation of this presumption resulted in a lack of equity that led to either the overthrow of the old-style capitalism in Russia or the transformation or modification of capitalism in other countries for increased economic intervention by the state.¹⁰²

The interventionist approach to economy theory was best displayed, after the Great Depression in the '30s, by John M. Keynes¹⁰³ and John Rogers Commons¹⁰⁴. They sought to provide

customs duties on imports in 1845, to the repeal of Corn Laws in 1846, and the annulment of the Navigation Acts in 1849. Roger Backhouse, *supra* note 90, at 56, 58-66.

¹⁰¹. C.B. Hoover, *supra* note 84, at 14.

¹⁰². Commenting on the reasons, Prof. Hoover pointed out that [U]nrestricted property, . . . , is so vulnerable from the standpoint of social equity that one might well wonder how an economic system based upon it could exist unless originally imposed or continually maintained at bayonet point.

See C.B. Hoover, *supra* note 84, at 12.

From the millions of unskilled and semiskilled workers, dependent upon a precarious daily wage, an economic system which placed no limits upon inequality in wealth and income, which provided no security against sickness and old age, which accepted no responsibility for preventing unemployment or compensating for it, or for any of the vicissitudes of life, could not be expected to receive unqualified support.

Id., at 19.

Economic recession was also attributable for the phase-out of this old-style capitalism.

¹⁰³. For Keynesian ideas, see John M. Keynes, *TREATISE ON MONEY* (1930) and *GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY* (1936).

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remedial measures to the problems of old-style capitalism by extending state-regulation in the field of economic management and promoting employment through fiscal activism.¹⁰⁵ After the Second World War, this theory was revised and reinforced into a new modified practice of state intervention in economy¹⁰⁶. Guided by this theory, countries have seen an increased role of the state represented by the government in the overall regulation of economy for its satisfactory operation.¹⁰⁷

¹⁰⁴. For brief introduction, see Roger Backhouse, *supra* note 90, at 79-80.

¹⁰⁵. H.J. Laski, *supra* note 96, at 185; Angus Maddison, *PHASES OF CAPITALIST DEVELOPMENT* 26 (1982).

Keynes, in Chapter 24 of his book *GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY*, finally sets out the "social philosophy" which matches his economic theory in proposing an extended role for the state in the modern capitalist economy: this is for him "...the only practicable means of avoiding the destruction of existing economic forms in their entirety and ... the condition of the successful functioning of individual initiative". John M. Keynes, *GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY* 380 (1936), *quoted in* John Hillard ed., *J.M. KEYNES IN RETROSPECT, THE LEGACY OF THE KEYNESIAN REVOLUTION* 157-58 (1988).

¹⁰⁶. The modified economy policy has effected governmental intervention in the economy in several ways, namely: 1) governmental assistance to and supervision over the process of production and administration; 2) funding of public services with governmental revenue; 3) establishment of GOCS through nationalization; and 4) legal protection accorded to consumers. For brief introduction, see Gong, Xiangrui, *supra* note 83, at 49-50.

¹⁰⁷. For brief introduction, see Randall G. Holcombe, *PUBLIC SECTOR ECONOMICS* (1987); Charles F. Andrain, *POLITICS AND ECONOMIC POLICY IN WESTERN DEMOCRACIES* (1980). For critical view against post-Keynesian state intervention in economy, see Research and Policy Committee, Committee for Economic Development (CED), *REDEFINING GOVERNMENT'S ROLE IN THE MARKET SYSTEM* (1979).

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The evolution of market economies clearly exhibits a gradual build-up of government intervention in the regulation of macro economy. In the initial stage, the functions of governments used to be one of keeping a watchful distance from business. A mere maintenance of social order was enough as far as the economy is concerned. Governments were not compelled to participate directly in business dealings, even though there had been some government monopolies, which was more of a combination of the state and feudal power than one of government intervention in the economy. As the economy grew to such an extent that when without the helping hand of the government, the market economy would have collapsed under its own operating weight, the government was compelled to intervene, arming its tools of intervention with the purpose of governmental functions.

Therefore, given the development of market economies and the changing role of state from non-interventionist to interventionist in regulating economy, and the fact that the scope of government in these economies used to be so clear of economic intervention, it is obvious to foresee that once they do enter the business in the form of SOCs or GOCs, they carry with them governmental objectives in regulating the economy.

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(ii) Government-Owned Corporations in Market Economies

The increased government role in regulating the economy has mainly focused on three areas: fiscal policies,¹⁰⁸ monetary policies,¹⁰⁹ and government ownership policies¹¹⁰. The need for more state intervention does not explain the choice of instrument. The state can choose to regulate the economy, either by employing the first two tools, as what has been the overwhelming Keynesian practice in the United States and Canada, or by relying heavily on government ownership, as is the case in France and Italy shown in table below.

Table Ownership of Economic Firms

Economic Firm	West						United States
	Italy	France	Sweden	Germany	Britain	Canada	
Transportation							
highways	G	G	G	G	G	G	G
railroads	G	G	M/G	G	G	M/G	M/P
airlines	G	M/G	M/G	M/P	M/G	M/G	P
auto manu- facturing	M/P	M/P	P	M/P	M/P	P	P

¹⁰⁸. Fiscal policies refer to a government's tax and spending programs. For brief introduction, see Charles F. Andrain, *id.*, at 11-15.

¹⁰⁹. Monetary policies include government decisions about the money supply and interest rates. For brief introduction, see C.F. Andrain, *supra* note 107, at 16-22.

¹¹⁰. Government ownership policies are policies directed toward public ownerships. The larger the government holdings are in industry and commerce, the greater the power the government has to affect both the employment situation and prices of goods. For brief introduction, see C.F. Andrain, *supra* note 107, at 22-27.

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Economic Firm	West					United	
	Italy	France	Sweden	Germany	Britain	Canada	States
Communications							
radio/							
television	G	G	P	G	M/G	M/P	
telephones	G	G	G	G	G	M/P	
postal							
service	G	G	G	G	G	G	M/G
PowerIndustries							
gas	M/G	G	M/G=P	G	G	P	P
electricity	M/G	G	M/G=P	M/G	G	M/G	M/P
coal	M/G	M/G	M/P	P	G	P	P
oil	M/G	M/G=PM/G=P	M/P	M/P	M/P	P	P
steel	M/G	M/P	M/G	M/P	G	P	P
Banks	G	M/G	M/P	M/P	M/P	M/P	P

NOTE: The table estimates the degree of government ownership during the early 1970s. G refers to ownership by the government, either central or local. P indicates private ownership. Mixed ownership includes three types: M/G means that government ownership predominates; M/P means private ownership predominates; M/G=P refers to a balance between government and private ownership.

SOURCE: (1) Anthony King, "Ideas, Institutions and the Policies of Governments: A Comparative Analysis," *Brit. J. Pol. Sci.* 3 (July 1973): 292-96; (2) Martin C. Schnitzer and James W. Nordyke, *Comparative Economic Systems*, 2nd ed. (Cincinnati: South-Western Publishing Co., 1977), pp. 189-93; (3) Stuart Holland, "Europe's New Public Enterprise," in Raymond Vernon, ed., *Big Business and the State: Changing Relations in Western Europe* (Cambridge, Mass.: Harvard Univ. Press, 1974), pp. 25-44; (4) *Encyclopedia Britannica: Macropaedia* (Chicago: Encyclopedia Britannica, 1975), vol. 3 (Canada), pp. 725-33; vol. 7 (France), pp. 599-601; vol. 8 (Germany), pp. 59-59; vol. 9 (Italy), pp. 1101-02; vol. 15 (Public Enterprises), pp. 198-202; vol. 17 (Sweden), pp. 847-50; vol. 18 (United Kingdom), pp. 880-85; (5) Kevin Allen and Andrew Stevenson, *An Introduction to the Italian Economy* (New York: Barnes and Noble, 1974), pp. 217-63; G. Corti, "Perspectives on Public Corporations and Public Enterprises in Five Nations," *Annals of Public And Co-operative Economy* 47 (January-March 1976): 47-48.¹¹¹

¹¹¹. Quoted from C.F. Andrain, *supra* note 109, at 23.

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One commentator remarked that

[t]he choice of the appropriate tool is partially a function of ideology, partially of political expedience, partially of historical inertia and to some extent, a result of economic calculation of costs and benefits associated with its use.¹¹²

In analyzing the role of these considerations, commentators have come up with various explanations. Yair Aharoni, in his book *The Evolution and Management of State-Owned Enterprises*¹¹³, listed a number of schools of thought. All the explanations offered by the commentators in their research for the reasons behind the establishment of GOCs converge on one central point --- that the choice of GOCs comes from the need to protect, stabilize and facilitate market operations against the haphazard of the market itself.¹¹⁴ No doubt, the task to employ the protection, stabilization and facilitation strategy (for the purpose of maintaining the well-being of the national economy) can only be

¹¹². Yair Aharoni, *THE EVOLUTION AND MANAGEMENT OF STATE-OWNED ENTERPRISES* 29 (1986).

¹¹³. *Id.*

¹¹⁴. According to these theories, government ownership exists because 1/ markets do not perform perfectly due to lack of information and its natural indifference to indirect benefits or losses (Normative Analysis); 2/ in countries late in industrialization, there is a development gap and lack of indigenous entrepreneurs to mobilize domestic resources (Neoclassical Economics); 3/ the more open the economy, the more vulnerable it is to external factors, and thus there is the need for the government to stabilize by means of ownership intervention; 4/ the structural inadequacies and other deficient market mechanisms cause the economy not to be responsive to Keynesian stimuli of demand (Keynesian theory); 5/ private producers fail to behave compatibly with the need for social welfare maximization (Welfare Economic Analysis). See Aharoni, *supra* note 112, at 29-31.

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achieved by the government instead of private businesses; GOCs, once established by the government, only serve as a policy tool to embody the governmental function of assisting the operation of the market.

The same conclusion could also be borne out by observing the different goals of privately owned business and GOCs. Privately owned enterprises are expected to be managed toward one goal: long term profits for their shareholders.¹¹⁵ GOCs are expected to steer their operations to achieve the goals of their owners - namely, the citizens of the country.¹¹⁶ This goal coincides with that the government. Of course, this social welfare goal does not preclude the government-owned corporations from maximizing its profits in a way not conflicting with the dictates of the government. As summed up by Yair Aharoni,

[T]hey [GOCs] remain both an instrument of government to achieve short-term policies, designed to catering to conflicting interest groups, and are expected to be an efficient producer of economic goods at the same time they are used as a vehicle for political patronage.¹¹⁷

However complex the formation of their goals, the motif of GOCs' goals is always the same: serve the overall interest of its citizens. In doing so, GOCs have no alternative other than running their business activities in parallel with the government's

¹¹⁵. See Y. Aharoni, *supra* note 112, at 122.

¹¹⁶. *Id.*

¹¹⁷. Aharoni, *supra* note 112, at 124.

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economic policies, thereby in the process rendering themselves the instrument of the government.

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- (iii) "Agency and Instrumentality" and Government-Owned Corporations from Market Economies

The concept of and criteria for "agency" or "instrumentality" are based on the market economy presumption that governments should keep themselves clearly away from engaging in business; once the government establishes GOCs, the intention is to load them with governmental functions to carry out governmental responsibility of protecting, stabilizing and facilitating the operation of the market. To hold that the GOCs are not government agencies or instrumentalities, to insist that the GOCs are not part of the government interventionist endeavour into the economy against the background discussed in the proceeding chapter, is a difficult argument.

Yet all this is valid in the market economy, where the role of the government used to be an administrative watchdog for the operating business environment instead of being an active participant and interventionist in the economic activity as it is now.

It is against this limited backdrop and with the mentality developed in this specific set of market concepts that the US Foreign Sovereign Immunities Act was conceived. As commented by Prof. Dellapenna,

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The blurring of lines between the public and the private sphere is the central problem in the Immunities Act. (footnote omitted) In this context the problem makes it difficult to distinguish agencies or instrumentalities of foreign states from private entities. The criteria in the Act are drawn from the experience of western-oriented free market economies and permit courts to resolve the status of entities from such societies through a relatively straightforward factual inquiry....¹¹⁸

When applied to facts arising from market economies with this presumptions about the role of government in business, these criteria may be foolproof. Since the government created and owned them to have a policy leverage, then it is safe to assume that the identification of government ownership will provide sufficient proof of government control, except for the few exceptions. However, when the economic environment and the policy presumptions change, as in the case of non-market economies, given their recent reform in particular, as shown below, these criteria work to ignore the specifics of a totally different regime, both in terms of economic structure and ideological conception.

¹¹⁸. J.W. Dellapenna, *supra* note 30, at 22 (notes omitted).

II. STATE-OWNED CORPORATIONS IN CHINA¹¹⁹

State-owned corporations, as other less important enterprise forms in China, have undergone drastic changes. Since their inception until 1983 when urban reform began, they served, as affiliates of the government in carrying out the national economic plan and fulfilling the national economic target. Beginning in 1983, urban reform has attempted to separate the formal function of government from the economic motivations of enterprises, leaving with them a degree of latitude that is capable of challenging the conventional notions about business in socialist countries.

A careful study of the above process of evolution in the relationship between state-owned corporations and the government in China will reveal the sharp difference in the basic premises and presumptions between non-market economies and market economies.

(i). Orthodox Enterprises

The Chinese economy is predicated on public ownership and is composed of three different regimes: individual ownership,

¹¹⁹. The following section deals with business forms in the People's Republic of China. Due to the fact that these forms are still governed by the Marxist and Leninist ideology, a considerable amount of terms call for explanation, giving rise to the need for some lengthy footnotes.

collective ownership and state ownership.¹²⁰

Individual ownership has always been played down as a minor form of property holding.¹²¹ The best recognition it has ever received is the 1982 constitutional provision stating

The individual economy of the urban and rural working people, within the limits prescribed by the law, is a complement to the socialist public economy.¹²²

So far no domestic individually-owned business is allowed to engage

¹²⁰. See generally, *Constitution of the People's Republic of China* [hereinafter CONSTITUTION], 9 REV. SOC. L. 183 (1983). Article 62 of the Chinese 1982 DRAFT CIVIL CODE provides:

The State protects the following property rights:

- 1) The property rights of the State;
- 2) The property rights of labouring mass collective organizations;
- 3) The property rights of individuals.

See William C. Johns translated, *A Translation of the Fourth Draft Civil Code (June 1982) of the People's Republic of China* [hereinafter CIVIL CODE], 10 REV. SOC. L. 193, 203 (1984).

¹²¹. Individual ownership includes income from labour, from individual plots of land, and from household sideline activities; private houses, savings and articles of daily use; privately owned trees and cattle; work tools; cultural objects and reading materials; gifts received from overseas Chinese, including foreign exchange and inheritance and the means of production, products and income of citizens obtained from production management or from social service undertakings. Art. 95, *Civil Code, id.*, at 207.

"[I]ndividual worker's and capitalist ownership of the means of production" was first recognized in the 1954 Constitution of PRC (Art. 5, PRC CONSTITUTION 1954), representing only a temporary measure to enable the necessary economic development to take place before the old forms of ownership could be phased out. The 1975 Constitution therefore recognized only two forms of ownership, state and collective. See Jill Barret, *What's New in China's New Constitution*, 9 REV. SOC. L. 305, 310 (1983). As a result, until 1979, the country witnessed a decrease of individual ownership.

¹²². Art. 11, CONSTITUTION, *supra* note 120, at 187.

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in foreign trade,¹²³ and that even if they were so permitted, they would not be covered under the provision of agencies or instrumentalities of the Act.¹²⁴

Both the collective ownership and state ownership are socialist sectors of the economy.¹²⁵ Considered a fundamental issue, they are defined at the very beginning of the Constitution.¹²⁶

Article 6 provides that:

The basis of the socialist economic system of the People's Republic of China is socialist public ownership of the means of production, that is, ownership by the whole people and collective ownership by the working people.¹²⁷

Together they are supposed to illustrate the socialist nature of the economy.

Collective ownership is exemplified by the right to engage in business or production in cities and towns, and to farm plots of land or run household side line production by a group of

¹²³. General Agreement on Tariffs and Trade (GATT), Restricted, L/6270, 27 Nov. 1987 (Limited Distribution), Working Party on China's Status as a Contracting Party, QUESTIONS AND REPLIES CONCERNING THE MEMORANDUM ON CHINA'S FOREIGN TRADE REGIME [hereinafter CHINA'S FOREIGN TRADE REGIME], 70, para 5.

¹²⁴. See text accompanying *supra* note 59.

¹²⁵. Arts. 7, 8, CONSTITUTION, *supra* note 120, at 187.

¹²⁶. CONSTITUTION, *supra* note 120.

¹²⁷. Article 6, CONSTITUTION, *supra* note 120, at 186-87.

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individuals.¹²⁸ The property rights of the collective organization belong to the collective organization of the labouring masses.¹²⁹ Like the case of individual ownership, collectively-owned enterprises do not fall under the domain of agencies or instrumentalities under the U.S. Foreign Sovereign Immunities Act.¹³⁰

State ownership is the principal form of socialist economy¹³¹. It is owned by the whole people and its ownership belongs to the State¹³². It refers to the holding of property by state enterprises,

¹²⁸. Rural people's communes, agricultural producers' co-operatives, and other forms of the co-operative economy, such as producer's supply and marketing, credit and consumers' co-operatives, belong to the socialist sector of the economy collectively owned by the working people. Working people who are members of organizations of the rural collective economy have the right, within limits prescribed by the law, to farm plots of agricultural and hilly land for private use, to engaged in household sideline production, and to raise privately-owned livestock.

The various forms of the co-operative economy in the cities and towns, such as those in the handicraft, industrial, building, transport, commercial and service trades, all belong to the socialist sector of the economy collectively owned by the working people.

Art. 8, CONSTITUTION, *supra* note 120, at 187.

¹²⁹. Art. 87, CIVIL CODE, *supra* note 120, at 206.

¹³⁰. See text accompanying *supra* note 59.

¹³¹. The state sector of the economy is the socialist sector owned by the whole people and is the leading force in the national economy. The state ensures the consolidation and development of the state sector of the economy.

Art. 7, CONSTITUTION, *supra* note 120, at 187.

¹³². Art. 80, CIVIL CODE, *supra* note 120, at 205.

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government agencies and certain nonprofit institutions.¹³³ State enterprise prevails in the industrial and commercial sector¹³⁴ and is the predominant form of enterprise in the Chinese economy.¹³⁵

The existence and maintenance of state-owned enterprises is an important feature of all socialist countries. It stems from the deep-rooted legacy of traditional Marxist-Leninist theory, which dictates that the socialist state is the intermediate phase between capitalism and communism.¹³⁶ According to the traditional Marxist-Leninist view, society is divided into social classes, one of which, by seizing control of the means of production,¹³⁷ is able to

¹³³. Howard Chao & Yang Xiaoping, *The Reform of the Chinese System of Enterprise Ownership*, 23 STAN. J. INT'L L. 365, 367 (1987).

¹³⁴. According to statistics released by China as of 1987, the proportion of the various economic elements in the total value of industrial output are: industry of the ownership by the whole people [state ownership] 68.7%; collectively-owned industry 29.2%; individual-owned small handicraft industry 0.3%; other industries, 1.8%. In the total value of retail sales, the state-run commerce 39.4%; commerce of collective ownership 36.4%; commerce of individual ownership 16.3%; other commercial forms 9%. As to the gross value of agricultural output, state-owned farms 2.3%, the rest collectively-owned forms and the agricultural households under contract system.

General Agreement on Tariffs and Trade (GATT), Restricted, L/6270, 27 Nov. 1987 (Limited Distribution), Working Party on China's Status as a Contracting Party, QUESTIONS AND REPLIES CONCERNING THE MEMORANDUM ON CHINA'S FOREIGN TRADE REGIME [hereinafter QUESTIONS AND REPLIES] 4, para 2.

¹³⁵. Chao & Xiaoping, *supra* note 133, at 367.

¹³⁶. See Brierley, *supra* note 80, at 162-65.

¹³⁷. *Id.*, at 158-59.

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economically exploit the other.¹³⁸ This ruling class seeks through the state and its laws to strengthen and perpetuate its domination.¹³⁹ Thus, class struggle is primarily the efforts of one class to seize the means of production from another and to establish its own dictatorship.¹⁴⁰ Only when all private ownership of the means of production is abolished, and productive property is made the property of the collectivity, will class antagonism end.¹⁴¹ In the resulting communism society, people will be transformed and the state and its laws useless and non-existent.¹⁴²

At the present stage of socialism, the Chinese ideology argues that the state must not wither away immediately.¹⁴³ Rather, the state and its laws must be maintained provisionally to economically restructure society.¹⁴⁴ In accordance with this interpretation of Marxism, most of the property and means of production are supposed to be owned and exploited by the people.¹⁴⁵ To place ownership of all important property in the hands of the representatives of the

¹³⁸. *Id.*

¹³⁹. *Id.*

¹⁴⁰. *Id.*, at 159-60.

¹⁴¹. *Id.*, at 160.

¹⁴². *Id.* at 160-61.

¹⁴³. *Id.*, at 175-76.

¹⁴⁴. *Id.*

¹⁴⁵. *Id.*

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people (the state or collectives) is the best way to avoid exploitation of the masses.¹⁴⁶

Consistent with this principle of maintaining the dominance of the working people's ownership, i.e. the state and the collective sector, in the early 1950s, the Chinese economy underwent a rapid "socialist transformation" during which all important private properties passed to state or collective ownership.¹⁴⁷ At the conclusion of this program, virtually all means of production were in the control of public enterprises.¹⁴⁸

Since then, enterprises were placed under the administration of the government, and acted as little more than branches of the state and scarcely had separate identities.¹⁴⁹ The government representing the state owns the enterprises in a way that makes government ownership tantamount to government management --- by comprehensive control.

¹⁴⁶. "The system of socialist public ownership has abolished the system of exploitation of man by man..." See Art. 6, *Constitution*, *supra* note 120, at 187.

¹⁴⁷. See generally Muqiao Xue, *CHINA'S SOCIALIST ECONOMY* 18-59 (1986).

¹⁴⁸. *Id.* Besides private enterprises bought during the process of socialist transformation, Goumindang enterprises were confiscated after 1949, foreign enterprises were nationalized in the 1950s, and new enterprises were established by the state. *Id.*

¹⁴⁹. Chao & Xiaoping, *supra* note 133, at 367.

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Assets held by state enterprises were not only "owned" by the state but were also administered by the government.¹⁵⁰ The government made all the decisions, which included not only questions of macroeconomic policy, such as production levels, interests and growth rates, but also microeconomic decisions, such as where individual factories would buy and sell their goods, what prices they would charge, and what they would produce.¹⁵¹ Economic units, as corporations were called under the system, were left with few of the rights which market economies would associate with the concept.¹⁵² The enterprise only had the right to use and manage the state's property.¹⁵³ Government exercised direct and rigid control and interference in all aspect such as the management of production, supply and marketing, personnel and finance.¹⁵⁴ Indeed, the government had the right to reassign property from one state enterprise to another without compensation.¹⁵⁵

¹⁵⁰. Art. 6, *Provisional Regulations on State Industrial Enterprises* [hereinafter *PRSIE*] (passed by the State Council, Apr.1, 1983), 1983 ZHONGHUA RENMIN GONGHEGUO GUOWUYUAN GONGBAO (State Council Gazette of the People's Republic of China) 268-77 [hereinafter *STATE COUNCIL GAZETTE*] (in Chinese).

¹⁵¹. Chao & Xiaoping, *supra* note 133, at 367.

¹⁵². *Id.*

¹⁵³. Chao & Xiaoping, *supra* note 133, at 368.

¹⁵⁴. *QUESTIONS AND REPLIES*, *supra* note 134, at 9, para. 2, and at 17, para. 4.

¹⁵⁵. Chao & Xiaoping, *supra* note 133, at 368.

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The state enterprises themselves, on the other hand, were severely limited in their ability to manage and dispose of their assets. The rule of "specified funds for specified uses" prevailed, which meant that state-owned enterprise would have to apply for funds,¹⁵⁶ and funds thus allocated to them could only be used for the purpose specified by state plans.¹⁵⁷ The enterprise received directions from its superior organization as to how assets were to be utilized or disposed of.¹⁵⁸ The state enterprise was also required to turn over all of its annual profits to the state, as well as a substantial portion of the cash flow generated by the depreciation of its fixed assets.¹⁵⁹ At the end of each year, the state reviewed and, if appropriate, adjusted the level of the enterprise's fixed and current assets.¹⁶⁰

The management of these state-owned enterprises was also carried out in a unified way.¹⁶¹ The leader or leading body of an

¹⁵⁶. Muqiao Xue, CHINA'S SOCIALIST ECONOMY 206-07 (1981).

¹⁵⁷. *Id.* Funds and assets allocated by the State to state enterprises were divided into two categories: fixed assets and current assets. Funds allocated to purchase fixed assets could only be used for that purpose. If fixed assets were sold, which usually required the permission of the enterprise's superior organization, the proceeds had to be used for the repurchase of fixed assets. Similarly, funds allocated for current assets had to be used to finance raw materials, inventory and other short-term assets or to purchase minor productive goods. *Id.*

¹⁵⁸. *Id.*

¹⁵⁹. *Id.*

¹⁶⁰. *Id.*

¹⁶¹. Xue, *supra* note 147, at 51.

enterprise was accountable for its performance only to the superior body.¹⁶² The enterprises had no direct contact with the market because all its products are purchased and marketed by state commercial departments.¹⁶³ The sense of government control¹⁶⁴ was so strong that it rarely allowed shifts of hand or of category (state-owned or collectively-owned), because of the supposedly unchangeable nature of socialist ownership.

Since all the rights an enterprise should have and exercise are managed by the government, it is accurate to say the government owned and controlled the management of all enterprises. It was free to determine the use and disposition of state property in state-owned corporations. As commented by the World Bank in 1976:

Chinese manufacturing enterprises are in some ways not unlike separate branch plants within a large company in a market economy. The management gets its assignment, plan and plan targets, capital, marketing, and most of its production inputs from higher levels, which bear the responsibility for the strategy, politics and administrative and accounting procedures followed, as well as all major decisions affecting the medium-term future, such as investments or significant changes in the enterprise's products. Even personnel assigned to the enterprise and wage and compensation plans are decided

¹⁶². *Id.*, at 52.

¹⁶³. *Id.*

¹⁶⁴. The unit of government that had the supervisory power over an enterprise often had this supposition, derived from originally starting or at least transforming or expanding it, using its own funds and management efforts, and also from sharing its revenue. World Bank, 2 CHINA, SOCIALIST ECONOMIC DEVELOPMENT (A WORLD BANK COUNTRY STUDY), THE ECONOMIC SECTORS, AGRICULTURE, INDUSTRY, ENERGY, TRANSPORT, AND EXTERNAL TRADE AND FINANCE 135 (1976).

from the outside....¹⁶⁵

It is from under these circumstances of water-tight state-managed economic activities that China started onto a road of economic reform. A study of the present day management of state-owned enterprises, without reference to this thirty years of non-existence of legal entity, would fail to appreciate the legal separateness of the new enterprises from the government brought about and to be brought about by a China in reform.

(ii). State-Owned Corporations in Reform

Enterprises in a pure centrally planned economy, as it is now recognized, lack initiative and are often wasteful and unprofitable.¹⁶⁶ For this reason, the Government has in the last few years, experimented with new forms of enterprises and revised the old forms in order to generate economically vigorous

¹⁶⁵. World Bank, *id.*, at 135.

¹⁶⁶. [U]nder this system, economic decision-making was over-centralized and regulations of the economy by State mandatory plans was overemphasized to the neglect of the role of market mechanism. As a result, the enterprises were low in economic efficiency due to lack of vitality, and commodity economy could not be developed properly.
CHINA'S FOREIGN TRADE REGIME, *supra* note 123, at 4, para. 4.

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enterprises.¹⁶⁷ During this trial and transformation, state enterprises will remain to play the leading role,¹⁶⁸ but even they have and will undergo significant modifications.¹⁶⁹

Government Control: In this decentralization process, governments at all levels separated their functions from those of the enterprises.¹⁷⁰ Government responsibility has shifted from direct control of production, supply and marketing to overall planning, co-ordination, providing services and supervision.¹⁷¹

¹⁶⁷. See Chao & Xiaoping, *supra* note 133, at 371. To overcome the defects of the existing economic system and give full play to the productive forces, China has conducted progressively an extensive and profound reform in its economic system since 1979. The objective of the reform is to establish a new system of planned commodity economy of Chinese style. CHINA'S FOREIGN TRADE REGIME, *supra* note 123, at 4, para. 5.

¹⁶⁸. For a long time to come, China will develop a multi-formed system of ownership of the means of productions, while ensuring the dominant position of the public ownership. See CHINA'S FOREIGN TRADE REGIME, *supra* note 123, at 4, para. 3.

¹⁶⁹. See Chao & Xiaoping, *supra* note 133, at 371.

¹⁷⁰. CHINA'S FOREIGN TRADE REGIME, *supra* note 123, at 5, para. 3.

¹⁷¹. *Id.*

The government is supposed to have eight categories of functions in economic administration:

1. to make strategies, plans, principles and policies of economic and social development;
2. to make plans for exploitation of natural resources, technical transformation and development of human resources;
3. to co-ordinate development plans and economic relations among regions, sectors and enterprises;
4. to deploy key projects, especially building of energy, communication and raw and semifinished materials industries;
5. to collect and disseminate economic information and to implement measures of economic regulation;
6. to make and supervise the implementation of laws and

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Among these government responsibilities, only mandatory planning is one control aspect that governments in market economies do not enjoy. Mandatory planning is an order with a lawful compulsory nature imposed by the State. It mainly covers the key enterprises; the supply, production and marketing of major products; construction of big projects; and important national scientific programmes, all of which are considered of vital importance of the national economy. Any amendment or adjustment must be subject to the approval of the competent departments. The reform has greatly reduced the number of products under State mandatory planning¹⁷² reduced. The government has also given up the rest of former planning privileges and placed them in two categories - guidance planning and market regulation. Guidance planning refers to plans of no compulsory nature, implemented by the state and intended to provide directions to enterprises by the employment of economic levers and indirect controls, such as application of differential

regulations;

7. to appoint officials within the designated authority;

8. to administer foreign economic and technology exchange and cooperation.

QUESTIONS AND REPLIES, *supra* note 134, at 9, para.2.

¹⁷². See CHINA'S FOREIGN TRADE REGIME, *supra* note 123, at 5.

The proportion of industrial products under mandatory planning in the total value of industrial output declined from 40% in 1984 to 17% in 1986; and the number of product items declined from 120 to about 60. In the area of commerce, the number of products subject to mandatory state distribution was reduced from 256 to 20. QUESTIONS AND REPLIES, *supra* note 134, at 24, para. 2.

The annual and medium-term national economic and social development plans approved by the National People's Congress spell out the objectives and measures of mandatory plans. QUESTIONS AND REPLIES, *supra* note 134, at 23, para. 6.

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interest rates on loans to promote the construction of industries of energy, transportation, communication, and raw and semifinished materials; lower product taxation on newly constructed power stations; and new legislations of construction tax to control the scale of investment. Administrative interference is seldom resorted to. The annual and medium-term national economic and social development plans approved by the National People's Congress also sets out the objectives and measures of guidance nature.¹⁷³ Market regulation is full power of decision-making with regard to prices delegated to enterprises, who adjust according to the natural market conditions to the extent permitted by laws and regulations promulgated by the state.¹⁷⁴ Reform has increased the scope of products under State guidance planning and market regulation.¹⁷⁵ Clearly, the reform in this aspect pointed to a tendency to increase the relative significance of guidance planning and market regulations.¹⁷⁶

¹⁷³. QUESTIONS AND REPLIES, *supra* note 134, at 23.

¹⁷⁴. *Ibid.*

¹⁷⁵. In the days to come, except from a few items of capital goods vital to the national economy such as electric power and petroleum and consumer goods "necessary for people's livelihood" such as food and edible oil, all other products will be put under guidance planning or market regulation. Even for products subject to mandatory distribution, "the principle of exchange at equal value" will apply in the implementation of contracts entered into between the State and the production enterprises. QUESTIONS AND REPLIES, *supra* note 134, at 24, para. 5.

¹⁷⁶. In the days to come, except for a few items of capital goods vital to the national economy such as electric power and petroleum and consumer goods necessary for people's livelihood

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Management Autonomy: Production enterprises practised a system under which the director or manager exercised full managerial responsibility or other systems of economic responsibility. The enterprises had considerable decision-making power in matters such as planning, purchasing and marketing, pricing, wage, bonus determination and labour regulations,¹⁷⁷ and they moved towards the direction of full authority for their own management and full responsibility for their own profits and losses.¹⁷⁸

The increasing independence of enterprises as separate business entities under the reform was reflected in their newly attained status as "legal persons" under Chinese law. In the 1981 Economic Contract Law, China recognized for the first time the concept of legal persons.¹⁷⁹ Shortly after, all state-owned enterprises were recognized as legal persons.¹⁸⁰ Article 41 of the

such as food and edible oil, all other products will be under guidance planning or market regulation. Even for products subject to mandatory distribution, the principle of exchange at equal value will apply in the implementation of contracts entered into between the State and the production enterprises. QUESTIONS AND ANSWERS, *supra* note 134, at p.24, para 5.

¹⁷⁷. CHINA'S FOREIGN TRADE REGIME, *supra* note 123, at 5, para. 3.

¹⁷⁸. *Id.*

¹⁷⁹. Art. 2, *Economic Contract Law* (passed by the Fifth National People's Congress, Fourth Session, Dec. 13, 1981), 1981 STATE COUNCIL GAZETTE 864-76.

¹⁸⁰. Art. 8, *PRISE*, *supra* note 150, at 18.

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General Principles of Civil Law reaffirmed this concept.¹⁸¹ Typically in market economy countries, status as a legal person for an enterprise entails a bundle of rights, including the right to sue and be sued, the right to contract, and the right to own property, all in the enterprise's own name.¹⁸² Under the Chinese law, a legal person must fulfil the following requirements:

1. It must be established in accordance with law;
2. It must possess the necessary property or funds;
3. It must possess its own name, organizational structure and premises;
4. It must be able to assume civil obligations independently.¹⁸³

And legal persons have "civil capacity, are competent to perform civil acts and, according to the law, independently enjoy civil

¹⁸¹. Art. 41. State-owned and collective enterprises that meet the capital requirements provided by the State, possess a charter, and organizational structure, and premises, and are able to assume civil obligations independently, acquire the status of legal person upon approval and registration by the responsible agency.

General Principles of Civil Law of the People's Republic of China [hereinafter *GPCL*] (passed by the Sixth National People's Congress, Fourth Session, Apr. 12, 1986), 1986 STATE COUNCIL GAZETTE 371-93. For an English translation, see Gray & Zheng, *General Principles of Civil Law of the People's Republic of China*, 34 AM. J. COMP. L. 715 (1986). Art. 41 at 723.

¹⁸². Modern corporate attributes - all consistent with the concept of the corporation as a separate entity - traditionally include (a) Power to take, hold, and convey property in the corporate name; (b) Power to sue and to be sued in the corporate name; (c) Centralization of management in the board of directors; (d) Ready transferability of interests; (e) Perpetual success; and (f) Limited liability. Such attributes are not necessarily found in all corporations, and some of them now inhere or can be achieved in unincorporated forms of business enterprises.

Henn, Harry G., *supra* note 88, at 109.

¹⁸³. Art. 37, *GPCL*, *supra* note 181, at 722.

rights and assume civil duties."¹⁸⁴

The management autonomy of state-owned enterprises was also demonstrated by Chinese law's recent recognition of their limited liabilities. Article 48 of the General Principles of Civil Law provides:

A State-owned enterprise legal person bears civil liability to the extent of the property the State has given to operate and manage....¹⁸⁵

In 1983, the State Council promulgated the State Industrial Enterprise Regulations, which permitted state enterprises to dispose of, rent or transfer their surplus fixed assets,¹⁸⁶ using terms that are much more active and implying actions by the enterprise. In the following two years, the State Council issued two other important documents¹⁸⁷, which further enlarged the autonomous power of state enterprises. These two set of regulations authorize state enterprises to sell or lease their fixed assets to

¹⁸⁴. *Id.*

¹⁸⁵. Art.48, *GPCL*, *supra* note 181, at 724.

¹⁸⁶. Arts. 8, 32, *PRSIE*, *supra* note 150.

¹⁸⁷. See Art. 6, *State Council Provisional Regulations Regarding Further Expanding the Autonomy of State Industrial Enterprises* (passed by the State Council, May 10, 1984) [hereinafter *Further Autonomy of State Industrial Enterprise Regulations*], 1984 *STATE COUNCIL GAZETTE* 323-25 (in Chinese); Art. 9, *Notice of the State Council Adoption of the State Economic and Reform Council's Provisional Regulations Regarding Certain Problems in Invigorating Large and Medium-Sized State Industrial Enterprises*, (Sept. 11, 1985) [hereinafter *Interim Provisions on Problems in Invigorating State Enterprises*], 1985 *STATE COUNCIL GAZETTE* 950-51 (in Chinese).

other enterprises without the approval of their superior organizations if the assets are redundant and idle.¹⁸⁸ The General Principles of Civil Law provide that a state enterprise has the power to "operate" its assets.¹⁸⁹ According to Prof. Tong Rou of People's University in Beijing, who was actively involved in the drafting of the GPCL, the phrase "right to operate" was chosen intentionally (in place of the older term "right to operate and administer") to highlight state enterprises' increased powers.¹⁹⁰ In the view of Prof. Tong, as soon as property is appropriated by the state for a state enterprise, the property is separated from state treasury property and becomes subject to the powers of the state enterprise to operate and manage it.¹⁹¹ The state loses direct control over such property and should compensate the state enterprise for a reacquisition of the property.¹⁹² The ownership right is rendered largely nominal.¹⁹³

188. *Id.*

189. See text accompanying *supra* note 185.

190. Tong & Zhou, *Discussion of Management Powers of State Enterprises*, 3 FAXUE YANJIU (Legal Studies) 12-18 (1986) (in Chinese).

191. *Id.*

192. *Ibid.*

193. As pointed out by an authority, Ownership right refers to the legal rights of the owner to occupy, employ, gain and dispose of its property. The separation of operation right from ownership right refers to the fact that the property holder of the enterprise of all people [state enterprise] is the state; however, the state does not exercise all the powers and functions of its property

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The new enterprise autonomy also extends to the use of after-tax profits. The conversion from a system of payment of all profits to the state to a system of payment of income taxes to the state¹⁹⁴ has left enterprises with more discretionary funds. These monies are required to be put into five special-purpose funds for use by the enterprise: the production development fund, the new product development fund, the reserve fund, the welfare fund, and the bonus fund.¹⁹⁵ While the state still maintains controls over these monies through rules limiting the use of and access to such special purpose funds, limitations on the use of funds are gradually loosening. For example, the Further Autonomy of State Industrial

right over the enterprise directly. The state, in accordance with the law, render its ownership right appropriately separate from its right to occupy, employ, gain and dispose. The certain power and functions thus detached, form, as a whole, an exclusive property right, delegated by the state and exercised by the enterprise. Therefore, the operation right refers to the right of enterprises of all people [state-owned enterprises] to occupy, employ and dispose in accordance with law with regard to the property that the state has placed under its operation and administration.

Qiye Falü Zhidu (The Legal Regime of Enterprises), QUANGUO LÜSHIZIGE TONGGAO FUXIZHIDAO DAQUAN (REVIEWS AND DIRECTIONS FOR THE NATIONAL BAR QUALIFICATIONS EXAM) 162, 163 (1988) (in Chinese).

¹⁹⁴. See Arts. 1, 2, *Ministry of Finance Trial Methods for the Conversion from the Payment of Profits to the Payment of Taxes by State Enterprises* (adopted by the State Council, Apr.12, 1983), 1983 STATE COUNCIL GAZETTE 475-76; Arts. 1-3, 10, *Trial Methods for the Further Conversion from the Payment of Profits to the Payment of Taxes* (reported by the Ministry of Finance, Aug.8, 1984, adopted by the State Council, Sept. 18, 1984) [hereinafter *Further Conversion*], 1984 STATE COUNCIL GAZETTE 798-800, 802-03.

¹⁹⁵. Art. 5, *Further Autonomy of State Industrial Enterprise Regulations*, *supra* note 201. For an illustration, see Chao & Xiaoping, *supra* note 133, at 375, fn38.

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Enterprise Regulations permit the mixing of the production development fund and the reserve fund.¹⁹⁶

On April 3, 1988, all these legislative measures to give autonomy to state-owned enterprises were summed up in the most recent and the most direct State Enterprises Law.¹⁹⁷ Besides those discussed above, it contained several articles clarifying the rights and obligations of state enterprises. Article 2 reiterated that state enterprises are legal persons under Chinese Civil law, with the same status and ability to undertake obligations as all legal persons.¹⁹⁸ Article 7 makes clear that the factory director bears responsibility for the enterprise's management; the Communist Party's role as guarantor and implementor of Party principles in the enterprise is stated in Article 8.¹⁹⁹ The most important chapter of the new law, Chapter Three, sets forth the rights and obligations of the enterprise. It promises an enterprise the right

¹⁹⁶. *Id.*

¹⁹⁷. *Law Concerning Enterprises Owned by the Whole of the People of the People's Republic of China* [hereinafter *State Enterprise Law*], passed by the First Session of the Seventh National People's Congress in April 1988. For introduction, see James V. Feinerman, *The Evolving Chinese Enterprise*, 15 *SYR. J. INT'L L. & COM.* 203 (1989).

¹⁹⁸. See *supra* notes 179-184 and accompanying text.

¹⁹⁹. *State Enterprise Law*, Art. 8:

The basic organization of the Communist Party of China in an enterprise ensures and oversees the implementation of general and specific policies of the party and state in the enterprise. It supports the director in discharging his authority according to law.

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to arrange its production;²⁰⁰ the right to request adjustment of the mandatory plan and to reject additional assignments outside the mandatory plan;²⁰¹ the right to sell on its own, outside the mandatory plan quotas;²⁰² the right to choose suppliers as it chooses;²⁰³ and the right to set its own prices, except for those under price controls set by the State Council.²⁰⁴ Other rights guaranteed to enterprises include: freedom to deal with foreign parties and to sign contracts with them, subject to State Council provisions,²⁰⁵ budgetary control over retained funds (retained earnings),²⁰⁶ control over fixed assets and their disposal,²⁰⁷ power to fix wages and bonuses,²⁰⁸ and the power to hire, fire and redeploy personnel.²⁰⁹ As for obligations, Chinese state enterprises are expected to meet mandatory plan quotas and perform lawful

²⁰⁰. *Id.*, Art. 22 (on condition that it be guided by the state plans).

²⁰¹. *Id.*, Art. 23 (but only "for goods whose planned supply and marketing are nonessential").

²⁰². *Id.*, Art. 24.

²⁰³. *Id.*, Art. 25.

²⁰⁴. *Id.*, Art. 26.

²⁰⁵. *Id.*, Art. 27.

²⁰⁶. *Id.*, Art. 28.

²⁰⁷. *Id.*, Art. 29.

²⁰⁸. *Id.*, Art. 30 ("in a manner it considers appropriate").

²⁰⁹. *Id.*, Arts. 30 and 32.

economic contracts²¹⁰ and observe applicable state economic regulations.²¹¹

Thus under the new Chinese law passed during the reform period, state enterprises, once permitted by law to establish, are not only capable of assuming their civil liabilities, but are also able to shoulder these liabilities financially, since the funds or property they have, upon their inception with funding from various levels of governments, are in effect, under their control. Those who have not enough property to meet business risks will, as a matter of law, not be permitted to start their business, and less likely to meet their civil liability by drawing from the state treasury.

Most of the state enterprises in China, as the term "industrial enterprises" shows, are manufacturers or producers. As far as international business is concerned, not all of these state-owned enterprises in China are permitted to engage in foreign trade.²¹² Some factories among them, could carry on contract

²¹⁰. *Id.*, Art. 35.

²¹¹. *Id.*, Art. 37.

²¹². Departments and enterprises of industrial production and local governments of various levels are allowed to engage in export and/or import instead of the centralized management by national foreign trade corporations under the former Ministry of Foreign Trade. Up till 1986, over 800 import-export corporations had been approved by the Ministry of Foreign Economic Relations and Trade. If trade related consultancies,

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negotiations and make payments out of foreign exchange funds under their own control, as early as 1980.²¹³ Yet the bulk of foreign trade is being carried out by the state-owned foreign trade corporations.²¹⁴

storehouses and transportation enterprises were included, the total would exceed 1,200. Among these foreign trade enterprises, some are specialized foreign trade corporations, others are amalgamated corporations formed by industrial and trading enterprises. In addition, some large and medium-sized enterprises or syndicates are approved to engage in exporting their own products and importing raw material for their own use.

See CHINA'S FOREIGN TRADE REGIME, *supra* note 123, at 11, para. 4.

²¹³. Edith Terry, *Decentralizing Foreign Trade*, 1(5) CHINA-INTERNATIONAL BUSINESS 445, 448 (1981).

²¹⁴. See *supra* note 212.

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(iii) State-Owned Corporations in International
Business

While a discussion of the relationship between the government and state-owned enterprises is important for understanding the overall business situation and the possible Chinese subjects under the provision of agencies or instrumentalities of the U.S. FSIA, the most likely party to FSIA lawsuits would be the foreign trade corporations, who constitute the majority of China's business entities empowered to engage in international business.²¹⁵

Being of the same type of economic structure as the state industrial enterprises before reform, the FTCs were also under heavy-handed administrative interference. Under the jurisdiction of the Ministry of Foreign Trade (MOFERT), they were the exclusive brokers of trade for Chinese end-users and producers.²¹⁶ The Ministry used to set budgets and profit targets for the head offices of the foreign trade corporations' branches.²¹⁷ Only the FTC

²¹⁵. Besides some large and medium-sized enterprises or syndicates approved to engage in exporting their own products and importing raw material for their own use, amalgamated corporations formed by industrial and trading enterprises approved to engage in foreign trade, the rest of foreign trade in China is performed by foreign trade corporations (FTCs), who are also state-owned legal persons. See *supra* note 212.

²¹⁶. See Edith Terry, *supra* note 213, at 447.

²¹⁷. *Id.*

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offices were empowered to sign import contracts; the branch corporations were limited to handling export business.²¹⁸ In the outlying provinces and municipalities, the ministry carried out its functions through Foreign Trade Bureaus (FTBs, now Departments or Commissions of Foreign Economic Relations and Trade) under the provincial or municipal governor's and mayors' offices. At the local level, the bureaus has sole authority over the activities of the branch offices of the foreign trade corporations. Though the bureaus were nominally under local jurisdiction, in practice the local authorities had little control over their actions. The FTBs and branch offices of FTCs under them reported directly on all business matters to the ministry and the appropriate corporation head offices.²¹⁹

Along with reforms in industrial enterprises, the foreign trade structure of China has also been subjected to reform since 1979.²²⁰ It all started from decentralizing the management of foreign trade.²²¹ Ministries, departments and enterprises of industrial production and local governments of various levels are

²¹⁸. *Id.*

²¹⁹. *Id.*

²²⁰. For details, see Edith Terry, *supra* note 213. See also *QUESTIONS AND REPLIES*, *supra* note 149; *CHINA'S FOREIGN TRADE REGIME*, *supra* note 123, at 11-13.

²²¹. See *CHINA'S FOREIGN TRADE REGIME*, *supra* note 123, at 11, para. 4.

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allowed to engage in export and/or import instead of the centralized management by national FTCs under the Ministry of Foreign Trade.²²²

While this did not alter the close relationship between the management of foreign trade and the various levels of government, the decentralization was a necessary step in the gradual shift to corporate independence in foreign trade. In 1984, the Government decided to delegate a substantial amount of its former power of interference by attempting to make use of exchange rates, customs duties, taxes and credits.²²³ The MOFERT and its subordinate Departments (or Commissions) of the provinces and municipalities now turn to exercise administrative control over foreign trade²²⁴.

²²². *Id.*

²²³. See CHINA'S FOREIGN TRADE REGIME, *supra* note 123, at 11, para. 5.

²²⁴. The MOFERT is responsible for implementing foreign trade policies, making and amending rules and regulations; drawing up long-term foreign trade development program, medium-term and annual import-export plans in coordination with the State Planning Commission, and supervising their implementation; organizing bilateral and multilateral trade negotiations between governments, concluding trade agreements and documents and organizing their implementation; approving the establishment of foreign economic and trade enterprises; exercising import and export licensing system; engaging in international market research and exchanging and disseminating information.

The Departments (or Commissions) of Foreign Economic Relations and Trade of provinces and municipalities administer and supervise foreign trade of the area under their respective jurisdiction in accordance with the authorization of the MOFERT....

CHINA'S FOREIGN TRADE REGIME, *supra* note 123, at 12, paras. 1-2.

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They are not supposed to interfere in the business activities of the corporations²²⁵.

The Government also urged the State foreign trade corporations to operate independently and at their own profit and losses.²²⁶ According to the government, MOFERT granted its approval to enterprises to engage in foreign trade according to the following requirements:

a. The enterprise as a legal person should pay tax according to relevant regulations, and assume independent account and full responsibility for its own profits and losses.

...

c. It should be in possession of enough capital resources in conformity with the scale of its operations.

d. It should have competent executive and professional.

e. It should also be in possession of necessary installation and facilities.²²⁷

So far, most of the trading units are independent financial entities, responsible for their own profits and losses from foreign trade.²²⁸

The reform of the foreign trade system also had its impact on

²²⁵. QUESTIONS AND REPLIES, *supra* note 134, at 76, para.1.

²²⁶. *Id.*, at 71, para. 1.

²²⁷. *Id.*, at 75, para. 2.

²²⁸. Z. Bian, S. Fei & W. Li, *The Organizational Structure of China's Trade*, Zhang Peiji & R. W. Huenemann eds., CHINA'S FOREIGN TRADE 43, 47 (1987).

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the foreign trade planning system.²²⁹ The totally mandatory foreign trade planning²³⁰ practised in the past has been replaced correspondingly by the combination of mandatory planning, guidance planning²³¹ and adjustment planning through market forces.²³² The direction of the planning reform is to reduce gradually the proportion of mandatory planning and to extend the scope of guidance planning and adjustment through market.²³³

Moreover, the reform has broken the monopoly of foreign trade and marketing by state foreign trade departments and enterprises. Some large and medium-sized state-owned enterprises or syndicates have been allowed to engage in exporting their own products and importing raw material for their own use,²³⁴ and amalgamated corporations were formed by industrial and trading enterprises

²²⁹. See CHINA'S FOREIGN TRADE REGIME, *supra* note 123, at 12, para. 4.

²³⁰. Refer to *supra* note 172.

²³¹. See *supra* note 173.

²³². CHINA'S FOREIGN TRADE REGIME, *supra* note 123, at 12, para. 4. For "adjustment planning through market forces", see *supra* note 174.

²³³. Refer to *supra* notes 174, 174.

²³⁴. These are normally large industrial complexes, such as the Capital Iron and Steel Company, Anshan Iron and Steel Company, Yanshang Petrochemical Company, and Harbin Flax Mill and so on. See Z. Bian, S. Fei & W. Li, *The Organizational Structure of China's Trade*, Zhang Peiji & R. W. Huenemann eds., *supra* note 228, at 46 (1987).

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approved to engage in foreign trade.²³⁵ So far, according to one statistic, over one thousand enterprises have, to varying degrees, been given the authority to handle their own foreign trade directly.²³⁶

One final word must be put in for the way most new foreign trade corporations were established. The decentralization process generated considerable interest in establishing new FTCs to materialize on the insufficiency of the traditional planning system. Applications for new establishments were filed by governments at various levels and state-owned enterprises. It signified a brand-new approach to the traditional governmental one of planned incorporation, with a momentum so strong that the government had to promulgate new rules for granting permission.²³⁷ The implication is profound; these new establishments were not so much initiated by government plans as by the drive for profit.

Despite of all these reforms, the separation of the administrative functions of government trade departments from the managerial functions of the enterprises and the total respect for

²³⁵. These include such industrial-commercial enterprises as the China National Petrochemical Corporation and such comprehensive entities as the China International Trust and Investment Corporation (CITIC). *Id.*, at 46-47.

²³⁶. Zhang Peiji, *Introduction and Overview*, Zhang Peiji & R. W. Huenemann eds., *supra* note 228, at 4.

²³⁷. See text accompanying *supra* note 226.

corporate independence have not been achieved completely.

The managerial latitude of government-owned enterprises is not unabridged. Although the state may assign the right to possess, use and dispose of a portion of state property to a government owned enterprise, it does not relinquish ownership.²³⁸ Rather it places the property in the operative management of that enterprise, which must administer it in accordance with the law and the designated purpose of the property left intact by the reform; and the management will find it more difficult to dispose of assets that are not redundant.²³⁹ Moreover, once the state represented by the government decides that it is not policy wise or economically profitable to continue the enterprise, it may modify or even revoke the assignment of state property.²⁴⁰ In this respect, as one

²³⁸. State property belongs to the people.

State property is sacred and inviolable; it is forbidden for any organization or individual to interfere with possession or to loot, secretly divide up, divert for personal use, or destroy [it].

Art. 73, *GPCL*, *supra* note 181, at 729.

²³⁹. See text accompanying *supra* note 188.

²⁴⁰. The state in this context is acting as a sovereign not restrained by the requirement of any explicit legal procedures. According to Art. 45 of *GPCL*,

[a]n enterprise legal person terminates for one of the following reasons:

1. It is cancelled in accordance with law;
2. It is dissolved;
3. It is declared bankrupt in accordance with the law;
4. Other reasons.

Art. 45, *GPCL*, *supra* note 181, at 723. The cancellation in accordance with law, the process of dissolution, and the termination for other reasons are not clearly specified, which

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commentator remarked, government regulations, together with economic plans (in China mandatory plans) determine state enterprises' activities, sometimes even in cases concerning the scope of their legal personality, separate property status, and responsibilities.²⁴¹ What's more, state property as a rule cannot be alienated to individual citizens.²⁴²

Besides this ownership right, the government has another power of influence over the state-owned enterprises, which has nothing to do with property right. The government, with its administrative mandate, discharges its governmental functions through the combination of mandatory planning, guidance planning, and market regulation.²⁴³ Among them, mandatory planning could be associated with the implementation of governmental functions in the strictest sense of the phrase.

Be that as it may, ten years of ownership reform has pointed to one direction, that these restrictions on a full autonomy of

gives the government unqualified discretion to terminate an enterprise, and more so if it is one owned by the state.

²⁴¹. See *Non-Market Economies*, *supra* note 13, at 174 and fn.108.

²⁴². In *QUESTIONS AND REPLIES*, a question was asked whether ownership of State enterprise would be transferred to the private sector. The answer is: "[c]ontracting and leasing out operations do not change the nature of public ownership." *QUESTIONS AND REPLIES*, *supra* note 134, at 21.

²⁴³. See *supra* notes 172-176 and accompanying text.

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Chinese enterprises will be removed eventually. The Chinese have no alternatives than invigorating the economy. A full autonomy would mean the complete separation of the government from enterprise management, which is just the reverse of the road that the market economies have gone. The government will restrict its own activities to safeguarding overall economic environment. On the other hand, the specifics of a developing country²⁴⁴ would prevent its leadership from discarding state-ownership as an important means of attaining economic prosperity. As a result, governmental controls over the enterprises were and will be reduced, rendering the ownership right of the government to some enterprises more and more nominal. On the other hand, the state control has and will become clearer and stronger in the legal form of mandatory planning in important sectors and overall maintenance of the business environment.

²⁴⁴. The specifics of developing countries place them under the category of intermediate regimes, whose economic prosperity could be optimally attained, arguably by maintaining state ownership in the important sectors, such as raw materials, energy and foreign trade. See Michal Kalecki, *Observations on Social and Economic Aspects of "Intermediate Regimes"*, *ESSAYS ON DEVELOPING ECONOMIES* 30 (1976). See also, *supra* note 114.

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III. A COMPARISON OF SOCS FROM CHINA AND GOCS IN MARKET ECONOMIES AND FOREIGN SOVEREIGN IMMUNITY

The proceeding sections indicate that in China, though all the significant enterprises are state-owned, they enjoy and will surely enjoy most of the ordinary legal rights of businesses. With regard to the necessary attributes, they possess and will possess enough capital resources,²⁴⁵ and are capable of assuming civil obligations independently. With regard to corporate rights, they are able to bear civil liabilities to the extent of the property the state has given them to operate and manage in principle.²⁴⁶ So far the law has allowed them to sell or lease their surplus fixed assets and mix the reinvestment fund with the reserve fund.²⁴⁷ These provisions may not be enough, yet the implications hold out encouraging signs of corporate autonomy. As to state plans, except for those key enterprises under mandatory planning, managerial decision-making of enterprises is now guided by guidance planning and market regulation.²⁴⁸ As shown above, in the future, it is hoped that mandatory planning will be further reduced and that enterprises will be guided by guidance planning and market regulation alone.

²⁴⁵. See text accompanying *supra* notes 183, 226.

²⁴⁶. See text accompanying *supra* notes 185-193.

²⁴⁷. See text accompanying *supra* note 196.

²⁴⁸. See text accompanying *supra* notes 171-176.

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Thus the determination of the Chinese leadership to invigorate the economy with capitalist incentives while sticking to the socialist nature of ownership has produced an interesting interplay between the newly granted autonomy and the orthodox state control. During the prime time of Chinese reform, when both corporate autonomy and state macro-management were brought into play, when mandatory planning was functioning in parallel with guidance planning and market regulation, it was quite possible for a state enterprise to act as an independent juridical person with enterprise autonomy, or in other cases engage in activities that are aimed at fulfilling governmental functions. This situation has presented a puzzling picture for the identification of state agencies on the basis of ownership test, whose possible targets are uniformly of a state-owned nature.

There is a material difference between the state-owned enterprises from the PRC and those from the market economies, esp. those from countries where the private sector is the dominating force. In market economies, while free enterprise is the rule, government-owned enterprises are an exceptional solution to economic problems. Eclipsed by, and set up to fill in the gaps left by the strong private sector, they are always founded to implement governmental functions or to be guided and controlled by the administrative bureaucracy. They are a direct result of government response to the deficiencies of laissez-faire and serve as a

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supplement to the economy of clearly private nature. Under these circumstances, it is convenient to identify a government agency or instrumentality by studying the ownership relationship, which is the decisive factor in the determination of any enterprise exercising government functions.

However, in cases involving economic entities from countries like China, it is not helpful, for the purpose of determining the status of foreign entities, to attach importance to the property relationship test in evaluating entities from China, since all of them are state-owned. Different from their counterparts from societies where private ownership is constitutionally sanctioned, their activities range from purely commercial in cases of guidance planning and market regulation, to some governmental functioning when required by mandatory plans.

Not all state-owned corporations in the People's Republic of China carry out governmental functions as their the majority of their counterparts in market economies. However, according to the definition of "agencies or instrumentalities" of the US Foreign Sovereign Immunities Act, as long as they are owned by the state, they are deemed to be "agencies or instrumentalities" of the government, and they are entitled to the foreign sovereign immunity.²⁴⁹ As shown, this presumption that all government-owned

²⁴⁹. See *supra* Chapter Two.

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corporations carry with them governmental functions originates from market economies and does not apply to enterprises from China.

Nevertheless, this does not mean there is no viable criteria in identifying the hand of sovereign in business dealings.

Despite the material difference, both government-owned corporations in market economies and state-owned corporations in non-market economies share one social or governmental purpose -- the protection, stabilization and facilitation of market operations. In the People's Republic of China, this purpose is served by the fulfilment of mandatory plans, which could be a sufficient and viable criteria of identifying whether a specific act done by the corporation represents the sovereign authority of the government. Beyond this point, all the state-owned corporations are just the same group of business associations, not different from private businesses in market economies. To hold them as government agencies or instrumentalities would not only blur the criteria mentioned above, but also confuse the demarkation line between profit-seeking private businesses and socially-fulfilling government enterprises in market economies.

CHAPTER FOUR: INCOMPATIBILITY OF USFSIA WITH SOCS FROM NON-MARKET ECONOMIES

The incompatibility of the criteria for "agencies or instrumentalities" in FSIA is more than a theoretical issue; it is capable of going beyond a mere legislative misconception. Relevant case-law developed by U.S. courts regarding such criteria have shown that this legislative standard is not capable of meeting its anticipated aim.

I Confusion Created by FSIA in U.S. Courts

(i). *Novosti*: Attempt to Follow the FSIA Standard

In *Yessenin-Volpin v. Novosti Press Agency*,²⁵⁰ the Federal District Court in New York had to decide whether *Novosti*, "an information agency of the Soviet public organizations ... operating under ... the Constitution of the U.S.S.R.,"²⁵¹ was an agency or instrumentality of the U.S.S.R. under the FSIA.²⁵² Plaintiff,²⁵³

²⁵⁰. See *supra* note 69 [hereinafter *Novosti*].

²⁵¹. NOVOSTI PRESS AGENCY STATUTE [hereinafter NOVOSTI STATUTE] § 1(1), reprinted in *Novosti*, 443 F. Supp. at 852. *Novosti* is a "mass organization" arising under Art. 126 of the U.S.S.R. Constitution which was slightly amended in 1977 as Art. 51. Under the 1977 Constitution, "mass organization" was amended to read "public organization." The NOVOSTI STATUTE is the charter for the *Novosti* Press Agency.

²⁵². *Novosti*, 443 F. Supp. at 852. See *supra* notes 58-60 and accompanying text for the definition of an agency or instrumentality of a foreign state under the FSIA.

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seeking damages from the Agency for libel, argued that Novosti did not meet one of the three necessary criteria for being an agency or instrumentality of a foreign state.²⁵⁴ The dispute concerned § 1603(b)(2), discussed above.²⁵⁵ Plaintiff claimed that the majority of Novosti's property assets did not belong to U.S.S.R. and thus it should not be considered to be an agency or instrumentality of the U.S.S.R. in order to claim the immunity protection.²⁵⁶ The court found that Novosti had free use of state-owned property, which accounted for sixty-three percent of Novosti's property assets.²⁵⁷ Plaintiff contended that free use of state property cannot be considered as ownership interest for purposes of § 1603(b)(2).²⁵⁸ The Court compared public organizations such as Novosti to state

²⁵³. Alexander S. Yessenin-Volpin.

²⁵⁴. The plaintiff conceded that Novosti satisfied the other two requirements for being an agency or instrumentality of the U.S.S.R. Under the Novosti Statute § III(8), Novosti is a "separate legal person" thus meeting the first criterion of an agency or instrumentality, § 1603(b)(1), FSIA. Novosti also satisfies the third criterion by not being a citizen of any State of the United States as provided in §1603(b)(3) of the FSIA. *Novosti*, 443 F. Supp. at 852.

²⁵⁵. 28 U.S.C. § 1603(b)(2) (1976). The plaintiff argued that Novosti cannot be an agency or instrumentality of the U.S.S.R. because the Novosti Statute authorizes Novosti to acquire and alienate property in its own name and provides the "[n]o Soviet state organ bears responsibility for the ... actions of the Agency." *NOVOSTI STATUTE* § III(10), reprinted in *Novosti*, 443 F. Supp. at 853.

²⁵⁶. *Novosti*, 443 F. Supp. at 852-54. The remaining thirty-seven percent of Novosti's property was owned by Novosti.

²⁵⁷. *Id.*, at 854.

²⁵⁸. *Id.*, at 853.

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economic enterprises in the U.S.S.R., and stated that even though state economic enterprises are "self-administering" legal entities, they use and operate on state property exclusively and are considered to be owned by the State.²⁵⁹ Likewise, the court held that the free use, management and control of state property by Novosti constituted a Soviet state majority ownership interest in Novosti, thus qualifying it as a Soviet agency.²⁶⁰ The court also found Novosti an organ of the U.S.S.R because it was essentially of public nature.²⁶¹ Therefore, the court held that Novosti qualified for sovereign immunity.

(ii). Edlow: Attempts to Circumvent the FSIA Standard

While the *Novosti* court considered the Soviet system of ownership crucial, the court in *Edlow International Company v.*

²⁵⁹. *Id.*, at 853-54. "[W]hat a state economic enterprise possesses, uses, and disposes of - it does not own." H. Berman, *JUSTICE IN THE U.S.S.R.* 115 (1963). Rather, the U.S.S.R. owns the property used and managed by the state economic enterprise thus making the enterprise itself owned by the U.S.S.R. since the U.S.S.R. has the ultimate right to possess, use and dispose of state-owned property. The ownership right of the state operates in the same way in China. See Chap. Three, II(ii) State-Owned Corporations in Reform.

²⁶⁰. *Novosti*, 443 F. Supp. at 852-53.

²⁶¹. *Id.*, at 854.

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Nuklearna Elektrarna Krsko,²⁶² found this factor insignificant.²⁶³ In *Edlow*, the court considered whether *Nuklearna Elektrarna Krsko* (NEK), a workers' organization created under the constitution and laws of Yugoslavia for the purpose of building and managing a nuclear power plant, was an agency or instrumentality of a foreign state as defined in § 1603 of the FSIA.²⁶⁴ Plaintiff²⁶⁵ claimed that the NEK was an agency or instrumentality of Yugoslavia and thus a "foreign state" for purposes of vesting subject matter jurisdiction in the U.S. Federal District Court under the Act.²⁶⁶ NEK argued that it was not an agency or instrumentality of a foreign state because it was neither an organ of Yugoslavia nor owned by Yugoslavia.²⁶⁷ Plaintiff based its argument on the premise that all property under a socialist government such as Yugoslavia's is owned by the state, thereby making all Yugoslav work organizations subject to state ownership.²⁶⁸ The court rejected this argument, stating that "a foreign state's system of property ownership, without more, ..." should not be determinative of the issue whether an entity is an

²⁶². See *supra* note 69 [hereinafter *Edlow*].

²⁶³. *Edlow*, 441 F. Supp. 832 (D.D.C. 1977).

²⁶⁴. *Id.*, at 831.

²⁶⁵. *Edlow International Co.*

²⁶⁶. See 28 U.S.C. § 1330(a) (1976).

²⁶⁷. The parties agreed that the other two requirements for being an agency or instrumentality were met. *Edlow*, 441 F. Supp. at 831.

²⁶⁸. *Edlow*, 441 F. Supp. at 831.

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agency or an instrumentality of a foreign state.²⁶⁹ Instead, the court found two more precise standards for determining if an entity is an agency or instrumentality of a foreign state:²⁷⁰ "the degree to which the entity discharges a governmental function ..." and "the extent of state control over the entity's operations."²⁷¹ The court found that the generation and distribution of electricity in Yugoslavia is provided by independent work organizations, such as NEK.²⁷² Based on this finding, the court concluded that the generation and distribution of electric power was a nongovernmental function in Yugoslavia.²⁷³ Regarding the degree of state control over NEK's operations, the court found that the Yugoslav Government did not hold seats on the NEK board, did not subsidize NEK, and did not participate in the daily management of NEK operations.²⁷⁴ Since

²⁶⁹. *Id.*, at 832. Here, the court explained that there was no concrete evidence that the Yugoslav Government had an ownership interest in worker organizations such as NEK. The court rejected the plaintiff's argument because it would "characterize virtually every enterprise operated under a socialist system as an instrumentality of the state within the terms of the ... [FSIA]." *Id.*, at 831.

²⁷⁰. *Id.*, at 832,

²⁷¹. *Id.*

²⁷². *Id.*

²⁷³. *Id.*

²⁷⁴. *Id.* The court cited *United States v. Orleans*, 425 U.S. 807, 814 (1976), which dealt with the analogous question of whether a federally subsidized agency was an instrumentality of the federal government, for an explanation of the "control" test principle. In *Orleans*, the Supreme Court focused on the power of the U.S. federal government to control the daily operations of an entity in order to determine if it is an agency or instrumentality of the federal

the Yugoslav Government did not satisfy any of these factors considered crucial by the court, the court found that Yugoslavia did not control NEK. Based on the above findings, the court ruled that NEK was not an agency or instrumentality of Yugoslavia and could not be a "foreign state" for purposes of vesting the court with subject matter jurisdiction under the FSIA.²⁷⁵

II. Inapplicability of the Ownership Test to Non-Market Economies.

Novosti and *Edlow* are different on the facts. That the systems of ownership in the U.S.S.R. and that of Yugoslavia are different in their operations,²⁷⁶ although both are socialist, is a factor one should not ignore in distinguishing the two cases.²⁷⁷

government. 425 U.S. at 814. The *Orleans* court also pointed out that the degree of government regulation is not controlling on the issue whether the entity is an instrumentality or agency of the government. 425 U.S. at 815-16. By analogy, the *Edlow* court stated that "the extent to which the Yugoslav state exercises ultimate control over the policies and operations of work organizations like NEK," does not derogate from the fact that worker organizations self-manage their daily operations. 441 F. Supp. at 832.

²⁷⁵. *Id.*

²⁷⁶. For details, see *Non-Market Economies*, *supra* note 13, at 170-78.

²⁷⁷. Worker's organizations in Yugoslavia are more detached from the government than public organizations in the U.S.S.R. are. See *id.*

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Nevertheless, the two cases represent two distinct approaches to the definition of "agency or instrumentality" provided for by § 1603(b)(2) of the United States Sovereign Immunities Act. One gives considerable weight to general notions of public ownership in socialist states, the other emphasizes the actual functioning of the entities in the case and the nature of its relationship to the government.²⁷⁸ Both the *Novosti* and *Edlow* courts, however, found the majority ownership test of § 1603(b)(2) to be "ill-suited" to the concept of "socially-owned" property, which is the principal form of ownership in the socialist economic systems, not to mention their domination of the countries' foreign trade with the forum states in the context of foreign sovereign immunity.²⁷⁹

The incompatibility of this criterion arises because the Act's ownership test is better designed for market economies such as the United States.²⁸⁰ The drafters of the 1976 Act did not ignore the

²⁷⁸. Kahale & Vega, *Immunity and Jurisdiction: Toward a Uniform Body of Law in Actions Against Foreign States*, 18 COLUM. J. TRANSNAT'L L. 211, 228.

²⁷⁹. The *Novosti* court explicitly recognized that the ownership test, "which seems designed to establish the degree of the foreign state's identification with the entity under consideration, is ill-suited to concepts which exists in socialist states such as the Soviet Union." *Yessenin-Volpin v. Novosti Press Agency*, 443 F. Supp. 849, 852 (S.D.N.Y. 1978). See also *Edlow International Co. v. Nuklearna Elektrarna Krsko*, 441 F. Supp. 827, 832 (D.D.C. 1977) (foreign state's property system not determinative of agency status when more precise indices available); See also *Capitalist Paradigm*, *supra* note 15, at 449-58.

²⁸⁰. See *Capitalist Paradigm*, *supra* note 15, at 449-51, 457-58.

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possibility of litigation with Socialist States,²⁸¹ yet the fact that the difficulties and the legislative gaps left to the courts as indicated in the two cases shows that at least they did not reasonably foresee the inadaptability of such a criterion for the definition of "agency or instrumentality" to the economic realities of countries of non-market nature. The criterion not only seemed to have broken down in an economic system with different ownership patterns but it is more confusing against one under extensive and drastic reform (i.e. in the case of China from 1979 to 1989).

The legislative history of the FSIA does not indicate whether the socialist system of public ownership is itself sufficient reason to treat an entity as a foreign state.²⁸² If a nation's system of property ownership were alone determinative of whether an entity is an agency or instrumentality under the Act, then every entity of a socialist state arguably would be an agency or instrumentality.²⁸³ Because the Act focuses the jurisdictional inquiry primarily on the nature of the activity, rather than on the

²⁸¹. The repeated reference to potential disputes with "foreign state trading companies" in the statement introducing the House Report obviously anticipated growing trade and accordingly increasing application of this act with the Socialist countries. *House Report*, at 6-7, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS, *supra* note 3, at 6604-05.

²⁸². HOUSE REPORT at 15-16, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS, *supra* note 3, at 6614-15.

²⁸³. Brower, Bistline & Loomis, *The Foreign Sovereign Immunities Act in Practice*, 73 AM. J. INT'L L. 200, 203 (1979).

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entity being sued, it appears that Congress may not have intended to include every single entity of a socialist country within the definition for the purpose of granting immunity.²⁸⁴ On the other hand, it seems explicit that the application of the definition was intended to be almost mechanical, obviating any intricate functional analysis which could give rise to factual disputes and uncertainties regarding the body of jurisdictional law relevant to a particular case.²⁸⁵

However, there does exist a functional difference between GOCs from market economies and SOCs from non-market economies, as elaborated in Chapter Two. It is no coincidence that in the context of foreign immunity in light of recent Chinese enterprise reform, some Chinese international lawyers have talked about the difference between state-owned enterprises and state-run enterprises,²⁸⁶ which tells that in a socialist country under economic reform, as in the case of China, a corporation state-owned is not necessarily government run. As shown in Chapter Three, the Chinese reform of property ownership has to some extent separated some state-owned enterprises from the functions of the government, and has rendered

²⁸⁴. See Kahale & Vega, *supra* note 278, at 227. See e.g., HOUSE REPORT at 15-16, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS, *supra* note 3, at 6614-15.

²⁸⁵. Kahale & Vega, *supra* note 278, at 228. See generally HOUSE REPORT at 15-16, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS, *supra* note 3, at 6614.

²⁸⁶. Conversation with Prof. Zhuang Yao, in April 1989,

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the legal fall-outs of state proprietorship less consequential and more nominal, which should affect the mechanical application of the ownership criterion.

It has been suggested that the U.S. Congress adopted the majority ownership requirement in § 1603(b)(2) in order to relieve courts of the burden to ascertain whether or not the state controls a particular legal entity.²⁸⁷ Unfortunately, the Act failed in this respect. Because of the incompatibility of the ownership test, the *Edlow* court had to resort to a "control" test. Thus the court added a new test to § 1603(b)(2) of the FSIA. In addition, both the *Novosti* and *Edlow* courts focused on whether the entity in question was of a public, governmental nature in order to determine whether it was an "organ" of the state. According to the legislative history behind the FSIA, however, it does not matter whether the nature of the "organ" is essentially governmental or commercial. Thus, these two recent decisions circumvent the congressional intent by limiting the scope of legal entities which can be organs of a foreign state under the FSIA. These developments demonstrate that the U.S. courts are still having problems in applying the doctrine of sovereign immunity to independent legal entities of a

²⁸⁷. G. Delaume states that this requirement is "[b]ased on a possibly crude but simple test, [which] affords a practical solution to a perennial problem. It has the advantage of avoiding the complexities of such notions as 'control' of the affairs of a corporation or such techniques as 'piercing the corporate veil'...." 2. G. Delaume, *supra* note 55, at §11.02.

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foreign state.²⁸⁸ Congress failed to provide the judiciary with the appropriate means by which to determine if an entity in a socialist country should be granted sovereign immunity. The problem will be compounded when considering the post-FSIA reforms to separate the government and enterprise in China during 1979-1989, where positive messages should be sent out to recognize and to encourage.

This insufficiency would result in a situation where courts are left to judge, without a clearly pronounced standard for determining the status of foreign entities. Uncertainty will ensue and the application of the provision will not create the degree of certainty that is required of legislation. On the other hand, the consequences for the non-market economy is not obviously damaging. Because of this majority ownership requirement, it is most likely that courts in the United States would consider enterprises from socialist countries, including the People's Republic of China to be agencies or instrumentalities under § 1603(b)(2), as the *Novosti* court has ruled, therefore according them the protection of foreign sovereign immunity. This does not seem to be detrimental to the interests of the non-market enterprises, who would be glad to have their commercial liabilities nullified on the basis of their "agency" status; on the contrary, this theoretical non-inapplicability issue can only be the source of disappointment in

²⁸⁸. LEGAL ENTITIES, *supra* note 69, at 183.

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the United States.²⁸⁹ If all the state-owned corporations from socialist states are given immunity by FSIA, then the Act is destroying its own purpose.²⁹⁰ However, for the United States, the issue has not been more than confusion, as shown by the court holdings in *Novosti* and *Edlow*. Beyond that, since in most of the cases these agencies or instrumentalities are in the U.S. for commercial reasons, the requirement for the commercial exception is met and the immunity already granted is thereby withheld.²⁹¹

Then the question arises: Can the non-granting of immunity to FGOs or FSOCs be achieved without such trouble in the first place. A simple recognition of the corporate independence would keep the FGOs and FSOCs away from becoming the beneficiary of foreign sovereign immunity and clear the confusion. Why not?

This is exactly what the PRC has suggested. The definition of State proper for the purpose of foreign sovereign immunity is itemized as the number one issue on the PRC list of concerns.²⁹² In its policy address to the U.N. Sixth Committee, China stated to the effect that it agrees in principle with the view of some Committee members, that the definition of state proper in the

²⁸⁹. See *supra* note 71.

²⁹⁰. See *supra* note 19.

²⁹¹. See *supra* notes 57, 75 and accompanying text.

²⁹². See *supra* note 52.

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Jurisdictional Immunities of States and Their Properties should not include entities who are established or possessed by the state, who bear civil liability independently and are responsible for it property in its business dealings.²⁹³

Why should the PRC worry? With or without the SOCs included in the state definition, its SOCs involved in commercial disputes will not receive the protection of foreign sovereign immunity, either way.

²⁹³. PRC SPEECH, *supra* note 50, at 1-2. The argument is: Viewed either from a jurisprudential or from a policy perspective, state-owned corporations, enterprises and other entities, who has their independent legal personality, who are able to sue and be sued and are capable of bearing their civil liability, should not enjoy jurisdictional immunity. In fact, in the majority of countries, including both the developing countries and the developed countries, state-owned or public-owned corporations and enterprises engaged in economic and trade activities are independent juridical entities. They do not represent the state, nor do they exercise the functions of the state or the government. Therefore they are not the constituent parts of the "state agency" (*Guojia Jigou*), and do not enjoy sovereign immunity in domestic law. To confuse this category of independent legal entities with the state or state agency, and to place them within the applicable area of state jurisdictional immunity, not only runs against the original purpose of the doctrine of state sovereign immunity, but also invites confusion as to liability of the state on the one hand, and that of these entities, and thus affecting application of the doctrine of state sovereign immunity.

PRC SPEECH, *supra* note 50, at 2.

III. Failure of the Ownership Test to Avoid Complexities
of Piercing the Veil.

A strict application of majority ownership test, as exemplified by the *Novosti* court, within its immediate reach, will not give rise to any inconvenience to entities from Socialist countries. On the contrary, it will only provide an immunity umbrella to SOCs from socialist countries against assertions of jurisdiction. The U.S. itself needs to worry about the majority ownership test, and its adaptability to SOCs from socialist countries.

However, the stiff ownership test of USFSIA has also had an unintended influence over courts. Because of the inevitable analysis in the jurisdictional stage about the close relationship between an agency or instrumentality and its home government, U.S. courts could not help but be influenced with the results of such an analysis. It is certain that they will not use the test directly to attribute liability conveniently among SOCs from socialist countries; yet the terms "agency" or "instrumentality" are frequently employed in domestic courts in association with a liability attributing doctrine of "piercing of corporate veil"²⁹⁴ - "complexities" and "techniques" that some commentators say the

²⁹⁴. See *infra* note 303 and accompanying text.

Act was designed to "avoid".²⁹⁵ As a result, a recent Supreme Court case²⁹⁶ chose not to study the relationship between the SOC involved and its home government, and held the SOC liable for the alleged wrongs of its home government. Reading the case would show that by begging several important questions, the Court implicitly replaced the "complexities" with the majority ownership test.

(i). Doctrine of "Piercing the Corporate Veil"

According to firmly established legal principles, a corporation is recognized as a legal entity,²⁹⁷ separate and distinct from its shareholders. The obligations of the corporation are the responsibility of the corporate entity, not the shareholders, who are liable only for the amount they voluntarily put "at risk" in the business venture.²⁹⁸ This insulation of shareholders is known as "limited liability."²⁹⁹

²⁹⁵. See *supra* note 287.

²⁹⁶. *First National City Bank v. Banco Para El Comercio Exterior de Cuba (Bancec)*, *supra* note 18. For details, see *infra* (ii) *Bancec* and U.S. FSIA, pp. 97-112.

²⁹⁷. Each legal theory that justifies the legality of distinct corporate existence encompasses the belief that individual shareholder interests are separable from their collective existence as a corporation. See H. Henn, *LAWS OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES* § 79, at 148 (3rd ed. 1983).

²⁹⁸. David H. Barber, *Piecing the Corporate Veil*, 17 *WILLAMETTE L. REV.* 371, 371 (1981).

²⁹⁹. *Id.*, at 371.

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Corporate personality is a court-created fiction,³⁰⁰ however, and courts will not allow their own creation to be used to defeat other legal or equitable duties.³⁰¹ When shareholders are found to have abused the privileges of limited liability to produce socially undesirable or unjust results, courts will ignore the legal persona of the corporation, refuse to limit financial responsibility to the corporation, and hold the shareholders personally liable. This is the application of the principle of "piercing the corporate veil", a phrase commonly used to describe a court's decision to ignore the distinct existence and liability of a corporation. This doctrine, under different appellations,³⁰² is also being applied, to varying degrees, by the courts of many other countries,³⁰³ and by the

³⁰⁰. Timburg, *Corporate Fictions, Logical, Social and International Implications*, 46 COLUM. L. REV. 533 (1946).

³⁰¹. *PIERCING THE VEIL*, *supra* note 69, at 453.

³⁰². The US judicial opinion in this respect indulge in verbal characterizations, epithets, and metaphors: "mere adjunct", "alias", "alter ego", "alter", "idem", "arm", "blind", "branch", "buffer", "cloak", "coat", "corporate double", "cover", "creature", "curious reminiscence", "delusion", "department", "dry shell", "dummy", "fiction", "form", "formality", "fraud on the law", "mouthpiece", "name", "nominal identity", "phrase", "puppet", "screen", "sham", "simulacrum", "snare", "stooge", "subterfuge", "tool", "agent", and "instrumentality". See E. Latty & G. Frampton, *BASIC BUSINESS ASSOCIATIONS: CASES, TEXT AND PROBLEMS* 721 (1963). It is interesting and not irrelevant to see such familiar words as "agent" and "instrumentality".

³⁰³. Courts in England, France, Greece, Italy, Norway, Switzerland, West Germany, and Argentina have also disregarded corporate integrity. Cohn & Simitis, *'Lifting the Veil' in the Company Laws of the European Continent*, 12 INT. & COMP. L.Q. 189 (1963) (France, Greece, Italy, Norway, Switzerland and West Germany); Note, *Multinational Enterprise*, 15 HARV. INT'L L.J. 528, 528-40 (1974) (Argentina); *Piercing Veil*, *supra* note 69 (England

International Court of Justice as well.³⁰⁴

While the U.S. courts have not articulated a definite standard for deciding when it is appropriate to "pierce the corporate veil," commentators recognize in judicial decisions a two prong test, which the courts require the party seeking "piercing the veil" to satisfy.³⁰⁵ If the facts of the case show "(1) that there be such unity of interest and ownership that the separate personalities of the corporation and the individual [shareholders] no longer exist; and (2) that, if the acts are treated as those of the corporation alone, an inequitable result will follow," then courts have been willing to impose liability upon the shareholders.³⁰⁶ These have been referred to respectively as the "formalities" and "fairness" requirements.³⁰⁷

The "fairness" test requires a general conclusion of injustice suffered by a party based on the commercial history of a particular

and the United States).

³⁰⁴. See, e.g., *Concerning the Barcelona Traction, Light and Power Company, Ltd., (Belg. v. Spain)*, 1970 I.C.J. 4.

³⁰⁵. See, e.g., Dobbyn, *A Practical Approach to Consistency in Veil-Piercing Cases*, 19 U. KAN. L. REV. 185 (1971); Barber, *supra* note 298; *Piercing the Veil*, *supra* note 69.

³⁰⁶. See Barber, *supra* note 298, at 376; Dobbyn, *supra* note 305, at 187; *PIERCING THE VEIL*, *supra* note 69, at 454-55.

³⁰⁷. See Barber, *supra* note 298, at 376; *PIERCING THE VEIL*, *supra* note 69, at 455.

transaction.³⁰⁸ The "formalities" test is not concerned with the injustice suffered by a party, but instead focuses on the precise structural and working relationship between shareholder and corporation.³⁰⁹ The theoretical justification for the "formalities" test is that if the corporation does not have autonomy from its shareholders, then in fact it is not a distinct entity.³¹⁰

The application of both tests call for extensive factual inquiries. The "fairness" test involves a demanding factual examination of all relevant transactions, since courts can base a conclusion of injustice only upon a full awareness of the course of contractual events.³¹¹ Likewise, courts can only satisfy themselves with the "formalities" test after an exhaustive analysis of the structural interaction of corporation and shareholder affairs.³¹² To decide whether to view the corporation as an alter ego requires a thorough understanding of both the relationship between the parties in the particular commercial triangle (the corporation, the corporation's controlling shareholders and the third party contractor) and the mechanics of control governing the

³⁰⁸. See Dobbyn, *supra* note 305, at 187.

³⁰⁹. *Ibid.*

³¹⁰. Barber, *supra* note 298, at 379; *PIERCING THE VEIL*, *supra* note 69, at 455.

³¹¹. Barber, *supra* note 298, at 374; *PIERCING THE VEIL*, *supra* note 69, at 456.

³¹². *PIERCING THE VEIL*, *supra* note 69, at 456.

corporation and its shareholders.³¹³

Now that under the majority ownership test, SOCs from socialist countries almost definitely fall into the category of "agencies or instrumentalities" of foreign states. Since the test is inserted to avoid the "complexities of ... such techniques as 'piercing the corporate veil'",³¹⁴ the result of the test itself can conveniently be brought to act to stand in place of the thorough understanding of the triangular relationship required for veil piercing. This is what happened in one veil piercing case decided by the U.S. Supreme Court. Even conceding that this cannot happen because of the clear declaration to the contrary in the Act's legislative history,³¹⁵ putting a test about the ownership relationship in the jurisdictional stage with the intention of avoiding the technique of piercing the veil in the substantive stage can hardly help the court to make a clear difference between the two.

³¹³. Barber, *supra* note 298, at 378; *PIERCING THE VEIL*, *supra* note 69, at 456.

³¹⁴. See *supra* note 287.

³¹⁵. See *infra* note 352.

(ii) *Bancec* and U.S. FSIA³¹⁶

The first post-FSIA case of foreign "corporate veil" pierced was *First National City Bank v. Banco Para El Comercio Exterior de Cuba (Bancec)*,³¹⁷ decided by the Supreme Court in 1983, in which the Court did not say a word about majority test of the §1603(b)(2) of the Act, nor did it conclude that a state-owned business entity was automatically an "agency or instrumentality" of the Cuban Government and thus implementing the doctrine without further studying the factual situation of the case. The court seemed to have refused to apply FSIA by stating that the act is not intended to affect the attribution of liability among the instrumentalities of a foreign state, giving the impression that the Court applied the traditional tests of "piercing the veil".

The court first recognized that the international setting raised concerns against piercing a foreign state corporation's veil. The first such concern was the advancement of foreign public corporations. The Court appreciated the important role of state enterprises in economic development, especially in developing

³¹⁶. The *Bancec* court relied heavily on the turn of factual events in piercing the corporate veil without further investigation. See *infra*. In the hope that the reader can see the arbitrariness of the ruling, this section will spend some pages on facts.

³¹⁷. See *supra* note 18 [hereinafter *Bancec*].

countries.³¹⁸ It admitted that the promotion and protection of these corporations depend upon a separate legal identity.³¹⁹ As the Supreme Court remarked, not only is corporate entity "typically established as a separate juridical entity, with the powers to hold and sell property and to sue and to be sued," but also that "[s]eparate legal personality has been described as 'an almost indispensable aspect of the public corporation.'"³²⁰ The Court cautioned that freely ignoring their separate status would result in uncertainty over whether an instrumentality's assets would be diverted to satisfy a claim against the sovereign, thereby causing third parties to hesitate before extending credit to a government-owned corporation without guarantee from the government.³²¹ Thus, the Court asserted a presumption upholding the foreign state corporation's independent legal identity³²² to show that denial of

³¹⁸. *Bancec*, 103 S. Ct. at 2598 (citing Department of Economic and Social Affairs of the U.N. Secretariat, ORGANIZATION, MANAGEMENT AND SUPERVISION OF PUBLIC ENTERPRISES IN DEVELOPING COUNTRIES 63-69, U.N. Doc. ST/TAO/M/65 (1974), which discusses the purpose of public enterprise in the industrialization of less developed nations).

³¹⁹. See Friedmann, *Government Enterprise: A Comparative Analysis*, in W.G. Friedmann & J.F. Garner eds., GOVERNMENT ENTERPRISES, A COMPARATIVE STUDY (1977), at 314-15.

³²⁰. *Bancec*, 103 S. Ct. at 2599. (citing Friedmann, *id.* at 314).

³²¹. *Bancec*, 103 S. Ct. at 2600 n.17 (citing Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 499, 516-17 (1976) (discussing whether a creditor of subsidiary corporation should always be able to "pierce the corporate veil" of a parent corporation)).

³²². *Bancec*, 103 S. Ct. at 2600.

separate identity would hinder economic development.³²³

The Court also recognized that respect for foreign sovereigns and for principles of comity between nations advises against piercing the corporate identity of the foreign state enterprise.³²⁴ Commenting on the legislative history of the FSIA, the Court noted that the U.S. Congress "clearly expressed its intention that duly created instrumentalities of a foreign state are to be accorded a presumption of independent status."³²⁵

There are two reasons for creating such a presumption. The first is the dictate of international comity per se.³²⁶ The second is a congressional concern for the preservation of U.S. public and private corporations. The Court, quoting the House Report on FSIA, stated that

If the U.S. law did not respect the separate juridical identities of different agencies or instrumentalities, it might encourage foreign jurisdictions to disregard the juridical division between different U.S. corporations or between a U.S. corporation and its independent subsidiary.³²⁷

³²³. *Id.*

³²⁴. *Id.* (citing *Hilton v. Guyton*, 159 U.S. 113, 163-64 (1895)).

³²⁵. *Bancec*, 103 S. Ct. at 2600.

³²⁶. See *supra* note 324 and accompanying text.

³²⁷. *Bancec*, 103 S. Ct. at 2600 (quoting HOUSE REPORT, at 29-30, reprinted in 1976 U.S. CODE & ADMIN. NEWS, *supra* note 3, at 6628-29).

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Nevertheless, the court pierced the Cuban state corporation in *Bancec*. Skirting any possible association with the implications of "agency or instrumentality" and circumventing any affiliation with the majority ownership provision in the §1603(b)(2) of the Act, the court focused, instead, superficially on the "fairness" and "formalities" elements and overcame the presumption of separate legal status accruing to a foreign state corporation.³²⁸ The court cited the two prongs used in the traditional U.S. analysis as "internationally recognized equitable principles." They were decisive in the Court's decision.³²⁹ However, the Court failed to apply the two-prong test in a convincing way.

Banco Para El Comercio de Cuba (*Bancec*) was established by the Cuban Government on April 25, 1960 as "[a]n official autonomous credit institution for foreign trade ... with full juridical capacity ... of its own"³³⁰ Its stated 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 Banco Nacional de Cuba."³³¹ *Bancec*'s capital was provided by the Republic of Cuba through the transfer

³²⁸. *Bancec*, 103 S. Ct. at 2603.

³²⁹. See *id.*, at 2601-04.

³³⁰. *Id.*, at 2593.

³³¹. *Id.* See also Joint Appendix at 39, *Bancec* (quoting Cuban Law No. 793 of April 25, 1960, Art. 1, By-Laws No. VIII (1960)).

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of capital from Banco Cubana del Comercio Exterior, a government corporation established in 1954 by the previous government. All of Bancec's profits went to the state treasury.

In a contract signed on August 12, 1960, Bancec agreed to purchase a quantity of sugar from El Institucio Nacional de Reforma Agraria (INRA), an instrumentality of the Cuban government which owned and operated Cuba's nationalized sugar industry, and to sell it to the Canadian Cuban Sugar Company.³³² The sales agreement was supported by an irrevocable letter of credit in favour of Bancec issued by Citibank (then First National City Bank) on August 18, 1960, which Bancec assigned to Banco Nacional for collection.³³³

In the interim, the Cuban Government, on July 6, 1960 enacted Law No. 851, nationalizing the Cuban properties of U.S. citizens.³³⁴ By Resolution No. 2 of September 17, 1960, the Cuban government forcibly expropriated the Cuban property of three U.S. banks, including Citibank.³³⁵ Under the Bank Nationalization Law promulgated on October 13, 1960 (Law No. 891), the government declared that banking functions could only be carried out by state instrumentalities, and ordered Banco Nacional to effect the

³³². *Bancec*, 103 S. Ct. at 2593.

³³³. *Id.*, at 2593-94.

³³⁴. *Id.*, at 2594.

³³⁵. *Id.*

nationalization.³³⁶

Prior to the nationalization, Bancec, on or about September 15, 1960, sought to collect on the letter of credit. A draft in the amount of \$193,280.30 was presented by Banco Nacional to Citibank for payment on sugar previously delivered.³³⁷ On September 20, 1960, immediately following the nationalization, Citibank credited the requested amount to Banco Nacional's account and applied the balance in the account as a set-off against the value of the assets expropriated from its Cuban branches.³³⁸

On February 23, 1961, Law No. 930 dissolved Bancec.³³⁹ This was twenty-two days after Bancec had brought a diversity action³⁴⁰

³³⁶. *Id.*

³³⁷. *Id.*

³³⁸. *Id.*

³³⁹. *Id.*

³⁴⁰. Before the Act, the usual basis of original competence by U.S. Federal District Courts over suits against foreign states was diversity of citizenship, embodied in the diversity statute, § 1332 of the judicial code, providing as follows:

The district courts shall have original jurisdiction of all civil actions where the matter in controversy exceeds ... \$10,000 ... and is between citizens of a State [of the United States], and foreign states or citizens or subjects thereof. Occasionally other specialized jurisdictional grounds could come into play, including, for example, jurisdiction over admiralty and maritime cases, or under the Edge Act. Admiralty: 28 U.S.C. 1333. Edge Act: 12 U.S.C. § 632 (providing original competence in federal district courts over all cases growing out of "transactions involving international or foreign banking"). See J.W. Dellapenna, *supra* note 30, at 33-39. The Act amends the diversity statute to

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to recover on the letter of credit in the United States District Court for the Southern District of New York,³⁴¹ but thirteen days before Citibank filed its answer seeking a set-off for the value of its seized branches. Bancec's assets after dissolution on February 23 were divided between Banco Nacional and the Ministry of Foreign Trade. Six days later, still seven days before Citibank filed its answer seeking a set-off, the Ministry of Foreign Trade created Empresa Cubana de Exportaciones (Cuban Enterprise for Exports) (Empresa), authorizing it to conduct all commercial export activities that Bancec previously transacted.³⁴² It remained subrogated to Bancec's rights and obligations regarding these commercial export transactions.³⁴³ Upon dissolution of Empresa by Resolution No. 102 of December 31, 1961, and by Resolution No. 1

foreclose diversity jurisdiction over foreign states. Section 3 of the Act amended § 1332(a)(2) by substituting the following language for the language quoted above: "(2) citizens of a State and citizens or subjects of a foreign state." It is unclear, however, whether this amendment made it impossible to maintain jurisdiction over foreign corporations under the diversity statute. 28 U.S.C. § 1332(a)(4) specifically provides that when a foreign state is a plaintiff, it can obtain jurisdiction over a United States defendant on diversity grounds. This may imply that U.S. Congress intended to foreclose diversity jurisdiction when the foreign government-owned corporation is not the plaintiff. At the same time, the Act creates a new section of the judicial code, § 1330, which grants district courts subject matter jurisdiction over "nonjury" civil actions against foreign states in which the claim for relief is "in personam." See *supra* note 76.

³⁴¹. *Bancec*, 103 S.Ct. at 2594.

³⁴². *Id.*

³⁴³. *Id.* (citing Appendix to Petition for Certiorari at 26d, *Bancec*).

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of January 1, 1962, Bancec's rights relating foreign sugar trade were again assigned to Empresa Cubana Exportadora de Azucar y sus Derivados (Cuba Zucar), a state trading company.³⁴⁴

Following Bancec's dissolution, on March 8, 1961, Citibank filed its answer. Seeking by way of counterclaim a set-off for the value of its eleven seized banks, Citibank alleged that Bancec's action had been brought "by and for the benefit of the Republic of Cuba" and that Bancec was "in form and function an integral part of and indistinguishable from the Republic of Cuba."³⁴⁵

The case lay dormant until May 2, 1975, at which point plaintiff moved for an order to substitute Cubazucar in its stead. The District Court denied the motion, apparently taking the view that the identity of the plaintiff was not dispositive.³⁴⁶ Following a bench trial in 1977, the District Court granted judgement for Citibank.³⁴⁷ In looking at the legal status of Banco Nacional, successor to Bancec's banking (as opposed to trade) interests, the District Court found no legal or factual basis for distinguishing

³⁴⁴. *Bancec*, 103 S. Ct. at 2594.

³⁴⁵. *Id.*

³⁴⁶. *Bancec*, 103 S. Ct. at 2595.

³⁴⁷. *Banco Nacional de Cuba v. Chase Manhattan Bank*, 505 F. Supp. 412 (S.D.N.Y. 1980).

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Bancec from Banco Nacional.³⁴⁸ The U.S. Court of Appeals for the Second Circuit disagreed and reversed.³⁴⁹ It stated that, as a general matter, courts should respect the independent identity of a government instrumentality created as "a separate and distinct juridical entity under the laws of the state that owns it" except "when the subject matter of the counterclaim assertible against the state is state conduct in which the instrumentality had a key role."³⁵⁰ The Second Circuit declined to hold that

a trading corporation wholly owned by a foreign government, but created and operating as separate juridical entity, is an alter ego of that government for the purpose of recovery for wrongs of the government totally unrelated to the operations, conduct, or authority of the instrumentality.³⁵¹

Soon afterwards, the Supreme Court granted certiorari.

As an initial matter, the Court dismissed Bancec's argument that the FSIA immunizes an instrumentality owned by a foreign government from a counterclaim based upon that government's actions,³⁵² and decided that principles common to both international

³⁴⁸. *Id.*

³⁴⁹. *Banco Para El Comercio Exterio de Cuba (Bancec) v. First National Citibank*, 658 F. 2d 913 (2d Cir. 1981), rev'd, *First National Citibank v. Banco Para El Comercio Exterio de Cuba (Bancec)*, 103 S. Ct. 2591 (1983).

³⁵⁰. *Id.*, at 918.

³⁵¹. *Id.*, at 920.

³⁵². *Bancec*, 103 S. Ct. at 2597. "The language and history of FSIA clearly establish that the Act was not intended to affect the substantive law determining the liability of a foreign state or instrumentality, or the attribution of liability among

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law and federal common law govern.³⁵³ Next the Court set about examining the principles involved in deciding whether or not to pierce the corporate veil of a foreign state enterprise.³⁵⁴ The court first established the presumption of a corporate legal existence.³⁵⁵ Second, the Court enumerated the principles involved in the traditional application of the corporate disregard question, specifically the two prongs of "fairness" and "formalities".³⁵⁶

Focusing on the alleged "injustice", the Court found that the presumption of corporate independence was overcome in the instant case;³⁵⁷ Bancec was liable to the extent of Citibank's set-off claim for the Cuban government's nationalization of Citibank's branches.³⁵⁸ In so holding, the Court found that the Cuban

instrumentalities of a foreign state." *Id.*

³⁵³. *Id.*, at 2597-98. The Court rejected Bancec's claim that under internationally recognized conflict of law principles Cuban law applied in determining whether an instrumentality escapes liability for acts of the sovereign. While acknowledging that the law of the state of incorporation generally determines issues relating to the internal affairs of the corporation, the Court found that different choice of law principles apply when the rights of other parties are at issue. *Id.*

³⁵⁴. *Id.*, at 2598.

³⁵⁵. *Id.*, at 2601. See also *supra* notes 323-326 and accompanying text.

³⁵⁶. See *Bancec*, 103 S. Ct. at 2601-02. See also *supra* notes 308-309 and accompanying text.

³⁵⁷. See *Bancec*, 103 S. Ct. at 2602-03.

³⁵⁸. See *id.*, at 2603.

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government had subjected itself to counterclaim through bringing a suit in the U.S.³⁵⁹ The Court explicitly agreed with the holding of the district court which found that "the devolution of Bancec's claim ... [brought] it into the hands of either the Ministry of Foreign Trade or Banco Nacional," each an alter ego of the Cuban government and hence each capable of being held liable on the counterclaim.³⁶⁰ While Bancec's assets had been transferred from the government agencies to Empresa and later Cubazucar, each a separate judicial entity, the Court regarded this as immaterial, arguing that a government cannot escape liability for violations of international law by merely effecting such retransfers.³⁶¹

In its reasoning, the Court failed to attach any importance to the role of Bancec in the Cuban expropriation³⁶², and directed its attention to identifying the true beneficiary.³⁶³

³⁵⁹. *Id.*

³⁶⁰. *Bancec*, 103 S. Ct. at 2603.

³⁶¹. *See id.* The court stated that "[t]o hold otherwise would permit governments to avoid the requirements of international law simply by creating entities whenever the need arises." *Id.*, at 2603.

³⁶². The Supreme Court mentioned this factor in its analysis, *Bancec*, 103 S. Ct. at 2602, while for the Second Circuit it was the dispositive element. *Bancec*, 658 F. 2d at 918.

³⁶³. *Bancec*, 103 S. Ct. at 2602-03. In finding that Bancec was in actuality an alter ego of the Cuban government, the Court seemed to be preoccupied by the reasoning of the Federal District Court: (1) all of Bancec's capital had been contributed by the Cuban government; (2) Bancec was engaged in a state function inasmuch it managed the export of commodities on behalf of the government; (3)

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The Court's analysis begs several questions. First, the key factor in its determination was the identification of the true recipient. But the Court did not explain its line of argumentation of how the Cuban government's possession of the claim at one time automatically invalidated the state corporation's separate identity and how the presumption of corporate integrity, supported by the important concerns enumerated by the Court itself, was overcome. To determine the financial and structural relationship between a foreign government and its state enterprise, a court must not only take into account the legal system of that nation, but also the economic features characterizing the business environment; yet none of them counted in the process of the Court's reasoning.³⁶⁴ To this question, the Supreme Court applied U.S. federal common law.³⁶⁵ It could also have applied principles of fairness and justice with due reference to the range of controls between the Cuban government and

no factual or legal distinction between Bancec and Banco Nacional could be drawn insofar as identity with the government was concerned; (4) at one time, the Ministry of Foreign Trade and Banco Nacional were vested with Bancec's claim, and (5) the equities strongly favoured the counterclaimant. *Id.* See also *Banco Nacional de Cuba*, *supra* note 346, at 425-30. While these descriptions of Bancec's function and its status as a wholly-owned instrumentality of the Cuban government are accurate, they fail, in and of themselves, to lead to the conclusion that Bancec was an alter ego of the government with respect to the expropriation of Citibank's assets, while the corporation should not be found an alter ego of the government for all purposes.

³⁶⁴. The Court itself noted, "the law of the state of incorporation normally determines issues relating to the internal affairs of a corporation." *Id.*, at 2597 (emphasis in original).

³⁶⁵. See *supra* note 353 and accompanying text.

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Bancec. The Court, however, did not.

Even assuming the Court was right in closing in on the beneficiary, the Court was hasty in its conclusion that the Government of Cuba was the true holder of the claim.³⁶⁶ Just Because Bancec's claims were assigned to the Ministry of Trade and Banco Nacional, entities which could be held liable on Citibank's counterclaim, the Supreme Court found no further inquiry to be necessary.³⁶⁷ Yet the Court did not consider material the fact that they assumed Bancec's claims for only five days, and then the claims were transferred to Empresa, and eventually to Cuba Zucar.³⁶⁸ The Court also refused to attach any importance to the fact that Empresa was created before Citibank filed its counterclaim,³⁶⁹ and that Bancec's rights and obligations were assigned specifically to Empresa.³⁷⁰ If the determination of the true recipient of Bancec's claims is the key factor in the Court's analysis, then the Court should have allowed Bancec to submit more evidence, which proposal by Bancec was rejected by the Court.³⁷¹ Of course, this does not necessarily lead to the conclusion that Empresa and Cuba Zucar

³⁶⁶. See *Bancec*, 103 S. Ct. at 2603.

³⁶⁷. See *id.*, at 2602 n.22.

³⁶⁸. See *supra* notes 342-45 and accompanying text.

³⁶⁹. *Bancec*, 103 S. Ct., at 2594.

³⁷⁰. *Id.*

³⁷¹. *Id.*, at 2602 n.22.

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should not be held liable for the expropriation of Citibank's assets, but rather that the Court could have inquired further into the facts. The Court failed to conduct a sufficient investigation for a finding of injustice.³⁷²

Lastly, despite the fact that Cuba was found to have violated international law in its expropriation of Citibank's branches,³⁷³ it does follow necessarily that the Court should disregard the corporate fiction between Bancec, Empresa or Cuba Zucar and the Cuban Government. Presumption of corporate independence would not be rightly upheld if the court pieced the veil solely because of the illegality of an action perpetrated by the controlling shareholder on the third-party contractor when the corporation is in no way involved. Even if that happens, the reasonable remedy would be to allow a direct action against the shareholder without attacking corporate assets.³⁷⁴ Yet the Court chose to beg the question by basing its corporate-veil piercing on the irrelevant resolution that Cuba should not escape liability for acts in violation of international law. It never touched upon the issue of

³⁷². See *supra* notes 311-313 and accompanying text.

³⁷³. *Banco Nacional de Cuba v. First National City Bank*, 478 F. 2d 191, 194 (2d Cir. 1973). See also *Bancec*, 103 S. Ct. at 2595 n. 3.

³⁷⁴. H. Henn, *supra* note 297, at 350 ("Creditors and shareholders enforce their claims against the individual property of the shareholders, including the shares owned by the latter in the corporation, but not against corporate property.").

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whether Bancec was in fact the alter ego of the Cuban government.

In a word, even if the Court was determined to apply the two traditional tests to pierce the veil, it failed to conduct an extensive investigation into the factual background in concluding that Bancec was involved in the nationalization act of the Cuban government. According to the Court,

The District Court adopted, and both Citibank and the Solicitor general urge upon the Court, a standard in which the determination whether or not to separate the juridical status of a government instrumentality turns in part on whether the instrumentality in question performed a 'governmental function'. We decline to adopt such a standard in this case, as our decision is based on other grounds. We do observe that the concept of a 'usual' or a 'proper' governmental function changes over time and varies from nation to nation.³⁷⁵

The reason the Court gave for not exploring the governmental function issue is its variation over time and territory; yet that should be the exact reason to dwell on the specifics including the degree of government control and the extent of the corporation's alleged discharge governmental functions in each particular case.

Nevertheless, the Court chose otherwise. It bypassed the "fairness" and "formalities" tests through not doing any serious factual investigation, an act in line with the alleged congressional intent to avoid the notion of control and the technique of piercing³⁷⁶; after this simple analysis, it pierced

³⁷⁵. *Bancec*, 103 S. Ct. at 2603 n.27.

³⁷⁶. See *Delaume*, *supra* note 287.

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the veil. If the *Bancec* case does blaze the trail for future suits against non-market economies, it would be working against the very principles of respecting the corporate integrity of public corporations from non-market economies, that the Court was right to pronounce in the first place.³⁷⁷

The possibility is not mere academic guesswork. As explained in Chapter Three, in China, only the approved SOCs including FTOs are international traders, and although they enjoy some unprecedented autonomy, they, under some circumstances, will have to discharge some governmental functions, as required by the mandatory plans or sometimes by laws passed by the state. Moreover, they have to abide by it economic, organizational, and political principles. The resulting range of autonomy available in such enterprises is different from western nations. Thus, the Supreme Court's analysis might never find sufficient independence in the state enterprises of centralized nations, and it is possible that without any hard evidence that the organization is an active participant in acts of injustice, a U.S. court may decide to hold FTO liable for the wrongs of the government by piercing the veil on the mere basis of socialist ownership, arguably as in *Bancec*.

Although this has not happened in actuality, the reverse -- attempts to hold the government liable for acts of its SOC has

³⁷⁷. See *supra* notes 318-25 and the accompanying text.

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already found its way into U.S. Courts in mid-1979. In *Scott v. People's Republic of China* (hereinafter *Scott*)³⁷⁸, the plaintiffs, a boy and his parents, alleged that the boy was injured in the eye by fireworks defectively manufactured by an unspecified Chinese factory.³⁷⁹ Originally, three U.S. organizations were also named as defendants, but the claims against them were dismissed for lack of jurisdiction. In May, 1980, a motion for a default judgement against the P.R.C. was filed. Before the hearing, however, the P.R.C. delivered a note to the U.S. State Department, asserting that the China "is a sovereign state and invokes the doctrine of sovereign immunity, and thus cannot be sued as a defendant."³⁸⁰ The plaintiff then added in their complaint the China National Native Produce and Animal Byproducts Import and Export Corp. as defendants.³⁸¹ Since the plaintiff could not serve on China National Native Produce, the P.R.C. State remained as the sole defendant. In 1982, the district court denied a motion by the China Council for the Promotion of International Trade for leave to appear as *amicus curiae* and file a brief.³⁸² Then it was not long before the

³⁷⁸. See *supra* note 18.

³⁷⁹. Memorandum of Law in Support of Dismissal of the Action Based upon the Sovereign Immunity of the Defendant (prepared by attorneys for the China Council for the Promotion of International Trade) filed Nov. 19, 1982, at 2, *Scott v. People's Republic of China*, No. CA3-79-0836-D (N.D. Tex. filed June 29, 1979).

³⁸⁰. *Id.*, at 3.

³⁸¹. *Id.*

³⁸². Docket at 6, *Scott*.

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plaintiffs filed notice of voluntary dismissal, apparently because of a private settlement with the P.R.C.³⁸³

Scott involves the same issue as *Bancec* -- treatment of the relationship between the SOCs and its home government in socialist countries under the FSIA. The proper defendant in *Scott* was China National Native Produce. The record indicates that the plaintiff's attorney brought the case against P.R.C. state partly because he failed to perfect service on China National Native Produce within the time allowed by the Court. The ownership idea behind § 1603(b) of FSIA almost has enabled the plaintiffs to exercise jurisdiction over the government of P.R.C. for the wrongs of China's state-owned corporations. *Scott* may be seen as a different issue, since the it is not a corporate veil piercing with the ruling that the corporation should be held liable for the alleged wrong of the government, as in *Bancec*. Yet the fact that holding the government liable for the alleged wrongs of its state-owned corporations reveals the same problem of the §1603(b) -- the tendency to identify a state-owned corporation with its home government in some socialist economies on the basis of ownership, though the phenomenon of piercing the veil in *Scott* is went the other way.

In sum, *Bancec* and *Scott* demonstrate that courts in the U.S. are not prevented by the crude criterion of majority ownership of

³⁸³. Docket at 8, *Scott*.

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§ 1603(b) in FSIA from pursuing the technicalities and complexities of piercing the corporate veil. Moreover, because of the close and chronological linkage between jurisdictional and substantial deliberation in the court and the similarity of the wording in the jurisdictional Act and the substantial law, courts can be enticed to reach a substantive finding with regard to corporate integrity on the basis of its jurisdictional deliberation, as seen in *Bancec*.

CHAPTER FIVE: THE ALTERNATIVE

I. Property Relationship: The Common Problem.

In the preceding Chapter, two scenarios are presented by the relevant U.S. cases decided under or with the U.S. Foreign Sovereign Immunities Act. One concerns the inapplicability of ownership test § 1603(b)(2) to state-owned corporations from non-market economies, and the other the paradoxical failure of the ownership test to avoid the complexities of "piercing the corporate veil", which came about in *Bancec* by a simple assumption to the effect that a corporation state-owned is definitely a government conspirator.

Both the scenarios boil down to one focal point, the identification of the relationship between the corporation and its home government from non-market economies by courts in the United States. The larger context is the U.S. FSIA, in which this issue has been considered.

The ownership test stems from the market-economy notion that ownership is a convenient test to trace back to the extent to which government exercises control over public corporations; to which public corporations discharge governmental functions in a

particular case.³⁸⁴ Since the discharge of government functions is the main reason to accord foreign states immunity,³⁸⁵ to apply this test to GOCs from market economies would definitely identify public acts, for which immunity is not granted. Nevertheless, this ownership test does not differentiate SOC's from non-market economies; more seriously, by avoiding a factual investigation into the extent to which the SOC discharges government functions which some suggest should be the optimal result of ownership test, U.S. courts, even in the process of deciding liability, would be tempted to jump to the conclusion the SOC in question is collaborating with the government just because of its nominal ownership relations, though this is not explicitly stated either in the Act or in the legislative history.

³⁸⁴. See *supra*, (iii) "Agency and Instrumentality" and Government-Owned Corporations from Market Economies, Chapter Three.

³⁸⁵. It is readily understandable that international comity and other considerations require that elements of the power structure of the foreign state thus physically transposed onto the territory of the local state with the consent of the latter receive a privileged treatment, including immunity from the jurisdiction of the local courts. No such transposition of physical elements of the foreign state's power structure is involved in trade activities carried out by the latter with nationals of the local state,
G.M. Badr, *supra* note 27 at 17-18.

II. Possible Alternatives

To meet the difficulties of the Act with regard to business entities from non-market economies, U.S. courts have come up with various solutions. Some courts have attempted to avoid the difficulties in applying the majority ownership test by abandoning analysis and assuming that any entity from a socialist system is necessarily a state agency or instrumentality.³⁸⁶ On the other extreme, courts have simply accepted the characterization of the foreign government.³⁸⁷ Nevertheless, none of them proves to be accommodating enough to solve the incompatibility problem.

³⁸⁶. For example, in *Patterson, Zochonis (U.K.) Ltd. v. Compania United Arrow*, 493 F. Supp. 621 (S.D.N.Y. 1980), the China Ocean Shipping Corporation (COSCO), an entity organized under the laws of the PRC, was sued for shipping losses. *Id.* at 622-23. The court observed that it "seemed clear" that COSCO was an "agency or instrumentality" of the PRC, without considering the relationship of COSCO with the Chinese Communications Ministry, under which COSCO is organized. *Id.*, at 623; See Recent Decision, *Government Shipping Company of the People's Republic of China is an "Agency or Instrumentality" for the Purpose of the Foreign Sovereign Immunities Act of 1976*, 14 VANDERBILT J. TRANSNAT'L L. 637, 648 (1981); *Non-Market Economies*, *supra* note 13, at 184, n193.

³⁸⁷. In several cases the only proof of ownership relationship was an affidavit or the oral testimony of a governmental official. *Vargés, Defining a Sovereign for Immunity Purposes: Proposals to Amend the International Law Association Draft Convention [hereinafter Defining a Sovereign]*, 26 HARV. INT'L L. J. 103, 146 (1985). In *S & S Machinery Co. v. Masinexportimport*, 706 F. 2d 411 (2d Cir. 1983), the court found determinative an affidavit from the Romanian Consul that the entity in question was a "state foreign trade company wholly-owned by the Romanian Government." *Id.* at 415; *Non-Market Economies*, *supra* note 13, at 184, n193.

The nearest suggestion came from *Edlow* and *Novosti*. In their decisions, the two courts put forward a function test: to the extent that an entity discharges a government function or is of an "essentially public nature", it is an organ of the government.³⁸⁸ Yet commentators agree that is a dangerous proposition,³⁸⁹ for it introduces into the analysis the element of public purpose, which can be attributed to all the economic units in socialist countries.³⁹⁰ When applied to socialist countries, the public purpose test can not avoid the kind of confusions that the majority ownership test has already caused. In addition, by not putting the public purpose test into the concepts of agency or instrumentality, the suggestion has not avoided the inevitable association with the doctrine of piercing the corporate veil, as happened in *Bancec*.

In addition to the function test, the *Edlow* court also proposed the control test. The control test would be a closer and clearer delineation of the notion of the discharge of government functions. It recognizes the fact that in socialist countries most of the significant property is owned by the state; it also concedes

³⁸⁸. *Novosti*, supra note 69 ("essentially public nature of ... organizations ... in the Soviet Union"); *Edlow*, supra note 69 ("degree to which the entity discharges a government function"); *Non-Market Economies*, supra note 13, at 185, n194. See also text accompanying supra notes 261 and 271.

³⁸⁹. *Non-Market Economies*, supra note 13, at 185; *Capitalist Paradigm*, supra note 15, at 445; *Legal Entities*, supra note 69, at 182.

³⁹⁰. See *Non-Market Economies*, supra note 13, at 185.

that some corporations, in some of their day-to-day business operate beyond the reach of mandatory plans or independently of government control. It appreciates the fact that when dealing with these countries, the administration of property is more consequential than the possession thereof. This test is also capable of serving as a basis for conducting evidential investigations into the actual relationship of the corporation and its home government, and thus avoiding the free and uninformed piercing of corporate veil. Nonetheless, since the test is still embodied in the terminology of "agency or instrumentality", it still is not able to escape the possibility of being subconsciously associated with the mechanic application of piercing the veil, though factual investigation is called for. What is more, it did not avoid what Congress was trying to avoid³⁹¹ - the complexities of the variables to be considered in the world of public corporations. By leaving the standard to the courts, Congress will not rest at ease to see courts arrive at inconsistent interpretations and both sides of business transaction subject to uncertainty.

However hard the courts in the United States try, the problem is there in the Act, which they are bound to abide by. Alternative attempts by courts can only be suggestive of the necessity for change while not capable of considering the issue beyond the

³⁹¹. See *supra* note 287.

framework of the Act itself. In this connection, state immunity legislations of other countries merit consideration.

The United Kingdom passed its State Immunity Act in 1978³⁹². Singapore³⁹³, Pakistan³⁹⁴ and South Africa³⁹⁵ followed suit from 1979 to 1981, using the British Act as a model. In 1982, they were joined by Canada,³⁹⁶ whose Act was more akin to the U.S. legislation

³⁹². State Immunities Act 1978 [hereinafter SIA], ch. 33, reprinted in 17 INT'L LEGAL MATS. 1123 (1978).

³⁹³. The Singapore State Immunity Act 1979, reprinted in Appendix IV, G.M. Badr, *supra* note 27, at 203. Concerning the definition of state, the Singapore Act has the exact wording of the U.K. Act of 1978. See Section 16, The Singapore State Immunity Act 1979, *id.*, at 208.

³⁹⁴. The Pakistani State Immunity Ordinance 1981, reprinted in Appendix V, G.M. Badr, *supra* note 27, at 210. The Pakistani Act also followed the U.K. mode in defining foreign state. See Section 15, The Pakistani State Immunity Ordinance 1981, *id.*, at 215-16.

³⁹⁵. The South African Foreign State Immunities Act 1981, reprinted in Appendix VI, G.M. Badr, *supra* note 27, at 218. The same definition of foreign state was inserted. See Section 1(2), The South African Foreign State Immunities Act 1981, *id.*, at 218.

³⁹⁶. The Canadian State Immunity Act 1982, reprinted in Appendix VII, G.M. Badr, *supra* note 27, at 225; see also, Molot & Jewett, *supra* note 7.

One Canadian commentator argues that until the enactment of the State Immunity Act in 1982, it was unclear whether Canadian law had formed a clear-cut public/private distinction. Edward M. Morgan, INTERNATIONAL LAW AND THE CANADIAN COURTS -- SOVEREIGN IMMUNITY, CRIMINAL JURISDICTION, ALIENS' RIGHTS AND TAXATION POWERS 33 (1990). Even so, relevant Canadian caselaw did display a realistic and coherent attitude towards foreign entities of a legal status separate from the state. See *Smith v. Can. Javelin Ltd.* (1976), 12 O.R. (2d) 244, 68 D.L.R. (3d) 428 (Ont.) (in which an entity of the U.S. government was found immune for its involvement in the implementation of the U.S. legislative policy); *Zodiak Internat. Products Inc. v. Polish People's Republic* (1977), 4 B.L.R. 179, 81 D. L. R. (3d). 656 (Que. C.A.) (in which a Polish state enterprise

in its provisions about foreign bodies other than the government.³⁹⁷ In addition to the national legislative efforts, there also came the International Law Association's Montreal Draft Convention on State Immunity of 1982³⁹⁸ and the International Law Commission of the U.N. Draft Convention on the Jurisdictional Immunities of States and Their Property in 1986 (first reading).³⁹⁹

A comparison of the national and international efforts shows:

1/ the Canadian Act, the ILA Convention and the ILC Convention employed the terminology of "agency" or "instrumentality", with different interpretations. "Agency" in the Canadian Act is an organ of the foreign state with a separate legal personality (without

having civil personality distinct from Polish Republic and engaging in import/export of films was ruled not immune in commercial matters); *Ferranti-Packard Ltd. v. Cushman Rentals Ltd.* (1980), 30 O.R. (2d) 194, 19 C.P.C. 132, 115 D.L.R. (3d) 391, reversing (1979), 26 O.R. (2d) 344, 14 C.P.C. 48, was affirmed (1981), 31 O.R. (2d) 799, 123 D.L.R. (3d) 766 (C.A.) (in which a New York highway authority was found according to Canadian law to be engaged in commercial activity and not immune, on the basis of evidences of its power to sue and to be sued, to acquire real property, to collect enough money to be self-efficient, etc. although New York legislature described the authority as "performing governmental functions"). The standard has been clear and coherent with the public/private distinction. There was no cases piercing the corporate veil of state-owned corporations from socialist countries. See THE CANADIAN ABRIDGEMENT, 2ND PERMANENT SUPPLEMENT (1979), 3RD PERMANENT SUPPLEMENT (1982).

³⁹⁷. Molot & Jewett, *supra* note 7, at 110.

³⁹⁸. The ILA Montreal Draft Convention on State Immunity (1982), reprinted in Appendix VIII, G.M. Badr, *supra* note 27, at 231 [hereinafter ILA Convention].

³⁹⁹. See U.N. 1986 Report, *supra* note 2 [hereinafter ILC Convention].

elaborating whether it is to be decided by ownership exclusively or not); it is treated the same as a foreign state for the purpose of foreign state immunity.⁴⁰⁰ The ILA's "agency or instrumentality" can be treated as a foreign state if (1) it does not have a separate legal status from the state, or (2) it possesses legal personality distinct from the state but performed the act or omission at issue in *jure imperii*.⁴⁰¹ In the ILC Convention, under Art. 3, a state includes, for the purpose of jurisdictional

⁴⁰⁰ 2. In this Act,

"agency of a foreign state" means any legal entity that is an organ of the foreign state but that is separate from the foreign state;

...
"foreign state includes

...
(b) any government of the foreign state or of any political subdivision of the foreign state, including any of its departments, and any agencies of the foreign state.

...
Canadian State Immunity Act, *supra* note 396, at 225. See *Bouchard v. J.L. Le Saux Ltée* (No.2) (Ont. H.C.), reversing on other grounds (1984), 45 O.R. (2d) 792, 46 C.P.C. 52 (Sub. nom. *Bouchard v. J.L. Le Saux Ltée* (No.1)) (Ont. Master), reversed on other grounds (1986), 11 C.P.C. (2d) 170, 58 O.R. (2d) 124 (note) (Ont. C.A.) (in which a corporation affiliated with Hydro-Québec completely controlled by Québec government was found to be immune). The Act excludes independent entities not acting as an alter ego of the state for the purpose of immunity. *Molot & Jewett*, *supra* note 7, at 110.

⁴⁰¹. Art. I. B provides:
The term "Foreign State" includes:

...
3. Agencies and instrumentalities of the State not possessing personality distinct from the State;

...
An agency or instrumentality of a foreign State which possess legal personality distinct from the State shall be treated as a foreign State only for acts or omissions performed in the exercise of sovereign authority, i.e. *jure imperii*.

See *supra* note 398, at 231.

immunities, state agencies and instrumentalities to the extent they perform sovereign functions for the state. As shown above, the terminology of agencies and instrumentalities are not terms of art and caution is required in using them.⁴⁰² The British model,⁴⁰³ followed by Singapore,⁴⁰⁴ Pakistan⁴⁰⁵ and South Africa⁴⁰⁶, used such terms as entity, which is more suited to designating the differences of the GOCs and SOCs⁴⁰⁷ without the danger of

⁴⁰². As then U.S. Judge Cardozo observed, The whole problem of the relation between parent and subsidiary corporations is one that is still enveloped in the mists of metaphor. Metaphors in law are to be narrowly watched, for starting as devices to liberate thought, they end often by enslaving."

Berkey v. Thrid Ave. Ry., 244 N.Y. 602, 155 N.E. 914 (1927). This warning was reiterated by the U.S. Supreme Court in *Bancec*, *supra* note 18 at 2591, 2598.

⁴⁰³. Section 14 provides:

(1) ... and reference to a State include reference to -

...

(c) any department of that government, but not to any entity (hereinafter referred to as a "separate entity") which is distinct from the executive organs of the government of the State and capable of suing or being sued.

(2) A separate entity is immune from the jurisdiction of the courts of the United Kingdom if, and only if -

(a) the proceedings relate to anything done by it in the exercise of sovereign authority;

(b) the circumstances are such that a State ... would have been so immune.

UK State Immunity Act of 1978, *supra* note 392, at 1127.

⁴⁰⁴. See *supra* note 393.

⁴⁰⁵. See *supra* note 394.

⁴⁰⁶. See *supra* note 395.

⁴⁰⁷. Entities of this kind are termed by some commentators as state economic vehicles (SEVs). *Defining a Sovereign*, *supra* note 387, at 120. An economic term, it however reflects the differences

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associating itself with the doctrine of piercing the corporate veil. 2/ The UK Act categorize separate entities under two headings - first, those that are departments or organs of the foreign state and are treated for all purposes in the same manner as the State itself and, second, those that are an SEV of a foreign state, such as a SOC over which there is lesser degree of governmental control.⁴⁰⁸ For the second category, there is immunity only when: (a) the proceedings relate to anything done by it in the exercise of sovereign authority; (b) the circumstances are such that a State ... would have been so immune.⁴⁰⁹ This standard is also taken by the ILA convention, which requires the SEV to perform an act or omission within sovereign authority, i.e. *jure imperii*.⁴¹⁰ The ILC convention definition of state includes agencies and instrumentalities for the purpose of immunity only to the extent that they perform sovereign functions for the state. As elaborated in the commentary of the Convention Document⁴¹¹,

The third category embraces the agencies and instrumentalities of the State but only in so far as they are entitled to perform acts in the exercise of "*prerogatives de la puissance publique*." Beyond or outside the sphere of acts performed by

of SEVs in nature, relationship with the government, and business activities. See *id.*, from 120-21.

⁴⁰⁸. Trooboff, *Foreign State Immunity, Emerging Consensus on Principles*, 200(V) RECUEIL DES COURS 235, 395 (1986).

⁴⁰⁹. See *supra* note 403.

⁴¹⁰. See *supra* note 401.

⁴¹¹. [1986] 2 Y.B. Int'l L. Comm'n, U.N. Doc. A/CN.4/1986/Add.1 (Part 2).

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them in the exercise of the sovereign authority of the State, they do not enjoy any jurisdictional immunity.⁴¹²

As one could see, both the ILA and the ILC endorsed the U.K. approach in including SEVs for the purpose of sovereign immunity.

This approach does not consider material whether under domestic law the entity is a legal person or not.⁴¹³ As long as in substance it is a department of the State in dispute, it is entitled to immunity; the difficult question whether the entity is a legal person or not is thus rendered irrelevant.

Whether the entity which is capable of suing and being sued is "distinct from the executive organs of the government" is a question of fact and depends on foreign law, i.e. the status which the foreign law confers upon the entity rather than the factual situation.⁴¹⁴ If the foreign legislature intends that it be distinct, then the fact that it acts in accordance within the directions of the government is not material. Conversely, if the entity is not intended by its home law to be distinct, then its actual independence of government organs cannot deprive it of

⁴¹². *Id.*, at 29.

⁴¹³. F.A. Mann, *The State Immunity Act 1978*, 50 BRIT. Y.B. INT'L L. 43, 48 (1979). It is possible that the entity meets the requirements of its domestic law of being a legal person, although it may not be a legal person under English law. *Id.*

⁴¹⁴. *Id.*

immunity.⁴¹⁵

The SIA's approach is better suited to dealing countries of different economic, especially ownership systems. It has avoided the definition of entities to be accorded immunity on the simplistic basis of their property relationship with the government, and appreciates the legislative intents of foreign laws in this regard. It has also achieved the aim that U.S. FSIA majority ownership requirement attempted to attain, the avoidance of factual investigations into the extent of control exercised by the foreign government over the entity.⁴¹⁶ By a simple recognition, it differentiates the foreign entities on the basis of foreign law, and bases the grant of immunity on this cognizance finding, rendering it less likely that international friction shall occur because of court refusal to take foreign law into account.

Secondly, the SIA, by avoiding any factual probe into the control relationship of the foreign entity, and by not using the term "agency or instrumentality" in deciding who to accord sovereign immunity, has put forward a clear jurisdictional approach free of any unnecessary association with the attribution of liability, especially in cases concerning the disregard of foreign corporate independence. Because of its easy-to-apply, and clear-

⁴¹⁵. *Id.*

⁴¹⁶. *See supra* note 67.

in-purpose nature, courts will have a sharper perception of how far jurisdictional immunity and piercing of corporate veil stand apart. Being a consistent approach, it also compels courts, among other factors, to conduct a thorough factual investigation into the control relationship for the purpose of piercing the corporate veil, whereas the U.S. Act, tends to confuse the two, although the legislative history suggests the contrary.⁴¹⁷

The avoidance of factual discovery of the British legislation does not entail that if the courts are confronted with the question of corporate integrity, they are to stop at the artificial threshold. The nonexistence of any excessive influence by the often-quoted terminology associated with the piercing of the corporate veil in the jurisdictional stage on the attribution of liability has provided English Courts with the latitude needed for conducting a thorough investigation into the extent of control exercised by the corporation's home government. British courts were able to maintain a consistency not seen in U.S. cases. In its pre-Act case of *Trendtex Trading Corp. v. Central Bank of Nigeria*,⁴¹⁸

⁴¹⁷. The bill is not intended to affect the substantive law of liability. Nor is it intended to affect ..., or the attribution of responsibility between or among entities of a foreign state; for example, whether the proper entity of a foreign state has been sued, or whether an entity sued is liable in whole or in part for the claimed wrong. House Report, at 12, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS, supra note 3, at 6610; see also supra note 351.

⁴¹⁸. *Trendtex Trading Corp. v. Central Bank of Nigeria* [hereinafter *Trendtex*], [1977] 1 Q.B. 529.

a U.K court declared the importance of a complete factual inquiry to discover whether the enterprise was under government control, and exercised traditional functions of the government, or merely engaged in business for the government.⁴¹⁹ Throughout the court's opinion, concern for the importance of foreign law in making such a determination was reiterated.⁴²⁰ In *C. Czarnikow Ltd. v. Centrala Handlu Zagranicznego 'Rolimpex'*,⁴²¹ which occurred after U.K. promulgated its foreign sovereign immunities act, the court, while balancing the laws of the forum and those of the foreign state, showed respect for the foreign depiction of the status of the public corporation in question and warned against imposing English corporate "veil-piercing" standard on other nations.⁴²² Unlike their American counterparts, courts in U.K. was not stripped of their traditional tools in handling "veil-piercing " cases and it would be reasonably inferred that either the U.K parliament was cautious enough not to undertaking a simplifying mission or that the courts were judicious enough not to allow any pre-conceived ideas to steering the course of judicial deliberations.

⁴¹⁹. *Trendtex, id.*, at 560, 572-74.

⁴²⁰. See *Piercing the Veil, supra* note 69, at 470-73.

⁴²¹. *C. Czarnikow Ltd. v. Centrala Handlu Zagranicznego 'Rolimpex'* [hereinafter *Rolimpex*], [1979] A.C. 351 (1978). See also *Piercing the Veil, supra* note 69, at 473-75.

⁴²². *Rolimpex, id.*, at 364.

Addressing the same problem, commentators have put forward several suggestions. One writer proposed that since the Act could suffice in disputes between market economies, Congress should in the Amendment include a provision establishing "what types of Socialist entities will be considered agents".⁴²³ This proposal can only aggravate the difficulty of the Court, for the term "Socialist" nowadays may need some unqualified definition to fit the group of non-market economies; moreover, the term "agent" seems to be more reminiscent of piercing the corporate veil than agency or instrumentality.⁴²⁴ Another commentator continued to employ the term agency or instrumentality while maintaining the same majority ownership test, thus keeping the problem intact.⁴²⁵

III. The Alternative Proposed

The approach adopted by the U.K. Act is ideal for treating the problems of the Act discussed in the preceding chapters. It is no coincidence that the two international conventions and national acts of other Commonwealth countries, except Canada, endorsed the same model. One commentator recommended its incorporation into the

⁴²³. *Capitalist Paradigm*, *supra* note 15, at 459-60.

⁴²⁴. *See supra* note 302.

⁴²⁵. *Defining a Sovereign*, *supra* note 386, at 152-54.

U.S. Act, for the reason that not all state-owned corporations from non-market economies should be immunized on the basis of their property relationship.⁴²⁶ For different reasons, this thesis endorses the same approach. §1603 concerning foreign entities of the U.S. FSIA could be modified to read as follows:

§ 1603. Definitions

"For purpose of this chapter:

"(a) A 'foreign state', except as used in section 1608 of this title, apply to any foreign State other than the United States; and references to a foreign state include references to:

- (1) the head of that foreign state in her/his public capacity;
 - (2) the government of that foreign state, and
 - (3) any department of that government, including organs not legally distinct from that government,
- but not to any entity (hereafter referred to as a 'separate entity') which is legally distinct from the government and capable of suing or being sued.

"(b) A 'separate entity', is immune from the jurisdiction of the courts of the United States if, and only if:

- (1) the proceedings relate to acts or omissions performed by it in the exercise of sovereign authority, i.e., *jure imperii*, of the government of that foreign state; and
- (2) the circumstances are such that a foreign state would have been so immune.⁴²⁷

This modification has all the advantages of the British Act, including the two major problems discussed in the preceding chapters about the U.S. Act: the problem of identifying foreign GOCs or SOC's on the basis of majority ownership for the purpose of immunity, and the problem of confusing the jurisdictional Act with the substantial attribution of liability in piercing the corporate

⁴²⁶. See *Non-Market Economies*, supra note 13, at 191, 159-91.

⁴²⁷. See also *Market Economies*, supra note 13, at 191.

veil. Only the term acts or omissions of "sovereign authority" needs clarification. Fortunately, U.S. Congress does have a pre-FSIA leading case, *Victory Transport, Inc. v. Comisaria General*,⁴²⁸ which lends some help in framing the standards for identifying acts of sovereign authority. The *Victory* Court enumerated five categories of governmental activities:

- (1) internal administrative acts, such as expulsion of an alien;
- (2) legislative acts, such as nationalization;
- (3) acts concerning the armed forces;
- (4) acts concerning diplomatic activity; and
- (5) public loans.⁴²⁹

Clearly, these five categories, if applied strictly, would exclude not only all GOCs of market economies but also all SOCs of socialist countries from the domain of social purpose, hence the domain of foreign sovereign immunity. In the area of public owned corporations, this would mean a denial of the true *raison d'être* of public ownership. In the area of foreign sovereign immunity, especially when one is consideration the FSIA, this application would not fulfil the purpose of the Act to include entities acting on behalf of governments. Therefore, to distinguish government acts from commercial acts done by SOCs, the writer proposes to add one

⁴²⁸. *Victory Transport, Inc. v. Comisaria General de Abastecimientos y Transportes*, 336 F. 2d 354, 357-58 (2d Cir. 1964), cert. denied, 381 U.S. 934. This case was the leading statement of commercial activity analysis in U.S. sovereign immunity cases prior to the passage of the FSIA. See *Non-Market Economies*, supra note 13, at 167.

⁴²⁹. *Id.*

more category, which should be acts in the exercise of sovereign authority. It shall include acts to protect, stabilize and facilitate the operation of the market for the well-being of the national economy. This criterion is capable of distinguishing the government conspirators from corporations merely owned by the government or the state. China would be a good case in point. Acts in accordance with mandatory plans should be regarded governmental, while acts in accordance with guidance planning and supply-demand relations of the market can be commercial. Similarly, profit-seeking acts by government-owned corporations from market economies should be commercial while policy-implementing acts are governmental. One may suggest again that this proposition brings in the element of public purpose, which can be attributed to all socialist business entities.⁴³⁰ Yet this is only true when the criterion is one of ownership. The specific acts that the SOCs are engaged in differ in nature, and can be identified with the way they cope with the state plan. Furthermore, there is always the need to set up a standard of where the line should be drawn. The purpose should be examined only in light of meaningful immediacy. As the reform in some socialist countries continues, this criterion is going to be more and more handy.

With the case law experience following *Victory*, U.S. courts could understandably be pulled into consistency regarding acts of

⁴³⁰. See *supra* note 390 and accompanying text.

a sovereign nature and cases like *Novosti* and *Edlow* could not possibly occur. *Novosti*, being a separate entity, would not have received immunity protection because its alleged act of libel does not fall into the categories listed above; whereas the *Edlow* court would have reached the same conclusion because generation of electricity is not is not one item of the Yugoslav state economic plan.⁴³¹ The *Bancec* court would have to conduct a thorough investigation into the facts of the case for the purpose of piercing the veil instead of jumping to an early conclusion with the predisposed idea of agency or instrumentality.

⁴³¹. See text accompanying *supra* note 273.

CONCLUSION

Sovereign immunity is an international law concept. It is true, as the drafters of the U.S. FSIA noted, that "its specific content and application have generally been left to the courts of the individual nations."⁴³² It is also true that there is a national interest in protecting the rights of those who deal with foreign states in commercial matters. Yet by definition, sovereign immunity involves more than one state, and its purpose includes the safeguarding of comity and respect for national sovereignty.⁴³³ Thus, whatever approach to sovereign immunity is adopted, it must consider the impact its application can have on international relations. International trade and political relations can hardly be aided if the relevant law of one state disregards the ideological, political, economic and social circumstances under which a foreign business operates.

A viable and coherent definition of state in the application of foreign sovereign immunity must meet the requirement of the predictability of law,⁴³⁴ given the impact the grant or denial of

⁴³². *House Report*, at 8, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS, *supra* note 3, at 6606,

⁴³³. For discussion, see Reeves, *Good Fences and Good Neighbours: Restraints on Immunity of Sovereign*, 44 AM.B.A.J. 521 (1958).

⁴³⁴. *Defining a Sovereign*, *supra* note 387, at 115.

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sovereign status may have on the minor but important privileges like service, discovery, jury trial, proof of foreign law, default judgement and punitive damages, and on such vital issues of international relations.⁴³⁵ In the context of the possible two scenarios discussed in the previous chapters, sovereign status also affects certain disadvantages and responsibilities that a defendant may wish to avoid. For example, a defendant may stand to lose some affirmative defence such as governmental force majeure, sovereign compulsion, and perhaps acts of state.⁴³⁶ Furthermore, sovereign status gives rise to jurisdictional problems of diversity and contacts,⁴³⁷ problems of authority for waivers, and such substantive problems like the corporate veil being pierced⁴³⁸.

The U.S. insertion of "agency or instrumentality" into the Act and its criteria of majority ownership not only ignores the reform of enterprises taking place in socialist countries, but also

⁴³⁵. *Id.*, at 115-16.

⁴³⁶. As in *Bancec*.

⁴³⁷. Sovereign status may subject to jurisdiction some defendants over which U.S. would not otherwise have jurisdiction. See *Edlow*, *supra* note 69. Unable to secure diversity jurisdiction (NEK was found to be a foreign corporation), the plaintiff relied on the FSIA for jurisdiction, since the Act grants federal jurisdiction if a foreign state agency or instrumentality is involved. See *Defining a Sovereign*, *supra* note 387, at 144. Further jurisdictional questions arise when the sovereign status of an entity may allow its contacts be used for asserting jurisdiction over another part of the sovereign. See *Defining a Sovereign*, *supra* note 387, at 116 n.64.

⁴³⁸. See Chapter Four III (ii), *Bancec* and USFSIA.

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threatens to hold foreign corporations liable for acts of their home government, or vice versa. Unnecessary threats or harassment brought against foreign government-owned corporations or foreign governments must be addressed, and addressed in a way that could take into account the legal facts of a totally different economy with its property relationship under reform.

National and international efforts at laying down the rules of foreign sovereign immunity have generated this trend of dividing state economic vehicles into two categories, and treating the independent entities as sovereign only when they act in *jure imperii*. This model, as exemplified by the British legislation, has not produced unreasonable inconsistencies in treating foreign SOCs or GOCs, and may prove to be effective in solving the problems that the U.S. FSIA has created. Commentators have suggested incorporating this model in the U.S. Act, and this thesis hereby seconds this suggestion, for reasons elaborated above. It is sincerely hoped that with this incorporation, U.S. courts could be given a more objective and fair standard in treating state-owned business entities from non-market economies, and thus contributing to the promotion of international trade and the codification of international law in the aspect of foreign sovereign immunity.

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APPENDIX

THE UNITED STATES
FOREIGN SOVEREIGN IMMUNITIES ACT OF 1976

AN ACT

To define the jurisdiction of United States courts in suits against foreign states, the circumstances in which foreign states are immune from suit and in which execution may not be levied on their property, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Foreign Sovereign Immunities Act of 1976".

Sec. 2. (a) That chapter 85 of title 28, United States Code, is amended by inserting immediately before section 1331 the following new section:

"§ 1330. Actions against foreign states

"(a) The district courts shall have original jurisdiction without regard to amount in controversy of any nonjury civil action against a foreign state as defined in section 1603(a) of this title as to any claim for relief in personam with respect to which the foreign state is not entitled to immunity either under sections 1605-1607 of this title or under any applicable international agreement.

"(b) Personal jurisdiction over a foreign state shall exist as to every claim for relief over which the district courts have jurisdiction under subsection (a) where service has been made under section 1608 of this title.

"(c) For purposes of subsection (b), an appearance by a foreign state does not confer personal jurisdiction with respect to any claim for relief not arising out of any transaction or occurrence enumerated in section 1605-1607 of this title."

"(b) By inserting in the chapter analysis of that chapter before:
"1331. Federal question; amount in controversy; costs."
the following new item:

"1330. Action against foreign states".

Sec. 3. That section 1332 of title 28, United States Code, is amended by striking subsections (a)(2) and (3) and substituting in their place the following:

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"(2) citizens of a State and citizens or subjects of a foreign state;

"(3) citizens of different States and in which citizens or subjects of a foreign state are additional parties; and

"(4) a foreign state, defined in section 1603(a) of this title, as plaintiff and citizens of a State or of different States."

Sec. 4. (a) That title 28, United States Code, is amended by inserting after chapter 95 the following new chapter:

"CHAPTER 97. JURISDICTIONAL IMMUNITIES OF FOREIGN STATES

"Sec.

"1602. Findings and declaration of purpose.

"1603. Definitions.

"1604. Immunity of a foreign state from jurisdiction.

"1605. General exceptions to the jurisdictional immunity of a foreign state.

"1607. Extent of Liability.

"1607. Counterclaims.

"1608. Service; time to answer default.

"1609. Immunity from attachment and execution of property of a foreign state.

"1610. Exceptions to the immunity from attachment or execution.

"1611. Certain types of property immune from execution.

"§ 1602. Findings and declaration of purpose

"The Congress finds that the determination by United States 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. Under international law, states are not immune from the jurisdiction of foreign courts insofar as their commercial activities are concerned, and their commercial property may be levied upon for the satisfaction of judgements rendered against them in connection with their commercial activities. 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.

"§ 1603. Definitions

"For purposes of this chapter:

"(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:

"(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

"(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.

"(d) 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.

"(e) A 'commercial activity' carried on in the United States by a foreign state' means commercial activity carried on by such state and have substantial contact with the United States.

"§ 1604. Immunity of a foreign state from jurisdiction

"Subject to existing international agreements to which the United States is a party at the time of enactment of this act a foreign state shall be immune from the jurisdiction of the courts of the United States and of the States except as provided in sections 1605 to 1607 of this chapter.

"§ 1605. General exceptions to the jurisdictional immunity of a foreign state

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

"(1) in which the foreign state has waived its immunity either explicitly or by implication, notwithstanding any withdrawal of the waiver which the foreign state may purport to effect except in accordance with the terms of the waiver;

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

"(3) in which rights in property taken in violation of international law are in issue and that property or any property exchanged for such property is present in the United States in connection with a commercial activity carried on in the United States by the foreign state; or that property or any property exchanged for such property is owned or operated by an agency or instrumentality of the foreign state and that agency or instrumentality is engaged in a

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commercial activity in the United States;

"(4) in which rights in property in the United States acquired by succession or gift or rights in immovable property situated in the United States are in issue; or

"(5) not otherwise encompassed in paragraph (2) above, in which money damages are sought against a foreign state for personal injury or death, or damage to or loss of property, occurring in the United States and caused by the tortious act or omission of that foreign state or of any official or employee of that foreign state while acting within the scope of his office or employment; except this paragraph shall not apply to:

"(A) any claim based upon the exercise or performance or the failure to exercise or perform a discretionary function regardless of whether the discretion be abused, or

"(B) any claim arising out of malicious prosecution, abuse of process, libel, slander, misrepresentation, deceit, or interference with contract rights.

"(b) A foreign state shall not be immune from the jurisdiction of the courts of the United States in any case in which suit in admiralty is brought to enforce a maritime lien against a vessel or cargo of the foreign state, which maritime lien is based upon a commercial activity of the foreign state: Provided That:

"(1) notice of the suit is given by delivery of a copy of the summons and of the complaint to the person, or his agent, having possession of the vessel or cargo against which the maritime lien is asserted; but such notice shall not be deemed to have been delivered, nor may it thereafter be delivered, if the vessel or cargo is arrested pursuant to process obtained on behalf of the party bringing the suit - unless the party was unaware that the vessel or cargo of a foreign state was involved, in which event the service of process of arrest shall be deemed to constitute valid delivery of such notice; and

"(2) notice to the foreign state of the commencement of suit as provided in section 1608 of this title is initiated within ten days either of the delivery of notice as provided in subsection (b)(1) of this section or, in the case of a party who was unaware that the vessel or cargo of a foreign state was involved, of the date such party determined the existence of the foreign state's interest. Whenever notice is delivered under subsection (b)(1) of this section, the maritime lien shall thereafter be deemed to be an in personam claim against the foreign state which at that time owns the vessel or cargo involved: Provided, That a court may not award judgement against the foreign state in an amount greater than the value of the vessel or cargo upon which the maritime lien arose, such value to be determined as of the time notice is served under subsection (b)(1) of this section.

"§ 1606. Extent of liability

"As to any claim for relief with respect to which a foreign state is not entitled to immunity under section 1605 or 1607 of this chapter, the foreign state shall be liable in the same manner and to the same extent as a private individual under like circumstances; but a foreign state except for an agency or instrumentality thereof shall not be liable for punitive damages; if, however, in any case wherein death was caused, the law of the place where the action or omission occurred provides, or has been construed to provide, for damages only punitive in nature, the foreign state shall be liable for actual or compensatory damages measured by the pecuniary injuries resulting from such death which were incurred by the persons for whose benefit the action was brought.

"§ 1607. Counterclaims

"In any action brought by a foreign state, or in which a foreign state intervenes, in a court of the United States or of a State, the foreign state shall not be accorded immunity with respect to any counterclaim;

"(a) for which a foreign state would not be entitled to immunity under section 1605 of this chapter had such claim been brought in a separate action against the foreign state; or

"(b) arising out of the transaction or occurrence that is the subject matter of the claim of the foreign state; or

"(c) to the extent that the counterclaim does not seek relief exceeding in amount or differing in kind from that sought by the foreign state.

"§ 1608. Service; time to answer; default

"(a) Service in the courts of the United States and of the States shall be made upon a foreign state or political subdivision of a foreign state;

"(1) by delivery of a copy of summons and complaint in accordance with any special arrangement for services between the plaintiff and the foreign state or political subdivision; or

"(2) if no special arrangement exists, by delivery of a copy of the summons and complaint in accordance with applicable international convention on service of judicial documents; or

"(3) if service cannot be made under paragraphs (1) or (2), by sending a copy of the summons and complaint and a notice of suit, together with a translation of each into the official language of the foreign state, by any form of mail requiring a signed receipt, to be addressed and dispatched by the clerk of the court to the head of the ministry of the foreign affairs of the foreign state concerned, or

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"(4) if service cannot be made within 30 days under paragraph (3), by sending two copies of the summons and complaint and a notice of suit, together with a translation of each into the official language of the foreign state, by any form of mail requiring a signed receipt, to be addressed and dispatched by the clerk of the court to the Secretary of State in Washington, District of Columbia, to the attention of the Director of Special Consular Services - and the Secretary shall transmit one copy of the papers through diplomatic channels to the foreign state and shall send to the clerk of the court a certified copy of the diplomatic note indicating when the papers were transmitted.

As used in this subsection, a 'notice of suit' shall mean a notice addressed to a foreign state and in a form prescribed by the Secretary of State by regulation.

"(b) Service in the courts of the United States and of the States shall be made upon an agency or instrumentality of a foreign state:

"(1) by delivery of a copy of summons and complaint in accordance with any special arrangement for services between the plaintiff and the agency or instrumentality; or

"(2) if no special arrangement exists, by delivery of a copy of the summons and complaint either to an officer, a managing or general agent, or to any other agent authorized by appointment or by law to receive service of process in the United States, or in accordance with applicable international convention on service of judicial documents; or

"(3) if service cannot be made under paragraphs (1) or (2), and if reasonably calculated to give actual notice, by delivery of a copy of the summons and complaint, together with a translation of each into the official language of the foreign state,

(A) as directed by an authority of the foreign state or political subdivision in response to a letter rogatory or request or

(B) by any form of mail requiring a signed receipt, to be addressed and dispatched by the clerk of the court to the agency or instrumentality to be served, or

(C) as directed by order of the court consistent with the law of the place where service is to be made.

"(c) Service shall be deemed to have been made:

"(1) in the case of service under subsection (a)(4), as of the date of transmittal indicated in the certified copy of the diplomatic note; and

"(2) in any other case under this section, as of the date of receipt indicated in the certification, signed and returned postal receipt, or other proof of service applicable to the method of service employed.

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"(d) In any action brought in a court of the United States or of a State, a foreign state, a political subdivision thereof, or an agency or instrumentality of a foreign state shall serve an answer or other responsive pleading to the complaint within sixty days after service has been made under this section.

"(e) No judgment by default shall be entered by a court of the United States or of a State against a foreign state, a political subdivision thereof, or an agency or instrumentality of a foreign state, unless the claimant establishes his claim or right to relief by evidence satisfactory to the court. A copy of any such default judgment shall be sent to the foreign state or political subdivision in the manner prescribed for service in this section.

"§ 1609. Immunity from attachment and execution of property of a foreign state

"Subject to existing international agreements to which the United States is a party at the time of enactment of this Act the property in the United States of a foreign state shall be immune from attachment, arrest and execution except as provided in sections 1610 and 1611 of this chapter.

"§ 1610. Exceptions to the immunity from attachment or execution

"(a) The property in the United States of a foreign state, as defined in section 1603(a) of this chapter, used for a commercial activity in the United States, shall not be immune from attachment in aid of execution, or from execution, upon a judgment entered by a court of the United States or of a State after the effective date of this Act, if:

"(1) the foreign state has waived its immunity from attachment in aid of execution or from execution either explicitly or by implication, notwithstanding any withdrawal of the waiver the foreign state may purport to effect except in accordance with the terms of the waiver, or

"(2) the property is or was used for the commercial activity upon which the claim is based, or

"(3) the execution relates to a judgment establishing rights in property which has been taken in violation of international law or which has been exchanged for property taken in violation of international law, or

"(4) the execution relates to a judgment establishing rights in property:
(a) which is acquired by succession or gift, or
(b) which is immovable and situated in the United States: Provided, That such property is not used for purposes of maintaining a diplomatic or consular mission or the residence of the Chief of such mission, or

"(5) the property consists of any contractual obligation or any proceeds from such a contractual obligation to indemnify or hold harmless the foreign state or its employees under a policy of automobile or other liability or casualty insurance covering the claim with merged into the judgment.

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"(b) In addition to subsection (a), any property in the United States of an agency or instrumentality of a foreign state engaged in commercial activity in the United States shall not be immune from attachment in aid of execution, or from execution, upon a judgment entered by a court of the United States or of a State after the effective date of this Act, if:

"(1) the agency or instrumentality has waived its immunity from attachment in aid of execution or from execution wither explicitly or implicitly, notwithstanding any withdrawal of the waiver the agency or instrumentality may purport to effect except in accordance with the terms of the waiver, or

"(2) the judgment relates to a claim for which the agency or instrumentality is not immune by virtue of section 1605(a)(2), (3), or(5), or 1605 (b) of this chapter, regardless of whether the property is or was used for the activity upon which the claim is based.

"(c) No attachment or execution referred to in subsection (a) and (b) of this section shall be permitted until the court has ordered such attachment and execution after having determined that a reasonable period of time has elapsed following the entry of judgment and the giving of any notice required under section 1608(e) of this chapter.

"(d) The property of a foreign state, as defined in section 1603(a) of this chapter, used for a commercial activity in the United States, shall not be immune from attachment prior to the entry of judgment in any action brought in a court of the United States or of a State, or prior to the elapse of the period of time provided in subsection (c) of this section, if:

"(1) the foreign state has explicitly waived its immunity from attachment prior to judgement, notwithstanding any withdrawal of the waiver the foreign state may purport to effect except in accordance with the terms of the waiver, and

"(2) the purpose of the attachment is to secure satisfaction of a judgement that has been or may ultimately be entered against the foreign state, and not to obtain jurisdiction.

"§ 1611. Certain types of property immune from execution

"(a) Notwithstanding the provisions of section 1610 of this chapter, the property of those organizations designated by the President as being entitled to enjoy the privileges, exemptions, and immunities provided by the International Organizations Immunities Act shall not be subject to attachment or any other judicial process impeding the disbursement of funds, to, or on the order of, a foreign state as the result of an action brought in the courts of the United States or of the States.

"(b) Notwithstanding the provisions of section 1610 of this chapter, the property of a foreign state shall be immune from attachment and from execution, if:

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"(1) the property is that of a foreign central bank or monetary authority held for its own account, unless such bank or authority, or its parent foreign government, has explicitly waived its immunity from attachment in aid of execution, or from execution, notwithstanding any withdrawal of the waiver which the bank, authority or government may purport to effect except in accordance with the terms of the waiver; or

"(2) the property is, or is intended to be used in connection with a military activity and

"(A) is of a military character, or

"(B) is under the control of military authority of defense agency."

(b) That the analysis of "Part IV. Jurisdiction and Venue" of title 28, United States Code, is amended by inserting after:

"95. Customs Court.",

the following new item:

"97. Jurisdictional Immunities of Foreign States."

Sec. 5. That section 1391 of title 28, United States Code, is amended by adding at the end thereof the following new subsection:

"(f) A civil action against a foreign state as defined in section 1603(a) of this title may be brought:

"(1) in any judicial district in which a substantial part of the events or omissions given rise to the claim occurred, or a substantial part of property that is the subject of the action situated;

"(2) in any judicial district in which the vessel or cargo of a foreign state is situated, if the claim is asserted under section 1605(b) of this title;

"(3) in any judicial district in which the agency or instrumentality is licensed to do business or is doing business, if the action is brought against an agency or instrumentality of a foreign state as defined in section 1603(b) of this title; or

"(4) in the United States District Court for the District of Columbia if the action is brought against a foreign state or political subdivision thereof."

Sec. 6. That section 1441 of title 28, United States Code, is amended by adding at the end thereof the following new subsection:

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"(d) Any civil action brought in a State court against a foreign state as defined in section 1603(a) of this title may be removed by the foreign state to the district court of the United States for the district and division embracing the place where such action is pending. Upon removal the action shall be tried by the court without jury. Where removal is based upon this subsection , the time limitations of action 1446(b) of this chapter may be enlarged at any time for cause shown."

Sec. 7. If any provision of this Act or the application thereof to any foreign state is held invalid, the invalidity does not affect other provisions or application of the Act which can be given effect without the invalid provision of application, and to this end the provisions of this act are severable.

Sec. 8. This act shall take effect ninety days after the date of its enactment.

Approved October 21, 1976