Vanderbilt Journal of Transnational Law

Volume 13
Issue 3 *Issue 4 - Fall 1980*

Article 5

1980

Recent Developments

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RECENT DEVELOPMENTS

INTERNATIONAL TAXATION—HEDGING—GAINS AND LOSSES RESULTING FROM HEDGING IN INTERNATIONAL CURRENCIES MAY BE CHARACTERIZED AS ORDINARY GAIN OR LOSS EVEN IF SUCH HEDGING IS NOT AN INTEGRAL PART OF THE BUSINESS WITHIN THE MEANING OF THE CORN PRODUCTS DOCTRINE

I. INTRODUCTION

In 1967 the British government devalued the pound as against the dollar. The year 1969 witnessed the floating of the German mark. More recently the dollar has fluctuated widely in international money markets. Under presently accepted accounting principles United States multinational corporations are required to convert their foreign assets and liabilities into dollars at the year's end rate of exchange.[1] When a foreign currency is devalued against the dollar, the value of that foreign subsidiary's assets also declines. In a corporation's consolidated financial statement such a drop in value may distract investors from the corporation's operating successes, with a corresponding loss of prestige in the investment community.[2] The corporate response to this dilemma has been to "hedge" against currency devaluations by making forward purchases of currency futures contracts.[3] This paper exam-

1. "To incorporate foreign currency transactions and foreign currency financial statements in its financial statements an enterprise must . . . express in its reporting currency all assets, liabilities, revenue, or expenses that are measured in foreign currency or denominated in foreign currency . . . ." 3 AICPA Professional Standards, AC § 1083.003 (1977).

2. In many cases, the devaluation results in a huge loss in the value of the subsidiary's assets. Such an extraordinary loss, which appears on the consolidated financial statement without explanation, may frighten potential investors away from that corporation. Corporations engage in currency hedges to offset devaluation losses and to preserve their financial equilibrium.

3. "Futures contracts" are contracts in which one party promises to sell to another a specified amount of a commodity at a particular price in the future. A "forward purchase" (or short sale) is the making of such a contract by a party who does not actually have the commodity (in this case, currency) on hand. A "forward purchase of a currency futures contract," then, is the present promise by one party to sell to another party a specified amount of another currency at a

ines the proper tax characterization of gains and losses produced by currency futures hedging. To benefit from tax advantages, corporations attempt to characterize gains and losses from hedging activities as either ordinary or capital, depending on their particular financial situation. Wrestling with this problem in *Hoover Co.*[4] and *American Home Products Corp. v. United States,*[5] the courts refined and clarified holdings from the earlier related cases of *Corn Products Refining Co. v. Commissioner*[6] and *International Flavors & Fragrances Inc. v. Commissioner.*[7]

II. LEGAL BACKGROUND

The foundation case in determining whether gain or loss from hedging transactions in commodity futures constitutes ordinary or capital gain or loss is *Corn Products Refining Co. v. Commissioner.*[8] In this case Corn Products Refining Co. (CPC) bought corn futures in order to insure a supply of raw corn from which it manufactured distilled corn products. Although CPC made a profit in 1940, it suffered a loss in 1942 from its futures trading. When calculating its tax liability, CPC reported these gains and losses as ordinary income. CPC later attempted to recharacterize these futures contracts as "capital assets" under section 117 of the 1939 Internal Revenue Code.[9] This would cause gains and losses to be treated as the products of sales of capital assets and result in a tax benefit for CPC. In support of this recharacterization, the company contended that its futures contracts were "property" separate and distinct from its manufacturing opera-

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particular rate.

4. 72 TAX CT. REP. DEC. (P-H) 113 (1979).
5. 601 F.2d 540 (1979).
6. 350 U.S. 46 (1955).
7. 62 T.C. 232 (1974).
8. 350 U.S. 46 (1955).
9. Sec. 117(a)(1) states:

> The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business of a character which is subject to the allowance for depreciation provided in section 23(1) . . . .

Int. Rev. Code of 1939, ch. 1, § 117(a)(1), 53 Stat. 50 (now I.R.C. § 1233).

tions. The Supreme Court rejected this argument, agreeing with the Tax Court and the Second Circuit that the futures transactions were an integral part of CPC's business, not separate and distinct from its operations. The Court found that Congress's purpose in granting preferential treatment to capital assets under section 117 was to avoid "excessive tax burdens on gains resulting from a conversion of capital investments . . . ."[10] Congress did not, however, intend to exempt transactions which were "the normal source of business income."[11] Thus, the doctrine emerging from *Corn Products* was that gains or losses from commodities futures transactions that are integral parts of the corporation's business must be characterized as ordinary income. The applicability of the *Corn Products* doctrine came into question in the *International Flavors & Fragrances* case.[12] In 1966 International Flavors & Fragrances, Inc. (IFF) had become concerned that the British government might devalue the pound, which would lower the value of IFF's holdings in its British subsidiary. To cover its net exposure,[13] IFF purchased a currency futures contract. Two weeks before the delivery date, but after the November 1967 pound devaluation, IFF sold its futures contract to another bank. IFF claimed that because the gain was realized from the sale of a capital asset held for more than six months, it should be treated as a long-term capital gain under section 1233(b) of the Internal Revenue Code.[14] The Internal Revenue Service (IRS) made two

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10. 350 U.S. 46, 52 (1955) (quoting Burnet v. Harmel, 287 U.S. 103, 106 (1932)).

11. 350 U.S. at 52.

12. Int'l Flavors & Fragrances, Inc. v. Comm'r, 62 T.C. 232 (1974).

13. "Net exposure" describes a parent corporation's possible loss if a foreign subsidiary's native currency is devalued. Net exposure may be calculated by multiplying the net assets exposed to risk by a fraction representing the parent's ownership interest precentage. "Net assets exposed to risk" are computed by subtracting from the subsidiaries' total assets the liabilities in the native currency, the fixed assets of the subsidiary, and the liabilities payable by that subsidiary in other currencies. Hoover Co., 72 TAX CT. REP. DEC. (P-H) 113, 118 (1979).

14. The pertinent portions of § 1233 are:

(a) CAPITAL ASSETS—For purposes of this subtitle, gain or loss from the short sale of property shall be considered as gain or loss from the sale or exchange of a capital asset to the extent that the property, including a commodity future, used to close the short sale constitutes a capital asset in the hands of the taxpayer.

(b) SHORT-TERM GAINS AND HOLDING PERIODS—If gain or alternative arguments. First, the IRS contended that the transaction at issue was not a bona fide sale, but rather a purchase by IFF through the bank of the pounds needed to meet its obligations. This, the IRS asserted, constituted a short-term capital gain under section 1233(b).[15] The IRS's second argument was that IFF's futures contract, although technically a capital asset within section 1221's definition,[16] was not a true capital asset under the *Corn Products* test. Accordingly, the IRS asserted that under the *Corn Products* doctrine the gain was ordinary income. The majority of the Tax Court accepted the IRS's second position without reaching the merits of the first argument. Three judges dissented, claiming that *Corn Products* was inapplicable because the property involved in this transaction, British currency, was not a nor-

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loss from a short sale is considered as gain or loss from the sale or exchange of a capital asset under subsection (a) and if on the date of such short sale substantially identical property has been held by the taxpayer for not more than 1 year . . . or if substantially identical property is acquired by the taxpayer after such short sale and on or before the date of the closing thereof—

(1) any gain on the closing of such short sale shall be considered as a gain on the sale or exchange of a capital asset held for not more than 1 year . . . .

For purposes of this subsection, the acquisition of an option to sell property at a fixed price shall be considered as a short sale, and the exercise or failure to exercise such option shall be considered as a closing of such short sale.

. . . .

(d) LONG-TERM LOSSES—If on the date of such short sale substantially identical property has been held by the taxpayer for more than 1 year, any loss on the closing of such short sale shall be considered as a loss on the sale or exchange of a capital asset held for more than 1 year . . . .

. . . .

(g) HEDGING TRANSACTIONS—This section shall not apply in the case of a hedging transaction in commodity futures.

I.R.C. § 1233. (Except as otherwise noted, all references are to the 1954 Code.)

15. *Id.*

16. Section 1221 defines capital assets as property held by the taxpayer whether or not connected with his trade or business but excludes: (1) stock in trade or other property usually inventoried by the taxpayer at the end of the tax year or property held primarily for sale to customers in the ordinary course of business; (2) property subject to depreciation under section 167 or real property used in business; (3) copyrights or similar property; (4) certain notes receivable; (5) certain United States notes payable; and (6) certain publications of the United States government. I.R.C. § 1221.

mal source of IFF's income.[17] Judge Tannenwald, however, concurred with the majority on entirely different grounds. The concurrence reasoned that since the bank was acting as an agent of IFF, there had been no bona fide sale of the futures contract. Therefore, the resulting income should be treated as short-term capital gain.[18] On appeal,[19] IFF adopted the dissenters' position. The IRS advocated Judge Tannewald's stance, and explicitly denied reliance upon *Corn Products* or section 1233. The Second Circuit reversed and remanded on the issue of whether the transaction was a bona fide sale to the bank or was actually part of an agency relationship.[20] Thus, the Tax Court's majority decision, based on *Corn Products,* was neither affirmed nor reversed. Whether the *Corn Products* doctrine applied to forward purchases of currency contracts, that is, whether such purchases are integral parts of a business, remained unclear.

III. Recent Decisions

A. *Hoover Co.*

In *Hoover Co.,*[21] the Tax Court addressed the applicability of the *Corn Products* doctrine to forward purchases of currency futures contracts. Hoover, attempting to offset its foreign subsidiaries' possible losses due to currency devaluations, engaged in eighteen forward purchases of currency futures contracts from 1968 to 1970. For tax purposes, Hoover treated its net gains and losses in these transactions as ordinary income and loss. Hoover advanced four arguments supporting its position. First, Hoover asserted that the forward sale agreements were bona fide hedging transactions. Hoover expressly denied applicability of *Corn Products* or the majority decisions in IFF as a basis for ruling in its favor. Thus, the taxpayer put squarely before the court the question whether gains and losses from hedging transactions that were not an integral part of taxpayer's business could be characterized as ordinary gain or loss. Second, Hoover argued that the losses resulted from a form of insurance which was deductible under sec-

17. Hall, Forrester and Sterrett, JJ., dissented.
18. 62 T.C. at 240 (Tannenwald, J., concurring).
19. Int'l Flavors & Fragrances, Inc. v. Comm'r, 524 F.2d 357 (2d Cir. 1975).
20. *Id.* at 360.
21. Hoover Co., 72 Tax. Ct. Rep. Dec. (P-H) 113 (1979).

tion 162 as an ordinary and necessary business expense.[22] Third, Hoover contended that the currency that it had purchased to meet its contract obligations[23] did not constitute a capital asset and, therefore section 1233, governing short sales, did not apply. Finally, Hoover posited that section 1233's closure requirement[24] was not met since the offsetting contracts entered into by Hoover should be considered a release of Hoover's obligation to deliver on the contracts. Before addressing these issues, the Tax Court found it necessary to decide for itself whether the *Corn Products* doctrine should apply. The Tax Court found that Hoover intended to protect the value of its stock ownership in foreign subsidiaries where the native currency was subject to devaluation risk and to offset required financial reporting losses due to currency fluctuations when entering into these transactions.[25] The court noted, however, that potential exchange losses of a subsidiary cannot reasonably be considered losses of the parent. The court stated that "[t]he touchstone of the Corn Products doctrine is that seemingly capital property transactions are entitled to ordinary treatment only when the transactions are an integral part of the taxpayer's day-to-day business or are necessary to protect or generate ordinary operating income."[26] Since these transactions were entered into to protect Hoover's stock investment in its subsidiaries rather than as part of its day-to-day business operation, the Tax Court concluded that the *Corn Products* doctrine was inapplicable. The court added that to the extent that *International Flavors & Fragrances* was inconsistent with this view, it would no longer follow its previous decision. The court then considered Hoover's arguments. In rejecting the notion that these

22. Section 162(a) provides, "There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . . ." I.R.C. § 162(a).

23. In most of Hoover's transactions, rather than actually purchasing and delivering the currency needed to fulfill its obligations, Hoover entered into separate contracts with the bank holding its currency futures contract, buying from that bank the foreign currency necessary to cover its obligation. Thus, in reality, the bank would merely offset the two contracts and, depending on whether a gain or loss had been made by Hoover, would credit or debit Hoover's account in the amount of the gain or loss. *See* Hoover Co., 72 TAX. CT. REP. DEC. (P-H) 113, 119-22 (1979) for details of each of the eighteen transactions.

24. I.R.C. § 1233(a). *See* note 14, *supra*.

25. 72 TAX CT. REP. DEC. (P-H) at 128.

26. *Id.* at 129.

transactions were legitimate hedges, the court set forth two tests for determining a bona fide hedge. First, true hedges must be engaged in to maintain the balanced market position of the corporation rather than to enhance, through speculation, the corporation's position. The corporation must be hedging to protect its market position, not, as the court found in the instant case, hedging to protect against a theorized loss in stock value. Second, a bona fide hedge must always be viewed as protecting ordinary operating profits realized in the day-to-day operation of the business. Again, the instant court found that Hoover failed this test as ordinary business operations were not involved. Joined with this second test, the court observed, is the concept that hedges must protect against a true and established risk of loss. In the case at bar, the subsidiaries continued to operate with the same assets and earning potential. Any risk was in the financial image projected by the consolidated financial statements after the revaluation of assets caused by devaluation of the subsidiary's native currency. The court found that this risk was not established in *Hoover*, therefore, the hedging was not a legitimate form of deductible business insurance because this transaction was not a bona fide hedge. In response to Hoover's third argument that these currency futures contracts were not capital assets rendering section 1233 inapplicable, the court determined that currency futures used to close a short sale were capital assets. The court then noted that section 1233(a) did not indicate whether long- or short-term treatment of the gain and loss is appropriate. Under sections 1233(b) and (d), however, "substantially identical property" must be held or acquired by the taxpayer for a certain time period before the short sale, or between the date of the short sale and the closing, for the property to have capital asset status.[27] When such property is acquired less than six months before the date of the short sale, or between the date of the short sale and the closing, any gain will be short-term capital gain. In all but one of Hoover's transactions, the time between the purchase of the currency and settlement date was less than one month. As a result, all but one of the transactions resulted in short-term capital gain or loss.[28] Finally, the court held that Hoover's short sales and purchases did meet section 1233's closure requirements. Because

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27. I.R.C. § 1233(b), (d). *See* note 14, *supra*.

28. 72 TAX CT. REP. DEC. (P-H) at 135-36. The one other contract was held for more than six months, resulting in treatment as long-term capital gain.

Hoover did not view the contracts as releases at the time it made them, the court refused to allow Hoover to retroactively recharacterize the nature of its transactions. Judge Tannenwald, concurring in the court's opinion, stated that he did not feel the majority opinion precluded the application of the *Corn Products* doctrine because, in certain circumstances, treatment of such transactions as ordinary gain and loss might be appropriate. One dissenter felt *Corn Products* did apply and that the transactions resulted in ordinary income and loss.[29]

B. *American Home Products Corp. v. United States*

American Home Products Corp. v. United States[30] also involved a United States corporation concerned with the effects of devaluation on its financial image. American Home entered into four forward currency futures contracts with two United States banks to cover the net exposure in American Home's British subsidiaries. American Home fulfilled two of the contracts and sold the other two contracts to the Canadian Imperial Bank two weeks before delivery of the pounds was due. Canadian Imperial paid American Home $336,000[31] for the contracts. American Home characterized this as long-term capital gain. After an audit, the IRS treated this sum as ordinary income for which American Home was charged deficient. American Home paid the discrepancy and then sought a refund in the Court of Claims. The Court of Claims agreed with American Home that its gain on the sale was properly characterized as long-term capital gain. The court rejected the IRS's contention that the assignments to Canadian Imperial were not bona fide by noting that American Home had clearly ceded all right, title, and interest in the contracts. The Court of Claims also rejected the IRS's argument that the assignment to Canadian Imperial invoked the capital gains rule on short sales in section 1233.[32] The court held section 1233 inapplicable to this taxpayer because American Home, like Hoover, never held "substantially identical property" at the time of the

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29. *Id.* at 137 (Chabot, J., dissenting).
30. 601 F.2d 540 (1979).
31. This amount equalled the difference between the contract exchange rate of $2.80 per pound sterling and the prevailing exchange rate of $2.40 per pound, minus a commission for Canadian Imperial.
32. I.R.C. § 1233(b). *See* note 14, *supra*.

short sales or after.[33]

IV. Analysis

Although the *American Home Products* and *Hoover* cases shed some light on the proper characterization of gains and losses produced by forward currency futures contracts, a clear cut test to determine the appropriate classification must still be enunciated by the courts. The parameters of such a test, however, are outlined in these cases. The formula evolving appears to be a two-part analysis. First, the court will inquire whether the *Corn Products* doctrine is applicable. The applicability of *Corn Products* will in turn hinge upon whether the transactions are found to be integral parts of the corporation's everyday business or are considered necessary to protect everyday income.[34] If the transactions are integral parts of the business or protect everyday income, the *Corn Products* doctrine applies and the gains or losses are considered ordinary. If, however, the transactions are not integral parts of the business or do not protect everyday income, the court will apply the second part of the test to determine whether the hedge is bona fide. A hedge is bona fide when the taxpayer is attempting to maintain a balanced market position in the particular commodity used in his trade or business and is attempting to protect ordinary operating profits.[35] If either of these elements is lacking, the hedge is not legitimate. The ramifications of finding a hedge to be legitimate or illegitimate are manifold. If it is a true hedge, the gain and loss it produces will not be considered a capital gain or loss from short sales under section 1233.[36] If it is not a true hedge, the gains and losses may, as in *Hoover* and *International Flavors & Fragrances,* fall within section 1233 and be characterized as long or short-term capital gain or loss. Up to this point, the treatment is no different from that accorded taxpayers prior to the *Hoover* and *American Home* cases. The *Hoover* court expressed the new development when it stated that, "in situations which do not constitute a true hedge, ordinary treatment of gains and losses on certain property transactions will be appropriate if a sufficient and direct relationship to the tax-

33. 601 F.2d at 549.
34. Hoover Co., 72 Tax Ct. Rep. Dec. (P-H) 113, 129 (1979).
35. *Id.* at 129-30.
36. I.R.C. § 1233(g). *See* note 14, *supra.*

payer's ordinary and operating aspects of its business is shown."[37] Thus, in certain circumstances in which hedging takes place but is of a character that places it outside of the *Corn Products* concept of "integral part of the business," if the hedging is still closely related to the business' everyday operation and profit, the gains and losses will be treated as ordinary.[38] This new doctrine makes it easier for a corporation to hedge and have the gain or loss treated as ordinary. For the corporation that would benefit from capital treatment of hedging gains and losses, however, this stance is hazardous because it widens the scope of ordinary tax treatment and narrows the applicability of section 1233.

V. Conclusion

The proper characterization of gains and losses produced by currency futures hedging remains murky. But the *Hoover* and *American Home* cases indicate that if a transaction does not fall squarely within the *Corn Products* doctrine as an integral part of the business operation, ordinary gain or loss treatment is not foreclosed. It is significant that the *Hoover* court was compelled to establish this new category, even though it held that Hoover Co. did not fit within it.[39] It would have been more helpful if the Tax Court had created the category and provided an example of a corporation which properly fits within it. Although this broadening of the ordinary treatment category may be a benefit to some multinational corporations, for others it may be a pitfall in their attempt to minimize the adverse effects of currency devaluations on their financial statements.

Benjamin W. Pardue

37. 72 Tax Ct. Rep. Dec. at 127.

38. *Id.*

39. It is also unusual that the Court of Claims, which decided the *American Home* case in June of 1979, made no reference to the *Hoover* opinion, decided in April of that year. Perhaps the case simply was not brought to the Court's attention.

SOVEREIGN IMMUNITY — JURISDICTIONAL PROBLEMS INVOLVING THE FOREIGN SOVEREIGN IMMUNITIES ACT AND EXTRATERRITORIAL APPLICATION OF UNITED STATES ANTITRUST LAWS

I. INTRODUCTION

United States antitrust laws were designed to promote economic prosperity and allocative efficiency at a time when the United States was not heavily involved in the world economic market.[1] The recent increase in trade between the United States, with its strong free enterprise doctrines and laws, and foreign nations, with contrary or even conflicting economic views, has caused disputes that drafters of the antitrust statutes did not envision. These disputes raise the question of when, if ever, the United States antitrust laws should apply to foreign business. The question involves not only the jurisdictional scope of the antitrust laws but also doctrines of public international law, such as the doctrine of sovereign immunity,[2] which concerns the amenability of foreign parties to suit in United States courts. Two recent United States District Court cases, *International Association of Machinists and Aerospace Workers v. Organization of Petroleum Exporting Countries*,[3] and *Outboard Marine Corporation v. Pezetel*[4] illuminate these issues. This paper will examine how the courts handled jurisdictional issues in these cases and whether the Foreign Sovereign Immunities Act[5] forces courts to make foreign policy decisions outside the scope of their constitutional role.

II. LEGAL BACKGROUND

In each of the instant cases, defendants raised the issue of sovereign immunity as a defense. Sovereign immunity is a doctrine of public international law under which domestic courts refrain from

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1. K. BREWSTER, ANTITRUST AND AMERICAN BUSINESS ABROAD 3 (1976); L. SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST 14 (1977).
2. *See generally* W. BISHOP, INTERNATIONAL LAW 531 (1971).
3. No. 78-5012-AAH(SX) (C.D. Cal., filed Sept. 18, 1979) [hereinafter cited as *IAM v. OPEC*].
4. 461 F. Supp. 384 (D. Del. 1978).
5. 28 U.S.C. § 1602 (1976).

asserting jurisdiction over a foreign state[6] to avoid possible interference with the internal management of the foreign country. In *The Schooner Exchange v. McFadden*,[7] the United States Supreme Court held that a foreign state was absolutely immune from suit unless it consented. This opinion typified the theory of absolute immunity that predominated in early judicial discussions and decisions. The theory of absolute immunity was generally accepted until the early 1900's when the restrictive theory of immunity developed in the European nations. The restrictive theory distinguished between commercial (*jure gestionis*) and governmental (*jure imperii*) activities. Although a state's governmental activities were immune under the restrictive theory, the commercial activities of the state were not. At the Brussels Convention of April 10, 1926, thirteen nations signed an agreement that formally recognized the restrictive theory of sovereign immunity.[8] The United States, however, did not sign the Brussels Convention document. At that time, United States courts relied heavily on suggestions made by the State Department in deciding whether or not to grant immunity. Although this was not a formal adoption of the restrictive theory, cases such as *Republic of Mexico v. Hoffman*[9] suggested that United States policy was shifting away

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6. BISHOP, *supra* note 2, at 531.
7. 11 U.S. (7 Cranch) 116 (1812).
8. *See* 176 L.N.T.S. 199; G. HACKWORTH, INTERNATIONAL LAW 463 (1941).
9. 324 U.S. 30 (1945). The *Hoffman* Court considered whether, without a policy statement by the Executive branch of government, a court should recognize jurisdictional immunity for a merchant vessel that is owned, though not possessed, by a friendly foreign government. *Id.* at 31. The plaintiff in *Hoffman* filed an *in rem* action for damages resulting from a collision at sea. The Mexican ambassador initially suggested that the ship was owned and possessed by the Republic of Mexico and was engaged in transporting cargo from Mexican ports. *Id.* The United States requested advice from the State Department which simply cited *Ervin v. Quintanilla*, 99 F.2d 935 (5th Cir. 1938) and *Compania Espanola v. The Navemare*, 303 U.S. 68 (1937). In *Ervin* jurisdictional immunity was recognized because the ship involved was in the possession and service of the Mexican government. In *Espanola*, however, jurisdictional immunity was rejected because the ship involved was not in the possession and service of the Spanish government when it was seized. The district court in *Hoffman* denied immunity because the ship was in the possession, operation, and control of a private Mexican corporation. The district court rejected the State Department's implied argument for immunity because the ship was property of the Mexican government and the Mexican government accepted liability for the ship. 324 U.S. at 32. The Court of Appeals for the Ninth Circuit had affirmed, rejecting the Petitioner's argument that the court should recognize the title of the Mexi-

from absolute immunity. The restrictive theory became official United States policy with the publication of the "Tate Letter" on May 19, 1952.[10] Henceforth, United States courts deferred completely to State Department suggestions concerning the granting of immunity. If a foreign defendant wished to invoke the doctrine of sovereign immunity, it first had to petition the State Department for a ruling which, if granted, was then followed by United States courts. If the defendant failed to petition the State Department but later wished to raise the issue of sovereign immunity the court would make its own determination of the defendant's status.[11] Thus, the law concerning the application of the doctrine of sovereign immunity was jointly articulated by the judiciary and the State Department.[12] In 1976, however, Congress enacted the Foreign Sovereign Immunities Act (FSIA)[13] which codified the restrictive theory of sovereign immunity. The bill had four goals: (1) to transfer the task of determining whether a foreign state is entitled to immunity to the courts; (2) to particularize the restrictive theory in statutory form; (3) to make foreign states more susceptable to execution on judgments rendered against them, thus making them conform more closely to the restrictive theory; and (4) to specify the means by which process may be served on a foreign state.[14] The new bill assured litigants that the crucial decisions of immunity were made on purely legal

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can government as grounds for immunity. *Id.* at 34. The court decided that in the absence of a recognized claim of jurisdictional immunity by the Executive branch of government a court may decide whether the requisites of immunity exist. *Id.* at 35. This was precisely the practice adopted by the courts when the restrictive theory of immunity was later adopted and the State Department offered no advice in a particular case. *See* note 10, *infra*. The *Hoffman* Court concluded that the test for determining whether a court should exercize jurisdiciton is whether the court's exercise of jurisdiction would embarrass the Executive branch in its conduct of foreign affairs. 324 U.S. at 39. Thus the trend toward a restrictive policy was evident in the behavior of both the *Hoffman* Court and the State Department.

10. 26 DEP'T STATE BULL. 984 (1952).

11. Letter from the Secretary of State to the Speaker of the House accompanying the draft bill of the FSIA (Jan. 16, 1973) [hereinafter cited as *Letter to the Speaker*]. In *Hoffman*, the State Department failed to render an opinion on an immunity request.

12. *Letter to the Speaker, supra* note 11.

13. 28 U.S.C. §§ 1602-1611 (1976).

14. *Letter to the Speaker, supra* note 11, at 2.

grounds and under procedures insuring due process.[15] Congress intended the FSIA to affect the level of judicial deference shown the State Department regarding sovereign immunity.[16] Following the enactment of the FSIA, the State Department could no longer dictate the outcome of sovereign immunity decisions. Congress had specifically legislated away any executive power in the determination of sovereign immunity status. This legislative act, in conjunction with Justice Jackson's analysis in the *Steel Seizure*[17] case, prohibited the executive branch from making any immunity decision in politically sensitive cases.[18] Thus, the FSIA disallowed the courts from deferring to the executive and forced them to bear the burden for ramifications resulting from immunity decisions.

Congress intended the FSIA to expedite and depoliticize litigation against foreign states and to minimize conflicts with foreign relations from such litigation.[19] Congress also expected the courts to apply the restrictive theory of immunity. One criticism of the pre-statute system was that the State Department made purely political determinations in the decisions to grant immunity without giving serious consideration to the distinction between com-

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15. *Id.*

16. H. MAIER, THE PROPOSED SOVEREIGN IMMUNITIES ACT: ITS EFFECT ON JUDICIAL DEFERENCE, in *Proceedings of the American Society of International Law* 48 (April, 1976).

17. Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579 (1952) (Jackson, J., concurring). Justice Jackson established three categories of Executive power based on the level of Congressional involvement. He then examined the nature of judicial deference that corresponded with each category of Executive power. The three categories of Executive power were: 1) When the Executive acts pursuant to an express or implied authorization of Congress; 2) When the Executive acts in absence of either a Congressional grant or denial of authority; and 3) When the Executive takes measures incompatible with the express or implied will of Congress. *Id.* at 635-37. In category number one, the judiciary must defer totally to the Executive. Category two, Justice Jackson's "zone of twilight," is an area of concurrent authority in which deference between branches of the government is optional and flexible. In category three, the Executive is at its lowest ebb of power, and courts cannot sustain Executive action without disabling Congress from acting upon the same subject. *Id.* at 637. Prior to the FSIA, category two arguably existed, and the judiciary and Executive worked together in solving difficult immunity problems. Because the FSIA is clearly within category three, the Executive is wholly without power to dictate policy and immunity decisions to the courts.

18. MAIER, *supra* note 16.

19. *Id.* at 50.

mercial and governmental activity.[20] Under the FSIA, however, courts must decide whether the activity involved is commercial or governmental in making sovereign immunity decisions. The question that remains is whether the judiciary is the proper branch of government to make such important decisions in United States foreign relations.

III. The Instant Cases

A. *International Association of Machinists and Aerospace Workers v. Organization of Petroleum Exporting Countries, et al.*

Plaintiff union[21] filed suit against the Organization of Petroleum Exporting Countries (OPEC)[22] and its individual member countries in December 1978, in the United States District Court for the Central District of California. Plaintiff alleged that the defendant's price setting activities[23] were a *per se* violation[24] of Section 1 of the Sherman Act.[25] Plaintiff's alleged injury con-

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20. *Id.*

21. The International Association of Machinists and Aerospace Workers (IAM) filed this suit from their Los Angeles headquarters.

22. The Organization of Petroleum Exporting Countries consists of thirteen member nations: Algeria, Ecuador, Gabon, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qator, Saudi Arabia, United Arab Emirates, and Venezuela.

23. The principal aim of OPEC was stated in its charter as "the unification of petroleum policies for the Member Countries and the determination of the best means for safeguarding the interests of the Member Countries individually and collectively." Resolution of the First Conference Resolution 1.2(4) as reported in *IAM v. OPEC*, at 3. The organization expressly wished to stabilize prices by regulating production to secure steady income to the producing nations. The system implemented by OPEC included establishing prices for crude oil. *Id.*

24. Determining a *per se* violation requires application of a two part test: 1) whether the practice is likely to cause substantial injury to completion; and 2) whether an inquiry into the alleged practice will be complex, time-consuming, or result in uncertainty. L. Sullivan, Handbook of the Law of Antitrust 193 (1977). The typical price-fixing agreement among competitors has come to be described as unlawful *per se*. Thus, no proof is required in the particular case for the collaborators' power, their purpose, or the effects. Areeda & Turner, Antitrust Law 47 (1978). *See also* United States v. General Motors, 384 U.S. 127 (1966); Northern Pac. R. Co. v. United States, 356 U.S. 1 (1957); United States v. Socony-Vacuum Oil Co., 310 U.S. 150 (1940).

25. 15 U.S.C. § 1 (1976), provides: "Every contract, combination in the form of trusts or otherwise, or conspiracy in restraint of trade or commerce among the several states, or with foreign nations is declared to be illegal."

sisted of higher consumer gasoline prices due to the anti-competitive activity of the OPEC countries. Plaintiff sought damages under Section 4 of the Clayton Act[26] and injunctive relief under Section 16 of the Clayton Act.[27] Jurisdiction was based upon the Foreign Sovereign Immunities Act[28] as well as the Sherman and Clayton Acts.[29] The court consolidated the evidentiary hearings for plaintiff's preliminary injunction and default judgment with the trial on the final injunction.[30] The court also issued an Order to Show Cause asking for factual and legal assistance on eighteen questions from the defendants and any other sources as *amici curiae*.[31] The thirteen member nations of OPEC were properly served but chose not to appear. The court entered a default, with judgment reserved until the hearings were complete. The court then considered whether OPEC could be properly served under

26. 15 U.S.C. § 26 (1976), which provides: "Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue in any district court of the United States in which the defendant resides, or is found or has an agent. . . ."

27. 15 U.S.C. § 26 (1976), which provides: "Any person . . . shall be entitled to sue for and have injunctive relief in any court of the United States having jurisdiction over the parties against threatened loss or damaged by a violation of the antitrust laws. . . ."

28. 28 U.S.C. §§ 1602-1611 (1976).

29. *See* notes 26 and 27, *supra*.

30. Plaintiff moved for a preliminary injunction on June 25, 1979. Defendants failed to appear. The court, following the requirements of 28 U.S.C. § 1608 (e), which provides that "[n]o judgment by default shall be entered by the court . . . unless the claimant establishes his claim or right to injunction relief by evidence satisfactory to the court," found that the defendant should have a full opportunity to be heard prior to any ruling on the motion for injunction. *IAM v. OPEC*, at 5. The court ordered an evidentiary hearing on the motion for preliminary injunction consolidated with the trial on the final injunction under Rule 65 of the Federal Rules of Civil Procedure. The evidentiary hearing on motions for default judgment was also set for the same day, August 20, 1979.

31. *IAM v. OPEC*, at 5. Judge Hauk filed the Order to Show Cause on June 25, 1979. The orders were sent out requesting assistance from plaintiffs, defendants, the State Department, the Justice Department, and the Department of Energy. Copies were also sent to all state attorneys general. The unique order included questions regarding the viability of the suit's subject matter jurisdiction, in pensonam jurisdiction, plaintiff's standing to sue, and entry of a default judgment. The order also sought advice on whether attachment or execution would be possible and on the propriety of a preliminary injunction in the case. Eleven briefs were submitted in response. The State Department did not file a brief. In addition, seventeen state attorneys general filed a joint memorandum of law urging that the suit not be dismissed.

either the FSIA or the International Organizations Immunities Act[32] (IOIA). The court held that the FSIA applied only to foreign sovereigns, and that OPEC could not be considered a foreign sovereign.[33] The court also held that the IOIA applied only to international organizations "in which the United States participates,"[34] and, since the United States was not an OPEC member, the IOIA was inapplicable to OPEC.[35] Therefore, the court dismissed OPEC from the suit because it could not be legally served.[36]

After dismissing plaintiff's damages claim and determining that, even though plaintiff was an indirect purchaser,[37] it could

32. 22 U.S.C. § 288 (1976).

33. IAM v. OPEC, at 6.

34. 22 U.S.C. § 288 (1976) as reported by the Court. *Id.*

35. *Id.*

36. *Id.*

37. The court dismissed the damages portion of the plaintiff's claim because after *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), a plaintiff in a price fixing case may recover only if it made purchases directly from the price fixer. Since the plaintiff did not allege or show that it purchased any crude oil or gasoline or had any direct dealings with the defendants, it was an "indirect purchaser." An "indirect purchaser" is one who is once or twice removed from the alleged violator. *Illinois Brick* effectively precludes any "indirect purchasers" from obtaining damages by denying the offensive or defensive use of the "pass-on" or "pass-through" doctrine by which an indirect purchaser can achieve the causal nexus necessary for a damages claim. *Id.* at 730. Plaintiff argued that it qualified under certain exceptions recognized in *Illinois Brick* where the pass-through doctrine would make an indirect purchaser a plaintiff who could recover damages. The *Illinois Brick* Court stated that a pre-existing cost-plus contract would be one instance where the pass-through doctrine would be allowed. *Id.* at 736. The Court also pointed out that the pass-through doctrine would be allowed where a direct purchaser is owned or controlled by its customers. *Id.* at 736, n. 16. Plaintiffs argued that the exception applied in the instant case because: (1) certain federal pass-through regulations are analogous to a cost-plus contract; (2) domestic oil companies conspired with the defendants; and (3) defendants controlled the United States oil companies from whom the plaintiff purchases gasoline. IAM v. OPEC, at 11. *See* 15 U.S.C. § 753(b)(2) (1976); 10 C.F.R. 212.83 (1978).

The instant court rejected plaintiff's first theory because the federal pass-through regulations did not have the necessary features of a cost-plus contract stated in *Illinois Brick*, namely: (1) a direct and easily measurable pass-on of costs and (2) a commitment for a fixed quantity. 431 U.S. at 730. The federal pass-through regulations allow for a dollar-for-dollar pass-through of net increases in the cost of crude oil faced by domestic companies. In practice, however, the oil companies do not directly and immediately pass-on any price increases in crude, but instead wait until market conditions are conducive to an seek injunctive relief under Section 16 of the Clayton Act,[38] the court faced the jurisdiction issue. The court had subject matter jurisdiction to hear the action under 28 U.S.C. § 1330(a) which grants jurisdiction to district courts in actions against foreign states.[39] The statute provides, however, that jurisdiction exists only when the foreign state is not entitled to immunity.[40] As a result, the court had to examine facts of this case under the FSIA to determine whether it had jurisdiction. Under the FSIA, the United States grants immunity to foreign states, subject to certain exceptions.[41] Plaintiff relied on 28 U.S.C. § 1605(a)(2) which states that foreign sovereigns are not immune in any case:

> in which the action is based upon a commercial activity carried on

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increase in gasoline prices. The instant court held that this practice was not a direct and easily measurable pass-through. The court also pointed out that because consumers are not required to buy fixed amounts of gasoline, plaintiff's first theory as an exception under *Illinois Brick* was completely disqualified. Plaintiff's theories concerning conspiracy with and control by the OPEC countries of the domestic oil producers were dismissed as vague and without factual support. IMA v. OPEC, at 13.

38. The courts faced the open question whether an indirect purchaser could seek injunctive relief under Section 16 of the Clayton Act. 15 U.S.C. § 26 (1976), *supra* note 27. In *Mid-West Paper Products v. Continental Group, Inc.*, 596 F.2d 573 (3d Cir. 1979) the Third Circuit held that *Illinois Brick* did not preclude an indirect purchaser from seeking injunctive relief. The Mid-West court distinguished Section 4 of the Clayton Act, which provides for damages for actual injury, from Section 16 of the Act, which allows for injunctive relief against *threatened* loss. The court noted that under Section 16 the plaintiff need "only demonstrate a significant threat of injury from an impending [violation] of the antitrust laws or from a contemporary violation likely to continue or occur." *Id.* at 591. The *Mid-West* court held that the test for standing under Section 16 would be a proximate cause standard, less vigorous than a Section 4 damages standard that requires direct injury. *Id.* at 591-92. It was also noted that as indirect purchasers, the plaintiffs that had obviously been damaged would be foreclosed from relief unless they could seek an injunction under Section 16. *Id.* at 593. The instant court felt that although certain evidentiary problems might exist in a suit for injunctive relief, Congress had not intended to exclude such a large class of potential plaintiffs from protection of the antitrust laws. The instant court followed the *Mid-West* ruling and allowed the plaintiff to sue for injunctive relief.

39. 28 U.S.C. § 1330(a) (1976) provides: "The district court shall have original jurisdiction without regard to amount in controversy in any non-jury civil action against a foreign state . . . to which a state is not entitled to immunity. . . ."

40. *Id.*

41. 28 U.S.C. § 1602 (1976).

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 commercial activity of the foreign state elsewhere and the act causes a direct effect in the United States.[42]

The crucial issue before the court was whether the defendant's activities were "commercial activities" under § 1605(a)(2). Rather than price-fixing, the court characterized defendant's pricing mechanism as the "ability and willingness to control the production of crude oil."[43] Thus, the instant court concluded that the "essence of [the OPEC] monopoly" was the control of supply or output restriction.[44] The court then examined the FSIA definition of "commercial activity," which provides that:

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 the *nature of the course of conduct* or particular transaction or act, rather than by reference to its purpose. (Emphasis added).[45]

Citing the legislative history of the FSIA, the court determined that the activity is non-commercial if it is one in which only a sovereign may engage.[46] The court narrowly defined the act involved in order to follow the legislative intent of the FSIA, that is, to keep the courts away from areas sensitive to foreign policy.[47] With this narrow interpretation, the court determined that the act in controversy was the setting, by a sovereign state, of the terms and conditions for the removal of a prime natural resource, crude oil. The court then decided that this regulation of crude oil was a sovereign, not a commercial, act. Emphasizing that the United Nations had repeatedly recognized under international law the right of a sovereign state to exercise sole control over its natural resources,[48] the instant court reasoned that this activity

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42. 28 U.S.C. § 1605(a)(2) (1976).
43. IAM v. OPEC, at 21.
44. *Id.*
45. 28 U.S.C. § 1603(d) (1976).
46. IAM v. OPEC, at 21. *See* H.R. REP. No. 94-1487, 94th Cong. 1st Sess. (1976) [hereinafter *House Report*].
47. IAM v. OPEC, at 21.
48. *See, e.g.*, G.A. Res. 1803, § 1(1), 17(2) U.N. GAOR, 327, U.N. Doc. A/C 2/ 5 R 850 (1962):

was inextricably bound to sovereignty, and that the defendant's control over its oil was therefore an essential element of its sovereignty.[49] Accordingly, the court concluded that the regulation of the extraction of oil was a sovereign act and rejected plaintiff's allegation that a conspiracy among nations to fix oil prices was a commercial act. The court reasoned that since each nation was regulating the extraction of natural resources, a sovereign act, an agreement among nations to regulate the performance of that activity was also a sovereign act.[50]

> *Bearing in mind* its resolution 1515(xv) of 15 December 1960, in which it recommended that the sovereign right of every state to dispose of its wealth and its natural resources should be respected.
> *Considering* that any measure in this respect must be based on the recognition of the unavailable right of all States freely to dispose of their natural wealth and resources in accordance with their national interest, and in respect for the economic independence of States, . . .
> *Declares*, that;
> 1. The right of people and nations to permanent sovereignty over their national wealth and resources must be exercised in the interest of their national development and of the well-being of the people of the State concerned.

Accord, Charter of Economic Rights and Duties of States, G.A. Res. 3281, Ch. II. Art. 2(1), U.N. Doc. A/Res/3281 (XXIX)(1974); Declaration on the Establishment of a New International Economic Order in 1974; G.A. Res. 3201 (S-VI), § 4(e), U.N. GAOR, 6th Spec. Sess., Supp. (No. 1) 3, U.N. Doc. A/9559; Res. 3171, G.A. Res. 3171, 28 U.N. GAOR 30 (vol. 1) 52, U.N. Doc. A/9030 (1973); Res. 3016, G.A. Res. 3016, Preamble and § 1, 27 U.N. GAOR, Supp. (No. 30), U.N. Doc. A/8730; Res. 2158, G.A. Res. 2158, § 1(1), 21 U.N. GAOR, Supp. (No. 16) 29, U.N. Doc. A/6316 (1966).

49. The instant court also noted that there is United States case law and statutory law that allows states to control and market their own resources. *See, e.g.*, Parker v. Brown, 317 U.S. 341 (1943); United States v. Brumfield, 85 F. Supp. 696 (W.D. La. 1949). The Federal Connally Hot Oil Act, 15 U.S.C. § 715 (1976).

50. IAM v. OPEC, at 26. In support of this conclusion, the court noted that the United States implicitly recognized the activities of OPEC member nations as sovereign activities in connection with the production and sale of oil when the United States entered into "consent decrees" with the seven largest domestic oil producers. These "consent decrees" granted specific "exceptions" and "permissive provisions" that allow the oil companies to engage in price fixing and production control when the law of foreign nations required them to do so. *Id.* The court made reference to the consent decrees set forth in Department of Justice, Antitrust Division Case No. 1163 on Nov. 14, 1960. The decrees were recognized in *United States* v. *Standard Oil Co. (New Jersey)*, [1960] TRADE CASES (CCH) ¶ 69,849, 77,735 (Nov. 14, 1960), and *United States v. Gulf Oil Corp.*, [1960] TRADE CASES (CCH) ¶ 69,851, 77,344, (Nov. 14, 1960).

Even though the instant court disposed of the case for lack of jurisdiction, it reached certain other conclusions.[51] Addressing the jurisdictional question with regard to the antitrust statutes, the instant court determined that plaintiff would be entitled to the relief in the instant case only if defendants were "persons" as defined in the Sherman Act.[52] Section 8 of the Sherman Act[53] and Section 1 of the Clayton Act[54] define "person" or "persons" to include "corporations and associations existing under or authorized by the laws of the territories, the laws of any state, or the laws of a foreign country."[55] Since the statute does not state whether a foreign sovereign is a person, the instant court turned to case law for its definition. Citing *Parker v. Brown*,[56] in which the Supreme Court held that a domestic state is not a person who may be sued under the antitrust laws, the instant court ruled that the same considerations that apply to domestic states apply with equal force to sovereigns. The court found support for this extension of the *Parker* rationale in *Hunt v. Mobil Oil Corp.*[57] in which the Second Circuit Court of Appeals also held that foreign sovereigns are not "persons" subject to Sherman Act liability. The Court further noted that the United States District Court for the State of Delaware had reached the same result in *International Refining Corporation v. Texaco Maracaibo, Inc.*[58]

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51. It can be argued that these other considerations and conclusions are merely *dicta*. If they are not *dicta*, however, they may be read as alternative holdings.

52. 15 U.S.C. § 1 (1976).

53. *Id.* § 7.

54. *Id.* § 12.

55. *See* notes 53 and 54, *supra*.

56. 317 U.S. 341 (1943).

57. 550 F.2d 68, 78 n. 14 (2d Cir. 1977), *cert. denied*, 434 U.S. 984 (1977). Even though the government of Libya was not a defendant in this case, the Second Circuit considered its possible liability and concluded that it could not be subject to Sherman Act liability because it was not a person under the terms of the statute.

58. 307 F. Supp. 1291, 1298 (D. Del. 1970). The *International Refining* court held that: "The Sherman Act refers only to persons, not to states or nations, and both the Act and the Constitution would be badly misinterpreted to permit liability for acts of a sovereign." *Id.* Plaintiff in the instant action argued, however, that the FSIA changed the law regarding jurisdiction over foreign sovereigns in antitrust actions. The plaintiff suggested that language in the legislative history indicated that terms in Section 1603(e) of the FSIA were not intended to alter the application of the Sherman Act to any defendant and thus the bill did not affect the holdings in several cases. *House Report*, *supra* note 46, at 19.

The instant court's reliance on *International Refining* and *Hunt* is significant in light of a recent Supreme Court case, *Pfizer Inc. v. India*.[59] The *Pfizer* Court held that a foreign sovereign may be a "person" under the antitrust laws in order to act as a plaintiff bringing suit. The *Pfizer* Court permitted the foreign sovereign to be a plaintiff "person" because in doing so the judiciary was not required to interfere in sensitive matters of foreign policy.[60] Plaintiff in the instant case, however, argued that since a foreign sovereign could file suit under the Sherman Act it should also be amenable to suit as a defendant. The instant court did not extend the *Pfizer* ruling to include foreign sovereigns as potential defendants for two reasons. First, the court found no Congressional intent to extend Sherman Act liability to foreign sovereigns in this situation. Second, the court noted that the accepted judicial policy has been to exercise restraint whenever areas of foreign policy are involved.[61] For these reasons the court concluded that it lacked jurisdiction over the defendants under the FSIA and the antitrust statutes.[62]

B. *Outboard Marine Corporation v. Pezetel, et al.*

Plaintiff Outboard Marine Corporation[63] (OMC) filed suit in the United States District Court in Delaware alleging antitrust

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> Neither the term "direct effect" nor the concept of "substantial contacts" embodied in Section 1603(e) is intended to alter the application of the Sherman Act . . . to any defendant. Thus, this bill does not affect the holdings in such cases as United States v. Pacific & Arctic Ry. & Nav. Co., 228 U.S. 87 (1913), or Pacific Seafarers, Inc. v. Pacific Far East Lines, Inc., 404 F.2d 803 (D.C. Cir. 1968), *cert. denied*, 393 U.S. 1093 (1969).

Id. The court pointed out, however, that the language relied on by the plaintiff did not refer to any cases where there was an attempt to assert jurisdiction over a foreign sovereign. These cases involved the extraterritorial reach of domestic antitrust laws, but did not involve a foreign sovereign as a party to suit. Thus the plaintiff's argument seems to be misguided, a conclusion shared by the instant court. IAM v. OPEC, at 30.

59. 434 U.S. 308 (1978).

60. *Id.* at 319.

61. IAM v. OPEC, at 32. (citing 434 U.S. 308, 330 (1978)).

62. Upon completion of the hearing, the court did not issue a default judgment against the OPEC nations. Since there was no default judgment, there could be no waiver of immunity. The court found alternatively that the plaintiffs failed on the merits as well.

63. Outboard Marine Corporation, a diversified Delaware corporation, a division of which, Cushman, formerly manufactured electric golf carts.

violations against defendants Pezetel,[64] and several of its United States importers and distributers.[65] The suit arose because an OMC subsidiary, Cushman, left the electric golf cart industry because it could not compete with the prices offered by Pezetel.[66] Pezetel answered plaintiff's four count complaint contesting the court's jurisdiction as well as the substantive antitrust claims.[67]

Defendant Pezetel contested the court's jurisdiction on the grounds that it was immune from jurisdiction under the FSIA, that it was not a person under the antitrust laws, and that the act of state doctrine precluded any jurisdiction by the court. Pezetel advanced four basic arguments in favor of its claim for immunity under the FSIA. First, Pezetel maintained that the FSIA was not intended to reach the antitrust claims presented in the instant

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64. Pezetel, a Foreign Trade Enterprise of the Aviation Industry of Poland, is an agency or instrumentality created by and responsible to the People's Republic of Poland.

65. Defendant Melex USA, a wholly-owned subsidiary of Pezetel, imports Pezetel golf carts and sells them in geographic areas where there are no Melex dealers. Defendant Ross Products, Inc., a Delaware corporation, distributes Melex golf carts in certain southern and southwestern states. Defendant Fern Clo Car, Inc., a Pennsylvania corporation, distributes Melex golf carts in Delaware, New Jersey, New York, New England, and parts of Pennsylvania. Defendant Eddietron Inc., a North Carolina corporation, distributes Melex golf carts in North and South Carolina, Virginia, parts of Tennessee, West Virginia, and Maryland. Defendant Boyland Leasing Company, a Michigan corporation, distributes Melex golf carts in certain midwestern states.

66. The electric golf cart industry has historically been very competitive. Until 1970, domestic manufacturers dominated the market. In 1970, a United States corporation, Products International, entered into an agreement with Elektrim Foreign Trade Company of Poland (Pezetel's predecessor) to manufacture an electric golf cart to its specification. Eight carts were imported in 1970. This increased to 6087 carts in 1973 and 8040 carts in 1974. Pezetel succeeded Electrim and established Melex as its importer and set up an extensive distribution network. By 1975, Pezetel had captured 35% of the domestic golf cart market. Pezetel's phenomenal success was linked to its position as the price leader in the market. Pezetel could offer low prices as a result of a cost subsidy provided by the Polish government. OMC's Cushman division was forced out of the market in 1975 because of antitrust violations on the part of Pezetel. 461 F. Supp. at 398.

67. Plaintiff cited the following violations in its complaint: (1) restraint of trade in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1 (1976); (2) illegal monopoly under Section 2 of the Sherman Act, 15 U.S.C. § 2 (1976); (3) violation of Section 73 of the Wilson Tariff Act, 15 U.S.C. § 8 (1976); and (4) violations of the Antidumping Act of 1916, 15 U.S.C. § 72 (1976).

case. Pezetel argued that under Section 1606 of the FSIA[68] a foreign state could not be liable for punitive damages. Since plaintiff was seeking punitive treble damages under the antitrust laws, these damages were not allowed under the FSIA. The court rejected this contention, noting that Pezetel had failed to include the language "except for an agency or instrumentality," in its reading of Section 1606 of the FSIA.[69] The court found that, as an agency or instrumentality of the Polish government, Pezetel was subject to the punitive damages sought by the plaintiff. Pezetel's second effort to succeed under the FSIA involved an attempt to limit the "commercial activity" language of Section 1605(a)(2)[70] to legal disputes based exclusively on tort and breach of contract claims. To support its position, Pezetel noted that the legislative history cited these types of cases as illustrations.[71] The court rejected this argument on three grounds: first, the plain meaning of the language of the statute had no qualifying language that would limit its applicability; second, the legislative history stated that the courts would have a great deal of latitude in determining what is a "commercial activity" for the purposes of the bill.[72] Finally, the legislative history expressly recognized the Sherman Act and its relation to the FSIA.[73] The Court also rejected Pezetel's third contention that, under the FSIA, antitrust laws could not apply to foreign sovereigns because it would involve an inquiry into the inner motives of governmental policy. The court stated that determining whether an activity is a "commercial activity" simply required consideration of the nature of the act and not its purpose.[74] Since the manufacture and sale of electric golf

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68. 28 U.S.C. § 1606 (1976) provides:

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 circumstance; but a foreign state *except for an agency or instrumentality thereof* shall not be liable for punitive damages. . . . (emphasis added).

69. 461 F. Supp. 384, 495 (D. Del. 1978).
70. 28 U.S.C. § 1605(a)(2) (1976).
71. *House Report, supra* note 46, at 7.
72. *Id.* at 16.
73. *Id.* at 19.
74. 461 F. Supp. at 395. *See* 28 U.S.C. § 1603(d) (1926), which provides: "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."

carts was clearly a commercial act, the court concluded that the FSIA applied. In its fourth and final argument, Pezetel tried to escape FSIA jurisdiction through a technical point. Pezetel argued that actions brought under the FSIA must be non-jury civil actions.[75] Since plaintiff was seeking jury trial against all of the other defendants except Pezetel, Pezetel maintained that the action could no longer be considered non-jury. The court rejected this argument as being an overly technical reading of the statute. The court also noted that the sovereign's right may be protected by parallel jury and non-jury trials.[76]

Pezetel then raised the issue of jurisdiction over foreign sovereigns under the antitrust laws, by claiming to be the equivalent of the Polish government. The court, however, declined to equate Pezetel with the government[77] and, as a result, rejected any arguments based on the *Pfizer* case.[78] The court also examined and rejected Pezetel's argument that case law grants immunity from the antitrust laws to entities acting under the authority of a sovereign state.[79] Finally, the court denied Pezetel's last general jurisdictional argument based on the act of state doctrine.[80] Thus,

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75. 461 F. Supp. at 396. *See* 28 U.S.C. § 1330 (1976); *supra* note 39.

76. 461 F. Supp. at 396.

77. *Id.*

78. *Id.; see also* Pfizer, Inc. v. India, 434 U.S. 308 (1978), where the Supreme Court permitted a foreign sovereign to file suit under the antitrust laws.

79. Pezetel argued that the *Parker v. Brown*, 317 U.S. 341 (1943), exemption for state action would be controlling in this case, thus granting immunity from suit. 461 F. Supp. at 397. The instant court made two points regarding this contention: (1) *Goldfarb v. Virginia State Bar*, 421 U.S. 773 (1975), limits the *Parker* state action exemption to conduct that is compelled and not merely promoted or allowed by the state, so that if Pezetel could prove that it was involved in state action (*i.e.* that it was acting for or in behalf of the government of Poland in selling golf carts in the United States) it must show that it was *compelled* to manufacture and sell golf carts in the manner it did; and (2) Pezetel's claim for immunity due to state action is not supported by the antitrust laws because they expressly cover corporations organized under foreign laws. *Id. See also*, 15 U.S.C. § 7 (1976).

80. The act of state doctrine precludes United States courts from inquiring into the validity of public acts of recognized foreign powers committed within their own territory. This doctrine is discussed in *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398 (1964). Under the *Sabbatino* rule, a litigant must fulfill three requirements in order to invoke the act of state doctrine: (1) a public act must be involved; (2) it must have been committed by a recognized foreign power; and (3) the act must be exclusively within the territory of the foreign power. The instant court noted that Pezetel failed to establish any of these cri-

the instant court found that it had proper jurisdiction over Pezetel. Having ruled on the jurisdictional portion of the motion to dismiss, the court then turned to the four substantive antitrust claims raised by the plaintiff.[81]

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teria. In *Hunt v. Mobil Oil Corp.*, 550 F.2d 68 (2d Cir. 1977), the Second Circuit Court of Appeals expanded the act of state doctrine to include a situation in which nationalization of the plaintiff's property was involved and the foreign power was not a defendant. The *Hunt* court reasoned that the suit would involve judicial inquiry into the acts and conduct of Libyan officials in conducting foreign policy. *Id.* at 72. The instant court, however, found no similarity between the *Hunt* case and Pezetel's situation, because in *Hunt* the sovereign was not an entrepreneur. *Id.* at 73. Pezetel did not rely on *Hunt* as authority to apply the act of state doctrine to a private defendant, but instead contended that Pezetel itself should be treated as the Polish government. This argument was again dismissed by the court. The court did not have to decide if this was a situation where the commercial activity of a foreign sovereign fell outside the act of state doctrine because Pezetel was not a foreign sovereign. 461 F. Supp. at 398.

81. Plaintiff had alleged that defendant's reduced prices and restricted distribution scheme violated Section 1 of the Sherman Act. 15 U.S.C. § 1 (1976). The court dismissed the Section 1 claim for two reasons: (1) the pricing scheme argument failed to state a claim; and (2) although the alleged horizontal restraints would suffice as a claim, plaintiff could show no injury resulting from the practice. Plaintiff's second claim alleged that defendant's pricing scheme and restricted distribution network violated Section 2 of the Sherman Act, 15 U.S.C. § 2 (1976), which makes illegal any attempts to monopolize the market where there is a probability of success. The court concluded that defendant's pricing activities were insufficient to imply the requisite intent for a Section 2 claim. 461 F. Supp. at 405. The court did find, however, that defendant's territorial restraints could possibly reflect the intent to eliminate competition by attempting to monopolize the market. *Id.* Thus, the Section 2 claim withstood the motion to dismiss. Plaintiff's third claim involved alleged violations of Section 73 of the Wilson Tariff Act, 16 U.S.C. § 8 (1976), which generally extends the Sherman Act to cover the importation of goods from foreign countries. The court concluded that the Wilson Act made it clear that antitrust laws applied to import trade and that the Act embraced both Section 1 and Section 2 of the Sherman Act. 461 F. Supp. at 407. The court pointed out that plaintiff would have the same problems proving specific intent under the Wilson Act as it would encounter in the claim under Section 2 of the Sherman Act, but that the cause of action should survive the defendant's motion to dismiss. Plaintiff's last claim involved alleged violations under the Antidumping Act of 1916, 15 U.S.C. § 72 (1976), which prohibits price discrimination between purchasers in different national markets. *See* J. Viner, DUMPING: A PROBLEM IN INTERNATIONAL TRADE 4 (1966). The court rejected this claim because the defendant was selling golf carts in only one country and therefore could not discriminate by price. 461 F. Supp. at 409.

IV. ANALYSIS

A. *The FSIA Issue*

The two instant cases provide examples of the jurisdictional problems which occur when the United States attempts to apply its antitrust laws to foreign nations. The *OPEC* court realized that it did not have enough information or expertise to render a complete and proper analysis of the foreign policy implications of its immunity decisions without additional aid.[82] Thus, the *OPEC* court issued an Order to Show Cause[83] to the defendants and other key parties, including the State Department. The State Department failed to reply to the order. Even though under the FSIA this opinion should be accorded the same weight as any other *amicus* brief, it is arguable that if the State Department had filed a brief suggesting that immunity could be consistent with existing foreign policy, the instant court would have construed OPEC's allegedly illegal activity as price fixing rather than the "establishment . . . of the terms and conditions for the removal of a prime natural resource."[84] As no brief was filed, however, under the FSIA, the instant court was forced to make its own foreign policy appraisal and, as a result, narrowly construed the activity involved as non-commercial. A truly depoliticized determination would not have required such a narrow reading of the statute's language. The instant cases indicate that the courts are in a very precarious position when they interpret the FSIA. Forced to take notice of political realities, the courts cannot make depoliticized jurisdictional rulings. Instead, in volatile litigation involving scarce resources, as in *OPEC*, the courts are forced to construe the statute's language very narrowly in order to avoid creating difficult foreign policy problems. By contrast, in less politically sensitive cases, like *Pezetel*, the courts have greater freedom to make an objective reading of the statute. In the effort to depoliticize the immunity decisions, Congress ignored the practical realities involved. Sovereign immunity decisions cannot be made without political ramifications that necessarily affect foreign relations. Although the drafters of the Constitution did not

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82. This is indicated by the court's issuance of the Order to Show Cause, seeking advice on the sensitive issues of the case. *See* note 19 *supra*; IAM v. OPEC, at 5.

83. *Id.*

84. *Id.* at 21.

intend foreign policy decisions to be made through interpretation of jurisdictional language by the courts[85] this result is inevitable under the FSIA. Future courts will most likely follow the trend in the instant cases and construe the FSIA language narrowly to facilitate smooth foreign relations when politically sensitive issues are involved. But this will not resolve the problems with the statute. Consider the application of the FSIA to politically sensitive disputes with Third World nations. Courts are expected to make jurisdictional decisions based on a differentiation between commercial and governmental acts. In the case of Third World nations, however, there is no such distinction. No economic decision based on the allocation of scarce resources can be severed from governmental and political activity. In developing nations, the existence of healthy government is directly linked to the ability of the country to market its resources in exchange for advanced technology and respect from industrial nations. This suggests that the FSIA is unworkable and unsatisfactory for use in litigation involving Third World parties. As long as courts are saddled with the statute, they will continue to avoid political problems by construing the statute narrowly. Congress should consider this dilemma and modify the statutory language or repeal the statute entirely. Repealing the FSIA would place the foreign policy determinations back in the hands of the executive resulting in greater flexibility without forced judicial statutory interpretations. Short of repealing the FSIA, Congress should contemplate changing the jurisdictional standard from consideration of commercial acts to a consideration of the importance of the act to the functions of the sovereign's government. This standard would still require attention to foreign policy on the part of courts but would allow more flexibility in sensitive areas than the current statutory language. Under this standard, the courts would not be forced to make political decisions to fit existing statutory language, as in the two instant decisions. Considering the political ramifications, the instant courts correctly decided the jurisdictional immunity issues. Because Congress has placed the courts in this difficult position, however, future courts will most likely follow the trend in the instant cases and construe the FSIA language more and more narrowly when politically sensitive issues are involved. These contrived statutory interpretations will result in good foreign policy

85. *See* U.S. CONST. art. II, § 2, cl. 2. The drafters indicated that the executive should conduct United States foreign policy rather than the judiciary.

but bad law.

B. *Scope of Antitrust Jurisdiction*

In both of the instant cases, foreign sovereign states were either directly or indirectly involved in private antitrust actions. Strong policy considerations must be considered in deciding whether United States antitrust law should apply to foreign nations if jurisdiction is otherwise proper. When the foreign sovereign is one of the defendants in an antitrust action, as in *OPEC*, the primary jurisdictional arguments under the antitrust laws revolve around whether a foreign sovereign is a "person" for the purposes of the antitrust statutes. The courts must manipulate the statutory language to formulate their jurisdictional test. The *OPEC* court refused to extend the *Pfizer*[86] doctrine allowing a foreign sovereign to be a plaintiff "person" under the antitrust laws by holding that a foreign sovereign could not be a defendant "person." The court correctly concluded that to subject a foreign sovereign to United States antitrust laws would involve judicial invasion into the sensitive inner policies and workings of a foreign sovereign. The political and economic repercussions of permitting the OPEC nations to be sued for antitrust violations could be devastating.[87] The result reached by this court on both the FSIA and antitrust jurisdictional issues indicates that the proper means for seeking redress for alleged abuses in the world oil market is through diplomatic channels, not the United States court system. In the *Pezetel* case, antitrust jurisdiction was conferred because there was no immediate threat to world political and economic systems. Regulation of the supply of golf carts to the United States is not as crucial to foreign relations as regulating the behavior of the OPEC nations in the oil market. Accordingly, the *Pezetel* court strictly interpreted the FSIA and the antitrust statutes in exercising jurisdiction over Pezetel. Although Pezetel tried to elevate its status to that of the Polish government, the court concluded that involvement on the part of the Polish government was not extensive enough to make inquiry into the alleged violations by the United States judiciary improper.

Thus, when faced with foreign anticompetitive activity, domes-

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86. *See* note 57, *supra*.

87. A likely repercussion would be an embargo on oil shipments to the United States followed by a withdrawal of investment assets from the United States in order to avoid attachment.

tic businesses must in effect decide whether the commercial activity is more like regulating golf carts or more like regulating oil prices in its relation to foreign policy. If the dispute resembles the *OPEC* case in its foreign policy ramifications, the court will find some way to refuse jurisdiction and the domestic plaintiff must turn to diplomatic channels for relief. If the case involves less sensitive foreign policy questions, as in *Pezetel*, the court will interpret the FSIA and the antitrust statutes literally in order to exercise jurisdiction. Domestic businesses face uncertainty in litigation because the jurisdiction question is based on the outcome of the court's foreign policy analysis. The unwillingness on the part of the courts to exercise jurisdiction over commercial activity that might have foreign policy overtones is directly opposed to the intent of the drafters of the FSIA to depoliticize sovereign immunity decisions.[88] Thus, in the area of extraterritorial antitrust law, it seems appropriate for Congress to reconsider the FSIA and become sensitive to the jurisdictional struggles that face the courts. Congress must face the essential question whether the courts are suited to make political decisions in foreign policy areas.

V. Conclusion

Under current law, state-owned entities that conduct business within the United States may be sued for violations of the antitrust statutes, but foreign sovereign states are not amenable to direct antitrust actions.[89] Antitrust disputes with foreign nations will most likely be resolved by diplomatic means as the courts attempt to avoid involvement in sensitive areas of foreign relations. The instant cases, however, have a wider applicability than merely extraterritorial antitrust cases. These cases reflect caution on the part of the courts in dealing with foreign policy questions. More importantly, these cases demonstrate the serious problems that courts have in interpreting and implementing the FSIA, suggesting that Congress has given the judiciary responsibilities in

88. *See* note 15, *supra*.

89. It must be noted that the Supreme Court has not ruled on the issue concerning the amenability of a foreign sovereign to suit under the antitrust laws and the FSIA. Thus, *OPEC* and *Pezetel* are the only cases to date in this area. The *OPEC* case has been appealed to the Ninth Circuit United States Court of Appeals. Plaintiffs filed their first brief March 21, 1980, in *IAM v. Organization of Petroleum Exporting Countries*, 79-3693.

the foreign relations realm that it should not have. Both cases also point out how courts will use the statutory language of the antitrust statutes in addition to the FSIA to effectuate jurisdictional policy in extraterritorial antitrust actions. The cases indicate that courts will use narrow statutory interpretations to avoid potentially politically embarrassing, yet legally correct, results. This trend indicates that future litigants with politically explosive issues will be forced by the court's jurisdictional manipulations to seek relief through diplomatic channels, thus reaching the correct result by incorrect means.

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