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Foreign Sovereign Immunity--The Status of Legal Entities in Socialist Countries as Defendants under the Foreign Sovereign Immunities Act of 1976

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RECENT DEVELOPMENT

FOREIGN SOVEREIGN IMMUNITY—THE STATUS OF LEGAL ENTITIES IN SOCIALIST COUNTRIES AS DEFENDANTS UNDER THE FOREIGN SOVEREIGN IMMUNITIES ACT OF 1976

I. INTRODUCTION

The Foreign Sovereign Immunities Act of 1976[1] (FSIA) grants an "agency or instrumentality" of a foreign state substantially the same immunities that are provided to the state itself under the Act.[2] An agency or instrumentality of a foreign state is defined in section 1603(b) of the FSIA. Section 1603(b) lists the following three criteria that must be met by an entity in order to qualify as an agency or instrumentality for sovereign immunity purposes: (1) the entity must be a legally independent person[3] under the laws of the foreign state in which it was created; (2) the entity must be either an organ of the foreign state or primarily owned by the foreign state; (3) the entity cannot be a citizen of the United States or a third country.[4] Prior to the enactment of the FSIA, the law concerning whether an agency or instrumentality would be treated as a foreign state for purposes of granting or withholding sovereign immunity was unsettled.[5] Congress resolved this uncertainty by

1. Pub. L. No. 94-583, 90 Stat. 2892 (codified at 28 U.S.C. §§ 1330, 1602-1611 (1976)). The FSIA embraces the restrictive doctrine of sovereign immunity. The basic premise of this doctrine is that the defense of sovereign immunity should not be available to a foreign state with respect to suits on commercial matters. 28 U.S.C. §§ 1602, 1605(a)(2) (1976). *See* Alfred Dunhill of London, Inc. v. Republic of Cuba, 425 U.S. 682, 701-02 (1976); H.R. REP. No. 1487, 94th Cong., 2d Sess. 1, 7 (1976) [hereinafter cited as COMMITTEE REPORT], *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS 6604, 6605; Tate Letter, 26 DEP'T STATE BULL. 984 (1952).

2. The FSIA defines foreign state to include agencies and instrumentalities of that state. 28 U.S.C. § 1603(a) (1976).

3. Congress intended that an agency or instrumentality be a legal person, such as a corporation, which can sue, be sued, contract, and hold property in its own name. COMMITTEE REPORT, *supra* note 1, at 15, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS, at 6614.

4. An "agency or instrumentality of a foreign state" means any entity — (1) which is a separate legal person, corporate or otherwise, and (2) which is an organ of a foreign state or political subdivision thereof, or a majority of whose shares or other ownership interests is owned by a foreign state or political subdivision thereof, and (3) which is neither a citizen of a State of the United States . . . nor created under the laws of any third country.

28 U.S.C. § 1603(b) (1976).

5. Weber, *The Foreign Sovereign Immunities Act of 1976: Its Origin, Meaning*

providing the agency or instrumentality with the privilege to invoke the immunity provisions of the FSIA. In solving this problem, however, Congress created another issue for the courts. In order to determine if the entity is an agency or instrumentality of the foreign state, courts now must determine whether the foreign state has a majority ownership interest in the organization or whether the entity is an organ of the foreign state. This problem becomes particularly confusing when the courts have to apply the 1603(b)(2) ownership requirement to socialist countries. Difficulty arises because public ownership is the foundation of most socialist economic systems, whereas capitalistic systems are based upon private ownership.[6] Due to these differences, it is more difficult for courts to ascertain the degree of state ownership of legal entities in socialist states. The federal courts confronted this problem in two recent decisions: *Yessenin-Volpin v. Novosti Press Agency*[7] and *Edlow International Co. v. Nuklearna Elektrarna Krsko.*[8] This paper will analyze these recent developments against the background of previous court decisions, the FSIA's legislative history, and the legal concepts of social ownership in Yugoslavia and the United Soviet Socialist Republic (U.S.S.R.).

II. LEGAL BACKGROUND

A. *Pre-FSIA Cases Concerning Sovereign Immunity of Agencies and Instrumentalities of Foreign States*

Prior to the enactment of the FSIA, United States courts generally denied sovereign immunity to a foreign state's agencies or instrumentalities if they were legal persons[9] under the law of the

and Effect, 3 YALE STUD. IN WORLD PUB. ORD. 1, 26-27 (1976). In the past, United States courts generally denied immunity to legally independent agencies or instrumentalities of a foreign state such as foreign governmental corporations. *See* Coale v. Societe Co-operative Suisse des Charbons, Basle, 21 F.2d 180 (S.D.N.Y. 1921); United States v. Deutches Kalisyndikat Gesellschaft, 31 F.2d 199 (S.D.N.Y. 1929); Ulen & Co. v. Bank Gospodarstwa Krajowego, 24 N.Y.S.2d 201(1940). Some United States courts, however, granted sovereign immunity to foreign governmental entities that were incorporated. *See In re* Investigation of World Arrangements with Relation to the Production, Transportation, Refining & Distribution of Petroleum, 13 F.R.D. 280 (D.D.C. 1952).

6. *See* note 46 *infra* & text accompanying note 58 *infra*.

7. 443 F. Supp. 849 (S.D.N.Y. 1978).

8. 441 F. Supp. 827 (D.D.C. 1977).

9. The concept of a legal person, as used in this paper, refers to the first criterion that an agency or instrumentality must satisfy in order to be considered a foreign state under the FSIA. *See* 28 U.S.C. § 1603(b)(1) (1976). For purposes

foreign state where they were created.[10] Most cases in the United States dealt with foreign governmental corporations that were either partially or completely owned by the foreign state. *Coale v. Societe Co-operative Suisse des Charbons, Basle*[11] and *United States v. Deutsches Kalisyndikat Gesellschaft*[12] established the general rule that a corporation wholly or partly owned or controlled by a foreign government was not entitled to the same immunity as the sovereign. In *Coale,* the court held that a corporation formed by the Swiss Government for the importation of coal was not exempt from jurisdiction in a United States court even though the Swiss Government had the right to appoint some of the corporation's directors and to receive excess profits.[13] The court in *Deutsches Kalisyndikat Gesellschaft* reached a similar conclusion by refusing to grant sovereign immunity to a corporation owned and incorporated by the French Government to serve as a governmental agency in administering French potash mining and to act as sales agent for state mines.[14] These decisions reasoned that a corporation was separate and distinct from the foreign state and thus not entitled to the same immunity as the incorporating government.[15] The Supreme Court established this proposition in *Bank of the United States v. Planters' Bank of Georgia,* which concerned the immunity of a banking corporation that was owned and operated by the State of Georgia.[16] Chief Justice John Marshall enunciated the restrictive view of sovereign immunity for domestic purposes in this decision when he wrote:

> [I]t is, we think, a sound principle, that when a government becomes a partner in any trading company, it divests itself, so far as concerns the transactions of that company, of its sovereign charac-

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of the FSIA, a legal person is defined as "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." COMMITTEE REPORT, *supra* note 1, at 15, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS, at 6614.

10. *See generally* 2 D. O'CONNELL, INTERNATIONAL LAW 872-76 (2d ed. 1970) D. GREIG, INTERNATIONAL LAW 250-51 (2d ed. 1976).

11. 21 F.2d 180 (S.D.N.Y. 1921).

12. 31 F.2d 199 (S.D.N.Y. 1929).

13. 21 F.2d at 180.

14. 31 F.2d at 203. The court noted that immunity should not be granted to a foreign corporation "merely because . . . its stock is held by a foreign state, or because it is carrying on a commercial pursuit, which the foreign government regards governmental or public." *Id.*

15. *See* 2 D. O'CONNELL, *supra* note 10, at 875.

16. 22 U.S. (9 Wheat.) 904 (1824).

> ter, and takes that of a private citizen. Instead of communicating to the company its privileges and its perogatives, it descends to a level with those with whom it associates itself, and takes the character which belongs to its associates, and to the business which is to be transcended . . . . The State of Georgia, by giving to the Bank the capacity to sue and be sued, voluntarily strips itself of its sovereign character, so far as respects the transactions of the Bank, and waives all the privileges of that character.[17]

In 1940, a New York state court reaffirmed *Coale* and *Deutsches Kalisyndikat Gesellschaft*[18] when it held that a legally independent bank, created and primarily owned by the Polish Government, was not immune from suit.[19] Thus, the general rule became that an independent legal entity, such as a corporation, could not receive sovereign immunity even though it was owned, controlled, and used by a foreign state as a governmental agency or instrumentality. In one case, *In re Investigation of World Arrangements with Relation to the Production, Transportation, Refining & Distribution of Petroleum,*[20] a court deviated from the general rule when it held that a corporation organized and controlled by a foreign state was entitled to sovereign immunity. That case concerned a British Government-owned oil company that was established to insure the oil supply of the British navy. In this decision the court said that the corporation was performing a "fundamental governmental function" by supplying Britain's fleet with oil and, therefore, should not be amenable to suit in a United States court.[21] The court emphasized that the noncommercial, public object and public purpose of the oil company distinguished this case from *Deutsches Kalisyndikat Gesellschaft.* In the latter case "the French Government was involved in a commercial venture, entirely divorced from any governmental function," and therefore not entitled to the immunity of the sovereign.[22] This court's applica-

17. *Id.* at 907.

18. Ulen & Co. v. Bank Gospodarstwa Krajowego, 24 N.Y.S.2d 201 (1940).

19. The court confronted the issue of whether the bank was amenable to suit on interest coupons attached to bonds issued by the bank and guaranteed by the Polish Government. The court stated that "a corporation organized by . . . foreign government for commercial objects in which the government is interested, does not share the immunity of the sovereign." *Id.* at 206. *See also* The Uxmal, 40 F. Supp. 258 (D. Mass. 1941), which held amenable to suit a corporation that was partly owned and controlled by the Mexican Government for purposes of promoting the sisal industry.

20. 13 F.R.D. 280 (D.D.C. 1952).

21. *Id.* at 290.

22. *Id.* at 291. The allowance of sovereign immunity for a foreign state's public.

tion of the object-purpose test established a new precedent. Certain problems arise in using this type of object-purpose test to determine whether a corporate agency or instrumentality of a foreign state is entitled to sovereign immunity. There is generally a mixture of public purpose and commercial activity within a foreign government's agency or instrumentality. For example, in *Deutsches Kalisyndikat Gesellschaft,*[23] the French Government regarded the object and purpose of the corporation in question as governmental and public. It became difficult for a court to decide whether an entity essentially performs a governmental function, and is thus immune, or if it is essentially commercial and therefore not immune from suit.[24]

United States courts also granted sovereign immunity to instrumentalities of foreign states, including for-profit corporations, when the executive branch determined that immunity should be granted.[25] The courts felt bound by an executive determination of immunity.[26] Although the Department of State followed the restrictive theory of sovereign immunity[27] since 1952, the executive branch occasionally bowed to diplomatic influences and requested sovereign immunity for a foreign state's corporate instrumentality that was being sued for a commercial rather than a public or governmental act.[28] In *Spacil v. Crowe* the court commented that

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acts but not for its commercial, private acts is the basic premise behind the "restrictive" theory of sovereign immunity. *See* note 1 *supra.* The restrictive theory of sovereign immunity "was adopted by the Department of State in 1952 and has been followed by the courts and by the executive branch ever since." COMMITTEE REPORT, *supra* note 1, at 7, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS, at 6605.

23. *See* note 14 *supra.*

24. The FSIA eliminated the reference to "purpose" and, instead, emphasized the nature of the transaction being sued upon in order to classify the sovereign's act as commercial or governmental when deciding whether sovereign immunity should be granted. *See* 28 U.S.C. § 1603(d) (1976).

25. F.W. Stone Engineering Co. v. Petroleos Mexicanos of Mexico, D.F., 352 Pa. 12, 42 A.2d 57 (1945); *see* Ex Parte Peru, 318 U.S. 573 (1943); Spacil v. Crowe, 489 F.2d 614 (5th Cir. 1974).

26. *See* COMMITTEE REPORT, *supra* note 1, at 7, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS, at 6606.

27. *See* note 1 *supra.*

28. *See* Spacil v. Crowe, 489 F.2d at 615-16. In this decision, the court granted immunity to a shipping corporation owned by the Cuban government at the request of the State Department. The court pointed out that the executive branch was seeking legislation which would transfer "to the courts the responsibility for determining whether a claim of immunity should be honored." *Id.* at 620 n.7. The FSIA accomplished this goal by transferring to the judiciary the responsibil-

"[t]he State Department has found that it cannot deny a claim of immunity without risking adverse effects on foreign relations."[29] State Department intervention and the inadequacies of the object-purpose test caused inconsistent results in United States courts concerning which legal entities belonging to a foreign state could successfully plead immunity from suit.[30]

B. *Legislative History Behind the FSIA*

The FSIA, a codification of the restrictive theory of sovereign immunity,[31] vests courts with exclusive jurisdiction over lawsuits involving a foreign state, its agencies and its instrumentalities.[32] Congress gave United States District Courts subject matter jurisdiction over "any nonjury civil-action" brought against a foreign state as defined in section 1603(a) of the FSIA.[33] An agency or instrumentality qualifies as a foreign state if it satisfies all three

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ity to decide when a foreign state and its agencies and instrumentalities are entitled to sovereign immunity. According to the legislative history behind the FSIA, this transfer of responsibility was one of the principal purposes for the FSIA's enactment. During the debate, proponent of the Act argued that "[t]he Department of State would be freed from pressures from foreign governments to recognize their immunity from suit and from any adverse consequences resulting from an unwillingness of the Department to support that immunity." COMMITTEE REPORT, *supra* note 1, at 7, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS, at 6606.

29. 489 F.2d at 620 n.7.

30. This uncertainty whether a court will grant sovereign immunity to an agency or instrumentality of a foreign state "is a matter of considerable importance in negotiating contracts with . . . instrumentalities or agencies of foreign sovereigns since it has a direct bearing upon the possible effectiveness of choice of forum clauses and the expected outcome of litigation." 2 G. DELAUME, TRANSNATIONAL CONTRACTS APPLICABLE LAW AND SETTLEMENT OF DISPUTES § 11.02 (1978).

31. "Under this principle, the immunity of a foreign state is 'restricted' to suits involving a foreign state's public acts (jure imperii) and does not extend to suits based on its commercial or private acts (jure gestionis)." COMMITTEE REPORT, *supra* note 1, at 7, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS, at 6605. *See also* 28 U.S.C. § 1602 (1976).

32. "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, *supra* note 30, at § 11.01.

33. 28 U.S.C. § 1330(a) (1976). The jurisdiction extends to any cause of action with respect to which the foreign state is not entitled to immunity under sections 1605, 1606 and 1607 of the FSIA. For example, a foreign state would not be immune from the court's jurisdiction where the suit is based upon the commercial activities of the foreign state. *See* 28 U.S.C. §§ 1602, 1605(2) (1976).

criteria listed in section 1603(b).[34] The first criterion, that the agency or instrumentality must be a legal person,[35] nullifies previous court decisions that refused to grant immunity to foreign governmental corporations because they were incorporated and legally independent.[36] 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.[37]

Therefore, a foreign state's agency or instrumentality, such as a commercial airline, could be granted immunity even though its object and purpose are purely commercial and nongovernmental provided, however, that the transaction upon which it is being sued is not of a commercial nature. In order for the agency or instrumentality to receive sovereign immunity it must not fall within the exceptions listed in sections 1605 through 1607.[38] For example, had *United States v. Deutsche Kalisyndikat Gesellschaft*[39] been decided under the FSIA, the French Government-owned potash mining corporation would have been entitled to sovereign immunity provided that one of the exceptions listed in sections 1605 through 1607, such as commercial activity, did not bar immunity. The second of the three criteria 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.[40] According to the legislative history behind the

34. *See* note 4 *supra*.

35. *See* note 9 *supra*.

36. "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." 2 D. O'CONNELL, *supra* note 10, at 875.

37. COMMITTEE REPORT, *supra* note 1, at 15-16, *reprinted in* [1976] U.S. CODE CODE. & AD. NEWS, at 6614.

38. *See* 28 U.S.C. §§ 1604-07 (1976); COMMITTEE REPORT, *supra* note 1, at 15, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS, at 6614.

39. 31 F.2d 199; *see* text accompanying note 14 *supra*.

40. G. Delaume states that this second criterion concerning ownership 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 30, at § 11.02.

FSIA, the foreign state must have majority ownership of the entity.[41] Neither the act nor the legislative history, however, clearly defines what is an organ of a state. Problems arise when applying this ownership criteria to socialist states, as illustrated in the two recent decisions[42] that are the subject of this paper. The last of the three 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 activities that are either commercial or private in nature."[43] If the agency or instrumentality does not meet all three of the criteria in section 1603(b), it is not entitled to sovereign immunity in any federal court. If the organization satisfies the three criteria outlined above, the next question is whether one of the exceptions to sovereign immunity contained in sections 1605 through 1607 applies. Immunity will be barred if any one of these exceptions is applicable.

C. *Concepts of Property Ownership in the U.S.S.R. and Yugoslavia*

The *Novosti* court faced the issue of whether a public organization, such as Novosti, satisfied the 1603(b)(2) ownership test to qualify as an agency or instrumentality of the U.S.S.R. In *Edlow*, the court concentrated on whether a worker organization, such as Nuklearna Elektrarna Krsko, met this 1603(b)(2) ownership requirement in order to be an agency or instrumentality of Yugoslavia. Before discussing how these two recent developments applied the 1603(b)(2) test, an understanding of the basic property ownership concepts in the U.S.S.R. and Yugoslavia is essential.

1. Ownership of Public Organizations in the U.S.S.R.

Under Article 51 of the U.S.S.R. Constitution, Soviet citizens "have the right to associate in public organizations that promote their political activity and initiative and satisfaction of their

41. COMMITTEE REPORT, *supra* note 1, at 15, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS, at 6614.

42. 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).

43. COMMITTEE REPORT, *supra* note 1, at 15, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS, at 6614.

various interests."[44] The property of these public organizations, along with state property, property of collective farms, cooperative organizations and trade unions comprise what is known as "socialist property" in the U.S.S.R.[45] This "socialist property" is the foundation of the Soviet Union's economic system.[46] Legally, the concept of ownership in the Soviet Union is similar to western democracies.[47] Soviet law indicates that an owner has the "powers of possession, use and disposal of property within the limits established by law."[48] The State proclaims that it solely owns "the principal form of socialist property": state property.[49] State eco-

44. U.S.S.R. CONST., art. 51, *reprinted in* Hazard, *Union of Soviet Socialist Republics* (Constitution) 29, in 14 CONSTITUTIONS OF THE COUNTRIES OF THE WORLD (A. Blaustein & G. Flanz eds. 1978). Public organization and mass organization are used interchangeably when referring to organizations of citizens arising under Article 51 of the Soviet Constitution, which is the amended version of Article 126 of the 1963 Soviet Constitution, *reprinted in* CONSTITUTIONS OF THE COMMUNIST PARTY-STATES 74 (J. Triska ed. 1968).

45. FUNDAMENTALS OF CIVIL LEGISLATION OF THE USSR AND THE UNION REPUBLICS (1961) art. 20, *reprinted in* FUNDAMENTALS OF LEGISLATION OF THE USSR AND THE UNION REPUBLICS 160 (M. Saifulin trans. 1974).

46. U.S.S.R. CONST., art. 10, *reprinted in* Hazard, *supra* note 44, at 22 provides that:

> The foundation of the economic system of the USSR is socialist ownership of the means of production in the form of state property (belonging to all the people), and collective farm - and - cooperative property. Socialist ownership also embraces the property of trade-unions and other public organizations which they require to carry out their purposes under their rules.

Ownership of "socialist property" consists of "state (popular) ownership; ownership by collective farms, other cooperative organizations and associations thereof; and ownership by public organizations." CIVIL CODE OF THE RUSSIAN SOVIET FEDERATED SOCIALIST REPUBLIC, art. 93, *reprinted in* SOVIET CIVIL LEGISLATION 25 (W. Gray ed. 1965). *See also* U.S.S.R. CONST., art. 10, *supra*. There is no right of private individual ownership of "socialist" property assets of state economic enterprises, collective farms, cooperative organizations, and public (mass) organizations. *See* U.S.S.R. CONST., art. 13, *reprinted in* Hazard, *supra* note 44, at 22-23.

47. *See* H. BERMAN, JUSTICE IN THE U.S.S.R. 115 (1963).

48. FUNDAMENTALS OF CIVIL LEGISLATION OF THE USSR AND THE UNION REPUBLICS (1961) art. 19, *supra* note 45, at 160. *See* Kiralfy, *Ownership*, in 2 ENCYCLOPEDIA OF SOVIET LAW 480 (F. Feldbrugge ed. 1973). Similarly, in the United States the chief incidents of ownership are possession, use and right to sell, or otherwise dispose of property. *See* Collier v. California Co., 73 F. Supp. 413, 415 (W. D. La. 1947); Trustees of Phillips Exeter Academy v. Exeter, 92 N.H. 473, 33 A.2d 665, 673 (1943).

49. U.S.S.R. CONST., art. 11, *reprinted in* Hazard, *supra* note 44, at 22.

> The land, its minerals, waters, and forests are the exclusive property of the state. The state owns the basic means of production in industry, construction, and agriculture; means of transport and communication; the banks;

nomic enterprises are allowed to possess, use, and dispose of the state property as managers for the Soviet state, but not as owners.[50] Public organization property is also "socialist property" but, unlike state property, it can be owned by the public organization.[51] This type of "socialist property" ownership has little economic significance because public organizations pursue non-economic goals.[52] Unlike state ownership, public organization ownership is of a non-productive character.[53] According to Soviet law,[54] these public organizations are juridical persons. A juridical person is capable of suing, being sued, and acquiring property and non-property rights in its own name. The owner of a public organization is not specified in either the Soviet Constitution or the 1961 Fundamentals of Civil Legislation. "Socialist property" may be owned by both the State and a public organization.[55] Since the Soviet Consti-

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the property of state-run trade organizations and public utilities, and other state-run undertakings; most urban housing; and other property necessary for state purposes.

Id.

50. FUNDAMENTALS OF CIVIL LEGISLATION OF THE USSR AND THE UNION REPUBLICS (1961) art. 21, *supra* note 45, at 160.

> Except in cases when the state appears as the subject of civil legal relations directly . . ., the right to possess, to use and to dispose of portions of the state property is exercised by state establishments and enterprises, which are assigned portions of the property for management. But they are not the owners of the property so assigned: the Soviet state remains the sole owner.

P. ROMASHKIN, FUNDAMENTALS OF SOVIET LAW 181-82 (1962). *See* H. BERMAN, *supra* note 47, at 110-16; Kiralfy, *supra* note 48, at 480. All of the property assets of a state economic enterprise are state-owned property. Under Soviet law, state economic enterprises are independent legal persons which are not liable for the obligations of the Soviet state nor is the Soviet state liable for the obligations of the state economic enterprises. CIVIL CODE OF THE RUSSIAN SOVIET FEDERATED SOCIALIST REPUBLIC, art. 33, *supra* note 46, at 9.

51. [P]ublic organizations possess, use and dispose of property belonging to them by right of ownership in accordance with their charters (by-laws). The right to dispose of property owned by . . . public organizations belongs exclusively to such owners.

CIVIL CODE OF THE RUSSIAN SOVIET FEDERATED SOCIALIST REPUBLIC, art. 102, *supra* note 46, at 27. *See* P. ROMASKIN, *supra* note 50, at 183-84.

52. Reghizzi, *Association*, in 1 ENCYCLOPEDIA OF SOVIET LAW 61 (F. Feldbrugge ed. 1973). *See* text accompanying note 44 *supra*.

53. *Id.* at 62.

54. FUNDAMENTALS OF CIVIL LEGISLATION OF THE USSR AND THE UNION REPUBLICS (1961) art. 11, *supra* note 45, at 156. This is the same as a "separate legal person, corporate or otherwise" in section 1603(b)(1) of the FSIA.

55. "Property may belong by right in common property to . . . the state and one or more . . . mass organizations . . . ." FUNDAMENTALS OF CIVIL LEGISLATION OF THE USSR AND THE UNION REPUBLICS (1961) art. 26, *supra* note 45, at 163.

tution stipulates that state property is the main form of "socialist property," it is likely that most "socialist property" asserts of public organizations are state property.[56]

2. Ownership of Worker Organizations in Yugoslavia

The socio-economic system of Yugoslavia is based on self-managed organizations of workers using socially-owned resources as a means of production.[57] The Yugoslav Constitution provides that "social property" is the exclusive means of production for the workers.[58]

> Socially-owned means of production . . . shall exclusively serve as a basis for the performance of work aimed at the satisfaction of the personal and common needs and interests of the working people and at the development of the economic foundations of socialist property and socialist relations of self-management.[59]

These worker organizations are legal persons with the capacity to sue, be sued, contract and acquire property in their own name.[60] The assets of the worker organizations are classified as "social property" according to Yugoslav law.[61] "Social property" is not defined in the Yugoslav Constitution. Insight into its meaning can be obtained from Article 12 of the Constitution which provides that

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56. *See* P. ROMASHKIN, *supra* note 50, at 184-85. It is likely that the state would be giving material assistance and financial aid to public organizations.

57. The socialist socio-economic system of the Socialist Federal Republic of Yugoslavia shall be based on freely associated labour and socially-owned means of production, and on self-management by the working people in production and in the distribution of the social product in basic and other organizations of associated labour and in social reproduction as a whole.

YUGO. CONST., art. 10, *reprinted in* Flanz, *Yugoslavia* (Constitution) 35, in 15 CONSTITUTIONS OF THE COUNTRIES OF THE WORLD (A. Blaustein & G. Flanz eds. 1974).

> A work organization is an independent self-managing organization of workers linked in labour by common interests and organized in basic organizations of associated labour of which the work organization is composed, or of workers directly linked together through the unity of the labour process.

YUGO. CONST., art. 35, ¶ 1, *reprinted in* Flanz, *supra* note 57, at 50-51.

58. YUGO. CONST., art. 12, ¶ 1, *reprinted in* Flanz, *supra* note 57, at 36.

59. YUGO. CONST., Basic Fundamentals, *reprinted in* Flanz, *supra* note 57, at 10; BASIC LAW OF ENTERPRISES, art. 1, *reprinted in* 13 INSTITUTE OF COMPARATIVE LAW: COLLECTION OF YUGOSLAV LAW 15 (B. Blagojevic ed. 1966).

60. BASIC LAW OF ENTERPRISES, *supra* note 59, art. 4.

61. An enterprise shall create the resources needed for the exercise of its activity by means of its operations. . . . The assets of an enterprise shall be social property.

BASIC LAW OF ENTERPRISES, *supra* note 59, art. 16.

"[t]he means of production and other means of associated labour, products generated by associated labour and income realized through associated labour, resources for the satisfaction of common and general social needs, natural resources and goods in common use shall be social property."[62] Ownership of "social property" also is not defined in the Yugoslav Constitution, which only states that "no one may acquire the right of ownership" of "social property."[63] The Constitution provides that "[m]an's labour shall be the only basis for the appropriation" of "social property."[64] The "social property" assets of worker organizations are "neither State nor private nor personal property."[65] In the foreword to the *Basic Law of Enterprises*, N. Balog states that worker organizations in Yugoslavia "cannot be considered as State-owned . . ."[66] because the workers in an enterprise manage their own operations[67] using socially-owned resources.[68] Balog further points out that "enterprises are not given property by the State; they acquire it themselves through their earnings by using their own resources, while means are obtained through the normal medium of banking."[69] Since ownership of "social property" is not explicitly defined in the Yugoslav Constitution or civil law, legal scholars dispute whether or not the State owns the "social property" assets of

62. YUGO. CONST., art. 12, ¶ 1, *reprinted in* Flanz, *supra* note 57, at 36.

63. YUGO. CONST., art. 12, ¶ 2, *reprinted in* Flanz, *supra* note 57, at 36; *see* Knapp, *Socialist Countries*, in 6 INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW 35, 46 (F. Lawson ed. 1975) (published under the auspices of the International Association of Legal Science; originally ch. 2 of vol. 6). "Since no one has the right of ownership over social means of production, nobody—not sociopolitical communities, nor organizations of associated labour, nor groups of citizens, nor individuals—may appropriate on any legal-property grounds the product of social labour of manage and dispose of the social means of production and labour, or arbitrarily determine conditions for distribution." YUGO. CONST., Basic Fundamentals, *reprinted in* Flanz, *supra* note 57, at 11.

64. YUGO. CONST., Basic Fundamentals, *reprinted in* Flanz, *supra* note 57, at 11.

65. A. CHLOROS, YUGOSLAV CIVIL LAW 161 (1970).

66. Balog, *Foreword* to 13 INSTITUTE OF COMPARATIVE LAW: COLLECTION OF YUGOSLAV LAW at 5 (B. Blagojevic ed. 1966).

67. BASIC LAW OF ENTERPRISES, *supra* note 59, art. 7.

68. "An enterprise shall decide autonomously regarding the use of its resources and the disposition thereof." BASIC LAW OF ENTERPRISES, *supra* note 59, art. 19, ¶ 1.

69. Balog, *supra* note 66, at 5. BASIC LAW OF ENTERPRISES, *supra* note 59, art. 16.

worker organizations.[70] This confusion, according to A. Chloros, is caused by the dual character of social property being "both part of state property and separate from it."[71] The State created "social property" out of state property when it granted workers in enterprises the absolute right to use social property in connection with their labor in order "to satisfy their personal and social needs and to manage, freely and on an equal footing with other workers in associated labour, their labour and the conditions and results thereof."[72] It appears that the Yugoslav state confers ownership rights on worker organizations since they are given the right to self-manage their "social property" assets.[73] Ownership of social property, however, remains an unanswered question under Yugoslav law.

70. A. Chloros points out that "many theories have been put forward to explain the nature of social property and the attempt of lawyers to supply a definition has caused a great deal of controversy." A. CHLOROS, *supra* note 65, at 168. Chloros discussed the following legal scholars' theories: (1) P. Rastovcan states that social property is vested in the state because the only juridical expression of society is the state. But in conjunction with "this aspect of ownership there is another, that of social management, which is far more important, for it represents the exercise of the right of ownership . . . ." *Reprinted in id.* at 172. (2) A. Gams' theory: To say that society is the owner of social property may be sociologically true but juridicially there must be a . . . legal subject of ownership. However, it is not only the State, for rights are exercised by . . . economic enterprises . . . . Social ownership is in effect a divided ownership . . . ." A. CHLOROS, *supra* note 65, at 172. (3) A. Finzgar's theory points out that the concept of ownership is useless because there exists workers' right to utilize social property. The individual workers organizations will appear as though they were owners. *Id.* at 173. (4) I. Lapenna views Yugoslav social property as being the same as Soviet State property. *Id.* at 174.

71. *Id.* at 175. Chloros described social property as being somewhere "between state property and private property, . . . but partaking in some measure of both." *Id.* at 163. Chloros also notes that there is state property which is separate and distinct from social property. "For example, in Yugoslav theory State funds, army equipment, warships, and aeroplanes are considered state property. Yugoslav theory, therefore, recognizes two kinds of property; state property and social property." *Id.* at 175.

72. YUGO. CONST., art. 13, ¶ 1, *reprinted in* Flanz, *supra* note 57, at 36.

73. A. Chloros points out that even though the State may reclaim social property as state property, this possibility does not derogate from the present validity of the rights of self-management which the worker organizations exercise. A. CHLOROS, *supra* note 65, at 176. This proposition is supported by Article 20 of the Basic Law of Enterprises which provides: "An enterprise may not be divested of its rights in relation to the social assets managed by it nor may it have those rights restricted, unless so dictated by general interests as determined by a federal law." BASIC LAW OF ENTERPRISES, *supra* note 59, art. 20.

III. Recent Decisions Concerning Whether an Entity is an Agency or Instrumentality of a Foreign State Under the FSIA

A. *Yessenin-Volpin v. Novosti Press Agency*[74]

In *Novosti,* the Federal District Court in New York confronted the issue of whether Novosti, "an information agency of the Soviet public organizations . . . operating under . . . the Constitution of the U.S.S.R.,"[75] was an agency or instrumentality of the U.S.S.R. under the FSIA.[76] Plaintiff,[77] 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.[78] The dispute revolved around section 1603(b)(2), which requires an agency or instrumentality of a foreign state to be an entity "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 . . . ."[79] Plaintiff claimed that the U.S.S.R. did not own a majority of Novosti's property assets and thus it could not be considered an agency of the U.S.S.R. in order to claim the immunity protection.[80] The court found that the Soviet Government provided Novosti with free use of state-owned property, which accounted for sixty-three

74. 443 F. Supp. 849 (S.D.N.Y. 1978).

75. Novosti Press Agency Statute § 1(1), *reprinted in* 443 F. Supp. at 852. Novosti is a "mass organization" arising under Article 126 of the U.S.S.R. Constitution which was slightly amended in 1977 as article 51. Under the 1977 Constitution "mass organization" was amended to read "public organization." *See* text accompanying note 44 *supra.* The Novosti Statute is the charter for the Novosti Press Agency.

76. 443 F. Supp. at 852. See note 4 *supra* for the definition of an agency or instrumentality of a foreign state under the FSIA.

77. Alexander S. Yessenin-Volpin.

78. The plaintiff agreed 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, section 1603(b)(1). Novosti also satisfies the third criterion by not being a citizen of any State of the United States as provided in section 1603(b)(3) of the FSIA. 443 F. Supp. at 852.

79. 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 that "[n]o Soviet state organ bears responsibility for the . . . actions of the Agency." Novosti Statute § III(10), *reprinted in* 443 F. Supp. at 853.

80. 443 F. Supp. at 852-54. The remaining thirty-seven percent of Novosti's property was owned by Novosti.

percent of Novosti's property assets.[81] Plaintiff contended that free use of state property cannot be considered an ownership interest for purposes of section 1603(b)(2).[82] In comparing a public organization such as Novosti to a state economic enterprise in the U.S.S.R., the court pointed out that even though state economic enterprises are "self-administering" legal entities, they exclusively use and operate with state property and are considered to be owned by the State.[83] By analogy, 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.[84] The court also found that because of its "essentially public nature," Novosti was an organ of the U.S.S.R.[85] Therefore, the court held that Novosti qualified for sovereign immunity.

B. *Edlow International Co. v. Nuklearna Elektrarna Krsko*[86]

The *Edlow* 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 section 1603 of the FSIA.[87] Plaintiff[88] claimed that NEK was an agency or instrumentality of Yugoslavia and thus a "foreign state" for purposes of vesting subject matter jurisdiction in the Federal District Court under the Act.[89] 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.[90] Plaintiff based its argument on the premise that all

81. *Id.* at 854.
82. *Id.* at 853.
83. *Id.* at 853-54. "[W]hat a state economic enterprise possesses, uses, and disposes of - it does not own." H. BERMAN, *supra* note 47, at 115. 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.
84. 443 F. Supp. at 852-53.
85. *Id.* at 854.
86. 441 F. Supp. 827 (D.D.C. 1977).
87. *Id.* at 831.
88. Edlow International Co.
89. *See* 28 U.S.C. § 1330(a) (1976).
90. This requirement of ownership by a foreign state is one of three criteria listed in section 1603(b) of the FSIA which must be satisfied in order for an entity to be an agency or instrumentality of a foreign state. *See* note 4 *supra*. The parties

property under a socialist government such as Yugoslavia's is owned by the state, thereby making all Yugoslav work organizations subject to state ownership.[91] 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 agency or an instrumentality of a foreign state.[92] Instead, the court found two more precise indicies for determining if an entity is an agency or instrumentality of a foreign state:[93] "the degree to which the entity discharges a governmental function . . ." and "the extent of state control over the entity's operations."[94] The court found that the generation and distribution of electricity in Yugoslavia is provided by independent work organizations, such as NEK.[95] Based on this finding, the court concluded that the generation and distribution of electrical power was a nongovernmental function in Yugoslavia.[96] 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.[97] Since the Yugoslav Government did not satisfy any of these crucial factors, the court found that Yugoslavia

agreed that the other two requirements for being an agency or instrumentality were met. 441 F. Supp. at 831.

91. 441 F. Supp. at 831.

92. *Id.* at 832. Here, the court complained that there was no concrete evidence that the Yugoslav Government had an ownership interest in worker organizations such as NEK. The court criticized 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.

93. *Id.* at 832.

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.* The court cited United States v. Orleans, 425 U.S. 807, 814 (1976), which dealt with the analagous 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 federal government to control the daily operations of an entity in order to determine if it is an agency or instrumentality of the federal 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, *see* note 73 *supra*.

did not control NEK. Based on the above findings, the court concluded 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.[98]

IV. Analysis of the Ownership Interest Test of Section 1603(b)(2) When Applied to Foreign Socialist States

The section 1603(b)(2) requirement presents a problem when the country in which the entity was created is a socialist state such as the U.S.S.R. or Yugoslavia. The complication, as pointed out by the court in *Novosti,*[99] is that the majority ownership interest requirement of section 1603(b)(2) is "ill-suited" to the concept of "socially-owned" property, which is the principal form of ownership in the socialist economic systems of Yugoslavia and the U.S.S.R.[100] In both of these socialist countries no right exists to privately own socialist property, which comprises the assets of legal entities such as worker organizations in Yugoslavia and state economic enterprises, collective farms, and public organizations in the U.S.S.R.[101] This presents courts with a major problem in determining what portion of the socially owned property in these economic legal entities is actually owned by the state. The 1603(b)(2) ownership interest test is better designed to apply to capitalist countries such as the United States and Great Britain, where the economic systems are founded on private ownership.[102] The *Novosti* and *Edlow* courts approached this problem in different ways. In *Novosti* the court held that Novosti Press Agency was an agency or instrumentality of the U.S.S.R. because the state owned sixty-three percent of Novosti's property assets. This satisfied the majority ownership interest requirement of section 1603(b)(2).[103] All assets of a public organization such as Novosti are termed "socialist property" under Soviet law.[104] Since state property is the predominant form of "socialist property" in the Soviet economic system,[105] it is likely that public organizations, such as Novosti, use

98. *Id.*
99. 443 F. Supp. at 852.
100. *See* text accompanying notes 46 & 58 *supra.*
101. *See* note 46 & text accompanying note 63 *supra.*
102. *See* text accompanying notes 45-46, 57-58 *supra.*
103. 443 F. Supp. at 854.
104. *See* text accompanying note 45 *supra.*
105. U.S.S.R. Const., *supra* note 49 art. 11.

state-owned property.[106] According to the Soviet Constitution,[107] the State owns the "basic means" of communication; therefore, it is understandable that a news press agency would use State owned communication equipment. Even though Novosti had free use, management and control of state property, the State still has ultimate ownership.[108] The court accurately demonstrated that possession, use, and disposition of state property by juridical persons did not equal the right of ownership.[109] Novosti's control over the state property assets was "something less than ownership, but something more than giving orders."[110] The *Novosti* court neglected to point out that the Soviet law conveniently defines ownership of "socialist property" as consisting of ownership by the State, collective farms, public and cooperative organizations.[111] The remaining thirty-seven percent of the socialist property of Novosti is owned by the Agency itself.[112] Furthermore, the court concluded that Novosti was an organ of the U.S.S.R. because of its "essentially public nature."[113] Thus, in order for an entity to be an "organ" of a state under section 1603(b)(2), it must perform a public function. This definition of "organ," adopted by the court, does not follow the congressional intent for an agency or instrumentality to "assume a variety of forms" regardless of whether it is purely commercial or governmental.[114]

In the *Edlow* case the court held that NEK, a worker organization, was not an agency or instrumentality of the Yugoslav state. On the surface this appears to counter the *Novosti* decision. The *Edlow* court, however, suffered from the disadvantage that Yugoslav law did not define "socialist property." In contrast, Soviet law clearly outlines the ownership of "socialist property."[115] As in the U.S.S.R., Yugoslav "social property" is the principal means of production.[116] Since Yugoslav law is unclear as to the ownership of

106. *See* text accompanying note 56 *supra.*
107. *See* note 49 *supra.*
108. *See* note 50 *supra.*
109. 443 F. Supp. at 853, *see* note 50 *supra.*
110. H. BERMAN, *supra* note 47, at 116.
111. *See* text accompanying note 45 *supra.*
112. *See* note 51 *supra.*
113. 443 F. Supp. at 854.
114. *See* text accompanying note 37 *supra.*
115. *See* text accompanying note 63 *supra.* "Social" property in Yugoslavia is the counterpart of "socialist" property in the U.S.S.R.
116. All assets of worker organizations are "social property." *See* text accompanying notes 61-62 *supra.*

"social property" used by worker organizations, the *Edlow* court substituted a "control" test for the "ownership" test in order to determine if NEK fulfilled section 1603(b).[117] Thus, the *Edlow* court equated the requirement that an agency or instrumentality must be owned by a foreign state with a means by which to determine if the sovereign controls the entity at issue. The court dangerously de-emphasized the importance of a foreign state's system of property ownership. If a foreign country's constitution mandates that all legal entities are owned by the state, then theoretically, all of these entities would be agencies or instrumentalities as defined by section 1603(b)(2). Although nothing in FSIA's legislative history precludes this possibility, the *Edlow* court concluded that Congress did not intend a foreign country's system of property ownership should determine whether an entity is an agency or instrumentality of a foreign state. Congress adopted the majority ownership requirement in section 1603(b)(2) in order to relieve courts of the duty to ascertain whether or not the state controls a particular legal entity.[118] Nevertheless, the *Edlow* court had to resort to a "control" test due to the equivocal concepts of property ownership in Yugoslavia. Thus, the court added a new test to section 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.[119]

V. Conclusion

Neither the "control" nor "governmental function" tests employed in these recent decisions are criteria listed in section 1603(b)(2) of the FSIA. These developments demonstrate that courts are still having problems in applying the doctrine of sovereign immunity to independent legal entities of a foreign state. Congress failed to provide the judiciary with the appropriate means by which to determine if an entity in a socialist country

117. *See* text accompanying notes 92-94 *supra.*
118. *See* note 40 *supra.*
119. *See* text accompanying note 114 *supra.*

should be granted sovereign immunity. Therefore, the "control" test was a necessary modification of the 1603(b)(2) ownership requirement. The "governmental function" test, however, was an unnecessary restriction of Congress' intention that an agency or instrumentality of a state can be either public or commercial. If the FSIA is to be an effective codification of the sovereign immunity doctrine, Congress must amend the Act in order to aid courts in confronting issues of sovereign immunity for socialist countries. Congress needs to supplement the 1603(b)(2) ownership requirement with a more appropriate test for countries with socialist economic systems. The *Edlow* court's "control test" may be a viable solution. If Congress fails to make the necessary amendments, there is a danger that courts may adopt conflicting means for determining if an entity in a socialist country is an agency or instrumentality of that state for the purpose of applying the FSIA.

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