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Federal Practice--Sovereign Immunity--Set-Off Against Foreign Government Allowed (National City Bank v. Republic of China, 75 Sup. Ct. 423 (1955))

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managers. The principle enunciated in this case of first impression permits shareholders to exercise a greater voice in the management of their business affairs.



FEDERAL PRACTICE—SOVEREIGN IMMUNITY—SET-OFF AGAINST FOREIGN GOVERNMENT ALLOWED.—The Shanghai-Nanking Railway Administration, an official agency of the Republic of China, established a \$200,000 account with the National City Bank of New York in 1948. Subsequently, the bank refused to permit withdrawal of the funds. The Republic of China thereupon brought suit in the federal district court wherein the bank raised two counterclaims for \$1,634,432,¹ which it later denominated as a set-off. Both the district court and court of appeals refused to allow such a set-off, stating that it was violative of the doctrine of sovereign immunity since the set-off did not arise out of the same transaction as the sovereign's claim. By a divided court, the Supreme Court reversed, *holding* that the doctrine of sovereign immunity did not preclude the defendant from raising any set-off. The Court reasoned that by initiating the action in this country the foreign sovereign impliedly subjected itself to such set-off or counterclaims. *National City Bank v. Republic of China*, 75 Sup. Ct. 423 (1955).

The origin of the doctrine of sovereign immunity is not clear. The prevailing opinion appears to be that it originated early in English history and reached its maturity with the divine right of kings theory.² When the United States Constitution was drafted little was said concerning this immunity principle, and nothing applicable to it was incorporated therein.³ In 1793 the Supreme Court, in *Chisholm v. Georgia*,⁴ held that a state was subject to a suit brought by a citizen of another state. Immediately after this decision, the Constitution was amended so as to preclude such suits.⁵ No mention, however,

¹ Both counterclaims arose out of treasury notes issued by the Chinese government which had become due and payable.

² See Pugh, *Historical Approach to the Doctrine of Sovereign Immunity*, 13 LA. L. REV. 476, 477-480 (1953). See also Barry, *The King Can Do No Wrong*, 11 VA. L. REV. 349, 350-355 (1925); Borchart, *Governmental Responsibility In Tort*, VI, 36 YALE L.J. 1, 17-37 (1926).

³ It has been suggested that a literal interpretation of Article III would justify a suit against the Federal Government. See Pugh, *supra* note 2, at 481. Blackstone recognized the doctrine of sovereign immunity in his writings and this played an important part in the molding of American thought concerning this question. *Id.* at 479, 481.

⁴ 2 Dall. 419 (U.S. 1793).

⁵ "The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United

was made concerning the Federal Government. Nevertheless, in 1821 Chief Justice Marshall declared by dictum that the Federal Government was immune from suit.⁶ Later decisions adopted this immunity rule and it is now firmly embodied in our law.⁷ It is to be noted, therefore, that the doctrine of national sovereign immunity had its genesis in judicial opinion.

Comparable to the Federal Government's immunity, is the immunity that is afforded to friendly foreign sovereigns. Under this doctrine, a foreign country may not be sued in our courts, unless that government gives its consent.⁸ Like the doctrine of national sovereign immunity this rule arose out of judicial opinion and was based upon policy considerations.⁹ The problem was first encountered in the case of *The Schooner Exchange v. M'Faddon*.¹⁰ The Court, traveling on what it termed an "unbeaten path," granted immunity. Chief Justice Marshall stated that, if the Court held foreign governments susceptible to process by our courts without their consent, it would violate our duty to respect the dignity of these foreign sovereigns.¹¹ It was believed that this immunity would assure the mutual benefit that is derived from free intercourse between nations.¹²

Both the national and foreign sovereign immunity rules are still recognized in the law. Neither rule, however, has escaped criticism from the bench¹³ and bar.¹⁴ The injustices resulting from the na-

States by Citizens of another State, or by Citizens or Subjects of any Foreign State." U.S. CONST. AMEND. XI.

⁶ "The universally received opinion is, that no suit can be commenced or prosecuted against the United States; that the judiciary act does not authorize such suits." *Cohens v. Virginia*, 6 Wheat. 264, 411-412 (U.S. 1821).

⁷ As early as 1850 the Supreme Court stated that "[n]o maxim is thought to be better established, or more universally assented to, than that which ordains that a sovereign, or a government representing the sovereign, cannot *ex delicto* be amenable to its own creatures or agents employed under its own authority for the fulfilment merely of its own legitimate ends." *Hill v. United States*, 9 How. 386, 389 (U.S. 1850). The Court's reasoning on why such immunity should be granted has varied over the years. See Pugh, *Historical Approach to the Doctrine of Sovereign Immunity*, 13 LA. L. REV. 476, 485 *et seq.* (1953).

⁸ *Berizzi Bros. Co. v. S. S. Pesaro*, 271 U.S. 562 (1926); see *Guaranty Trust Co. v. United States*, 304 U.S. 126, 134 (1938); *Kingdom of Roumania v. Guaranty Trust Co.*, 250 Fed. 341, 343 (2d Cir.), *cert. denied*, 246 U.S. 663 (1918).

⁹ See *National City Bank v. Republic of China*, 75 Sup. Ct. 423, 426 (1955).

¹⁰ 7 Cranch 116 (U.S. 1812).

¹¹ *Id.* at 136-137. In reflecting on the *Exchange* case, the court in *The Roseric*, 254 Fed. 154, 158 (D.N.J. 1918) stated: "The immunity there accorded was not due to a lack of judicial power. The power was assumed, but its exercise was waived out of a due regard for the dignity and independence of a sister sovereignty, with whom this nation was at peace."

¹² See *The Schooner Exchange v. M'Faddon*, *supra* note 10 at 136. In such cases, the Supreme Court takes the view that it is better that such disputes be settled through diplomatic negotiation. See *Ex parte Republic of Peru*, 318 U.S. 578, 589 (1943).

¹³ The court of appeals in the instant case stated that, "[w]e have no high regard for the idea that, without its consent, a government may not be sued

tional immunity rule, however, have been greatly diminished over the course of years by congressional legislation. In order to insure a just determination, as early as 1797 Congress enacted a law that allows a party sued by the Government to raise any set-offs that he may have.¹⁵ Later enactments have subjected the Government to direct suits brought by its citizens¹⁶ or those of foreign countries.¹⁷

Congress, however, has done nothing to alleviate the hardships and injustices resulting from the doctrine of foreign sovereign immunity. Indeed, as applied in the United States, it has been termed the "absolute" rule. While some text writers refer to this absolute rule as being a rule of international law,¹⁸ a review of contemporary European decisions will show that this is not correct.¹⁹ Although the *Exchange* case had exerted great influence upon the European courts,²⁰ the more recent trend has been to take a more restrictive view. In these countries, the courts distinguish between contracts entered into by a foreign sovereign in the performance of its governmental functions, and those of a purely commercial character. If it is a governmental or public contract then the courts will recognize the sovereign's immunity, but if it is of a commercial nature then no immunity will be extended.²¹

for acts which, if done by a private person, would be actionable wrongs." Republic of China v. National City Bank, 208 F.2d 627, 630 (2d Cir. 1953). In matters of national sovereign immunity, the Court of Appeals for the Second Circuit has expressed its displeasure at such a doctrine. See Wallace v. United States, 142 F.2d 240, 243 (2d Cir.), cert. denied, 323 U.S. 712 (1944).

¹⁴ For a comprehensive analysis of the doctrine of foreign sovereign immunity and suggested reforms see Lauterpacht, *The Problem of Jurisdictional Immunities of Foreign States* in 28 BRIT. Y.B. INT'L L. 220 (1951). The doctrine of national immunity has been assailed in various law review articles. See, e.g., Barry, *The King Can Do No Wrong*, 11 VA. L. REV. 349 (1925); Pugh, *Historical Approach to the Doctrine of Sovereign Immunity*, 13 LA. L. REV. 476 (1953).

¹⁵ 1 STAT. 515 (1797), 28 U.S.C. § 2406 (1952). Under this statute a defendant who is sued by the Government may set up cross claims to the amount of the Government's claim. Such set-offs may be legal or equitable and need not arise out of the same transaction. See *United States v. Shaw*, 309 U.S. 495, 501-502 (1940); *United States v. Buchanan*, 8 How. 83, 105 (U.S. 1849); *United States v. Wilkins*, 6 Wheat. 135, 143-144 (U.S. 1821).

¹⁶ In 1855 Congress enacted the Court of Claims Act whereby the Government waived much of its immunity and became susceptible to a suit brought by a citizen. 10 STAT. 612 (1855), as amended, 28 U.S.C. § 1491 *et seq.* (1952). In 1946 Congress further extended the Government's liability by passing the Federal Tort Claims Act. 28 U.S.C. § 1346(b) (1952).

¹⁷ 28 U.S.C. § 2502 (1952). One qualification to this privilege is that equal privileges be afforded to citizens of the United States who wish to sue that foreign country in their courts.

¹⁸ See 1 OPPENHEIM, INTERNATIONAL LAW 239 (7th ed., Lauterpacht, 1952).

¹⁹ See Lauterpacht, *The Problem of Jurisdictional Immunities of Foreign States* in 28 BRIT. Y.B. INT'L L. 220, 250 *et seq.* (1951).

²⁰ See Lauterpacht, *supra* note 19, at 228-229.

²¹ For a complete listing of various European courts' interpretation of this rule, see Lauterpacht, *supra* note 19, at 250 *et seq.* In 1952, the State Depart-

In the United States, under the absolute rule of immunity, an individual is precluded from bringing any type of suit against a foreign sovereign, and must seek his recourse exclusively through diplomatic channels.²² Moreover, an individual sued by a foreign government was not permitted to raise a counterclaim against such government,²³ unless the counterclaim arose out of the same transaction which gave rise to the initial claim.²⁴ The sum recoverable by the counterclaim was limited to the amount of the sovereign's claim.²⁵

The instant case does not alter the fundamental rule that a friendly foreign government may not be subjected to a suit brought by a person in our courts. The Court did, however, make some important inroads upon the absolute rule. Perhaps the most notable is the abandonment of the "same transaction rule." This view, according to Mr. Justice Frankfurter, is ". . . too indeterminate, indeed too capricious, to mark the bounds of the limitations on the doctrine of sovereign immunity."²⁶ Petitioners in the present case sought only to counterclaim for the amount of the Republic of China's claim against them, and a fair reading of the Court's opinion indicates that it should be so restricted. In addition, unlike the European courts, the Supreme Court expressly refused to distinguish, in this instance, between contracts of a public character and those of a private nature.²⁷

In effect, therefore, the Supreme Court has brought the rule of foreign immunity in line with the rule concerning national sovereign immunity laid down by the Act of 1797. Thus, an individual may, in an action brought by a foreign sovereign, interpose a counterclaim as a set-off in mitigation of any recovery by such sovereign regardless of how the transaction arose. In this respect the Court was unquestionably correct. There is little justice in allowing one person to raise a counterclaim against a foreign sovereign because it arose out of the same transaction, and, at the same time, preclude another

ment expressed its approval of this view in a letter to the Attorney General which reviewed both the absolute rule and the European restrictive concept. It was therein stated that because of the widespread practice of foreign governments to engage in commercial activities in the United States, the restrictive view should be adopted to protect our citizens in their dealings with these countries. See 26 DEP'T STATE BULL. 984 (1952).

²² See *Ex parte* Republic of Peru, 318 U.S. 578, 589 (1943).

²³ *French Republic v. Inland Nav. Co.*, 263 Fed. 410 (E.D. Mo. 1920); see *In re Patterson-MacDonald Shipbuilding Co.*, 293 Fed. 192, 193-194 (9th Cir. 1923), *cert. denied*, 264 U.S. 582 (1924).

²⁴ In reality this is not a true counterclaim, but merely the common-law defense of recoupment. See *Pennsylvania R.R. v. Miller*, 124 F.2d 160 (5th Cir. 1941), *cert. denied*, 316 U.S. 676 (1942). Such a claim has always been permitted against the United States regardless of consent. See *United States v. Wessel, Duval & Co.*, 115 F. Supp. 678, 687 (S.D. N.Y. 1953).

²⁵ Because it is in the nature of a defense, any allowance is limited to the amount awarded to the sovereign. See *United States v. Wessel, Duval & Co.*, *supra* note 24.

²⁶ *National City Bank v. Republic of China*, 75 Sup. Ct. 423, 429 (1955).

²⁷ *Ibid.*

merely because his action arose separately. In the latter instance, the individual is compelled to pay his judgment and rely upon the uncertainties and delays of diplomatic negotiations to afford him relief.

As was stated initially, the rule of foreign immunity evolved entirely from judicial opinion, and therefore may be altered as the Supreme Court deems it necessary. The question remains, however, whether it is proper for the Court to exercise this power. Much of Chief Justice Marshall's reasoning is valid today and care should be taken so as not to injure friendly relations with foreign governments. It is not intended to imply, however, that the rule should remain unaltered. What was deemed good 134 years ago might well be detrimental today. Rather, it is submitted that the legislative and executive branches of the Government, being in a better position to evaluate the effect of such changes, should re-appraise the entire concept of foreign sovereign immunity. This method would give foreign governments notice of any change in policy. The instant case might well prove to be the impetus needed to stimulate such re-appraisal of the rule.



SALES—BREACH OF WARRANTY—SUPPLYING OF BLOOD BY HOSPITAL NOT A SALE.—The plaintiff, a patient at defendant hospital, was given a blood transfusion by a physician. The blood, supplied to the plaintiff by the hospital for \$60, contained jaundice viruses and, as a result, the plaintiff developed homologous serum hepatitis. An action was commenced for breach of implied warranty.¹ The defendant moved to dismiss the complaint for insufficiency, but the Special Term denied the motion and the Appellate Division unanimously affirmed. The Court of Appeals, in reversing,² held that the supplying of blood for a price by a hospital is not a sale but merely an incident of an entire contract for services to which implied warranties do not attach. *Perlmutter v. Beth David Hospital*, 308 N.Y. 100, 123 N.E.2d 792 (1954).

In order for there to be an implied warranty under Section 96 of the Sales Act, there must be a contract of sale.³ However, when

¹ "Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are required, and it appears that the buyer relies on the seller's skill or judgment . . . , there is an implied warranty that the goods shall be reasonably fit for such purpose." N.Y. PERS. PROP. LAW § 96(1). "Where the goods are bought by description from a seller who deals in goods of that description . . . , there is an implied warranty that the goods shall be of merchantable quality." *Id.* § 96(2).

² In a four-three decision, Conway, Dye and Froessel, J.J., dissented.

³ *Haag v. Klee*, 162 Misc. 250, 293 N.Y. Supp. 266 (Sup. Ct. 1936); see WHITNEY, LAW OF SALES § 145 (4th ed. 1947).