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Hearing on Chinese Investment in the United States

The Foreign Sovereign Immunity Act of 1976 ("FSIA"), 28 U.S.C. § 1602 et seq., governs all litigation in both state and federal courts against foreign states and governments, including their “agencies and instrumentalities.” It “contains a comprehensive set of legal standards governing claims of immunity in every civil action against a foreign state or its political subdivisions, agencies, or instrumentalities,” and “provides the sole basis for obtaining jurisdiction” over these entities in U.S. courts.

The FSIA serves to codify in U.S. law protections equivalent to those that U.S. entities enjoy in foreign courts as a matter of international law. Sovereign immunity has long been acknowledged as a matter of comity among nations. The recognition in foreign courts of the United States’ immunity from suit has long been of vital importance to U.S. interests. It has only become more so in recent years, given the increasing prevalence of transnational commerce. In enacting the FSIA, Congress recognized that, by adhering to these widely held international norms, the United States furthers its own long-term interests.

Although, in some circumstances, Chinese state-owned enterprises ("SOEs") are entitled to immunity in U.S. courts under the FSIA, the instances in which Chinese SOEs have availed themselves of that protection are few in number and make up only a small proportion of the overall number of cases in which a foreign state or its SOE asserted immunity under the FSIA. To the extent that Chinese entities have from time to time successfully asserted sovereign immunity in U.S. courts, those

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1 The views offered here are mine alone and not those of any other firm, entity, or organization.
5 Id.
6 First Nat’l City Bank v. Banco Para El Comercio Exterior de Cuba (Bancec), 462 U.S. 611, 628 (1983) (quoting House Report at 29-30) (“If U.S. law did not respect the separate juridical identities of different agencies or instrumentalities, it might encourage foreign jurisdictions to disregard the juridical divisions between different U.S. corporations or between a U.S. corporation and its independent subsidiary.”).
judgments reflect an unexceptional application of this decades-old statutory framework for adjudicating claims against foreign sovereigns—a framework that effectively and appropriately balances litigants’ right to recovery for harms caused by certain governmental activities with the United States’ interest in maintaining conformity with central and long-established principles of international law.

I. Brief History of the FSIA

The FSIA rests on a long-established policy of granting foreign sovereigns immunity in U.S. courts. Indeed, for more than 200 years, the United States has recognized that foreign sovereigns are generally immune from suit. In *Schooner Exchange v. McFaddon*, Chief Justice Marshall observed that, “as a matter of grace and comity,” “the international community had implicitly agreed to waive the exercise of jurisdiction over other sovereigns in certain classes of cases.” In keeping with that observation, courts consistently deferred to the Executive Branch’s recommendations about whether to exercise jurisdiction over actions against foreign sovereigns and their instrumentalities.

Up until 1952, “the United States generally granted foreign sovereigns complete immunity.” In 1952, the State Department adopted a more restrictive view of sovereign immunity, whereby foreign governments were immune from suits involving their public acts, but not from suits involving their commercial or private conduct. But because the “restrictive theory” was not enacted into law, initial responsibility for deciding questions of sovereign immunity continued to fall primarily upon the Executive Branch. The State Department made formal suggestions of immunity to the courts, and the courts largely abided by those recommendations. Foreign states, however, often “attempt[ed] to bring diplomatic influences to bear upon the State Department’s [immunity] determination[s],” leading to inconsistent application of the sovereign immunity doctrine.

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7 11 U.S. 116 (1812).
9 See id. at 688.
10 Verlinden, 461 U.S. at 486.
12 Altmann, 541 U.S. at 690.
In 1976, Congress enacted the FSIA, with input from the State Department, Justice Department, bar associations, and the academic community. A primary goal of the FSIA was to enhance “uniformity in [immunity] decision[s], which [wa]s desirabl[e] since a disparate treatment of cases involving foreign governments may have adverse foreign relations consequences.” To that end, the FSIA codified the restrictive theory of foreign sovereign immunity and assigned primary responsibility for deciding foreign sovereign immunity claims to the courts, instead of the State Department.

The basic premise of the FSIA is that foreign states and governments—including their political subdivisions, agencies, and instrumentalities—are immune from suit in the United States unless the action falls under one or more of the FSIA’s specific exceptions. If the claim does not fall within one of these enumerated exceptions, the defendant is entitled to immunity and the courts lack both subject-matter and personal jurisdiction.

The protections and benefits the FSIA provides to foreign governmental agencies “[r]eflect the particular sensitivities of litigation against [such] entities.” The FSIA thus provides “extended time for answering complaints, a right of removal from state to federal court, entitlement to a non-jury trial, limitations on award of punitive damages, and constraints against attachment of and execution against government property.” Moreover, “FSIA immunity is immunity not only from liability, but also from the costs, in time and expense, and other disruptions attendant to litigation.” Consistent with that understanding, the FSIA requires courts to address immunity at the very outset of a case, and an order denying immunity is immediately appealable under the collateral order doctrine.

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16 Id. at 13.
17 Samantar, 560 U.S. at 313.
20 Id.
22 See Verlinden, 461 U.S. at 495 n.20 (“E[ven] if the foreign state does not enter an appearance to assert an immunity defense, a District Court still must determine that immunity is unavailable under this Act.”).
23 Terenkian v. Republic of Iraq, 694 F.3d 1122, 1130 (9th Cir. 2012).
In short, in keeping with the long-standing recognition of foreign sovereign immunity, and undergirded by principles of comity and respect, “[t]he FSIA seeks to avoid affronting other governments by making it hard for private litigants to haul them into court.” *Patrickson v. Dole Food Co.*, 251 F.3d 795, 806 (9th Cir. 2001), *aff’d in part, cert. dismissed in part*, 538 U.S. 468 (2003).

II. Definition of “Foreign State”

The FSIA does not distinguish between a “state” and its “government.” “Thus, the statute applies whether the named defendant is, for example, China, the People’s Republic of China, the Government of China, or one of its integral governmental components (such as the National People’s Congress, the People’s Liberation Army, or the Ministry of State Security).”24 The FSIA’s definition of “foreign state” includes a “political subdivision of a foreign state,”25 meaning that a suit against one of China’s provinces, autonomous regions, or municipalities would be treated the same as a suit against China itself. The definition of “foreign state” also includes “an agency or instrumentality of a foreign state.”26 In turn, § 1603(b) defines “agency or instrumentality of a foreign state” to include any entity that is (1) “a separate legal person, corporate or otherwise,” that is (2) “neither a citizen of a State of the United States … nor created under the laws of any third country,” and (3) either “is an organ of a foreign state or political subdivision thereof” or an entity “a majority of whose shares or other ownership interest is owned by a foreign state or political subdivision thereof.”

The first element “is intended to include a corporation, association, foundation, or any other entity which, under the law of the foreign state where it was created, can sue or be sued in its own name, contract in its own name or hold property in its own name.”27 For example, an “agency or instrumentality of a foreign state” could include “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, [or] a governmental procurement agency.”28

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26 Id.
28 Id.
The FSIA does not elaborate any further on what makes an entity an “organ” of the foreign state. However, in *California Department of Water Resources. v. Powerex Corp.*, the Ninth Circuit explained that “[a]n entity is an organ of a foreign state (or political subdivision thereof) if it engages in a public activity on behalf of the foreign government.” In the Ninth Circuit’s view, to determine whether an entity satisfies this test, courts should consider (1) “the circumstances surrounding the entity’s creation”; (2) “the purpose of its activities”; (3) “its independence from the government”; (4) “the level of government financial support”; (5) “its employment policies”; (6) and “its obligations and privileges under state law.”

By contrast, whether an entity meets the definition of “instrumentality” based on ownership is comparatively straightforward. A foreign corporation incorporated in, and at least 50% owned by, a foreign state (or a political subdivision of that state) will typically qualify as an “agency or instrumentality.” Accordingly, a foreign country’s SOEs often will fall within the definition of “instrumentality of a foreign state,” and thus within the protections of the FSIA. But that is not to say that an entity will always be considered an instrumentality of a foreign state based on a claim of state-owned enterprise status. For instance, an entity wholly owned by a corporate parent, which is in turn wholly owned by a foreign sovereign, might reasonably be called a “state-owned enterprise,” but such an entity is not entitled to benefit from the sovereign’s immunity: Under *Dole Food Co. v. Patrickson*, an entity qualifies under § 1603(b)(2)’s majority ownership clause only if the foreign state (or political subdivision) directly owns a majority of the entity’s shares.

**III. Exceptions to Sovereign Immunity**

The FSIA creates a number of exceptions to immunity, including (1) waiver, (2) commercial acts, (3) expropriations, (4) rights in certain kinds of property in the United States, (5) non-commercial torts, and (6) enforcement of arbitral agreements and awards. For U.S. companies doing business with Chinese SOEs, the FSIA’s broad

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29 533 F.3d 1087 (9th Cir. 2008).
30 *Id.* at 1098.
31 *Id.*
34 *Patrickson*, 538 U.S. at 474.
exception to sovereign immunity for “commercial activity” and the exception for waiver of immunity are likely to be of particular importance.

A. Commercial Activity Exception

Section 1605(a)(2)’s commercial activity exception is the FSIA’s “most significant”—and most frequently litigated—exception to sovereign immunity. The commercial activity exception provides that a foreign state is not immune from suit in any case in which the action is based upon (1) “a commercial activity carried on in the United States by the foreign state”; (2) “an act performed in the United States in connection with a commercial activity of the foreign state elsewhere”; or (3) “an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere[,] and that act causes a direct effect in the United States.”

“Commercial activity” is defined as “either a regular course of commercial conduct or a particular commercial transaction or act.” This definition was intended to cover “a broad spectrum of endeavor.... A ‘regular course of commercial conduct’ includes the carrying on of a commercial enterprise such as a mineral extraction company, an airline or a state trading corporation.” “If an activity is customarily carried on for profit, its commercial nature can readily be assumed.” But even “a single contract,” falls within the definition of commercial activity “if of the same character as a contract which might be made by a private person.”

As the Supreme Court explained in Republic of Argentina v. Weltover, Inc., “whether the foreign government is acting with a profit motive or instead with the aim of fulfilling uniquely sovereign objectives” is irrelevant. “Rather, the issue is whether the particular actions that the foreign state performs (whatever the motive behind them) are the type of actions by which a private party engages in trade and traffic or commerce.” Thus, “a contract to buy army boots or even bullets is a ‘commercial’ activity, because private companies can similarly use sales contracts to acquire

37 House Report at 16.
38 Id.
39 504 U.S. at 614.
40 Id. (internal quotation marks omitted).
goods.” Indeed, any contract between a foreign state and a private party for the purchase and sale of goods and services is presumptively commercial.\textsuperscript{42} Recent cases discussing the commercial activity exception have held a contract made by the Ukrainian government for asset recovery services was a commercial activity,\textsuperscript{43} as was a Hungarian bailment agreement to return plunders of war,\textsuperscript{44} but Monaco’s hiring of an individual to perform intelligence services was not a commercial activity because contracting for intelligence services is “not the type of employment private parties can undertake.”\textsuperscript{45}

B. Waiver Exception

Section 1605(a)(1) provides an exception to immunity when the foreign state has waived its immunity “either explicitly or by implication.” Explicit waivers are typically found in contractual provisions, but they could also arise from independent statements. They are normally construed narrowly, in favor of the sovereign.\textsuperscript{46} Implied waivers have been found when a foreign state has agreed in the provisions of a contract or lease agreement that the agreement is to be governed by the law of a particular country,\textsuperscript{47} and when a foreign state has filed a responsive pleading in a case without raising the defense of sovereign immunity.\textsuperscript{48}

IV. State-Owned Enterprises

Throughout the world, governments participate in commercial activity through SOEs.\textsuperscript{49} They exist in European countries, such as Germany, France, Italy and

\begin{itemize}
  \item \textsuperscript{41} Id. at 614-15.
  \item \textsuperscript{42} Practical Concepts, Inc. v. Republic of Bolivia, 811 F.2d 1543, 1549 (D.C. Cir. 1987).
  \item \textsuperscript{43} Universal Trading & Investment Co. v. Bureau for Representing Ukrainian Interests in International & Foreign Courts, 727 F.3d 10, 12 (1st Cir. 2013).
  \item \textsuperscript{44} de Csepel v. Republic of Hungary, 714 F.3d 591, 594 (D.C. Cir. 2013).
  \item \textsuperscript{45} Eringer v. Principality of Monaco, 533 F. App’x. 703, 704-05 (2013).
  \item \textsuperscript{46} See, e.g., World Wide Minerals, Ltd. v. Republic of Kazakhstan, 296 F.3d 1154, 1162 (D.C. Cir. 2002) (“A foreign sovereign will not be found to have waived its immunity unless it has clearly and unambiguously done so.”).
  \item \textsuperscript{47} See, e.g., Themis Capital, LLC v. Democratic Republic of Congo, 881 F. Supp. 2d 508, 516-17 (S.D.N.Y. 2012) (contract); Joseph v. Office of Consulate Gen. of Nigeria, 830 F.2d 1018, 1022-23 (9th Cir. 1987) (lease).
  \item \textsuperscript{48} Haven v. Polska, 215 F.3d 727, 731-32 (7th Cir. 2000).
  \item \textsuperscript{49} PriceWaterhouseCoopers, SOEs, Catalysts for public value creation (April 2015).
\end{itemize}
Sweden, Central and South American countries, such as Brazil, Colombia, Mexico, and Venezuela, and Asian counties, such as India, Japan, Malaysia. Their formation may occur for a number of reasons but often “because markets were imperfect or unable to accomplish critical societal needs such as effectively mobilizing capital or building enabling infrastructure for economic development.”

China has approximately 156,000 SOEs (SOEs). Approximately one-third of these are owned by the central government, with the remaining companies owned by local governments. The State-owned Assets Supervision and Administration Commission (SASAC), and thus the central government, directly controls and runs 106 SOEs; 66 of these companies are listed on stock exchanges. SOEs account for 20% of China’s employment and 30% to 40% of its GDP.

V. Chinese-Manufactured Drywall Litigation

The recent dismissal of a Chinese entity from an ongoing products liability litigation involving Chinese-manufactured drywall is a perfect illustration of the proper application of the FSIA with respect to SOEs. As background, between 2005 and 2008, the housing boom and rebuilding efforts necessitated by Hurricanes Rita and Katrina led to a shortage of construction materials. To meet that demand, gypsum wallboard manufactured in China (“drywall”) was brought into the United States and used in the construction and refurbishing of homes. Subsequently, a number of homeowners filed suit in state and federal courts, alleging that the drywall was defective. They named a range of defendants, from the homebuilders and developers, to the suppliers, importers, exporters, distributors, and manufacturers of the drywall (e.g., Taishan) and the parent and grandparent companies of those manufacturers.

Among the latter cohort was China National Building Materials Group (CNBM Group). The parties agreed that CNBM Group is a state-owned enterprise directly

50 Id. at 9.
51 Id. at 14.
53 Id.
54 Id.
55 Id.
and wholly owned by the People’s Republic of China. As such, CNBM Group qualified as an “agency or instrumentality of a foreign state” under the FSIA, and therefore was presumptively immune from suit. Accordingly, it moved to dismiss the claims brought against it on sovereign immunity grounds. The plaintiffs alleged, however, that CNBM Group fell within both the FSIA’s commercial activity exception and the tortious activity exception. The district court disagreed and granted CNBM Group’s motion to dismiss.

The court explained that § 1605(a)(5)’s exception to sovereign immunity for tortious activity applies only when alleged injury and the foreign state’s tortious conduct occurred within the United States. CNBM Group, which was merely a shareholder of the manufacturers, had not engaged in any drywall-related conduct in the United States.

Turning to the commercial activity exception, the court explained that this exception applies only if the plaintiffs’ claims are “based upon” an act or activity by the foreign state defendant. The commercial activity that formed the basis of the plaintiffs’ claims was the manufacture, sale, and export of allegedly defective drywall. But, again, CNBM Group’s involvement was limited to that of a shareholder of a shareholder of the manufacturers; CNBM Group itself had never manufactured, inspected, sold, supplied, distributed, marketed, exported, or delivered any drywall.

The plaintiffs also argued that CNBM Group exercised such a significant degree of control over the manufacturers that the manufacturers’ conduct should be attributed to CNBM Group on an “alter ego” theory. The court rejected this argument. It concluded that to the extent CNBM Group exercises control over the manufacturers, it is no different than the type of control any corporate investor has in the company it holds shares in. Such control, the court recognized, is inadequate to find an alter ego relationship between CNBM Group and the manufacturers. Ultimately, the court dismissed CNBM Group because the company is not directly engaged in any commercial activity in the United States. And owning shares in a company that does engage in commercial activity in the United States is not, the court explained, a sufficient basis for subjecting a sovereign to suit.

Notably, if CNBM Group itself had been engaged in selling allegedly defective drywall to the United States, those sales would likely fall within the commercial activity exception to sovereign immunity and CNBM Group would therefore likely have been subject to the court’s jurisdiction, notwithstanding CNBM Group’s state-owned
enterprise status. And if CNBM Group had exercised a great deal of control over the day-to-day activities of its subsidiary companies—including the manufacturers—those companies’ commercial activities would have been attributable to CNBM Group under an “alter ego” theory. Because CNBM Group was the only entity that asserted immunity, the litigation now continues against the remaining defendants.

Perhaps the most important takeaway from the Chinese Drywall litigation is how closely the court adhered to settled law. The dismissal of a parent company from a suit where the alleged harms arose from actions taken by a subsidiary is an everyday occurrence in this country. Under ordinary principles of corporate law, a corporate parent is not liable for the acts of its subsidiary, except in cases of fraud or other exceptional circumstances that warrant “piercing the corporate veil.” In the Chinese-manufactured drywall litigation, then, CNBM Group would ultimately have been dismissed from the lawsuits, irrespective of the operation of the FSIA. However, in recognition of the respect the United States has long accorded to foreign sovereigns and their instrumentalities, the question of sovereign immunity is to be decided at the very outset of any litigation. In other words, by bringing its motion under the FSIA, CNBM was simply able to secure its dismissal from the suit at an earlier stage in the litigation.

VI. Other Recent Cases

*Global Technology, Inc. v. Yubei (XinXiang) Power Steering System Co.* is another recent court of appeals decision in which a Chinese state-owned enterprise invoked a sovereign immunity defense under the FSIA. There, Global Technology, a Michigan-based sales representative and global business consultant, agreed to assist Yubei in its attempted acquisition of an automotive-steering company, Nexteer. After Yubei’s bid failed, Nexteer was purchased by a different Chinese company, Pacific Century. Subsequently, Yubei’s grandparent company, Aviation Industry Corporation of China (“AVIC”), one of China’s largest SOEs, acquired a controlling stake in Pacific Century. Global Technology then sued Yubei and AVIC for breach of contract.

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57 See *Bancec*, 462 U.S. at 629, 632.

58 See *United States v. Bestfoods*, 524 U.S. 51, 61 (1998) (“It is a general principle of corporate law deeply ‘ingrained in our economic and legal systems’ that a parent corporation (so-called because of control through ownership of another corporation’s stock) is not liable for the acts of its subsidiaries.”); *Patrickson*, 538 U.S. at 475.

59 807 F.3d 806 (6th Cir. 2015)
AVIC (but not Yubei) moved to dismiss on sovereign immunity grounds. In denying AVIC’s motion, the district court assumed the truth of Global Technology’s allegations and therefore concluded that AVIC’s activities fell within the commercial activity exception. AVIC brought an interlocutory appeal, and the Sixth Circuit vacated the district court’s judgment. The Sixth Circuit reasoned that because AVIC’s assertion of sovereign immunity amounted to a factual attack on the district court’s jurisdiction, the district court was obliged to make factual findings necessary to determine its jurisdiction. The court explained that because the parties agreed that AVIC was a foreign state within the meaning of the FSIA, the burden of production fell on the plaintiff to rebut the presumption of immunity by showing that an enumerated exception applies. “If the plaintiff succeeds,” the court explained, “the burden shifts to [the defendant] to demonstrate that its actions do not satisfy the claimed exception.” And, the court noted, AVIC, as the party claiming immunity, “retains the burden of persuasion throughout this process.” On remand, the parties settled. As a result, the case establishes only the procedure by which the court makes its “critical preliminary determination” of immunity.

Though the cases discussed above involve Chinese SOEs, it should be noted that SOEs exist the world over. In fact, a survey of recent cases involving SOEs claiming sovereign immunity under the FSIA demonstrates that SOEs claiming immunity in federal court are predominantly owned by foreign states other than China. For instance, as compared to cases involving Chinese SOEs, cases involving South American SOEs comprise an outsized share of the federal judiciary’s recent FSIA docket. Likewise, many FSIA cases involve actions directly against foreign governments, as distinct from the SOEs they own.

60 Id. at 809-10.
61 Id. at 811.
62 Id.
63 Id. at 813.
And a review of recent SOE cases demonstrates the vigilance with which courts have reinforced the FSIA’s limited but sensible reach. For instance, they have stayed true to *Dole Food’s* recognition that the definition of “agency or instrumentality of a foreign state” extends only to those with a “direct ownership of a majority of shares by the foreign state” and not those entities indirectly owned by foreign states. And where it can be said that foreign states or instrumentalities are operating as alter egos of companies that otherwise would be subject to U.S. jurisdiction, courts have expressed a willingness to subject them to jurisdiction, while, at the same time, reinforcing the same principles that underlie U.S. corporate laws and refusing to hale into courts entities that satisfy *Bancec’s* test for corporate separateness. Finally, where SOEs satisfy a FSIA exception, courts have not hesitated to subject them to jurisdiction.

**VII. Conclusion**

Generally speaking, when U.S. companies are engaged in business dealings with foreign states or SOEs, those transactions will often fall within the commercial activity exception to sovereign immunity. That holds true in the context of Chinese SOEs. If engaged in business in the United States, they will be subject to litigation here. And if they are not, then, just as the United States would not want a foreign country haling a U.S. company into foreign courts, then a SOE will not be subject to suit here. As recent litigation involving these issues reveals, Chinese SOEs receive the same treatment as American companies. The only difference being that respect for sovereigns and principles of comity afford them the opportunity to exit the litigation slightly earlier than their U.S. counterparts.*

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*See e.g., First Inv. Corp. of the Marshall Islands v. Fujian Mawei Shipbuilding, Ltd. of People’s Republic of China, 858 F. Supp. 2d 658, 671 (E.D. La. 2012).*

*See, e.g., First Inv. Corp. of Marshall Islands v. Fujian Mawei Shipbuilding, Ltd., 703 F.3d 742, 753 (5th Cir. 2012), as revised (Jan. 17, 2013).*