SOVEREIGN IMMUNITY

NATIONAL CITY BANK OF NEW YORK v. *REPUBLIC OF CHINA*

The Supreme Court of the United States in *National City Bank of New York* v. *The Republic of China*[1] destroyed a boundary to which sovereign immunity hitherto extended, and which had been recognised by both English and American courts. The path which the Supreme Court took was well marked by judicial *dicta*, by executive recommendation and legislative action,[2] and the fact that the court did not specifically delineate another boundary in its narrowing of the field of sovereign immunity does not derogate from the importance or usefulness of the decision.

The Shanghai-Nanking Railway Administration, an official agency of the respondent, had established a $200,000 deposit account in 1948 with the National City Bank of New York. When the bank refused to pay funds as and when the respondent requested, the respondent brought suit in the Federal District Court. In addition to the various defenses the petitioner interposed two counter-claims seeking an affirmative judgment for $1,634,432 on defaulted Treasury Notes of the respondent owned by the petitioner. After the plea of sovereign immunity, the District Court dismissed the counter claims. The petitioner sought leave to amend by denominating the counter-claims set-offs and including additional data, but this was denied.

On appeal the Court of Appeals for the Second Circuit affirmed the dismissal and the denial on the grounds that the counter-claims were not based on the subject-matter of the respondent's suit (whether they were treated as requests for affirmative relief or as set-offs), and therefore it would be an evasion of the respondent's sovereign immunity for the United States courts to allow them.

Certiorari was granted by the Supreme Court, and before that court the petitioner dropped its demand for affirmative relief; and confined its counter claim to reducing the amount of the sovereign's recovery. The court held in a judgment delivered by Mr. Justice Frankfurter that the counter claims should be allowed and were not prohibited by sovereign immunity.

The learned Justice pointed out firstly that the trend of legislation was towards admitting suits against the United States in its own courts,[3] stating that "a steady legislative trend, presumably manifesting a strong social policy, properly makes demands on the judicial process." Secondly, he maintained that the trend of executive action and pronouncements was similarly in favor of restricting sovereign immunity; and thirdly, that the present issue was not "an attempt to bring a recognised foreign government into one of our courts as a defendant and subject it to the rule of law to which non-governmental obligors must bow." It was a situation where, he said, "a foreign government was invoking our law but resisting a claim against it which barely would curtail its recovery."

He then proceeded to examine the decision in *Schooner Exchange* v. *M'Faddon*,[4] the foundation stone for the doctrine of sovereign immunity in the United States, saying that the principles behind that decision were "the power and dignity of the foreign sovereign" and standards of public morality, fair dealing, and reciprocal self-interest.

Dealing, therefore, with the question whether any of these should bar the respondent's claim, Mr. Justice Frankfurter stated that having regard to the fact that the Court of Claims[5] was available to foreign nationals or governments

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[1] (1954) 348 U.S. 356.
[2] *Id.* 359-62.
[3] *Cf.* Crown Proceedings Act, 1947.
[4] (1812) 7 Cranch 116.
[5] S.28 U.S.C. 1491 states that the Court of Claims has jurisdiction over the court of

who may sue the United States there, provided that the foreign government could be sued in its own courts by United States citizens,[6] as could China, there was no affront to "the power and the dignity" of the plaintiff.[7] Further, he maintained that the doctrine of immunity was by no means absolute, for it was recognised that a counter-claim based on the subject-matter of the sovereign suit should be allowed; but

> The limitation of "based on the subject-matter" is too indeterminate, indeed, too capricious, to mark the bounds of the limitation on the doctrine of Sovereign Immunity. There is great diversity among courts of what is and what is not a claim "based on the subject-matter of the suit" or "growing out of the same transaction". . . . No doubt the present counter-claims cannot be deemed to be related to the railway agency's deposit of funds, except insofar as the transactions between the Republic of China and the petitioner may be regarded as aspects of a continuous business relationship. The point is that the ultimate thrust of the consideration of fair dealing which allows the set-off or counter-claim based on the same subject-matter reaches the present situation. The considerations found controlling in the *Schooner Exchange* are not here present, and no consent to the immunity can properly be implied.

The minority opinion was delivered by Mr. Justice Reed (Mr. Justice Burton and Mr. Justice Clark agreeing with him). He agreed generally with the majority that the exclusion of foreign sovereigns from the courts of the United States was based on comity, and he said that if counter-claims were for more than the plaintiff's claim there was jurisdiction to allow set-offs to that extent. There was no justification without executive or legislative action in restricting the immunity,[8] just as such action had been necessary to support a limited set-off against the United States in its own courts.[9]

However, assuming it was a proper matter for judicial concern, with which conclusion he did not agree, he saw no reason why a claim which would not be allowed offensively be allowed defensively, being entirely disconnected from the plaintiff's claim. By its decision, he said, "the Court sanctions a circuitous

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claims of the United States founded upon either the Constitution or any act of Congress, or executive regulation, or contract with the United States, or non-tortious cases for liquidated or non-liquidated damages.

[6] See s.28 U.S.C. 2502.

[7] It is surely questionable whether these factors are of much weight where the question is one whether a United States citizen may sue a foreign government in the United States courts. If this right is comparable with the right of a foreign citizen to bring suit against the United States in the United States courts or that of United States citizens against a foreign government in that government's courts, it would follow that the "power and dignity" of a government which does not permit itself to be sued in its own courts by its own or foreign subject is more to be respected than one which does.

Does it not mean that the foreign sovereign dictates its immunity by and through its domestic policy and that the rights of a United States citizen before the United States courts depend on their rights before foreign courts? The concept of power and dignity does not require such a surrender of one's own sovereignty. The only right which could logically be comparable is that of a Chinese subject to sue the United States Government in a Chinese court. See for the rejection of reciprocity in this sense as a basis for granting sovereign immunity, *Compagnia Naviera Vascongado* v. *Steamship "Cristina"* (1938) A.C. 485, 518 (*per* Lord Maugham) and *U.S.* v. *Dollfus Mieg* (1952) A.C. 582, 613 (*per* Lord Porter).

[8] While it would be necessary for a sovereign to declare through the body enacting its laws, the extent to which it could be sued in its own courts, when a foreign sovereign voluntarily submits to jurisdiction and waives a judicially founded immunity, it is submitted that the decision as to what this entails is one for the courts.

[9] Act of March 3, 1797, allowing cross claims to the amount of the government's claim when the government voluntarily sues. The Act as construed in *U.S.* v. *Wilkins* (1821) 6 Wheat. 144 ". . . intended to allow the defendant the full benefit at the trial of any credit, *whether arising out of the particular transaction for which he was sued or out of any distinct and independent transaction which would constitute a legal or equitable set-off*. . . ." (Emphasis supplied).

Cf. Crown Proceedings Act, 1947, ss.1 and 35(2)(g).

The fact that a set-off or counter-claim could not prior to 1947 be used against the Crown did not prevent the admission of a counter-claim—though strictly limited—against a foreign sovereign in England.

evasion of the well-established rule prohibiting direct suits against foreign sovereigns."[10]

The decisions of *The Duke of Brunswick* v. *The King of Hanover*[11] and that of the Court of Appeal in *Strousberg* v. *The Republic of Costa Rica*[12] form the basis of the modern English rule on this point.

In the former decision Lord Langdale remarked that cases which had been decided prior to the one at issue went no further than "where a foreign sovereign filed a bill, or prosecutes an action in this country, he may be made defendant to a cross bill or bill of discovery in the nature of a defense to the proceedings which the foreign sovereign has himself adopted."[13] It was added by the Master of the Rolls that the fact that the sovereign was a plaintiff before the court in a suit for an entirely different matter did not have any bearing on deciding whether the court would have jurisdiction over him in the case at issue.

In the latter case James, L.J. stated that there was but one exception to the rule that the jurisdiction of the court did not extend to a foreign sovereign and that is for the purpose of obtaining a remedy. "Then by way of defense to that proceeding," he said, "the person sued here may file a cross claim against that sovereign or state enabling complete justice to be done between them. The defendant in that case is in fact only giving notice to the foreign sovereign's attorney . . . so as to bring in whatever defense or counter-claim there might be as a set-off."[14]

These two *dicta* were seized upon by North, J. when he decided the case of the *South African Republic* v. *La Compagnie Franco-Belge du Chemin de Fer du Nord*.[15]

In this case plaintiff claimed (*inter alia*) an injunction to restrain the defendant's dealing with certain funds, which had been placed by agreement through the plaintiff and defendant on deposit in the joint name of two trustees. The trustee who was the nominee of the plaintiff had died, and the defendants thereupon had claimed the right to deal as they pleased with the funds, now standing in the name of their nominee. The defendants put in a counter-claim by which they claimed damages for alleged breaches by the plaintiff's government of the terms of the concession, under which the defendants had been granted power to issue certain bonds. The proceeds of these bonds were the funds at issue.

North, J. held that, since the damages would have to be paid by the government out of its general revenue, there was no claim on the fund in question in any way, and therefore, having regard to the *Strousberg* and *Duke of Brunswick Cases*, he did not see how the claim against the government could be allowed, which was entirely outside of and independent of the subject-matter of the present action.

The English courts have up to this point allowed the foreign sovereign in great part to have his cake and eat it. He can take both material recovery and keep his "power and dignity". The courts will recognize his wishes in that he has no desire to sacrifice his dignity beyond his material gain, imposing as the only liability arising from his submission to jurisdiction the very limited one of having to plead to a counter-claim rising out of the same subject-matter as his own claim.[16] It was maintained in the cases concerned with procedural points, that a foreign sovereign submits to the jurisdiction of the court if he

[10] It is submitted that this conclusion in no way follows from the decision of the court (see *infra*).
[11] (1844) 6 Beav. 1.
[12] (1880) 29 W.R. 125.
[13] (1844) 6 Beav. 1.
[14] (1880) 29 W.R. 125.
[15] (1898) 1 Ch. 190.
[16] The writer respectfully agrees with the views of Mr. Justice Frankfurter (at 2) on the utter inadequacy and arbitrariness of this limitation (see *supra*).

brings suit therein[17]—and it seems contrary to good sense and good law to draw an arbitrary line through the defenses permitted in an action between subjects, and in an action where a foreign sovereign is the plaintiff, to allow only certain ones. There is no reason why the defendant should be allowed to employ not only a shield but also like weapons in a trial called by the sovereign; for it is not until the moment of imminent material gain that the courts have reason to end the contest on the cry of "immunity". It is at that point that the logical boundary between offense and defense and between recovery and gain is reached.

The essential question is the extent of the submission of the foreign sovereign. The courts have taken an illogical middle course in holding that a foreign sovereign must face a counter-claim which arises out of the same subject-matter as his own claim but no others. It is submitted that this is a limitation for which there is no basis in principle. There is no reason why if the sovereign comes to our courts he should not be made to meet every defense available—including that of his own bad faith in prior transactions. The rule remains preventive—it does not say that the foreign sovereign must take a chance on the granting of affirmative relief to the defendant, and his being then placed under an obligation which would be contrary to his power and dignity—that of being forced to act by the court of another sovereign.[18] It does say that it is perfectly consistent with his power and dignity and follows naturally from his submission to jurisdiction that he should recover only that to which he is entitled as plaintiff in an English court.[19]

Limitation of set-off or counter-claim to the same subject-matter appears to rest essentially on the words of North, J. in the *South African Republic Case*,[20] but it is submitted that the authorities he relies on do not support his position. In the case of *Strousberg* v. *Costa Rica*[21] the court denied a claim by the defendant in a prior action on the grounds that the final order which was being given in that action was in the nature of a final judgment for payment and that was an end to the former action. Therefore there was no real controversy as to what would be allowed if there was a cross claim. The words of James, L.J., as cited by North, J., do not state any limitation to the same subject.

In a similar manner the words of Lord Langdale in the case of *The King of Hanover*[22] do not specify the limitation to be allowed in a cross claim. They merely say that the sovereign may be made a defendant to a cross bill in the nature of a defense to the proceeding which the foreign sovereign has himself adopted. Lord Langdale went on to deal with a point made by counsel in the argument, that there was another case present in the court in which the King of Hanover was a plaintiff, merely stating an obvious proposition by saying that the fact that the King was the plaintiff in an entirely different suit was irrelevant to the question at issue. The one decision follows thus

[17] In that coming voluntarily into an English court he is bound by the rules and practice of the court. (*King of Spain* v. *Hullett* (1833) 1 Cl. and F. 332).

[18] *Cf. Juan Ysmael* v. *Indonesian Government* (1954) 3 W.L.R. 531, 533: "The basis of the rule (of foreign sovereign government immunity) is that it is beneath the dignity of a foreign sovereign government to submit to the jurisdiction of an alien court, and no government should be faced with the alternative of either submitting to such indignity or losing its property" (*per* Earl Jowitt, delivering the opinion of the Privy Council).

[19] The conclusion of Mr. Justice Reed in the *National City Bank Case* ((1954) 348 U.S. 356) appears to ignore the essential distinction between affirmative relief and prevention of recovery.

[20] (1898) 1 Ch. 190. The decision in *Imperial Japanese Government* v. *P. & O. Co.* (1895) A.C. 644, is often cited as an authority for the limited counter-claim theory, but it should be noted (a) the basis for the decision was the limited jurisdiction of the consulate courts—to claims by Japanese subjects against British citizens; (b) the counter-claim had its origin in the same circumstances as the claim and still it was refused; (c) that the counter-claim was for affirmative damages and the plaintiffs had put security into court.

Thus the case was concerned essentially with the problem of defining the jurisdiction of a court; and also the defendants were using the counter-claim as a weapon of offense for the purpose of potential gain.

[21] (1880) 29 W.R. 125.

[22] (1844) 6 Beav. 1.

naturally from the other, and both go no further in saying that the submission to jurisdiction in one action by a foreign sovereign does not mean submission generally—or in particular, submission in another entirely different action.

North, J. widened the doctrine of sovereign immunity in applying an unduly restricted meaning to the allowance of a set-off. The claims of the defendants in the *South African Republic Case*,[23] although if they had succeeded would have had to be paid out of other funds of the plaintiff government, surely arose out of the same transaction in the sense that they arose from a concession granted to the defendant company, yet the counter-claim or set-off pleaded by the defendants was not allowed.[24] If the particular result of this decision is regarded as binding, the theory behind the judgment of Mr. Justice Reed in the *National City Bank Case*[25] will be vindicated. This, however, would be following the result of a principle rather than the principle itself, for in the *Parliament Belge*[26] there appear the same words of Marshall, C.J., as they were cited both by Mr. Justice Frankfurter and Mr. Justice Reed. The principle of sovereign immunity is there announced as a "consequence of the absolute independence of every sovereign state to respect the independence and dignity of every other sovereign state."

Precedent, surely, should be the following of a principle and not the particular results of that principle, which appears to be the theory behind the majority opinion of the Supreme Court in the case under discussion. The minority, on the other hand, proceed on the basis that the result based on a particular principle has established a precedent which needs executive or legislative action to be overcome, at best resulting in a dependence on extra-judicial agencies for any legal progress, and in application completely preventing any constructive advance by a court.

The English courts face the same theoretical problem as the United States Supreme Court. A true application of the principle of precedent would lead to a narrow immunity; for the flexibility of the common law in this area is based on the principles of expediency, consciousness of sovereignty of other nations, and a feeling that the sovereign itself would not desire to see courts of other sovereigns pronounce on its own rights without express submission to jurisdiction. This all adds up to the blanket expression of "comity". It does not appear to be a deniable proposition that the ideas of how far comity should interfere with the submission to jurisdiction, and hence the pronouncement of the rights of the subjects of one sovereign against another sovereign, have changed with the increased government influence and activity of today. Hence, it is submitted that the courts should follow the principle behind the decisions which is in itself the precedent, and ensure a narrowing of sovereign immunity, and, as the Supreme Court, allow set-offs and counter-claims on a wider basis than hitherto.

The question then arises as to what is to be the limitation placed on counter-claims and set-offs, if any. We should start from the principle that affirmative relief should not be given to the defendant where a foreign sovereign is the plaintiff. Hence the power and dignity so much stressed is maintained. If a further limitation is still required[27] in this particular type

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[23] (1898) 1 Ch. 190.

[24] See also *U.S.S.R.* v. *Belaiew* (1925) 42 T.L.R. 21. *Cf. U.S.* v. *The National City Bank* (83 F. 2d. 236 (Second Circuit 1936)). There was a deposit to the credit of the plaintiff at the defendant bank, the defendant owning promissory notes of the depositor (i.e. Russia—the United States being assignee by international agreement) payable at the bank. It was held that the bank could set-off the amount covered by these notes against the claim, for while it was necessary that the claim should arise out of the same transaction in order to be set-off against the sovereign, the same transaction does not necessarily mean acts occurring at the same time. The transaction, it was further stated, may comprehend a series of many occurrences depending not so much upon the immediateness of their connection as upon their logical relationship.

[25] (1954) 348 U.S. 356.

[26] (1880) 5 P.D. 197.

[27] In addition to the discretion to declare that matters brought in by counter-claim are really independent actions. See RSC O. 21, v. 15.

of case, which is questionable, a passing remark of Mr. Justice Frankfurter, in the *National City Bank Case*,[28] that the transactions between the Republic of China and the petitioner could be regarded as aspects of "a continuous business relationship", may form at least a suggestive guide. Perhaps we can say that that is the "ultimate thrust of the consideration of fair dealing", with reference to allowing a set-off and counter-claim. Policy and principle such as this would far more guarantee the full justice[29] which the principle of permitting any set-off or counter-claim demands.

DAVID C. JACKSON, B.A., B.C.L. (Oxford); Bigelow Teaching Fellow, Law School, University of Chicago, 1954-1955; Fellow of the Association of the Bar of the City of New York, 1955-1956.

MITIGATION OF DAMAGE IN TORT

BRITISH TRANSPORT COMMISSION v. *GOURLEY*

I

In this case,[1] the plaintiff sustained injuries because of the defendant's negligence. The item of his damages comprising loss of wages was assessed by the trial judge at £37,720 without regard to the income tax and surtax which would normally have been payable by him on such wages had he not been injured. The trial judge alternatively estimated this sum at £6,695, taking such hypothetical taxation into account. The Court of Appeal held, following previous cases, that taxation was *res inter alios acta* and therefore irrelevant in assessing damages. Now their decision has been reversed by the House of Lords (Earl Jowitt, Lords Goddard, Reid, Radcliffe, Tucker, and Somervell of Harrow; Lord Keith of Avonholm dissenting).

In so deciding, the House of Lords considered, and—for the most part—overruled a line of precedents dating from 1933. That the problem had not arisen before that date is due, no doubt, to the low pre-war incidence of taxation. It first arose for consideration in *Fairholme* v. *Firth & Brown Ltd.*,[2] in which the plaintiff, formerly the Managing Director of the defendant company, sued the defendants for wrongful dismissal; having decided in his favour on the issue of liability, the Court of Appeal then held that the fact that his wages would normally be liable to taxation was not a valid consideration in the computation of damages. Their decision was based on the reasoning that taxation was *res inter alios acta*, and was further bolstered by considerations of "inveterate practice". This line of reasoning commended itself to Atkinson, J. in *Jordan* v. *Limmer & Trinidad Lake Asphalt Co. Ltd.*,[3] to the Supreme Court of South Australia in *Davies* v. *Adelaide Chemical & Fertilizer Co. Ltd.*,[4] to Lord Keith sitting as Lord Ordinary in *Blackwood* v. *Andre*,[5] and to the Court of Appeal in *Billingham* v. *Hughes*.[6] An example of the logic of these cases is found in the remarks of Lord Keith in *Blackwood's Case*: "The Court, in my opinion, has no concern with the incidence of taxation in assessing the damages of an injured taxpayer. The argument rests on a consideration of facts which really are *res inter alios acta*, and for these reasons the argument must in my opinion be rejected."[7] Behind this purely legal reason there is a quite apparent

[28] (1954) 348 U.S. 356, 365.

[29] See *Strousberg* v. *Costa Rica* (1880) 29 W.R. 125 (*per* James, L.J. at 125).

[1] (1956) 2 W.L.R. 41. For other discussions of the case, see W. T. Baxter, "*British Transport Commission* v. *Gourley*" (1956) 19 Mod. L.R. 365, and M. Stevenson and A. Orr, "The Tax Element in Damages" (1956) 1 *British Tax Review* 5, neither of which articles was available to the writer in time to incorporate any reference to the arguments of their learned authors in the text of this case-note. Case now reported (1956) A.C. 185.

[2] (1933) 149 L.T. 332; 49 T.L.R. 470.

[3] (1946) K.B. 356.

[4] (1947) S.A.S.R. 67.

[5] (1947) S. C. 333.

[6] (1949) 1 K.B. 643.

[7] (1947) S.C. 333, 334.