EDITORIAL COMMENT

SOVEREIGN IMMUNITY LIMITED TO ESSENTIAL GOVERNMENT FUNCTIONS: NEW YORK V. UNITED STATES

It is not an unusual phenomenon in American Constitutional practice to have a group of States join in resisting what they believe to be an encroachment upon their powers by the Federal Government. It will be recalled that, in September, 1944, thirty-eight States filed a joint petition in the Supreme Court requesting a rehearing of the case in which the Court had ruled that the business of insurance in interstate commerce was subject to the Federal anti-trust laws and regulations. The case involved the interpretation of Federal legislation under the interstate commerce clause and was not a question of sovereign immunity. Recently the alleged encroachment upon the sovereign right of a State of the Union by the Federal taxing power was resisted by New York State with the active support of forty-five other States appearing as *amici curiae.* The decision of the Supreme Court handed down January 14, 1946,[1] merits our attention because the doctrines enunciated are applicable in principle to international relations as well.

The United States brought action to recover taxes assessed against the State of New York, under the Revenue Act of 1932,[2] on the sale of mineral waters taken from Saratoga Springs. The State claimed immunity from the tax upon the ground that "in the bottling and sale of said waters the defendant State of New York was engaged in the exercise of a usual, traditional, and essential governmental function." The Supreme Court overruled this contention in a six to two decision. Justice Frankfurter, writing the opinion (Justices Douglas and Black dissenting) quoted with approval from *Ohio v. Helvering* [3] holding that a State which sells liquor, even in the exercise of the police power, is amenable to federal taxing power:

> If a state chooses to go into the business of buying and selling commodities, its right to do so may be conceded so far as the Federal Constitution is concerned; but the exercise of the right is not the performance of a governmental function. . . . When a state enters the market place seeking customers it divests itself of its *quasi* sovereignty *pro tanto,* and takes on the character of a trader, so far, at least, as the taxing power of the federal government is concerned.

Substantially the same question had come before the Supreme Court prior to the Eighteenth Amendment and had been decided against the State. South Carolina sought to operate a dispensary system monopolizing the sale of intoxicating liquors. There the Court drew a line between taxation of the historically recognized governmental functions of a State and business

[1] *State of New York and Saratoga Springs Commission and Saratoga Springs Authority* v. *The United States of America.* Advance Opinions, 1946, U. S. Law Week 4089.

[2] 47 Stat. 169, 264; Sec. 615 (a) (5). [3] (1934) 292 U. S. 360 at p. 369.

of a kind which theretofore had been pursued by private enterprise.[4] Nor was this distinction novel in our judicial history. As early as 1824 Chief Justice Marshall applied the principle to a Georgia banking corporation in which the State of Georgia was a part owner. He expressed the principle as follows:[5]

> It 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 character, and takes on that of a private citizen. Instead of communicating to the company its privileges and its prerogatives, 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 transacted.

The dissenting opinion of Justices Douglas and Black in the Saratoga Springs case did not assume to draw any distinction between a Federal tax on South Carolina's liquor business and a Federal tax on New York's mineral water business. On the other hand, they refused to be bound by the rule of *stare decisis*, which, in their opinion, has only "a limited application in the field of Constitutional law." While this contention has been the subject of much discussion, we mention it only in passing as it is not material to the subject here under discussion. What we desire to emphasize is that the decision in the instant case has a direct bearing upon the judicial settlement of international disputes in which sovereign immunity is claimed as a ground of exemption from the jurisdiction of the local courts even in respect to transactions which are not essential government functions. The international character of the problem was also recognized in the opinion of the dissenting justices when they remarked that "the Constitution is a compact between sovereigns." They differed with the majority only as to the extent of the powers delegated. The correctness of the decision of the Court, when viewed from this angle, therefore rests upon the validity of the proposition that sovereign immunity is based upon the exercise by a government of some essential government function.

The opinion of Chief Justice Stone concurring with the majority expresses the principle as follows:

> If we are to treat as invalid, because discriminatory, a tax on "State activities and State-owned property that partake of uniqueness from the point of view of intergovernmental relations," it is plain that the invalidity is due wholly to the fact that it is a State which is being taxed so as unduly to infringe in some manner the performance of its functions as a government which the Constitution recognizes as sovereign.

We have previously had occasion to point out that this distinction has not always been recognized by the Supreme Court, especially where the property of a foreign government, such as a merchant ship, has been employed in

[4] *South Carolina* v. *United States*, 1905, 199 U. S. 437.

[5] *United States Bank* v. *Planters' Bank of Georgia*, 1824, 9 Wheat. 904, 907.

purely commercial business.[6] The principle cannot be said to be well established but may be in the process of development, having gained recognition at least in some countries.[7] The importance of limiting sovereign immunity where the state enters the arena of commercial business has only recently begun to assume vital importance. The nationalization of all export and import business by Soviet Russia has now been followed, although to a more limited degree, by the nationalization of certain industries by Great Britain, France, and other countries. The significance of this phenomenon in international life must soon be recognized as one deeply affecting both economic and political relations. The fact that the Supreme Court of the United States has restricted the immunity of State governments to the exercise of essential government functions should not be overlooked in the conduct of our foreign relations. The principle is a corollary to the maintenance of a system of free enterprise.

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THE LEADERS' AGREEMENT OF YALTA

On February 11, 1946, the United States Department of State released the following text of a secret agreement signed at Yalta, in the Crimea, on February 11, 1945:

> The leaders of the three Great Powers—the Soviet Union, the United States of America and Great Britain— have agreed that in two or three months after Germany has surrendered and the war in Europe has terminated the Soviet Union shall enter into the war against Japan on the side of the Allies on condition that:
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> (1) The *status quo* in Outer Mongolia (the Mongolian People's Republic) shall be preserved;
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> (2) The former rights of Russia violated by the treacherous attack of Japan in 1904 shall be restored, viz.:
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> (a) The southern part of Sakhalin as well as all the islands adjacent to it shall be returned to the Soviet Union,
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> (b) The commercial port of Dairen shall be internationalized, the preëminent interests of the Soviet Union in this port being safeguarded and the lease of Port Arthur as a naval base of the U.S.S.R. restored.
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> (c) The Chinese Eastern Railroad and the South Manchurian Railroad which provides an outlet to Dairen shall be jointly operated by the establishment of a joint Soviet-Chinese Company, it being understood that the preëminent interests of the Soviet Union shall be safeguarded and that China shall retain full sovereignty in Manchuria;
>
> (3) The Kurile Islands shall be handed over to the Soviet Union.
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> It is understood that the agreement concerning Outer Mongolia and the ports and railroads referred to above will require concurrence of Generalissimo Chiang Kai-shek. The President will take measures in order to obtain this concurrence on advice from Marshal Stalin.

[6] See the writer's editorial comment in this JOURNAL, Vol. 21 (1927), p. 742.

[7] See editorial comments in this JOURNAL, Vol. 28 (1934), pp. 119–122; Vol. 39 (1945), p. 772. See also Harvard Research in International Law, draft treaty, in Supplement to this JOURNAL, Vol. 26 (1932), p. 455, Arts. 11, 23, 25.