

Republic of Argentina v. Weltover, Inc.: THE FOREIGN SOVEREIGN IMMUNITIES ACT: COMMERCIAL ACTIVITY AND DIRECT EFFECT REVISITED

In an attempt to refinance its debt and stabilize its currency, Argentina issued government bonds to its foreign creditors. These bonds, or "Bonods," provided for the payment of both principal and interest in U.S. dollars, through transfer on the London, Frankfurt, Zurich, or New York markets. As the Bonods began to mature, however, Argentina determined that it lacked sufficient foreign exchange to retire them, and unilaterally extended the time for payment of the Bonods. Respondents, two Panamanian corporations and a Swiss bank, refused to accept the rescheduling and insisted on full payment of their Bonods, specifying that such payment should be made in New York. When Argentina failed to comply with their demands, respondents filed suit for breach of contract, relying on the Foreign Sovereign Immunities Act of 1976 (FSIA or Act) as the basis for U.S. federal court jurisdiction. Argentina moved to dismiss the action for lack of subject-matter jurisdiction, lack of personal jurisdiction, and forum non conveniens. The United States District Court for the Southern District of New York denied these motions, holding that Argentina was not entitled to sovereign immunity under U.S. law because its actions constituted "commercial activity," an exception to sovereign immunity under the Act.¹ Argentina appealed, asserting that it had acted as a sovereign entity in issuing the Bonods and rescheduling the payments, and was therefore immune from jurisdiction. The Second Circuit Court of Appeals affirmed the district court's finding of commercial activity, and also held that the activity had sufficient "direct effect" in the United States to satisfy the requirements of the exception.² The United States Supreme Court affirmed, holding that Argentina is subject to jurisdiction in the U.S. under the FSIA due to the commercial nature of its actions and the direct effect of these actions in the United States. *Republic of Argentina v. Weltover, Inc.*, 112 S.Ct. 2160 (1992).

The U.S. Supreme Court has determined that the Foreign Sovereign Immunities Act³ "provides the sole basis for obtaining jurisdiction" over a foreign sovereign.⁴ The Act codifies the "restrictive" approach to sovereign

1. *Weltover, Inc. v. Republic of Arg.*, 753 F. Supp. 1201, 1206 (S.D.N.Y. 1991).

2. *Weltover, Inc. v. Republic of Arg.*, 941 F.2d 145, 151-53 (2d Cir. 1991).

3. 28 U.S.C. §§ 1602-1611 (1976).

4. *See Argentine Republic v. Amerada Hess Shipping Corp.*, 488 U.S. 428, 439 (1989).

immunity, which recognizes jurisdictional immunity of a foreign sovereign with regard to its public acts (*jure imperii*), but not with respect to private acts (*jure gestionis*).⁵ Shortly before the Act was passed, the Supreme Court endorsed this approach in *Alfred Dunhill of London, Inc. v. Republic of Cuba*, holding that a foreign sovereign acting as a private entity in the marketplace is not entitled to immunity.⁶

In order for federal courts to assert jurisdiction, a claim against a foreign sovereign must fall within one of the FSIA's specified exceptions to sovereign immunity.⁷ Section 1605(a)(2) of the Act specifically states that U.S. federal courts will not grant immunity to a foreign sovereign "when an act is performed outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and causes a direct effect in the United States."⁸ Commercial activity is defined generally in the FSIA as a regular course of commercial conduct or a particular commercial transaction or act.⁹ The FSIA further requires that commercial activity be determined by reference to the nature of the act, not by reference to the purpose for which it is undertaken.¹⁰

The Act, therefore, provides specific guidelines for finding a commercial activity exception to a claim of sovereign immunity. Congress' intent during the formation of the Act, however, was to grant the courts a great deal of latitude in determining what constitutes commercial activity for the purposes of sovereign immunity.¹¹ The result of these divergent intentions has been much litigation and confusion regarding the meaning of commercial activity in the context of the

5. See Letter of Jack B. Tate, Acting Legal Advisor, to Acting Attorney General, 26 DEP'T STATE BULL. 984 (1952). The traditional rule granted a foreign sovereign absolute immunity from suit in the U.S. *The Schooner Exchange v. M'Faddon*, 11 U.S. (7 Cranch) 116 (1812).

6. 425 U.S. 682, 701-05 (1976) (emphasizing that a foreign government, when acting in a commercial capacity, does not exercise powers peculiar to sovereigns, but only those that can also be exercised by a private citizen).

7. *Verlinden B.V. v. Central Bank of Nig.*, 461 U.S. 480, 489 (1983). Exceptions to immunity include, in part, (1) waiver of immunity, (2) commercial activities having a nexus with the U.S., (3) actions involving property expropriated in violation of international law, (4) inherited, gift, or immovable property located in the U.S., (5) noncommercial torts occurring in the U.S., and (6) maritime liens. See 28 U.S.C. § 1605.

8. 28 U.S.C. § 1605(a)(2) (emphasis added). The commercial activity exception also applies to a commercial act carried on in the U.S. by the foreign state or an act performed in the U.S. in connection with a commercial activity of the foreign state elsewhere.

9. *Id.* § 1603(d).

10. *Id.*

11. H.R. REP. NO. 1487, 94th Cong., 2d Sess. 16 (1976), reprinted in 1976 U.S.C.C.A.N. 6604.

FSIA.

The legislative history of the FSIA reveals the extent to which a foreign sovereign's activities constitute commercial activity under the Act.¹² The House of Representatives Report on the FSIA indicates that a commercial act would include, *inter alia*, a foreign government's sale of a service or product, the borrowing of money, or an activity customarily engaged in for profit.¹³ Furthermore, after much debate, Congress specifically concluded that the sale of bonds to the public is an activity that is commercial in nature, and that it should therefore be treated like any other commercial transaction.¹⁴

In accordance with the explicit requirements of the FSIA, some courts have refused to grant sovereign immunity when a state's conduct amounts to an act that is commercial in nature. In *Shapiro v. Republic of Bolivia*, the Second Circuit Court of Appeals stated that issuance of public debt is a commercial activity within the meaning of Section 1605(a)(2).¹⁵ Therefore, the Bolivian Air Force's issuance of promissory notes guaranteed by the Central Bank of Bolivia was found to constitute a commercial activity.¹⁶ The Second Circuit's narrow interpretation of the FSIA had previously been demonstrated in *Texas Trading & Milling Corp. v. Federal Republic of Nigeria*, in which Nigeria's contracting to buy cement from U.S. suppliers was found to constitute a commercial activity, even though the purpose of the contract was to construct infrastructure.¹⁷ Similarly, the D.C. Circuit Court in *Practical Concepts, Inc. v. Republic of Bolivia* looked to the nature of the specific act (the contract for sale of services) rather than to the governmental nature of the entity or its purpose, to determine that the commercial exception applied to an action for breach of contract.¹⁸

Although the FSIA requires that the nature of the activity be examined to determine whether an act is commercial, some courts have nevertheless focused on whether the purpose of the government's act was to serve a sovereign obligation or objective. For example, in *De Sanchez v. Banco Central de Nicaragua*, the Fifth Circuit Court of Appeals held that the Nicaraguan Central Bank's issuance of a check payable in U.S. dollars was a sovereign act, rather

12. *Id.*

13. *Id.*

14. *Id.* at 10.

15. 930 F.2d 1013, 1018 (2d Cir. 1991).

16. *Id.* at 1018-19.

17. 647 F.2d 300, 310 (2d Cir. 1981), *cert. denied*, 454 U.S. 1148 (1982).

18. 811 F.2d 1543, 1551 (D.C. Cir. 1987).

than a commercial activity, because Nicaragua's purpose for issuing the check was to maintain stable exchange rates.¹⁹ The transaction was therefore not a simple sale of dollars which could have been performed by a private entity.²⁰ In contrast to the *Practical Concepts* approach, the court in *De Sanchez* defined the activity in question broadly as the "regulation and supervision of a nation's foreign exchange reserves," rather than a simple "sale of dollars."²¹ The court recognized that, according to the FSIA, commercial activity should be determined by reference to the nature of the act, but further noted that "commercial acts themselves are defined largely by reference to their purpose."²² Thus, despite the FSIA's explicit language, the court treated the sovereign's purpose as a defining characteristic of its nature.

In determining whether an act falls within an exception to the FSIA, Section 1605(a)(2) also requires a court to decide whether an act has a direct effect in the U.S.²³ Unlike commercial activity, direct effects are not defined under the FSIA.²⁴ A majority of circuit courts has adopted the Restatement of the Foreign Relations Law of the United States (Third) (Restatement) test for direct effect,²⁵ which focuses on whether the effects of the government's act in the U.S. are "substantial" and "foreseeable."²⁶ Accordingly, several courts, including the Ninth Circuit in *America West Airlines, Inc. v. GPA Group, Ltd.*, have held that the consequences of a foreign nation's commercial activity must be substantial and foreseeable in order to constitute a direct effect for the purposes of the FSIA.²⁷ In particular, the court rejected the contention that financial loss alone is sufficient to satisfy the statute.²⁸ The D.C. Circuit, in

19. 770 F.2d 1385, 1393 (5th Cir. 1985).

20. *Id.*

21. *Id.* at 1392-93. See also *MOL, Inc. v. Peoples Republic of Bangladesh*, 736 F.2d 1326, 1329 (9th Cir. 1984) (holding that contracting for the sale of rhesus monkeys was a sovereign act because its purpose was to accomplish the "uniquely sovereign function" of regulating imports and exports as well as natural resources).

22. *De Sanchez*, 770 F.2d at 1393.

23. 28 U.S.C. § 1605(a)(2).

24. H.R. REP. NO. 1487, *supra* note 11, at 19.

25. RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 18 (1965).

26. Renana B. Abrams, Comment, *The Foreign Sovereign Immunities Act: Inconsistencies in Application of the Commercial Activity Direct Effect Exception*, 5 EMORY INT'L L. REV. 227 (1991).

27. 877 F.2d 793, 799 (9th Cir. 1989).

28. *Id.*

Zedan v. Kingdom of Saudi Arabia, also applied the Restatement test to reject a finding of direct effect based solely upon financial loss.²⁹ The court required financial loss to be accompanied by a "legally significant" event in the United States that is foreseeable and substantial in order to satisfy the direct effect requirement.³⁰

Other courts have rejected the Restatement test on the grounds that there is no evidence that Congress intended this rigid approach to be determinative in the direct effect analysis. In *Texas Trading*, the Second Circuit held that financial loss to an American corporation resulting from Nigeria's actions was sufficient to constitute a direct effect, where a causal link existed between Nigeria's breach of payment and the loss in the United States.³¹ The court further held that Nigeria's breach had an effect in the U.S. because the underlying contract contained a clause specifying that payment was to be made in the United States.³² The court's approach in *Texas Trading* may be viewed as more consistent with the legislative purpose of facilitating access to United States courts in suits against foreign sovereigns,³³ but the majority of circuit courts rejects this financial loss/causal connection test in favor of the more rigid Restatement approach.³⁴

In the noted case, the Supreme Court acknowledged that the FSIA leaves the commercial character of an activity "largely undefined."³⁵ The Court recognized, however, that the Act codifies the restrictive theory of sovereign immunity discussed in *Dunhill*.³⁶ The plurality in *Dunhill* determined that when a foreign state participates in the market in the same manner as a private entity, sovereign immunity does not apply because the sovereign is not exercising powers peculiar to its authority, but only those that may be exercised by private

29. 849 F.2d 1511, 1514 (D.C. Cir. 1988).

30. *Id.* at 1514-15. The court suggests, however, that this requirement may be fulfilled if the contract specifies a particular location in the U.S. where the money would be forwarded. *Id.* at 1515, n.2.

31. *Texas Trading*, 647 F.2d at 312. The opinion does not apply to financial loss to an individual.

32. *Id.*

33. *Abrams*, *supra* note 26, at 230-31.

34. *Id.* For other variants of the direct effects analysis, see generally Robert B. Hagedorn, *The Foreign Sovereign Immunities Act: Defining Commercial Activity and Direct Effects Jurisdiction*, 25 SANTA CLARA L. REV. 105 (1985).

35. *Weltover*, 112 S.Ct. at 2165.

36. *Id.*

citizens as well.³⁷ The *Weltover* Court afforded great significance to *Dunhill*, concluding that when a foreign sovereign acts as a private participant in the market, its actions are commercial for purposes of the FSIA.³⁸ Thus, the issue before the Court was whether the actions performed by Argentina could also be performed by a private party.³⁹ The Bonods were "garden variety" debt instruments that could be held, negotiated, and traded by private parties; therefore, the Court concluded that Argentina's issuance of Bonods was a commercial activity.⁴⁰

In making its determination, the Court looked to and strictly construed the language of the FSIA. Section 1603(d) of the Act provides that the nature of an act, and not its purpose, should determine its commercial character.⁴¹ The Court adhered to this requirement, and rejected Argentina's contention that a court must, notwithstanding this provision, consider the context of a transaction to determine whether it is commercial.⁴² Argentina argued that the transactions in which the Bonods were issued did not have "the ordinary commercial consequences of raising capital or financing acquisitions."⁴³ The Court noted that this contention may have been based on the purpose of the act, in which case it would not be a valid argument under the FSIA.⁴⁴ The Court circumvented this problem by noting that private parties also issue bonds to refinance debt, and that Argentina's actions were therefore not those of a sovereign deserving of judicial immunity.⁴⁵ The Court did not expressly affirm the *per se* rule established in *Shapiro* that issuing public debt is a commercial activity within the meaning of the FSIA, but did hold that the issuance of debt instruments by a sovereign acting in a private manner is commercial in nature regardless of its purpose.⁴⁶

The Court explicitly rejected the test employed by the Fifth Circuit in *De*

37. *Dunhill*, 425 U.S. at 703-05.

38. *Weltover*, 112 S.Ct. at 2166.

39. *Id.*

40. *Id.*

41. 28 U.S.C. § 1603(d).

42. *Weltover*, 112 S.Ct. at 2167.

43. *Id.*

44. *Id.*

45. *Id.*

46. *Id.*

Sanchez, which concluded that the nature of an act could not be ascertained without inquiring into its purpose.⁴⁷ Argentina relied on *De Sanchez* in asserting that the distinction between nature and purpose was merely a formality.⁴⁸ The Court stated that this argument is "squarely foreclosed by the language of the FSIA," which "unmistakably commands" that purpose be separated from nature.⁴⁹ Accordingly, it is insignificant that Argentina entered the market in order to alleviate a "domestic debt crisis" or the "nation's critical shortage of foreign exchange;" it is relevant only that Argentina participated like a private actor.⁵⁰ The Court therefore concluded that Argentina's issuance of the Bonods constituted commercial activity under the FSIA.⁵¹ Argentina's activity was thus subject to the jurisdiction of the United States.

The Court also rejected the Restatement's requirement of both a "substantial" effect and a "direct and foreseeable" result in order to satisfy the direct effect requirement of the commercial activity exception.⁵² Thus, the Court denied any unexpressed requirement of substantiality or foreseeability in the Act or its legislative history. Instead, the Court endorsed the Second Circuit approach, under which an effect is direct if it follows "as an immediate consequence of the defendant's . . . activity."⁵³ The Court concluded that rescheduling payment of the Bonods directly affected the U.S. because New York was designated as the "place of performance for Argentina's ultimate contractual obligations."⁵⁴ Moreover, "[m]oney that was supposed to have been delivered to a New York bank for deposit was not forthcoming."⁵⁵ The Court therefore held that this effect satisfied the Act's requirement of a direct effect.⁵⁶

The Supreme Court's decision in *Weltover* marks a significant step toward resolving the conflicts surrounding the commercial activity exception to immunity under the Foreign Sovereign Immunities Act. The Court's decision to

47. *Weltover*, 112 S.Ct. at 2167.

48. *Id.*

49. *Id.*

50. *Id.*

51. *Id.* at 2167-68.

52. *Weltover*, 112 S.Ct. at 2168.

53. *Id.*

54. *Id.*

55. *Id.*

56. *Id.*

look solely to the nature of the activity to determine its commercial character embraces "both the principles of the restrictive theory of immunity as well as the broad purposes behind the enactment of the FSIA,"⁵⁷ resulting in a much-needed uniform application of the Act. Although the Act's legislative history indicates that courts should have great latitude in determining whether an act was commercial,⁵⁸ the *Weltover* decision clearly recognizes that the courts cannot overtly ignore the Act's statutory language.

The Court's analysis of direct effects similarly resolves a split among the lower courts. The Court's holding that a substantial and foreseeable result is not essential to meet the direct effects requirement seems contrary to the legislature's intent that "commercial conduct abroad having direct effects within the United States" be subject to jurisdiction in the U.S. consistent with the principles of the Restatement.⁵⁹ However, although the Court did not follow the approach chosen by the majority of circuit courts, its decision appears to be reasonable in light of the fact that no rigid test is explicitly stated in the FSIA. *Weltover* instead adopts the Second Circuit test, which defines a direct effect as that which follows as an "immediate consequence" of the sovereign's activity.⁶⁰

The court in *Weltover* resolves the previous inconsistencies in the case law with regard to both the distinction between nature and purpose and the direct effect analysis. The decision provides workable guidelines for lower courts to follow in the future and signifies a promising step toward achieving predictability and uniformity in the law regarding the commercial activity exception to foreign sovereign immunity.

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57. *Id.*

58. H.R. REP. NO. 1487, *supra* note 11, at 16.

59. *Id.*

60. *See Weltover*, 112 S.Ct. at 2168.