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Republic of Argentina v. Weltover: Adding Clarity to the Foreign Sovereign Immunities Act Commercial Activities Exception

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COMMENT: *Republic of Argentina v. Weltover*: ADDING CLARITY TO THE FOREIGN SOVEREIGN IMMUNITIES ACT COMMERCIAL ACTIVITIES EXCEPTION

I. INTRODUCTION

In its pristine form, the doctrine of sovereign immunity was absolute, and foreign nations were not amenable to the jurisdiction of United States courts.[1] Despite the increased participation of foreign states in the international marketplace, many private parties were denied the opportunity to litigate their commercial claims against foreign states claiming sovereign immunity.[2] In response to this harm,

1. J. BRIERLY, *The Law of Nations* 243 (H. Waldhock 6th ed. 1963). The principle that sovereign states will decline jurisdiction over other sovereign states, their official agents and public property, is a rule of customary law which grants a foreign state immunity from local jurisdiction unless it consents to that jurisdiction.

2. Elihu Lauterpacht, *The Problem of Jurisdictional Immunities of Foreign States*, 28 BRIT. Y.B. INT'L L. 220, 239 (1951).

the "absolute theory" of sovereign immunity began to erode and the "restrictive theory"[3] emerged.[4]

In 1976, the United States enacted the Foreign Sovereign Immunities Act (FSIA), which codifies several exceptions to sovereign immunity.[5] In enacting the FSIA, Congress attempted to depoliticize immunity decisions and limit the defense of sovereign immunity to foreign states that engaged in governmental[6] acts.[7] Over time, the commercial activities exception became the most litigated exception of the FSIA. However, courts lacked a precise standard to determine whether an activity was commercial.[8]

In *Republic of Argentina v. Weltover*,[9] the Supreme Court of the United States ruled on whether Argentina's activity fell within the FSIA commercial activities exception.[10] The plaintiffs, bond holders who were not citizens of either Argentina or of the United States, brought an action for breach of contract against Argentina in the Federal District Court for the Southern District of New York.[11] The plaintiffs relied on the FSIA as a basis for jurisdiction.[12]

This case arose from Argentina's attempt to stabilize its currency.[13] Banco Central, the financial agent for the government of Argentina,

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3. Letter from Jack B. Tate, acting Legal Advisor, Department of State, to Attorney General Phillip B. Perlman (May 19, 1952) [hereinafter "Tate letter"], *reprinted in* 26 STATE DEP'T BULL. 984-985 (1952), and in Alfred Dunhill of London, Inc. v. Republic of Cuba, 425 U.S. 682, 711-15 (1976) (the restrictive theory denies immunity to foreign states who engage in commercial or private acts).

4. *See* Victory Transport, Inc. v. Comisaria General de Abastecimientos y Transparteo, 336 F.2d 354 (2d Cir. 1964) (discussing the erosion of sovereign immunity); *see also* Note, *Foreign Sovereign Immunity and Commercial Activity: A Conflicts Approach*, 83 COLUM. L. REV. 1440 (1983); Hill, *A Policy Analysis of the American Law of Foreign State Immunity*, 50 FORDHAM L. REV. 155 (1981).

5. 28 U.S.C. §§ 1330, 1332(a)-(4), 1391(b), 1441(d), 1602-1611 (1988).

6. The terms "public," "sovereign," and "governmental" are used interchangeably for purposes of this comment.

7. H.R. REP. NO. 1487, 94th Cong., 2d Sess. 12 (1976) [hereinafter House Report], *reprinted in* 1976 U.S.C.C.A.N. 6604, 6605-6606. The FSIA legislative history expressly states four basic objectives: 1) to codify the restrictive principle of sovereign immunity; 2) to depoliticize the determination of immunity by transferring the decision from the executive to the judicial branch; 3) to provide a statutory procedure for service of process and obtaining personal jurisdiction; and 4) to provide for enforcement of judgments.

8. Georges R. Delaume, *Public Debt and Sovereign Immunity: The Foreign Sovereign Immunities Act of 1976*, 71 AM. J. INT'L L. 399, 404 (1977).

9. 112 S. Ct. 2160 (1992).

10. *Id.* at 2169.

11. *Id.* at 2163.

12. *Id.*

13. *Id.* at 2163 (finding that "in 1981 [Argentina and its central bank], instituted a foreign

borrowed money from the plaintiffs. Due to an ongoing economic crisis, Argentina was unable to meet its financial obligation to the plaintiffs.[14] With the plaintiffs' approval, Argentina refinanced the debts by issuing bonds payable at a New York bank on a specified date.[15] However, difficulties in Argentina persisted, and, ultimately, Argentina defaulted on the bonds.[16]

Finding the FSIA applicable, the District Court denied Argentina's motion for dismissal for lack of jurisdiction, and the Court of Appeals for the Second Circuit affirmed.[17] The Supreme Court affirmed the decision of the Second Circuit, finding that the transaction met the requirements of the FSIA commercial activities exception.[18] First, the Supreme Court characterized the bond transaction as a commercial activity.[19] Second, because the bonds required payment to be made at a New York bank, the Supreme Court found that there was a direct effect in the United States.[20] Thus, the Supreme Court unanimously HELD that Argentina's activity fell within the FSIA.[21]

This comment will focus specifically on the definition of "commercial activity" in the FSIA, in light of the holding in *Republic of Argentina v. Weltover.*

II. BACKGROUND

A. *Traditional Notion of Sovereign Immunity*

Traditionally, the doctrine of sovereign immunity conferred to sovereigns absolute immunity from suits brought in the United States.[22] The doctrine was based on neither the Constitution nor on a rule of law, but on the idea of grace and comity among nations.[23]

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exchange insurance contract program (FIEC), under which Argentina effectively agreed to assume the risk of currency depreciation in cross-border transactions involving Argentine borrowers. This was accomplished by Argentina's agreeing to sell to domestic borrows, in exchange for a contractually predetermined amount of local currency, the necessary U.S. dollars to repay their foreign debts when they matured, irrespective of intervening devaluations)."

14. *Id.* at 2163.
15. *Id.* at 2163-64.
16. *Id.*
17. Weltover v. Republic of Argentina, 941 F.2d 145 (2nd Cir. 1991).
18. *Weltover*, 112 S. Ct. at 2166-67.
19. *Id.* at 2169.
20. *Id.*
21. *Id.*
22. *See* Schooner Exchange v. M' Faddon, 11 U.S. (7 Cranch) 116, 136-37 (1812).
23. *Id.*

Initially, the Executive branch, acting through the State Department, was responsible for deciding when to grant sovereign immunity.[24] As a result, foreign states placed diplomatic pressure on the State Department to grant sovereign immunity.[25] Decisions of sovereign immunity were inconsistent and often tainted by political factors.[26]

The doctrine was problematic not only because of the arbitrary effect of political consideration, but because it left many private citizens without an adequate means for resolving legal disputes with foreign states.[27] As participation in the international marketplace increased, foreign states that breached commercial contracts with private parties were able to hide behind the cloak of sovereign immunity.[28] In response to the inequitable effects of sovereign immunity, the "restrictive theory" of sovereign immunity arose.[29]

B. *The Restrictive Theory of Sovereign Immunity*

First articulated in the "Tate letter"[30] and purportedly adopted by the United States in 1952, the restrictive theory limits sovereign immunity to foreign states that engage in public activity.[31] Conversely, foreign states that engage in commercial[32] activity are denied immunity.[33] The "Tate letter" directed the State Department not to grant immunity to foreign states that engaged in commercial activity.[34] However, the "Tate letter" did not provide criteria for differentiating be-

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24. *See, e.g., Ex parte* Republic of Peru, 318 U.S. 578, 586-87 (1943); Mexico v. Hoffman, 324 U.S. 30, 33-36 (1945).

25. *Republic of Peru*, 318 U.S. at 386-87.

26. *Id.* at 588 (explaining that courts may not so exercise their jurisdiction . . . as to embarrass the executive arm of the [g]overnment in conducting foreign relations); *see also* Verlinden B.V. v. Central Bank of Nigeria, 461 U.S. 480, 488 (1982) (noting that prior to FSIA the "governing standards were neither clear nor uniformly applied").

27. Stena Rederi AB v. Comision de Contratos del Comite, 923 F.2d 380, 384 (5th Cir. 1991).

28. *Id.*

29. "Tate letter," *supra* note 3.

30. *Id.*

31. *See* Victory Transport, Inc. v. Commisaria General de Abastecimentos, 336 F.2d 354 (2d Cir. 1964) (leading case which utilized the restrictive theory as enunciated in the "Tate letter").

32. The terms "commercial" and "private" are used interchangeably for purposes of this comment.

33. "Tate letter," *supra* note 3.

34. *Id.*

tween a foreign state's "commercial" versus "governmental" acts.[35] Thus, decisions of immunity continued to trouble the courts notwithstanding the advent of the restrictive theory.[36]

C. *The Enactment of the Foreign Sovereign Immunities Act*

In 1976, Congress enacted the FSIA in order to assist the courts in rendering immunity decisions.[37] By transferring the immunity decisions from the Executive to the Judicial branch, Congress attempted to depoliticize immunity decisions.[38] Furthermore, Congress sought to provide uniformity by codifying the restrictive theory and by setting a standard for courts to apply when making immunity decisions.[39]

Under the FSIA, "foreign state[s] [are] immune from jurisdiction of the courts of the United States," unless an exception to the Act applies.[40] In an attempt to give the courts flexibility in making immunity decisions, Congress left operative provisions of the FSIA vague.[41] As a result, courts had limited guidance for applying the FSIA.

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35. *Victory Transport, Inc.*, 336 F.2d at 359; *see generally* Lauterpacht, *supra* note 2, at 222-24 (discussing the difficulty in differentiating between a state's public act versus a purely commercial act because a state can always be termed a "public person" who acted for the benefit of its community).

36. *See Victory Transport, Inc.*, 336 F.2d at 359 (noting that the "Tate letter" offered no guidelines or criteria for differentiating between public or sovereign acts and private or commercial acts).

37. In 1973, the Department of Justice and the State Department undertook a joint effort to provide a standard for immunity decisions made in United States courts. Two identical bills that codified the restrictive theory were introduced into Congress. After debate, Congress passed the FSIA. *See* Note, *Sovereign Immunity: Proposed Statutory Elimination of State Department Role — Attachment, Service of Process and Execution — Senate Bill 566, 93d Cong., 1st Sess. (1973)*, 15 HARV. INT'L L.J. 157 (1974).

38. House Report, *supra* note 5, at 12, *reprinted in* U.S.C.C.A.N., *supra* note 5, at 6610.

39. 28 U.S.C. §§ 1602-1611 (1988).

40. 28 U.S.C. § 1604 (1988).

41. House Report, *supra* note 7, at 6615. The House Report put its faith in the United States courts and made sections 1605-1607 ambiguous in order to give the courts "a great deal of latitude in determining what is a commercial activity for purposes of [the] bill. It . . . seemed unwise to attempt an excessively precise definition of [the] term." At the Hearings, Monroe Leigh testified: "We realize that we probably could not draft legislation which would satisfactorily delineate that line of demarcation between commercial and governmental. We therefore thought it was better part of valor to recognize our inability to do that definitely and to leave it to the courts with very modest guidance." The FSIA: Hearings on House report 11315 Before Subcom. on Administrative Law and Governmental Relations of the House Committee on the Judiciary, 94th Cong., 2d Sess. 25, 53 (1976).

1. The Commercial Activities Exception

In relevant part, the FSIA commercial activities exception denies immunity to a foreign state that engages in commercial activity outside the United States, when that commercial activity has a direct effect in the United States.[42] Under this exception, the existence of immunity turns on the definitions of "commercial" and "direct effect." Notwithstanding Congress' good intentions, application of the FSIA commercial activities exception has troubled the courts.[43]

The FSIA defines commercial activity as "either a regular course of commercial conduct or a particular commercial transaction or act."[44] Under the FSIA, the commercial character of an activity is determined by the nature of the course of conduct, particular transaction, or act, rather than by its purpose.[45] The "nature test" embodied in the FSIA makes the purpose of the activity irrelevant and the nature of the activity critical.[46]

2. Application of the Commercial Activities Exception

Five years after the enactment of FSIA, in *Texas Trading & Milling Corp. v. Federal Republic of Nigeria*[47], the Court of Appeals

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42. 28 U.S.C. § 1605(a)(2) (1988) (defining the commercial activity exception as follows:

> a) A foreign state shall not be immune from the jurisdiction of the courts of the United States or of the States in any case —
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> * * *
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> 2) in which the action is based upon a commercial activity carried on in the United States by the foreign state; or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere; or *upon 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*) (emphasis added).

43. Gibbons v. Udaras na Gaeltachta, 549 F. Supp. 1094, 1105 (S.D.N.Y. 1982) (frequently cited opinion where the court observed:

> [T]he Foreign Sovereign Immunities Act of 1976 . . . [is a] statutory labyrinth that, owing to the numerous interpretive questions engendered by its bizarre structure and its many deliberately vague provisions, has during its brief lifetime been a financial boon for the private bar but a constant bane of the federal judiciary.

See also Rush-Presbyterian-St. Luke's Medical Center v. Hellenic Republic, 877 F.2d 574, 577 (7th Cir. 1989)(noting that a number of other courts have recognized that the definition of commercial activity is not "especially helpful" and is "somewhat circular").

44. 28 U.S.C. § 1603(d) (1988).

45. *Id.*

46. *Id.* (stating that "the commercial character of an activity shall be determined by reference to the nature of the course of conduct or particular transaction or act, rather than by reference to its purpose").

47. 647 F.2d 300 (2d Cir. 1981).

for the Second Circuit addressed whether an alleged breach of contract action brought against Nigeria and its central bank fell within the FSIA commercial activities exception.[48] To develop its infrastructure, the government of Nigeria extended letters of credit to various suppliers of cement.[49] Unfortunately, Nigeria was unable to handle the tonnage of cement and breached its contracts by unilaterally canceling its orders.[50]

To determine whether the activity was commercial, the Second Circuit applied the "private party" test: that is, if the activity were one in which a private person could engage, then there was no entitlement to immunity.[51] The court reasoned that when a state enters the marketplace and performs a commercial activity, i.e. one that a private actor could perform, then it should be subject to all the rules of the marketplace, thereby making the underlying purpose of the activity irrelevant.[52] Because Nigeria's activity was one in which a private party could engage, the Second Circuit found the activity to be commercial within the meaning of the FSIA.[53]

In using the private party test, the Second Circuit set forth a clear and precise standard for determining the nature of an activity.[54] That is, if a private party might engage in a given activity, then the activity is commercial in nature regardless of its purpose.[55] However, not all courts chose to follow this standard, and courts continued to grapple with immunity decisions, even after *Texas Trading*.[56]

3. Lack of Uniformity Among the Courts' Decisions

In *De Sanchez v. Banco Central De Nicaragua*,[57] the Court of Appeals for the Fifth Circuit failed to differentiate between the con-

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48. *Id.* at 307-08.

49. *Id.* at 302.

50. *Id.* at 305.

51. *Id.* at 309; *see also* Practical Concepts, Inc. v. Republic of Bolivia, 811 F.2d 1543, 1549 (D.C. Cir. 1987) (following *Texas Trading* in applying the "private party" test).

52. *Texas Trading*, 647 F.2d at 310.

53. *Id.* (stating that, "Nigeria's activity . . . is in the nature of a private contract for the purchase of goods. Its purpose — to build roads, army barracks, whatever — is irrelevant.").

54. House Report, *supra* note 7, at 6615 (If a contract is "of the same character as a contract which might be made by a *private person*, [then it] could constitute a 'particular transaction or act' within the definition of commercial activity § 1603(d).") (emphasis added).

55. *Texas Trading*, 647 F.2d at 310.

56. *See, e.g.*, Callejo v. Bancomer, 764 F.2d 1101, 1107 (5th Cir. 1985) (referring to the FSIA as a "remarkably obtuse" document).

57. 770 F.2d 1385 (5th Cir. 1985).

cepts of nature and purpose.[58] In *De Sanchez*, the plaintiff, a payee on a check issued by the defendant, brought an action after the defendant placed a stop-payment order on the check.[59] The Fifth Circuit looked at the defendant's purpose, namely, to regulate foreign exchange reserves.[60] The Fifth Circuit held that the defendant's purpose was not ancillary to its conduct, but, instead, defined its conduct.[61] Using this approach, the Fifth Circuit concluded that, because the defendant's purpose was intrinsically governmental, the regulation of foreign exchange reserves was not commercial in nature.[62] Thus, the *De Sanchez* court imbued the cloak of immunity upon an otherwise commercial activity.[63]

Although the Fifth Circuit gave lip service to the nature test embodied in the FSIA, it engaged in seemingly tautological reasoning to find that the purpose underlying the activity determines its nature.[64] The Fifth Circuit failed to distinguish the two concepts, making the nature of an activity dependant upon its purpose. Rather than sharpen the line between commercial and public activity, the court blurred the distinction.

One cause offered for the *De Sanchez* decision has been the tension between Nicaragua and the United States.[65] Should this tension have been the catalyst for the decision, then the holding would seem contrary to the FSIA's purpose of depoliticizing immunity decisions. The Fifth Circuit would thereby have utilized the very political criteria that Congress sought to eliminate in enacting the FSIA.[66]

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58. *De Sanchez*, 770 F.2d at 1393; *see also* Gregorian v. Izvestia, 871 F.2d 1515 (9th Cir. 1988) (examining the purpose of the activity in question and rejecting the application of the nature test), *cert denied*, 493 U.S. 891 (1989).

59. *De Sanchez*, 770 F.2d at 1388.

60. *Id.* at 1393.

61. *Id.* at 1391.

62. *Id.* at 1399.

63. *Id.* at 1395.

64. *Id.* (The court stated that the "essence of an act is defined by its purposes — gift giving, for example. Unless we can inquire into the purpose of such acts, we cannot determine their nature.").

65. *See* Goodwin E. Benjamin, Comment, De Sanchez v. Banco Central De Nicaragua: *Too Many Exceptions to the Commercial Activities Exception of the Foreign Sovereign Immunities Act of 1976?*, 14 BROOK. J. INT'L L. 715 (1988).

66. *See also* Kimberly D. Reed, *Recent Development Foreign Sovereign Immunity — Foreign Sovereigns Are Immune From Claims of Libel Under the Foreign Sovereign Immunities Act Even if the Allegedly Libelous Statements were Printed in Connection with a Commercial Activity*, 28 VA. J. INT'L L. 251, 265 (1987) ("[d]espite Congress' goal of depoliticizing immunity decisions by transferring authority from the executive branch to the judicial branch, judges

The inconsistent results of *De Sanchez* and *Texas Trading* illustrate the difficulty courts have encountered in applying the FSIA commercial activities exception. To resolve the conflict among the courts, the Supreme Court addressed the issue of commercial activity in *Republic of Argentina v. Weltover.*[67]

III. A DEMARCATION BETWEEN NATURE AND PURPOSE

A. Republic of Argentina v. Weltover

In the instant case, the Supreme Court tried to render a definitive interpretation of the FSIA commercial activities exception.[68] The Supreme Court found that, under the FSIA, courts may not consider the purpose of a sovereign's activity in determining whether the activity is commercial.[69] Furthermore, the Supreme Court reaffirmed the private party test as a means of determining whether an activity is commercial in nature.[70]

Using the private party test, the Supreme Court found that the nature of Argentina's activity was commercial.[71] The Supreme Court characterized Argentina's bonds as "garden-variety debt instruments" which can be held by private parties.[72] Thus, Argentina's bond activity was commercial, thereby satisfying the first requirement of the FSIA commercial activities exception.[73]

In addition to finding that the activity was "commercial," the Supreme Court analyzed whether the activity had a direct effect in the United States.[74] The Supreme Court found that since the bonds re-

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have tended to dismiss claims based on the commercial activity exception when the subject of the litigation is politically sensitive").

67. 112 S.Ct. 2160 (1992).

68. *See* AMPAC Group, Inc. v. Republic of Honduras, 797 F. Supp. 473 (S.D.Fla. 1992) (relying on the standard set out in *Weltover* and noting that the *Weltover* decision "reaffirmed and clarified the distinction between nature and purpose of the activity").

69. *Weltover*, 112 S. Ct. at 2167. The Court recognized that it may be difficult "in some cases to separate 'purpose' (*i.e.*, the *reason* why the foreign state engages in the activity) from the 'nature' (*i.e.*, the outward form of the conduct that the foreign state performs or agrees to perform) . . . the statute unmistakably commands that to be done." *Id.*

70. *Id.* at 2166. The court concluded that "when a foreign government acts, not as a regulator of a market, but in the manner of a *private player* within it, the foreign sovereign's actions are 'commercial'." *Id.* (emphasis added).

71. *Id.*

72. *Id.*

73. *Id.* at 2166.

74. *Id.* at 2168; *see also* International Housing Ltd. v. Rafidain Bank of Iraq, 712 F. Supp. 1112, 1117 (S.D.N.Y. 1989) (finding that the payment of funds in the United States had a direct effect for purposes of the FSIA commercial activities exception).

quired payment in New York, their nonpayment had a direct effect in the United States.[75] Thus, Argentina's activity satisfied both requirements of the FSIA commercial activities exception, and immunity was properly denied.

B. *Legal Ramifications*

1. *De Sanchez*, Functionally Overruled

Although it did not do so expressly, in the instant case the Supreme Court functionally overruled the Fifth Circuit's reasoning in *De Sanchez*. The Court stated that the purpose behind an activity is irrelevant in determining the nature of an activity.[76] A court may not inquire into the purpose of an activity without completely disregarding the Supreme Court's decision in *Weltover*.[77]

2. International Trade Fostered

The holding in the instant case could foster international trade between foreign states and private parties. Private parties now know that they have a meaningful forum in which to bring actions against foreign states. Consequently, private parties will be less reluctant to deal with foreign states that enter into the marketplace. Because they are no longer judgment-proof, foreign states can enter into transactions without paying the premium required by private parties who anticipate a judgment-proof client. Furthermore, attorneys who advise clients involved in international commercial transactions will be able to give a more certain opinion as to forum access in the event of a breach.

Despite these benefits, the holding in the instant case will subject foreign governments to greater liability and amenability to United States jurisdiction. As a result, foreign states may seek other avenues of commercial activity. Thus, the holding in the instant case could

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75. *Weltover*, 112 S. Ct. at 2166 (noting that the issuance of a public debt has often been characterized as a sovereign activity, however, it pointed out that there is nothing distinct about the states' assumption of a debt); *see also* Shapiro v. Republic of Bolivia, 930 F.2d 1013, 1018 (2nd Cir. 1991) (stating that "it is self-evident that issuing public debt is a commercial activity within the meaning of [the FSIA]").

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

77. *But see* Walter Fuller Aircrafts Sales, Inc. v. Republic of the Philippines, 965 F.2d 1375, 1385 (5th Cir. 1992) (recognizing the standard set forth in the instant case and explaining the decision in *De Sanchez* as an unusual case where it was extremely difficult to separate the nature from the purpose).

discourage foreign governments from dealing with private parties and may have a chilling effect on trade between foreign states and private parties.

3. Notice to Foreign States Provided

With the instant case's clarification of the law, foreign states are now put on notice as to what activities will subject them to jurisdiction in United States courts. Because foreign states are now fully apprised of the meaning of "commercial" within the FSIA, those foreign states predisposed toward entering frivolous transactions will be deterred. Foreign states will no longer be able to veil their commercial activity in the guise of a public function. Thus, the clarification provided by the instant case may deter foreign states that are not serious about backing up their agreements from entering into deals with private parties.

4. Equity and Justice Fostered

The brighter line between nature and purpose will make it easier for courts to resolve disputes concerning activity under the FSIA commercial activities exception. Courts will no longer grapple with the definition of "commercial" within the FSIA.[78] Thus, the standard in the instant case may help to eliminate immunity decisions tainted with diplomatic and political concerns and foster decisions based on equity and justice.

IV. CONCLUSION

The standard set forth in *Weltover* is consistent with the Congressional intent underlying enactment of the FSIA. Congress intended to limit the immunity of foreign states engaged in commercial activities. The nature of the activity is dispositive of the question of whether a given activity is commercial or sovereign. If the activity is one that could be performed by a private party, then it is deemed commercial, regardless of the purpose of the activity. The approach followed by the Supreme Court in *Weltover* provides a suitable standard that should be followed by courts in determining whether an activity is commercial within the meaning of the FSIA.

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78. *See* AMPAC Group, Inc. v. Republic of Honduras, 797 F. Supp. 973 (S.D. Fla. 1992) (following the standard set forth in *Weltover* and noting that *Weltover* "clarified" and "reaffirmed the distinction between nature and purpose").