September 1, 2015

Foreign Sovereign Immunity

Second Circuit Issues New Ruling on Central Bank Immunity Under the Foreign Sovereign Immunities Act

SUMMARY

In an important sovereign immunity decision, the United States Court of Appeals for the Second Circuit ruled yesterday that plaintiffs seeking to establish that foreign central banks or other foreign government instrumentalities are alter egos of their parent government must meet a high standard. They must show that the parent government controls the day-to-day operations of the central bank or other instrumentality or that, for example, the central bank's commercial activities in the United States (such as the purchase of dollars) are not merely incidental to the alter-ego claims. The Second Circuit emphasized that, "[g]iven New York's role as a financial center, . . . weakening the immunity from suit or attachment traditionally enjoyed by the instrumentalities of foreign states" could lead to withdrawal of central bank reserves from the United States, to the detriment of the U.S. economy and the global financial system. The Second Circuit reversed a decision by the United States District Court for the Southern District of New York denying a motion to dismiss a complaint seeking a declaratory judgment that the Central Bank of Argentina (known by its initials in Spanish as "BCRA") is the alter ego of the Republic of Argentina, and is therefore liable for Argentina's debts. *EM Ltd.* v. *Banco Central de la República Argentina*, No. 13-3819-cv (2d Cir. Aug. 31, 2015). Sullivan & Cromwell LLP represented BCRA in the case.

BACKGROUND

Plaintiffs NML Capital, Ltd. and EM Ltd. hold over $2 billion in judgments against Argentina, stemming from Argentina's historic default on its sovereign debt in December 2001. In September 2006, plaintiffs filed an action seeking a declaratory judgment that BCRA is an alter ego of Argentina under the United States Supreme Court's holding in a decision known as *Bancec*.[1] The Supreme Court had explained that "government instrumentalities established as juridical entities distinct and independent from their

sovereign should normally be treated as such," unless the instrumentality "is so extensively controlled by its owner that a relationship of principal and agent is created" or if recognizing the separateness of the instrumentality "would work fraud or injustice."[2]

The district court denied motions to dismiss the complaint, holding that BCRA was subject to the court's jurisdiction on two grounds: first, BCRA was bound by Argentina's waiver of immunity from jurisdiction because BCRA is an alter ego of Argentina "for certain purposes"; and second, BCRA had purchased dollars in the United States, which the district court held was a commercial activity and thus fell within an exception to immunity found in § 1605(a)(2) of the FSIA.[3]

THE SECOND CIRCUIT'S DECISION

In an opinion by Judge José A. Cabranes, the Second Circuit reversed the district court's decision and remanded with instructions to dismiss the complaint with prejudice. The Second Circuit explained that plaintiffs had failed to rebut the *Bancec* presumption with respect to BCRA. The Court held that plaintiffs seeking to show extensive control must adequately allege day-to-day control over the instrumentality by the parent government.[4] The Court rejected plaintiffs' argument that Argentina's control over the appointment of officers and directors to BCRA demonstrated extensive control, because this appointment power "is an exercise of power incidental to ownership" and does not by itself mean that Argentina "interfere[d] in and dictate[d] BCRA's daily business decisions. . . . The sovereign must instead use its influence over these directors in order to interfere with the instrumentality's ordinary business affairs."[5] The Second Circuit also found that loans between central banks and governments, and coordination between the two in setting monetary policy, are common and do not demonstrate day-to-day control.[6] In addition, the Second Circuit rejected the notion that recognizing BCRA's separate status would work a "fraud or injustice," noting that there was no abuse of the corporate form in this case and that Argentina had not used BCRA to shield its assets from plaintiffs.[7]

The Second Circuit also reversed the district court's decision on an alternative ground for jurisdiction—namely, that BCRA had engaged in a commercial activity in the United States that would subject it to jurisdiction by purchasing dollars in the United States. The Second Circuit reaffirmed that any alleged commercial activity must have a close connection to "the gravamen of plaintiffs' complaint," and held that BCRA's purchase of dollars was only incidental to plaintiffs' claims, because the alleged harm to plaintiffs would be the same no matter where BCRA had purchased the dollars.[8] The Second Circuit also observed that expanding the commercial-activity exception to apply to dollar purchases by central banks that are only tangentially related to plaintiffs' claims "could have an immediate and adverse impact on the U.S. economy and the global financial system."[9]

IMPLICATIONS

In a ruling in 2011 in this case, the Second Circuit found that the FSIA offers central bank reserves strong protection from attachment, holding that the statute protects assets used for traditional central banking functions regardless of whether the central bank was alleged to be an alter ego or was independent of its parent state.[10] The decision this week provides similarly robust protection from the underlying alter-ego claims. The Second Circuit's decision clarifies the test for establishing alter-ego status in cases involving foreign sovereign instrumentalities in the Second Circuit: day-to-day control over the instrumentality by the sovereign. This will make for a more predictable legal environment for foreign central banks and other foreign sovereign instrumentalities going forward, and sets a relatively high bar for creditors of foreign sovereigns to recover against central banks and other independent instrumentalities.

The decision is also significant because of the Second Circuit's reliance on public policy grounds in interpreting the FSIA. The Second Circuit demonstrated its continuing concern that the scope of sovereign immunity protections be calibrated in light of New York's status as a financial center and the significance of the dollar's role as a reserve currency.[11]

* * *

Copyright © Sullivan & Cromwell LLP 2015

ENDNOTES

[1] *First National City Bank* v. *Banco Para El Comercio Exterior de Cuba*, 462 U.S. 611, 626-27 (1983).

[2] *Id.* at 626-27, 629 (internal quotation marks omitted).

[3] *EM Ltd.* v. *Banco Central de la República Argentina*, No. 13-3819-cv (L), slip op. at 13-16 (2d Cir. Aug. 31, 2015).

[4] Slip op. at 26-27, *citing LNS Invs., Inc.* v. *Republic of Nicaragua*, 115 F. Supp. 2d 358, 363 (S.D.N.Y. 2000), *aff'd sub nom. LNC Invs., Inc.* v. *Banco Central de Nicaragua*, 228 F.3d 423 (2d Cir. 2000); *Seijas* v. *Republic of Argentina*, 502 F. App'x 19, 22 (2d Cir. 2012); *First Inv. Corp. of the Marshall Islands* v. *Fujian Mawei Shipbuilding, Ltd.*, 703 F.3d 742, 753 (5th Cir. 2012); *Doe* v. *Holy See*, 557 F.3d 1066, 1080 (9th Cir. 2009).

[5] Slip op. at 29.

[6] *Id.* at 30-34.

[7] *Id.* at 34-37.

[8] *Id.* at 38-42.

[9] *Id.* at 41.

[10] *NML Capital Ltd.* v. *Banco Central de la República Argentina*, 652 F.3d 172, 187-91 (2d Cir. 2011). Sullivan & Cromwell LLP represented BCRA in that earlier case as well.

[11] *See* slip op. at 41 & n.93; *NML Capital*, 652 F.3d at 190 (noting Congress' concern that "execution against foreign central bank deposits might 'discourage[]' foreign states from depositing their reserves in the United States.")

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 800 lawyers on four continents, with four offices in the United States, including its headquarters in New York, three offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers listed below, or to any other Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future related publications from Stefanie S. Trilling (+1-212-558-4752; trillings@sullcrom.com) in our New York office.

CONTACTS

New York		
Sergio J. Galvis	+1-212-558-4740	galviss@sullcrom.com
Joseph E. Neuhaus	+1-212-558-4240	neuhausj@sullcrom.com
Washington, D.C.		
Jeffrey B. Wall	+1-202-956-7660	wallj@sullcrom.com