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COMMENTARY

Recent Decision on Sovereign Immunity Highlights Need for Advance Planning When Transacting With Foreign Sovereign Entities

On December 1, 2015, the United States Supreme Court issued its decision in *OBB Personenverkehr AG v. Sachs*,[1] which presented a seemingly simple question: When do commercial activities in the United States strip foreign states and state-owned entities of sovereign immunity and subject them to jurisdiction in U.S. courts? The answer, according to the Court, is that they are subject to U.S. jurisdiction only when the plaintiff's claim is "based upon" commercial activity in the United States. This decision reversed an *en banc* decision of the U.S. Court of Appeals for the Ninth Circuit and made it more difficult to sue foreign sovereigns and state-owned entities in U.S. courts. This was less of a jurisprudential revolution than a simple reminder that when U.S. individuals and companies transact business with foreign sovereigns, proactive negotiation of arbitration clauses, forum selection clauses, or investment treaty planning is a paramount element of risk mitigation.

Commercial Activity and Foreign Sovereigns: A Primer

For more than half a century, U.S. law has reflected a policy of "restrictive sovereign immunity," which provides immunity to foreign states for claims arising out of governmental acts but denies the same immunity for claims arising out of commercial activities. And since 1976, sovereign immunity in the United States has been implemented through the Foreign Sovereign Immunities Act ("FSIA"), which reflects this policy of restrictive immunity in section 1605. That provision subjects foreign states to U.S. jurisdiction in connection with any case:

> 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.[2]

This provision sets forth a number of bases to find an adequate nexus to the United States for jurisdiction to attach. But general language like "in connection with" and "direct effect" has given rise to significant litigation and jurisprudence as states have increasingly entered the marketplace, breached their contracts, and committed commercial torts.

OBB Personenverkehr AG v. Sachs

This case focused on a different open-ended phrase in the statute: when a claim is "based upon" a commercial activity.

Sachs involved tort claims brought by an American tourist who was seriously injured while boarding a train in Austria. The train was operated by OBB Personenverkehr AG, an Austrian state-owned railway and member of the Eurail Group. Sachs was traveling on a Eurail pass, which she had purchased online from Rail Pass Experts ("RPE"), a travel agent located in Massachusetts.

Sachs filed suit against OBB and other parties in the U.S. District Court for the Northern District of California. Unsurprisingly, OBB asserted sovereign immunity, and the district court dismissed the case on that basis, finding that there was insufficient evidence to find that RPE was OBB's agent such that RPE's sale of the Eurail pass could be imputed to OBB for purposes of establishing jurisdiction under the commercial activity exception of the FSIA. On appeal, a divided panel of the Ninth Circuit affirmed, but the case then went *en banc*.

The *en banc* Court of Appeals held that RPE's sale of the Eurail pass was imputable to OBB under traditional agency doctrine. Thus, OBB had engaged in "commercial activity" in the United States under the FSIA. The court of appeals then considered the question of whether the plaintiff's claims were "based upon" that commercial activity—i.e., whether there was an adequate nexus between Sachs's purchase of the Eurail pass in the United States and her claims. The court said that there was; Sachs's purchase of the pass established a passenger-carrier relationship with OBB, a necessary element of her negligence claim, and further provided the basis for the warranties that Sachs claimed OBB breached.

The Supreme Court reversed in a unanimous opinion by Chief Justice Roberts. The Court's analysis focused primarily upon whether Ms. Sachs's claims were "based upon" OBB's alleged commercial activity in the United States. The Court relied upon its decision in *Saudi Arabia v. Nelson*, in which it determined that this inquiry requires a court to "identify[] the particular conduct on which the [plaintiff's] action is 'based,'" by looking to the "the 'gravamen of the complaint,'" or "those elements … that, if proven, would entitle a plaintiff to relief."[3] The Court found that the Ninth Circuit's decision did not comport with this standard. Specifically, the Court found that while the U.S. sale of the Eurail pass indeed provided "an element" of her claim, "[u]nder Nelson … the mere fact that the sale of the Eurail pass would establish a single element of a claim is insufficient to demonstrate that the claim is 'based upon' that sale."[4] The Court explained that a "one-element approach" was incompatible with *Nelson*, which required an analysis of the "gravamen" of the claim, or the "core of [the] suit."[5] Citing Justice Holmes, the Court noted that "the 'essentials' of a personal injury narrative will be found at the 'point of contact'—'the place where the boy got his fingers pinched.'"[6]

In this case, "the gravamen of Sachs's suit plainly occurred abroad," as "[a]ll of her claims turn on the same tragic episode in Austria, allegedly caused by wrongful conduct and dangerous conditions in Austria, which led to injuries suffered in Austria."[7] The Court also reiterated its concern that applying a broader standard "would allow plaintiffs to evade the Act's restrictions through artful pleading."[8] To wit, any plaintiff could "recast virtually any claim of intentional tort … as a claim of failure to warn, simply by charging the defendant with an obligation to announce its own tortious propensity before indulging it."[9] This, the Court held, would "effectively thwart[] the Act's manifest purpose."[10]

This is becoming a familiar approach of the U.S. Supreme Court. Whether presented as a question of sovereign immunity, personal jurisdiction,[11] or statutory interpretation,[12] claims for acts occurring abroad are getting pushed away from U.S. shores.

The Upshot for U.S. Business Interests

The Supreme Court's decision in *Sachs* illustrates the difficulty of obtaining jurisdiction under the FSIA. The "gravamen" of a commercial tort committed by a foreign sovereign will rarely occur in the territorial United States,[13] and while political expropriations and nationalizations can sometimes be addressed by U.S. courts, the exception from immunity in those cases is vanishingly small.[14] Accordingly, putative plaintiffs with claims against foreign sovereigns are increasingly forced to thread the eye of a needle to sustain the jurisdiction of a U.S. court.

Ms. Sachs had little opportunity to plan for the risk of a personal injury while traveling in Europe; she could not, as a practical matter, force the putative defendant to consent to U.S. jurisdiction or international arbitration when she bought the ticket and left for Europe. Business interests, though, have much more leverage when transacting or investing abroad, and there are four considerations they should keep in mind.

First, to the extent that a U.S. party wants resort to a U.S. court for its foreign sovereign contracts, it is important to structure the transaction so that the "gravamen" of any breaches will be in the United States. Where, for instance, a foreign sovereign breaches a contract by failing to complete a contractual obligation that must be performed in the United States (for example, payment in U.S. dollars into a U.S. account), such a breach is usually sufficient to be a direct effect in the United States and, thus, implicate the commercial activity exception to the FSIA.[15]

Second, state parties can consent to a particular forum—like U.S. courts—to settle their disputes, and such a choice is typically respected.[16] That choice may also strip a state or state-owned entity of its sovereign immunity.[17] Again, though, it should come as no surprise to learn that states and state-owned entities rarely agree to having their acts—even their commercial acts—adjudicated by a foreign court.

Third, a more typical strategy is for the parties to choose international arbitration in a third state. If a state or state-owned entity can meaningfully contract (to the purchase or sale of good, for instance), it can also meaningfully consent to a private arbitral forum to resolve any disputes resulting from the contract. Sovereign immunity is not implicated, at least at the outset, and the choice to arbitrate will typically be enforced.[18] Immunity issues will arise down the line only if the claim is successful, the respondent refuses to pay, and the claimant needs to attach the state's assets to satisfy the award.

Fourth, when a state or state-owned entity will not agree to specify a neutral forum, that choice can, in some respects, be unilaterally imposed on it. Private parties who are broad-based "investors" in a foreign state—because, for instance, they own shares in local companies, tangible or intangible rights, and long-term operations—can and should structure those investments to take advantage of investment treaties. There are more than 3,000 such treaties in force, and by routing that investment through a country that has an investment treaty with the host state, disputes arising from those investments (and even the contracts in furtherance of those investments) can be subject to compulsory arbitration against the state. With this simple step, the investor is assured of a neutral forum for its disputes.[19]

With these structures in place, the difficulties and idiosyncrasies of the FSIA can be largely avoided, and claims can be brought against a foreign state in a neutral forum (i.e., not its own courts). For multinational business interests, no less than personal injury plaintiffs like Ms. Sachs, this can often be a case-determinative result.

Lawyer Contacts

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Endnotes

1 *OBB Personenverkehr AG v. Sachs*, 136 S.Ct. 390 (2015).

2 Foreign Sovereign Immunities Act, 28 U.S.C. § 1605(a)(2) (2012).

3 *Saudi Arabia v. Nelson*, 507 U.S. 349, 356-57 (1993) (citations omitted).

4 *Sachs*, 136 S.Ct. at 395.

5 *Id.* at 396.

6 *Id.* at 397 (citation omitted)

7 *Id.* at 396.

8 *Id.*

9 *Id.* (internal quotation marks omitted) (citation omitted).

10 *Id.* at 397 (internal quotation marks omitted) (citation omitted).

11 *See Goodyear Dunlop Tires Operations, S.A. v. Brown*, 131 S.Ct. 2846 (2011) (holding that the isolated presence of a foreign companies' products in the state as a result of others' actions do not justify general personal jurisdiction over that company for claims having nothing to do with those products).

12 *See*, *e.g.*, *Kiobel v. Royal Dutch Petroleum Co*., 133 S.Ct. 1659 (2013) (holding that the Alien Tort Statute does not apply to violations of the law of nations that take place in another sovereign's territory outside the U.S. and that there is a rebuttable presumption against extraterritorial application of the Statute); *Morrison v. National Australia Bank*, 561 U.S. 247 (2010) (holding that the antifraud provisions of U.S. securities laws apply only with respect to the purchase or sale of a security listed on a U.S. stock exchange or the purchase or sale of any other security in the United States).

13 *See*, *e.g.*, *Saudi Arabia v. Nelson*, 507 U.S. 349 (1993) ("gravamen" of lawsuit of American employee of Saudi hospital bringing claim based on injuries arising from alleged detention and torture by Saudi government was Saudi Arabia, even though employee was recruited and signed an employment contract in the U.S.); *Sun v. Taiwan,* 201 F.3d 1105 (9th Cir. 2000) (lawsuit by parents of deceased American student who drowned in Taiwanese government cultural tour in Taiwan was found to be based in Taiwan even though based on failure to warn parents in the U.S. and administration and application to the cultural promotion took place in the U.S.).

14 For the expropriation exception to apply, property must be taken in violation of international law and such expropriated "property or any property exchanged for such property [must be] owned or operated by an agency or instrumentality of the foreign state and that agency or instrumentality [be] engaged in a commercial activity in the United States." Foreign Sovereign Immunities Act, 28 U.S.C. § 1605(a)(3) (2012); *see Kalamazoo Spice Extraction Co. v. Provisional Military Govt. of Socialist Ethiopia*, 616 F. Supp. 660, 663-65 (W.D. Mich. 1985) (finding jurisdictional nexus satisfied by Ethiopian government's alleged expropriation of majority ownership of American corporation's stock in Ethiopian corporation by failing to pay reasonable compensation for property seized).

15 *See*, *e.g.*, *Republic of Argentina v. Weltover, Inc*., 504 U.S. 607, 618-19 (Argentine government's rescheduling of bond payments had a "direct effect" in U.S., the designated place of performance of Argentina's contractual commitments, even though bond holders were foreign corporations); *Cruise Connections Charter Management v. Canada*, 600 F.3d 661 (D.C. Cir. 2010) (finding a direct effect when the Canadian Police reneged on a contract to provide cruise ships to a U.S. corporation during the 2010 Winter Olympics). *But see Helmerich & Payne Inter. Drilling Co. v. Bolivarian Republic of Venezuela*, 784 F.3d 804 (D.C. Cir. 2015) (finding that Venezuela's breach of oil drilling contracts with wholly owned Venezuelan subsidiary of U.S. oil company did not cause a "direct effect" in the U.S.); *Terenkian v. Republic of Iraq*, 694 F.3d 1122 (9th Cir. 2012) (finding that non-deposit of oil payments in New York bank due to non-purchase of oil and non-sales to potential U.S. customers insufficient to constitute a "direct effect" of Iraq's termination of contracts for oil sale to Cyprus oil brokerage companies).

16 *See*, *e.g.*, *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585 (1991) (holding forum-selection clauses enforceable but subject to judicial scrutiny for fundamental fairness); *M/A Bremen v. Zapata Off-Shore Co*., 407 U.S. 1, 9-10 (1972) (finding forum-selection clauses "prima facie valid" even though they "have historically not been favored by American courts").

17 *See* Foreign Sovereign Immunities Act, 28 U.S.C. § 1605(a)(1) (2012).

18 Foreign Sovereign Immunities Act § 1605(a)(6); *see also U.S. Titan, Inc. v. Guangzhou Zhen Hua Shipping Co., Ltd*., 241 F.3d 135 (2d Cir. 2001) (finding arbitration clause in charter party between U.S. charterer and Chinese government satisfied FSIA arbitration exception because China and the U.S. had both signed the Convention on Recognition and Enforcement of Foreign Arbitral Awards and the parties had agreed to the charter party containing arbitration clause).

19 *See* Jones Day *Commentary*, "United States Supreme Court Gives Deference to Arbitrators in Investment Treaty Cases," March 2014.