SOVEREIGN WEALTH FUNDS AND U.S. LAW: STRATEGIES FOR NAVIGATING THE REGULATORY AND LEGAL LANDSCAPE

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I. Introduction

Five years before the Soviet Union launched Sputnik, State Department Legal Adviser Jack Tate foresaw a "widespread and increasing practice on the part of governments in engaging in commercial activities."[1] Tate's prediction proved prophetic. A shrinking world has indeed increasingly put foreign sovereigns into direct contact with private parties.[2]

The global financial crisis of 2007 accelerated this trend. As U.S. stocks and real estate became available at bargain-basement prices, many foreign governments and their instrumentalities, particularly government investment vehicles known as sovereign wealth funds,[3] were in a position to make aggressive acquisitions. Sovereign wealth

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[1] Letter from Jack B. Tate, Acting Legal Adviser, to Philip B. Perlman, Acting Att'y Gen., Changed Policy Concerning the Granting of Sovereign Immunity to Foreign Governments, *reprinted in* 26 DEP'T ST. BULL. 984, 984–85 (May 19, 1952).

[2] Observers note that U.S. companies of all sizes can hardly help having commercial relationships with foreign partners, many of which are to some degree state-owned. *See* Michael L. Morkin, et al., *Doing Business with Foreign Sovereign Entities*, 17 BUS. L. TODAY 43 (2007). American expatriates working abroad can also be involved in suits against foreign sovereigns. *See, e.g.*, Saudi Arabia v. Nelson, 507 U.S. 349 (1993) (dismissing suit by former employee of Saudi state hospital against Saudi government and hospital's U.S.-based purchasing agent).

[3] Sovereign wealth funds are government-owned investment vehicles. They are generally funded by a state's foreign exchange income, often via the sale of natural resources. The definition of "sovereign wealth fund" remains unsettled. *See, e.g.*, Richard A. Epstein & Amanda M. Rose, *The Regulation of Sovereign Wealth Funds: The Virtues of Going Slow*, 76 U. CHI. L. REV. 111, 114 n.9 (2009) (describing various sovereign wealth fund definitions). The funds themselves often have unique relationships with their home governments, ranging from private corporations in which a government is a majority shareholder or is a fiduciary for the fund's liabilities to entities that are directly controlled by or are considered a part of government ministries or central banks. While many of these distinctions are irrelevant to the funds' legal status, definitional concerns and legal analysis do overlap in several significant respects. *See* Joel Slawotsky, *Sovereign Wealth Funds and Jurisdiction Under the FSIA*, 11 U. PA. J. BUS. L. 967, 974 (2009) (noting that the purpose and character of a sovereign wealth fund's investments, along with its corporate governance, may impact its ability to claim immunity). This Paper will use the term "sovereign wealth fund" or "SWF" to refer to investment funds owned or controlled by foreign governments. *Cf.* Sovereign Wealth Funds and the (in)Security of Global Finance, Testimony Before the Comm. On Financial Services, 110th Cong. (2008)) (statement of Prof. Daniel W. Drezner) (defining sovereign wealth funds as "government investment vehicles that acquire international financial assets to earn a higher-than-risk-free rate of return."), *available at* http://financialservices.house.gov/hearing110/9-10-08_drezner_house_testimony.pdf. Section IV, *infra*,

funds (SWFs) were the "largest single investors" in U.S. financial institutions in late 2007 and early 2008.[4] These funds invested heavily in U.S. banks and private equity houses during this period, acquiring large stakes in Morgan Stanley, Citigroup, Blackstone, Carlyle and Merrill Lynch.[5] SWFs have also made significant purchases in the U.S. real estate market. Most notably, an Abu Dhabi-based SWF has acquired "substantial interests" in the GM and Chrysler buildings in New York City.[6]

Close contact has inevitably created friction. Recent disputes involving foreign sovereign activity in the United States range from front-page political scandals[7] to relatively mundane civil litigation.[8] Particularly given the high profile—if not notoriety—sovereign investment currently has in the United States,[9] it seems likely that

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will address those details of fund management, structure or ownership that may impact SWF status under U.S. law.

[4] Steven Davidoff & David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 62 ADMIN. L. REV. 463, 472–73 (2009) (citing Hearing Before the Subcomm. on Domestic and Int'l Monetary Policy, Trade, and Technology and the Subcomm. on Capital Markets, Insurance, and Government Sponsored Enterprises of the H. Comm. on Financial Servs., 110th Cong. (2008) (statement of Scott G. Alvarez, General Counsel, Board of Governors of the Federal Reserve System)).

[5] Michael S. Knoll, *Taxation and the Competitiveness of Sovereign Wealth Funds: Do Taxes Encourage Sovereign Wealth Funds to Invest in the United States?*, 82 S. CAL. L. REV. 703, 704 (2009).

[6] Knoll, *supra* note 7, at 712. *See also* David Alan Richards, *Sovereign Wealth Funds and U.S. Real Estate Investment*, 23 PROB. & PROP. 38, 44 (2009).

[7] The Dubai Ports World scandal is perhaps the best example of the political baggage SWF investment can have. *See, e.g.*, Jonathan Weisman, *Port Deal to Have Broader Review: Dubai Firm Sought U.S. Security Probe*, WASH. POST, Feb. 27, 2006, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2006/02/26/AR2006022600737.html (describing negotiations surrounding and opposition to Dubai Ports World transaction). While issues beyond sovereign investment per se may have been in play, "SWFs and other foreign investors [. . .] of political necessity, settled on a common blueprint for U.S. investment" in the wake of the Dubai Ports World scandal, avoiding sensitive sectors. Mark Gordon & Mark F. Veblen, Sovereign Wealth Fund Investment in the U.S. Just Warming Up?, American Bar Association business law committee newsletter, *available at* http://www.abanet.org/buslaw/committees/CL930000pub/newsletter/200803/gordon.pdf.

[8] Foreign sovereigns were defendants in actions filed in U.S. courts in over 200 cases between 2004 and 2008. George K. Foster, *Collecting From Sovereigns: The Current Legal Framework for Enforcing Arbitral Awards and Court Judgments Against States and Their Instrumentalities, and Some Proposals For its Reform*, 25 ARIZ. J. INT'L & COMP. L. 665, 667 (2008). *See also* Justin Donoho, Comment, *Minimalist Interpretation of the Jurisdictional Immunities Convention*, 9 CHI. J. INT'L L. 661, 682 (2009) (noting "an increasing amount of transactions between state governments and private parties" in the context of a commercial activities exception to sovereign immunity).

[9] *See, e.g.*, Weisman, *supra* note 7.

SWFs will continue to face challenges from the U.S. foreign investment regulatory scheme to complaint-waiving litigants for years to come.

This Paper will review legal and regulatory strategies foreign sovereigns interested in investing in the U.S. market may adopt to minimize friction between the sovereign investor and its local surroundings. By carefully considering the strategic options available to them under U.S. law, foreign sovereigns can limit their regulatory headaches and litigation exposure.

II. Regulatory Framework: Navigating CFIUS

Sovereign Wealth Funds are generally considered "foreign government entities" whose investments in the United States are subject to review by the Committee on Foreign Investment in the United States (CFIUS).[10] CFIUS acts as a gatekeeper, tasked with enforcing U.S. laws that restrict foreign investments that pose a threat to the United States' national security interests.[11] U.S. law prohibits foreign control of American nuclear assets or airlines, for example.[12] CFIUS review is mandatory across a wide variety of deal structures, including joint ventures.[13]

While certain transactions such as these are clearly forbidden, it can be difficult for SWFs and their potential U.S. partners to predict how CFIUS will apply its

[10] *See* 31 C.F.R. Sections 800.213–14.

[11] Though the White House has the authority to suspend, prohibit or reverse any such transaction under U.S. law, it should be acknowledged that a foreign sovereign might successfully challenge U.S. restrictions on foreign investment in an international tribunal. Indeed, the United States itself mounted a successful challenge to Canada's now-defunct "Foreign Investment Review Act," arguing that its application to U.S. investment in Canada violated Article III(4)'s guarantees of national treatment. Brendan J. Reed, Note, *Sovereign Wealth Funds: The New Barbarians at the Gate? An Analysis of the Legal and Business Implications of Their Ascendancy*, 4 VA. L. & BUS. REV. 97, 123 (2009) (citing M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 298 (2004)). Such considerations are beyond the scope of this analysis, however, which assumes the application of current U.S. law.

[12] Epstein & Rose, *supra* note 3, at 118 (citing Michael Hagan & Heidi Johanns, *Sovereign Wealth Funds: Risks, Rewards, Regulation and the Emerging Cross-border Paradigm*, 8 M&A J. 1, 5 (2008)) (additional citations omitted).

[13] See 31 C.F.R. Section 800.301(d).

regulations. Significantly, "national security" is not clearly defined in this regulatory scheme,[14] leaving proposed deals at the mercy of "a broad, vague generality subject to numerous inconsistent interpretations" made by White House officials on a case-by-case basis.[15]

Recent legislation has not made CFIUS approval easier to predict or obtain. The Foreign Investment and National Security Act of 2007 (FINSA) added new requirements to the range of CFIUS regulations, including compliance with U.S. and multilateral counterterrorism, proliferation, and export control regimes.[16] FINSA also expands the scope of transactions subject to CFIUS review to include "critical infrastructure" from power generators to gas storage tanks.[17] While FINSA has erected new barriers, it has not clarified how SWFs might clear existing hurdles. "Control," for example, remains poorly defined under the statute: there must "be evidence that the acquisition's purpose is solely for investment"[18] for the transaction to be approved; even if a SWF does not have a majority ownership in a U.S. enterprise, it may nevertheless be prohibited from completing the deal under the "control" standard.[19]

On a related note, as witnessed by Dubai Ports World's attempted acquisition of Britain's Peninsular and Oriental Steam Navigation Company (P&O) in 2006, political considerations play a powerful role in determining whether SWFs can go forward with

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[14] Zhao Feng, Note, *How Should Sovereign Wealth Funds Be Regulated?*, 3 BROOK. J. CORP. FIN. & COM. L. 483 (2009) (citing Christopher F. Corr, *A Survey of the United States Controls on Foreign Investment and Operations: How Much is Enough?*, 9 AM. U. J. INT'L L. & POL'Y 417, 421 (1994)).
[15] *Id.* (quoting Robert Shearer, *The Exon-Florio Amendment: Protectionist Legislation Susceptible to Abuse*, 30 HOUS. L. REV. 1729, 1741–42 (1993)) (internal quotation marks omitted).
[16] David Alan Richards, *Sovereign Wealth Funds and U.S. Real Estate Investment*, 23 PROB. & PROP. 38, 39 (2009).
[17] Feng, *supra* note 9, at 505-06.
[18] Richards, *supra* note 11, at 40.
[19] Feng, *supra* note 9, at 503–04.

acquisitions or investments regardless of CFIUS approval.[20] CFIUS review and disclosure requirements, coupled with a history of embarrassing leaks, make this process politically dangerous for SWFs. Transactions subject to CFIUS review are examined for 30 days, then reviewed for an additional 45 days unless an official with the rank of Deputy Secretary or above signs off on them first.[21] During these review periods, the parties must submit sensitive personal and proprietary information to CFIUS, including "their businesses' structures, commercial relationships and affiliations, transactional documents, market share and business plans."[22] This information is officially exempt from Freedom of Information Act requests and should not be disclosed except through administrative or judicial proceedings; nevertheless, the Department of the Treasury itself has admitted to "several instances" in which major leaks occurred.[23]

Although CFIUS review applies in principle to real estate transactions involving SWFs,[24] certain real estate investment may be relatively safe bets as they do not require CFIUS approval. Acquisition of unimproved land, for example, is generally exempt from CFIUS review,[25] as is the purchase of unused buildings if that purchase does not "include customer lists, intellectual property, or other proprietary information, or other intangible assets or the transfer of personnel."[26] CFIUS's recent decision not to intervene in SWF

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[20] *See, e.g.*, Jonathan Weisman, *Port Deal to Have Broader Review: Dubai Firm Sought U.S. Security Probe*, WASH. POST, Feb. 27, 2006, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2006/02/26/AR2006022600737.html (describing negotiations surrounding and opposition to Dubai Ports World transaction).
[21] Epstein & Rose, *supra* note 3, at 118–19.
[22] *See, e.g.*, Letter from Henry M. Paulson, Secretary of the Treasury, to Max Baucus, Chairman of the Senate Finance Committee (Apr. 15, 2008), *available at* blog.nam.org/treasury-ms-ltr041508.pdf.
[23] *Id*.
[24] Experts characterize the impact of the new CFIUS regulations quite broadly. *See* Richards, *supra* note 10, at 41 (noting that these regulations "have the potential to reach any American real estate transaction in which an SWF is involved.").
[25] *Id*. at 43 (citing 31 C.F.R. Section 800.302(c), ex. 1, subsection (b)).
[26] *Id*.

investments in the Chrysler and GM buildings in New York further suggests that even relatively high-profile real estate investments may pass regulatory muster.[27]

In any case, experts note that "[i]t is often prudent to make a voluntary filing with CFIUS if the likelihood of an investigation is reasonable high or if competing bidders are likely to take advantage of the uncertainty of a potential investigation," recommending a proactive approach to negotiations with the U.S. Treasury.[28]

III. Minimizing Litigation Exposure

Before the SWF begins operating in the U.S. market, it must prepare to defend itself in U.S. courts.[29] The first line of defense available to all foreign sovereigns in U.S. courts is the Foreign Sovereign Immunities Act of 1976 (FSIA).[30] The FSIA can be a powerful shield for sovereigns doing business in the United States.

Foreign sovereign clients should primarily seek protection from what foreign investors fear most: U.S. juries and the verdicts they award.[31] Further, much like multinational corporations, SWFs should work to head off lengthy merits discovery. Allowing plaintiffs to fish through the sovereign defendant's files would provide ammunition to potential litigants in other countries and might in any case prove

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[27] *Id*. at 44.
[28] EDWARD D. HERLIHY, TAKEOVER LAW AND PRACTICE 2009 476–77 (2010).
[29] Where applicable, a foreign sovereign defendant should review its rights under bilateral or multilateral investment treaties or under the common law "act of state doctrine." *See* Morkin, et al., *supra* note 3, at 44.
[30] Pub. L. No. 94-583, 90 Stat. 2891 (codified as amended at 28 U.S.C. §§ 1330, 1602–1611).
[31] *See, e.g.*, Asa Markel, *American, English and Japanese Warranty Law Compared: Should the U.S. Reconsider Her Article 95 Declaration to the CISG?*, 21 PACE INT'L L. REV. 163, 165 (2009) (observing that "commercial parties, concerned about uncertain exposure to damages awards from American juries, have consistently sought to resolve their disputes outside American courts.") (citation omitted). *See also* Kevin M. Clermont, *Litigation Realities Redux*, 84 NOTRE DAME L. REV. 1919, 1967 (2009) (describing 'foreigners' fear of U.S.' courts); Tom McNamara, Special Features of Transnational Litigation in United States Courts, Presented to the Russian-American Symposium on Private International Law, June 29, 2004, *available at* http://www.abanet.org/intlaw/committees/disputes/litigation/moscow.shtml.

embarrassing.[32] Finally, it is important to note that plaintiffs will often abandon their claims if they cannot bring them in a U.S. court. Arbitration alternatives may be beyond many plaintiffs' budgets,[33] while proceedings in foreign countries—particularly those, such as the United Kingdom, that force the losing party to pay both sides' litigation costs—may deter plaintiffs from trying their luck.

A. The Foreign Sovereign Immunities Act: An Overview

The FSIA wrote the "restrictive" theory of sovereign immunity into U.S. law.[34] Until the shift heralded by the Tate Letter,[35] foreign sovereigns enjoyed absolute immunity from suit in U.S. courts.[36] With the FSIA, Congress mandated that "the sovereign immunity of foreign states should be 'restricted' to cases involving acts of a foreign state which are sovereign or governmental in nature, as opposed to acts with are either commercial in nature or those which private persons normally perform."[37]

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[32] *C.f.*, Natasha Singer, *Trial Puts Spotlight on Merck*, N.Y. TIMES, May 13, 2009 (reporting on potential consequences of discovery revelations in Australian class action for international drug maker in parallel litigation in different countries), *available at* http://www.nytimes.com/2009/05/14/business/14vioxx.html?_r=1&hpw.

[33] Ronald J. Offenkrantz, *Arbitrating Commercial Issues: Do You Really Know the Out of Pocket Costs?*, 81 N.Y. ST. B. J. 30, 30–32 (2009) (discussing arbitration costs, which in complex commercial cases may exceed the cost of litigation).

[34] *See, e.g.*, Permanent Mission of India to the United Nations v. City of New York, 551 U.S. 193, 199 (2007) (summarizing the history of the FSIA). The Supreme Court has also noted that the "restrictive" theory had been adopted by "the majority of other countries" by the 1950's, and may thus have been settled international law before the FSIA was passed.

[35] Republic of Argentina v. Weltover, 504 U.S. 607, 612–13 (1992). *See also* Joshua A. Kirstein, Note, *Commerce Flaws: Taking Exception with* Garb v. Poland's *Misinterpretation of the Commercial Activity and Takings Exceptions of the FSIA*, 17 CARDOZO J. INT'L & COMP. L. 315 320–25 (2009) (describing the historical development of U.S. policy toward sovereigns engaging in commercial activity).

[36] Letter from Jack B. Tate, *supra* note 1, at 984 (describing "classical or virtually absolute theory of sovereign immunity" according to which, at the time, a sovereign could not "without his consent be made a respondent in the courts of another sovereign.").

[37] Cassirer v. Kingdom of Spain, 580 F.3d 1048, 1057 (9th Cir. 2009) (quoting H.R. Rep. No. 94-1487, at 14 (1976)).

Though the FSIA strips foreign sovereigns of absolute immunity,[38] it does not leave them defenseless. Once a sovereign defendant invokes immunity through a prima facie showing that it is a foreign sovereign under the FSIA,[39] the defendant can bring a variety of procedural rights and protections to bear. First, if the plaintiff has brought his case in state court, the FSIA guarantees the foreign sovereign the right to remove the case to a federal district court.[40] The foreign sovereign may then demand a bench trial, dodging exposure to the much-feared, plaintiff-friendly American jury.[41]

The Supreme Court's decision in *Powerex v. Reliant Energy Services* raises the stakes for sovereign defendants wishing to remove their cases from state courts. *Powerex* began as a state-court enforcement action. The state of California sued Powerex, an energy-trading firm owned by a Canadian state power firm. California brought its case in a state trial court, alleging that the company had taken part in a price-fixing conspiracy.[42] Powerex, along with various other Canadian government co-defendants, attempted to remove the case to federal court under the FSIA.[43]

The district court concluded that at least some of the Canadian defendants were immune from suit under the FSIA, though it decided that Powerex was not.

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[38] The FSIA applies retroactively to conduct that occurred prior to the enactment of FSIA or the adoption of the Tate Letter. *See generally* Republic of Austria v. Altman, 541 U.S. 677 (2004) (rejecting Austrian claim of absolute immunity for Nazi-era seizure of paintings allegedly in violation of international law). Foreign sovereigns must therefore work within the FSIA framework even where suits against them arise from acts prior to 1952. *Id.*

[39] *See, e.g.*, Drexel Burnham Lambert Group, Inc. v. Committee of Receivers, 12 F.3d 317, 325 (2d Cir. 1993) (describing FSIA requirements for presenting and overcoming an immunity defense).

[40] *See* 28 U.S.C. §§ 1330(a); 1441(d).

[41] *Id.* *See also* Powerex Corp. v. Reliant Energy Servs., Inc., 551 U.S. 224, 237–38 (2007) (describing procedural rights of foreign sovereigns under FSIA, including the right to a federal bench trial on removal). Sections IV, *infra*, will also address the impact of the Powerex decision on foreign sovereign defendants' FSIA rights.

[42] *Id*. at 226–27.

[43] *Id*. at 227.

Nevertheless, it remanded the entire case back to state court.[44] Though the Ninth Circuit reversed the district court's decision not to dismiss California's case against the sovereign defendants on appeal,[45] the Supreme Court reinstated the district court's order, finding that 28 U.S.C. 1447(d) precludes appellate review of district court remand decisions where there is a "colorable" jurisdictional argument for remand by the district judge,[46] including in cases governed by the FSIA.[47] As the Court itself admitted, this ruling has serious consequences for foreign sovereign defendants:

> We are well aware that § 1447(d)'s immunization of erroneous remands has undesirable consequences in the FSIA context. A foreign sovereign defendant whose case is wrongly remanded is denied not only the federal forum to which it is entitled (as befalls all remanded parties with meritorious appeals barred by §1447(d)), but also certain procedural rights that the FSIA specifically provides foreign sovereigns only in federal court (such as the right to a bench trial, see 28 U.S.C. §1330(a); §1441(d)).[48]

Foreign sovereign defendants are thus working without an appellate "net" in challenging district court remand decisions. To the extent a defense team might otherwise have relied on appellate review in these cases, strategy should be adjusted to reflect the reality that the district court is the first and last stop for these arguments. Tactics that might antagonize the judge, such as motions to disqualify, should probably be left off the table except in extreme cases, as long as the current §1447 regime persists.

Once it is safely in federal court, the sovereign defendant will enjoy presumptive immunity under the FSIA.[49] To rebut this presumption, the plaintiff must show that the

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[44] *Id*. at 228.
[45] *Id*.
[46] *Id*. at 234.
[47] *Id*. at 237–38.
[48] Powerex Corp. v. Reliant Energy Servs., Inc., 551 U.S. 224, 237–38 (2007) (Scalia, J.). *See also Id*. at 245 (Breyer, J., dissenting) *and* Carlsbad Tech., Inc. v. HIF Bio, Inc., 129 S.Ct. 1862, 1869 (Breyer, J., concurring) (recommending statutory revisions to restore appellate review under § 1447) (citing Powerex Corp., 551 U.S. at 224, 238–39)).
[49] *See* 28 U.S.C. §§ 1603, 1604, 1605. *See also* Butler v. Sukhoi Co., 579 F.3d 1307, 1312–13 (11th Cir. 2009) (summarizing FSIA procedural requirements).

foreign sovereign should be subject to suit under one of the FSIA's exceptions.[50] If the plaintiff meets this requirement, the burden shifts back to the foreign sovereign defendant, which must prove by a preponderance of the evidence that the plaintiff's claims do not fall within the exception the plaintiff identified.[51] If the plaintiff fails to carry his initial burden, however, the defendant can ask the federal district court to dismiss his claims for lack of subject matter jurisdiction under the FSIA.[52]

Once the foreign sovereign defendant has wedged itself into the FSIA's protection, the plaintiff's freedom of movement will be severely circumscribed. Merits discovery will likely be denied; indeed, district court decisions to limit or even deny jurisdictional discovery have been upheld in FSIA cases where the plaintiff has failed to make a prima facie showing of jurisdiction under a FSIA exception.[53]

The foreign sovereign defendant thus is strongly incentivized to work toward achieving two objectives when the case is filed: invoking immunity under the FSIA and ensuring that an argument for application of a statutory exception will fail. Because the FSIA's sovereign immunity framework turns the tables on the plaintiff and obviates the risk of a state jury trial, it is appropriate to begin by reviewing how the foreign sovereign can ensure that its status is recognized under the FSIA.

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[50] *See, e.g.*, BP Chemicals, Ltd. v. Jiangsu Sopo Corp., 285 F.3d 677, 682 (8th Cir. 2002) (noting that once a defendant demonstrates that it is a foreign sovereign, it is "ostensibly immune from suit" unless the plaintiff can show that jurisdiction is appropriate under a FSIA exception).

[51] Butler, 579 F.3d at 1313.

[52] *See, e.g.*, Argentine Republic v. Amerada Hess Shipping Corp., 488 U.S. 428, 434 (1989) (noting that the FSIA is the "sole basis for obtaining jurisdiction over a foreign state in [U.S.] courts."). *See also* Michael A. Granne, *Defining "Organ of a Foreign State" Under the Foreign Sovereign Immunities Act of 1976*, 42 U.C. DAVIS L. REV. 1, 3 (2008) (observing that the FSIA "provides the exclusive vehicle for lawsuits against foreign sovereigns and their agencies and instrumentalities.") (citing Republic of Argentina v. Weltover, Inc., 504 U.S. 607, 610–11 (1992) (additional citations omitted).

[53] *See, e.g.*, Frontera Resources Azerbaijan Corp. v. State Oil Co. of Azerbaijan, 582 F.3d 393, 402 (2d Cir. 2009). *See also* EM Ltd. v. Republic of Argentina, 473 F.3d 463, 486 (2d Cir. 2007) (noting that "in the FSIA context, discovery should be ordered circumspectly and only to verify allegations of specific facts crucial to an immunity determination.") (internal quotation marks omitted).

B. Claiming Sovereign Status Under the FSIA: Strategies to Avoid Unnecessarily Waiving Sovereign Immunity

The FSIA purports to be the "only source of subject matter jurisdiction over a foreign sovereign in the courts of the United States."[54] However, unlike other federal jurisdictional requirements, jurisdictional objections under the FSIA can be waived.[55] The FSIA provides that foreign states forfeit their FSIA immunity if they have "waived their immunity either explicitly or by implication, notwithstanding any withdrawal of the waiver which the foreign state may purport to effect except in accordance with the terms of the waiver."[56] In addition to explicit and implicit waiver through the sovereign's activities prior to the filing of the case, a foreign sovereign may also waive its immunity by its conduct as a defendant, by failing to properly preserve its sovereign immunity defense, or by bringing claims as a plaintiff. Each of these circumstances will be addressed below.

1. Waiving Sovereign Immunity Under the FSIA: Explicit Waiver

Explicit waiver is relatively straightforward; courts will find that the sovereign has explicitly waived its immunity where it has made a "clear and unambiguous" statement of its intention to do so.[57] Thus, a contractual provision waiving sovereign immunity globally or specifically in the United States will satisfy the FSIA's "explicit waiver" standard.[58]

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[54] Garb v. Republic of Poland, 440 F.3d 579, 581 (2d Cir. 2006).
[55] *Compare* Lerner v. Fleet Bank, N.A., 318 F.3d 113, 128 (2d Cir. 2003) (Sotomayor, J.) (noting that standing, as a" jurisdictional limitation," can generally not be waived) (citation omitted) *with* Capital Ventures Intern. v. Republic of Argentina, 552 F.3d 289, 293 (2d Cir. 2009) (citing 28 U.S.C. §§ 1604; 1605(a)(1) (noting that foreign states are not immune from suit under the FSIA where they have implicitly or explicitly waived their statutory immunity).
[56] 28 U.S.C. § 1605(a)(1).
[57] Capital Ventures, 552 F.3d at 293.
[58] *See, e.g.*, Walker Intern. Holdings, Ltd. v. Republic of Congo, 395 F.3d 229, 234 (5th Cir. 2004) (noting that where sovereign contracted to waive sovereign immunity "whether in the United States or otherwise,"

It may seem difficult to "explicitly" waive sovereign immunity unintentionally. Nevertheless, foreign sovereigns can explicitly waive immunity prior to the start of litigation through poorly-drafted forum selection or sovereign immunity clauses. Foreign sovereign defendants have thus found themselves satisfying the "explicit" waiver standard, apparently by accident, where courts have read forum selection and sovereign immunity waiver provisions together to waive immunity in the United States.

It is worth noting, particularly in the context of multi-national, often multi-lingul business deals, that a single word can mean the difference between immunity and waiver in these cases. In *Capital Ventures*, for example, Argentina offered Deutsche Mark and Euro-denominated bonds pursuant to an offering circular that included side-by-side forum selection and sovereign immunity provisions.[59] Argentina failed to pay interest on the bonds, provoking a suit by investors including Capital Ventures in the Southern District of New York.[60] Though the district court dismissed the case for lack of subject matter jurisdiction under the FSIA, the Second Circuit reversed, finding that Argentina had explicitly waived immunity to suit in its offering circular.[61]

The case hinged on sections 13(3) and 13(4) of the circular, which, respectively, provided that Argentina submitted to the jurisdiction of certain German and Argentinean courts, and that Argentina waived "any immunity (sovereign or otherwise) from the jurisdiction of any court or from any legal process," without limiting its waiver to particular jurisdictions.[62] Argentina argued that the provisions, read together, merely

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sovereign explicitly waived immunity under the FSIA) (quoting Atwood Turnkey Drilling, Inc. v. Petroleo Brasileiro, 875 F.2d 1174, 1177 (5th Cir. 1989)).

[59] Capital Ventures, 552 F.3d at 291.

[60] *Id.*

[61] *Id*.

[62] *Id*. at 291–92.

demonstrated Argentina's intent to waive immunity in the jurisdictions named in section 13(3).[63] The Second Circuit disagreed, holding that Argentina's waiver of its immunity in "any" court served as an explicit waiver of sovereign immunity in the United States under the FSIA.[64]

Capital Ventures thus demonstrates the importance of careful drafting, particularly where the foreign sovereign wishes to waive its immunity in or submit to the jurisdiction of courts outside of the United States. The sovereign client should be reminded that open-ended language in these provisions, even if they do not reference the United States,[65] may allow a plaintiff to anchor his suit in a U.S. court. The *Capital Ventures* court itself offered examples of waivers that would not give a U.S. plaintiff this sort of opening, citing provisions in prior cases which made it "clear" that there was no intent to waive sovereign immunity in the United States.[66] The safest course may thus be either to waive immunity exclusively in non-U.S. jurisdictions, naming them individually, or to explicitly reserve sovereign immunity in the United States.

2. Waiving Sovereign Immunity Under the FSIA: Implied Waiver

Foreign sovereigns can also implicitly waive immunity under the FSIA.[67] Congress articulated three examples of implicit waiver when it passed the FSIA in 1976: (1) an agreement to arbitrate in another country; (2) an agreement that the law "of a particular country" should govern a contract; and (3) filing a responsive pleading in an

[63] *Id*. at 294.
[64] *Id*. at 296.
[65] *Id*. at 294–95.
[66] *Id*. at 295–96 (citing Eaglet Corp. v. Banco Central de Nicaragua, 839 F. Supp. 232, 234 (S.D.N.Y. 1993); Atlantic Tele-Network, Inc. v. Inter-Am. Dev. Bank, 251 F. Supp. 2d 126, 133 (D.D.C. 2003)).
[67] 28 U.S.C. § 1605(a)(1).

action without raising the defense of sovereign immunity.[68] Courts have generally been reluctant to expand the "implied waiver" standard beyond these three cases.[69]

Thus, for example, plaintiffs' arguments that international treaties which do not specifically mention sovereign immunity may imply waiver have not been successful.[70] Indeed, even failure to appear before the court does not implicitly waive sovereign immunity under the FSIA, as "subject matter jurisdiction turns on the existence of an exception to foreign sovereign immunity. Accordingly, even if the foreign state does not enter an appearance to assert an immunity defense, a district court still must determine that immunity is unavailable under the Act."[71]

The foreign sovereign should take measures to ensure that it does not implicitly waive its FSIA immunity. First, the sovereign should insist that FSIA immunity be explicitly invoked, at a minimum, in every responsive pleading.[72] Indeed, experts suggest that it may be advisable simply to raise the FSIA defense in every pleading, responsive or otherwise.[73] This approach may be overly cautious, as the foreign sovereign can safely make motions to claim immunity in and remove an action from state court without

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[68] H.R. Rep. No. 1487, 94th Cong., 2d Sess. 18 (1976), *reprinted in* 1976 U.S.C.C.A.N. 6604, 6617. *See also* Af-Cap, Inc. v. Republic of Congo, 462 F.3d 417, 426–27 (5th Cir. 2006) ("This Court has identified three circumstances in which a waiver is ordinarily implied: (1) a foreign state agrees to arbitration in another country; (2) the foreign state agrees that a contract is governed by the laws of a particular country; (3) the state files a responsive pleading without raising the immunity defense.") (internal quotation marks and citations omitted).

[69] Corporacion Mexicana de Servicios Maritimos, S.A., v. de C.V. v. M/T Respect, 89 F.3d 650, 655 (9th Cir. 1996) (citing Rodriguez v. Transnave, Inc., 8 F.3d 284, 287 (5th Cir. 1993)) (additional citation omitted).

[70] Capital Ventures, 552 F.3d at 295 (distinguishing Argentine Republic v. Amerada Hess Shipping Corp., 488 U.S. 428 (1989)).

[71] Von Dardel v. U.S.S.R., 736 F. Supp. 1, 4 (D.D.C. 1990) (quoting Verlinden, B.V. v. Central Bank of Nigeria, 461 U.S. 480, 493–94 n.20 (1983)) (internal quotation marks and citation omitted).

[72] *See supra* note 42 and accompanying text. *See also* Autotech Technologies LP v. Integral Research & Dev. Corp., 499 F.3d 737, 743 (7th Cir. 2007) (citation omitted) ("Failing to raise sovereign immunity and then participating fully in a court proceeding amount to an implied waiver of immunity.").

[73] *See, e.g.*, 44B AM. JUR. 2D *International Law* § 136 (2009) (noting that a foreign sovereign "must assert its immunity under the FSIA *either before or in* its responsive pleading" to preserve its FSIA immunity) (emphasis added).

risking waiver; state courts reliably permit foreign sovereigns to make special appearances for the purpose of raising an FSIA defense without waiving their immunity,[74] and filing a notice of removal will not risk waiver of sovereign immunity under the FSIA.[75] Nevertheless, it costs little to include the point, and the consequences of waiver can be disastrous for the foreign sovereign's case.

Next, the foreign sovereign should carefully review its agreements with U.S. partners to weed out any provision that "contemplates adjudication of a dispute by the United States courts."[76] Though courts require "strong evidence" that the sovereign intended to waive its immunity to support an implied waiver theory,[77] the safest course in these cases might be to supply "strong evidence" to the contrary.

3. *Waiving Sovereign Immunity Under the FSIA: Becoming a Defendant by Becoming a Plaintiff*

In addition to the explicit and implicit waiver criteria outlined above, foreign sovereigns should be wary of the consequences of bringing an action in a U.S. court. Bringing a civil case does not waive sovereign immunity altogether.[78] Entering a U.S. court as a plaintiff will, however, expose the foreign sovereign to counterclaims that might otherwise be barred by the FSIA if they either (1) arise out of the "transaction or occurrence that is the subject matter of the claim of the foreign state"[79] or (2) do not "seek relief exceeding in amount or differing in kind from that sought by the foreign state."[80]

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[74] *See, e.g.*, In re China Oil and Gas Pipeline Bureau, 94 S.W. 3d 50, 55–56 (Tex. App. 2002).
[75] Siderman v. Republic of Argentina, 965 F.2d 699, 720–21 (9th Cir. 1992).
[76] *Id.* at 721 (additional citation and internal quotation marks omitted).
[77] Af-Cap, Inc. v. Republic of Congo, 462 F.3d 417, 427 (5th Cir. 2006) (citation omitted).
[78] *See* Calzadilla v. Banco Latino Internacional, 413 F.3d 1285, 1287 (11th Cir. 2005) (rejecting plaintiff's argument that pursuing civil litigation amounted to implied waiver of FSIA immunity).
[79] 28 U.S.C. § 1607(b).
[80] 28 U.S.C. § 1607(c).

A sovereign plaintiff, however, should keep in mind that courts construe the counterclaim exception fairly narrowly. This is illustrated by the Second Circuit's decision in *Cabiri v. Republic of Ghana*, in which the court found that Ghana's state court action to evict its former trade representative from a government-supplied house in the New York City suburbs neither waived the country's sovereign immunity nor exposed it to counterclaim liability except for claims strictly related to the eviction proceeding.[81]

The plaintiff, Bawol Cabiri, claimed that his government lured him from his post in New York to Ghana, where he was detained and tortured.[82] Cabiri was kept in Ghana for a year while his family continued to live in the house the government supplied to him pursuant to his employment contract as Ghana's trade representative.[83] The government then began its eviction proceeding in a Nassau County trial court, allegedly to put pressure on Cabiri by forcing his family to return to Ghana as well.[84] Cabiri and his family brought a variety of counterclaims against Ghana, including breach of contract, fraudulent misrepresentation, false imprisonment and intentional infliction of emotional distress.[85]

Cabiri's claims all arguably arose from the same transaction and occurrence as the Ghanaian eviction proceeding; the eviction was, after all, simply leverage in the government plot against Cabiri according to his theory of the case. Nevertheless, the Second Circuit held that only Cabiri's breach of contract claim was sufficiently related to

[81] Cabiri v. Republic of Ghana, 165 F.3d 193 (2d Cir. 1999), *cert. denied*, 527 U.S. 1022 (1999).
[82] *Id*. at 195.
[83] *Id*. at 195–96.
[84] *Id*. at 196.
[85] *Id*. at 198–99.

the eviction proceeding to secure jurisdiction under the FSIA counterclaim exception.[86] In reaching its conclusion, the Second Circuit placed particular emphasis on the fact that discovery of Cabiri's other claims would not be "co-extensive" with discovery for the eviction proceeding.[87]

Thus, foreign sovereigns may confidently bring discrete claims as plaintiffs in U.S. courts without fear that doing so will expose them to a flood of counterclaims or otherwise-related claims.[88] However, the foreign sovereign should be warned that it will necessarily open the door to some counterclaims by filing a suit. Depending on the skeletons the sovereign has in its closet that may be unearthed through discovery that overlaps with discovery required for the sovereign's claim, it may be advisable for the foreign state to forego its claims in some circumstances.

On this point, it should also be noted that the foreign sovereign will not automatically waive its immunity where it makes a motion to intervene in an ongoing proceeding as a plaintiff,[89] as this is not considered a responsive pleading for the purposes of the FSIA. As noted above, however, cost-benefit analysis weighs in favor of preserving the point. Indeed, the fact that there are cases where these issues were litigated suggests that it may save the foreign sovereign money, time and aggravation to conscientiously include a reasonably brief section on FSIA immunity wherever possible.

C. Securing Sovereign Status Under the FSIA: The Dangers of Using Organs, Agencies and Instrumentalities

[86] *Id*.
[87] *Id*. at 199.
[88] *See, e.g.*, Shapiro v. Republic of Bolivia, 930 F.2d 1013, 1017–18 (2d Cir. 1991) (declining to hold that a suit by a foreign sovereign "in a United States court with respect to a particular matter constitutes a waiver of immunity from jurisdiction as to associated claims.") (citations omitted) (superseded on other grounds by amendment to 28 U.S.C. § 1605(a)(7)).
[89] Corporacion Mexicana de Servicios Maritimos, S.A., v. de C.V. v. M/T Respect, 89 F.3d 650, 655–56 (9th Cir. 1996)

Though sovereign status is relatively easy to demonstrate where a state is not acting through intermediaries or agents, it is often difficult to predict when the FSIA's protections will extend to a state's instrumentalities that exist independent of the foreign sovereign itself.[90] If the foreign sovereign cannot stave off a plaintiff assault on this point, it will face suit in any U.S. court of the plaintiff's choosing as though it had waived its immunity.[91]

The FSIA extends the presumption of immunity to "foreign states," including "a political subdivision of a foreign state or an agency or instrumentality of a foreign state."[92] In cases where the foreign sovereign is conducting business directly with private parties, the question of sovereign status under the FSIA is generally not contested.[93] Increasingly, however, foreign sovereigns are using entities legally distinct from the state itself to conduct its business, commercial and investment activity abroad.[94] As plaintiffs may see these entities as a weak point in the foreign sovereign's immunity defense, the

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[90] *See, e.g.*, Powerex Corp. v. Reliant Energy Servs., Inc., 551 U.S. 224, 227–28 (2007) (describing dispute over Canadian power company's status as the "organ" of a foreign state).

[91] *See* 28 U.S.C. § 1605(a) (providing that the "foreign state shall not be immune from the jurisdiction of courts of the United States *or of the States*" in any case where FSIA immunity does not apply) (emphasis added). Courts interpreting the FSIA note that, although Congress did express an "unusually strong preference for adjudication of claims against foreign sovereigns in the federal court system," the statute does not confer exclusive jurisdiction over sovereign suits on the federal courts, leaving the door open for state-court actions. *See, e.g.*, In re Texas Eastern Corp. PCB Contamination Ins. Coverage Litig., 15 F.3d 1230, 1243 (3d Cir. 1994) (noting that "the FSIA does not confer exclusive jurisdiction in the federal courts and does not explicitly limit a foreign state's ability to waive its right to remove" in suits otherwise covered by the FSIA).

[92] 28 U.S.C. § 1603(a).

[93] *See, e.g.*, Republic of Argentina v. Weltover, 504 U.S. 607, 612–13 (1992) (FSIA suit arising from Argentinean default on government bonds). However, it should be noted that recognition of an entity as a foreign sovereign depends at least in part on Executive Branch determinations, as "[a]n Executive Branch decision to recognize an entity as a foreign sovereign" is binding on U.S. courts. See, e.g., O'Bryan v. Holy See, 490 F. Supp. 2d 826, 829 (W.D. Ky. 2005) (holding that U.S. government recognition of the Holy See as a foreign state for FSIA purposes entitled the Holy See to FSIA protection). *But see* Morgan Guar. Trust Co. v. Republic of Palau, 924 F.2d 1237 (2d Cir. 1991) (analyzing status of U.S. trust territory to conclude that Palau was not a sovereign state under international law and thus was not entitled to foreign state status under the FSIA).

[94] *See supra* notes 4–7 and accompanying text.

issue of sovereign status in these cases is likely to be an important battleground in FSIA litigation.

Scholars note that the requirements for claiming "agency or instrumentality" status are distinct from those necessary to demonstrate entitlement to sovereign immunity as the "organ" or "subdivision" of a foreign state.[95] The FSIA provides that an entity that is majority-owned by a foreign state qualifies for sovereign immunity as an "agency or instrumentality."[96] The Supreme Court has clarified, however, that only direct ownership by the foreign state will satisfy this standard. Thus, ownership of a corporation's shares through a third corporation which is itself owned by a foreign state would not satisfy the FSIA.[97] With this caveat in mind, however, foreign sovereigns should reliably be able to predict when an entity will qualify as an agency or instrumentality based on its ownership structure.

The status of "organs" and "political subdivisions" is unfortunately more difficult to determine. Courts typically apply a five-factor test to determine whether an entity is an organ of a foreign state, examining

> (1) whether a national purpose motivated the establishment of the corporation; (2) whether the sovereign directly manages the corporation's activity; (3) whether the sovereign mandates hiring public employees and pays their salaries; (4) whether the corporation wields exclusive rights in the sovereign; and (5) how the corporation is treated under foreign state law.[98]

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[95] Slawotsky, *supra* note 4, at 994.
[96] 28 U.S.C. § 1603(b)(2).
[97] Dole Food Co. v. Patrickson, 538 U.S. 468, 480 (holding that "a foreign state must itself own a majority of the shares of a corporation if the corporation is to be deemed an instrumentality of the state under the provisions of the FSIA.") *See also* Filler v. Hanvit Bank, No. 01 Civ. 9510, 2003 WL 21729978 (S.D.N.Y. July 25, 2003) (vacating ruling that defendant bank was immune from suit as a foreign sovereign in light of Dole Food decision).
[98] Slawotsky, *supra* note 4, at 995 (citing Kelly v. Syria Shell Petroleum Development B.V., 213 F.3d 841, 846–47 (5th Cir. 2000)).

The Ninth Circuit, meanwhile, uses a "public activity" test that is faulted by scholars for producing somewhat inconsistent results.[99] This analysis recently yielded a controversial outcome in *Powerex*. Though *Powerex* was ultimately decided on §1447 grounds,[100] the Supreme Court originally granted certiorari in the case to determine whether Powerex, was a foreign sovereign for the purposes of the FSIA. The Court's majority never reached the question of Powerex's status under FSIA.[101] However, Justice Breyer took up the issue in his dissent. Comparing Powerex to the United States' own Tennessee Valley Authority, Breyer argued that the Ninth Circuit had incorrectly characterized Powerex as a non-sovereign.[102] Powerex, Breyer noted, was government-owned and operated, had been created by a government directive, and was subject to review and regulation by British Columbia's comptroller general.[103] Dismissing the Ninth Circuit's reliance on Powerex's profitability as proof that it should not have sovereign status under the FSIA Breyer observed that

> [t]he Ninth Circuit noted that Powerex may earn a profit and that the Government of British Columbia does not provide financial support. And the Ninth Circuit thought these facts made a critical difference. But a well-run nationalized firm *should* make a reasonable profit; nor should it have to borrow from the government itself. The relevant question is not *whether* Powerex earns a profit but where does that profit go? Here it does not go to private shareholders; it goes to the benefit of the public in payments to the province and reduced electricity prices.[104]

Foreign sovereigns may thus gain peace of mind under the FSIA by engaging in commercial activity directly, either through an entity that is unquestionably an arm of the

[99] *Id*. at 995–96.
[100] *See supra* notes 22–28 and accompanying text.
[101] *Id*.
[102] Powerex Corp. v. Reliant Energy Servs., Inc., 551 U.S. 224, 245 (Breyer, J., dissenting).
[103] *Id*. at 246–47.
[104] *Id*. at 247–48 (emphasis in original) (internal citations omitted).

sovereign or through a corporation that is majority owned by the sovereign itself, without any intermediaries between the sovereign and the commercial activity.

Establishing a clear command-and-control structure that gives an officer of the sovereign decision-making power may also help to defuse arguments against an entity's sovereign status. In *Butters v. Vance International*, for example, a plaintiff sued a Virginia security firm contracted to protect a Saudi princess.[105] The plaintiff worked for Vance as a security agent and brought a state-law gender discrimination suit against the company when, at the direction of a Saudi army officer, Vance failed to promote her.[106] Vance removed to federal district court and obtained a dismissal, successfully arguing that the firm enjoyed derivative FSIA immunity as it was "acting under the direct military orders" of the Saudi army.[107] The Fourth Circuit affirmed the district court's ruling, reasoning that derivative sovereign immunity was appropriate where the government delegated "governmental functions" to its agents.[108]

These considerations are especially important with regard to sovereign wealth funds. In many respects, SWFs fit the criteria that led the Ninth Circuit to conclude that Powerex was not a sovereign entity: they are generally profit-seeking (and, if successful, profitable) and they are often not subject to the same regulations as government departments. A foreign sovereign might thus be well-advised to structure investment vehicles intended for the U.S. market to survive a potential application of the Powerex analysis. This could be accomplished either by organizing the SWF as a corporate entity

[105] Butters v. Vance Intern., Inc., 225 F.3d 462, 464 (4th Cir. 2000).
[106] *Id*.
[107] *Id*. at 465.
[108] *Id*. at 466.

wholly-owned by the sovereign itself, or by tying the SWF directly to an arm of the foreign sovereign's government.

However, while this strategy of direct sovereign involvement will support a threshold showing of FSIA immunity, it may hurt the foreign sovereign's ability to argue against the application of the FSIA's "commercial activity" exception.

D. Defeating an Appeal to the FSIA Commercial Activity Exception

The FSIA includes a number of exceptions to the presumptive immunity it grants foreign sovereigns. These exceptions range from the waiver provision described above,[109] to violations of international law,[110] to state sponsorship of terrorism.[111] The most-cited exception in commercial litigation under the FSIA, however, is likely to be the "commercial activities exception." This provision provides that foreign states are not immune from jurisdiction in cases in which the plaintiff's claims are based on "commercial activity carried on in the United States or an act performed in the United States in connection with a commercial activity elsewhere, or an act in connection with a commercial activity of a foreign state elsewhere that causes a direct effect in the United States."[112] A defense on the commercial activity point may thus involve arguments on two fronts: whether the sovereign's acts constitute "commercial activity" and, if they take place outside of the United States, whether that activity causes a "direct effect in the United States."

1. The Commercial Activity Exception: An Unprotectable Flank?

[109] 28 U.S.C. § 1605(a)(1). *See also* Section III, *supra*.
[110] 28 U.S.C. § 1605(a)(3).
[111] 28 U.S.C. § 1605(a)(7).
[112] 28 U.S.C. § 1605(a)(2).

In its opinion in *Argentina v. Weltover*, the Supreme Court noted that the FSIA left "the critical term 'commercial' largely undefined."[113] The court applied a test that focuses on the objective character of the conduct rather than its motive or purpose.[114] Thus, even if the foreign sovereign is engaging in commercial activity for reasons directly related to its sovereign or governmental functions, the commercial activity exception will apply where the conduct constitutes "the type of actions by which a private party engages in trade and traffic or commerce."[115]

The exception is dangerously broad for sovereign defendants. Where sovereigns have defeated the exception, their past victories tend to be construed narrowly. The Fourth Circuit, for example, has rejected a sovereign defendant's argument that government contracts concerning the state's natural resources were sovereign, rather than commercial activity, based on prior cases rejecting application of the commercial activity exception to, *inter alia*, wildlife management agreements.[116] Particularly where the foreign sovereign is engaged in raising capital[117] or purchasing investment properties,[118] the commercial activities exception will thus create a critical area of vulnerability that it may be difficult or impossible to shield.

Recent precedent in the area of the liability of foreign states for the acts of their instrumentalities may offer an alternative defensive structure. Over the past nine years, the District of Columbia Circuit and Fifth Circuit have applied corporate law principles

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[113] Republic of Argentina v. Weltover, 504 U.S. 607, 612 (1992).
[114] *Id*.
[115] *Id*. at 614 (internal citations and quotation marks omitted).
[116] Globe Nuclear Servs. and Supply (GNSS), Ltd. v. AO Techsnabexport, 376 F.3d 282, 291 (4th Cir. 2004).
[117] *See, e.g.*, Weltover, 504 U.S. at 607.
[118] *See, e.g.*, Practical Concepts, Inc. v. Bolivia, 811 F.2d 1543, 1549 (D.C. Cir. 1987) (noting that contracts between foreign sovereigns and private parties "for the purchase of goods or services may presumptively be, but [are] not inevitably, commercial activity.") (internal quotation marks and citations omitted).

suggested by the Supreme Court's decision in First National City Bank v. Banco Para el Comercio Exterior de Cuba ("Bancec") to FSIA suits against alleged sovereign instrumentalities.[119] Under this standard, a sovereign is not amenable to suit under FSIA based on the actions of a government instrumentality organized as a distinct legal entity unless it is (1) extensively controlled by its owner, creating a principal-agent relationship, or (2) so closely tied to the parent-sovereign that recognition of the instrumentality "as an entity apart from the state would work fraud or injustice."[120]

Structuring government-related commercial entities around such an approach, however, may prove penny-wise and pound-foolish. Though this strategy would preserve the sovereign's FSIA immunity, spinning off the government instrumentality would cast the investment vehicle and its assets to the wolves.[121] Particularly given the advantages of sovereign status in attachment proceedings,[122] the benefits of acting through a third-party agent appear to be outweighed by the disadvantages of surrendering that agent's own ability to claim immunity under the FSIA. Unfortunately, however, it otherwise appears impossible to protect the "commercial activity" flank without risking casualties among the sovereign's legally distinct business instrumentalities.

2. *Replying to Plaintiff Allegations of "Direct Effect"*

The "direct effect" requirement only applies in cases where plaintiffs allege that the commercial conduct creating jurisdiction under the FSIA occurred outside of the

[119] First National City Bank v. Banco para el Comercio Exterior de Cuba ("Bancec"), 462 U.S. 611 (1983); Doe v. Holy See, 557 F.3d 1066 (9th Cir. 2009); Transamerica Leasing v. Venezuela, 200 F.3d 843 (D.C. Cir. 2000); Arriba Ltd. v. Petroleos Mexicanos, 962 F.2d 528 (5th Cir. 1997).
[120] Transamerica, 200 F.3d at 847–48 (internal quotation marks and citations omitted).
[121] *See supra* Section IV.
[122] *See infra* Section VI.

United States.[123] The Supreme Court addressed this issue in *Weltover*, holding that an Argentinean bond default caused a direct effect in the United States because a New York bank had been designated to receive income from the bonds.[124] Though this seems to suggest that any financial loss on U.S. soil may enable plaintiffs to make claims under the "commercial activity" exception, courts applying the *Weltover* standard have construed the exception narrowly, to the benefit of foreign sovereigns. Sovereign defendants facing a "direct effect" theory of jurisdiction should thus push plaintiffs to show more than mere financial loss in the United States.

Precedent suggests that plaintiffs must identify particular objects or funds tied to specific addresses or places within the United States to carry this point.[125] Successful "direct effect" cases thus often involve U.S. banks or financial institutions acting as agents or trustees.[126] The fact that an individual or entity is physically present in the United States when it suffers a financial loss elsewhere, however, will not satisfy the standard.[127] Nor does a loss caused or suffered by third parties.[128]

In addition to taking a hard line at the pleadings stage of the case, sovereign defendants can take prophylactic measures to head off "direct effect" cases by structuring transactions to bypass or avoid U.S.-based financial institutions. By keeping their commercial activity offshore as much as possible, sovereign defendants may be able to

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[123] 28 U.S.C. § 1605(a)(2).
[124] Republic of Argentina v. Weltover, 504 U.S. 607, 618 (1992).
[125] *See, e.g.*, Zedan , 849 F.2d at 1514.
[126] I.T. Consultants, Inc. v. Pakistan, 351 F.3d 1184, 1190 (D.C. Cir. 2003) (holding that "direct effect" standard is satisfied where the involvement of a U.S. bank "immediate and unavoidable" as part of the commercial activity cited by the plaintiff).
[127] Soudavar v. Iran, 67 Fed. Appx. 618, 619 (D.C. Cir. 2003), *cert. denied*, 540 U.S. 1109 (2004).
[128] Virtual Countries, Inc. v. Republic of South Africa, 300 F.3d 230 (2d Cir. 2002); Zedan v. Saudi Arabia, 849 F.2d 1511, 1515 (D.C. Cir. 1988) (holding that losses possibly suffered by third-party investors due to suspension of trading on the New York stock exchange failed to establish "direct effect" under FSIA).

avoid FSIA jurisdiction where they might otherwise have triggered the FSIA's "direct effect" exception.

E. When All Else Fails: Fighting Attachment Under the FSIA

Finally, the FSIA provides a last line of defense as robust as its pre-judgment protections. Indeed, observers note that "executing [judgments] pursuant to the FSIA is even more difficult than obtaining jurisdiction."[129]

Just as the FSIA creates a presumption of immunity, the statute's attachment provision starts with a presumption that property of a foreign state in the United States is immune from attachment unless it satisfies a statutory exception.[130] The FSIA permits U.S. courts to execute judgments only against sovereign "property in the United States … used for a commercial activity in the United States."[131] Even where a foreign state waives its immunity, U.S. courts must execute judgments exclusively against property that meets both of these statutory criteria.[132]

Courts have interpreted the FSIA to require identification of specific property for attachment.[133] A wide range of tangible and intangible property could theoretically be attached to satisfy a judgment.[134] However, only property actually used for commercial activity in the United States at the time the writ of attachment or execution issued is

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[129] Jonathan C. Lippert, *Vulture Funds: The Reason Why Congolese Debt May Force a Revision of the Foreign Sovereign Immunities Act*, 21 N.Y. INT'L L. REV. 1, 12 (2008).
[130] 28 U.S.C. § 1609.
[131] *See, e.g.*, Connecticut Bank of Commerce v. Republic of Congo, 309 F.3d 240, 247 (5th Cir. 2002) (quoting 28 U.S.C. § 1610(a)(1)).
[132] *Id*.
[133] Autotech Technologies LP v. Integral Research & Dev. Corp., 499 F.3d 737, 750 (7th Cir. 2007) (citing *Af-Cap, Inc. v. Republic of Congo*, 383 F.3d 361, 367 (5th Cir. 2004)).
[134] *See, e.g.*, Connecticut Bank of Commerce, 309 F.3d at 257 n.7 (noting that bank accounts are not precluded from FSIA attachment per se, but cannot be attached if they are being used to fund diplomatic or consular functions, for example) (citing Liberian Eastern Timber Corp. v. Republic of Liberia, 659 F. Supp. 606 (D.D.C. 1987)); *Id*. at 258–59 (noting that letter of credit obtained by state-owned company to do business with an American drilling company was used for a "commercial activity" and was thus attachable)(citation omitted).

subject to attachment under FSIA.[135] Because the plaintiff's ability to attach property hinges on the defendant's use of the property at a particular point in time, plaintiffs would have to discover what assets located in the United States were being used for non-state, commercial purposes.

Meanwhile, a foreign sovereign could effectively render itself judgment proof by controlling the sort of property it keeps in the United States, how it uses that property, and how it exercises control over that property. While certain classes of assets would likely be hopelessly vulnerable—commercial real estate investments, for example, would be difficult either to classify as in use for a sovereign purpose or to slip out of the country—a simple program funneling investment income back to government accounts in the home country would place those funds irretrievably out of plaintiffs' reach under the FSIA. Leasing arrangements would be another option, depending on the sovereign's willingness to shoulder an additional tax burden to control the risk of seizure in the event of an adverse judgment.[136] Once again, direct sovereign involvement in the commercial activity seems the safest course.

F. FSIA: Summary

On the whole, the FSIA appears to encourage foreign sovereigns to meld their governmental and commercial functions to minimize litigation exposure in U.S. courts. This strategy may leave foreign sovereigns amenable to suit under the FSIA's "commercial activity" exception. However, it will also enable the foreign sovereign to keep the case out of state court and away from a jury by invoking the FSIA's removal

[135] Aurelius Capital Partners, L.P., v. Argentina, 584 F.3d 120, 130 (2d Cir. 2009).
[136] Leasing arrangements may be particularly attractive for national airlines, as aircraft owned outright by foreign sovereigns would be prime targets for hungry plaintiffs.

provision and will maximize the foreign sovereign's ability to frustrate plaintiffs' attempts to satisfy a judgment. In addition, by slowing the process of discovery through the required period of limited jurisdictional discovery that follows a prima facie showing of sovereign immunity, foreign sovereigns may be able to starve weaker plaintiffs out of court. By carefully crafting their commercial strategies with the FSIA in mind prior to entering the U.S. market and conscientiously preserving their FSIA immunity when they are defendants in U.S. courts, foreign sovereigns should thus be able to neutralize a large number of potential lawsuits before they can embarrass or impoverish the home country.

IV. Tax Considerations

The United States currently treats SWFs as sovereigns for tax purposes.[137] Sovereign status in this context can be a significant benefit; as long as the SWF does not engage in commercial activity other than "portfolio investments," which are defined as the acquisition of non-controlling stakes, the funds can avoid both U.S. income and withholding taxes on their U.S. investments.[138] Curiously, U.S. law arguably treats SWFs more favorably than private foreign investors, taxing the latter (albeit relatively "lightly") and declining to tax the former.[139] Scholars note that such generosity is not required under international law, as "the international doctrine of sovereign immunity as such imposes no restrictions" on the United States' right to tax SWFs.[140]

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[137] Michael S. Knoll, *Taxation and the Competitiveness of Sovereign Wealth Funds: Do Taxes Encourage Sovereign Wealth Funds to Invest in the United States?*, 82 S. CAL. L. REV. 703, 712 (2009) (noting that, under Section 892 of the U.S. Tax Code, SWFs are exempt from taxation of noncontrolling investments. *See also* Victor Fleischer, *A Theory of Taxing Sovereign Wealth*, 84 N.Y.U. L. REV. 440 (2009).
[138] Fleischer, *supra* note 23, at 461.
[139] *Id*. at 464–65.
[140] *Id*. at 459 (citing Qantas Airways, Ltd. v. United States, 62 F.3d 385, 388–90 (Fed. Cir. 1995)).

However, when SWFs do engage in taxable activities, they are taxed at corporate rates heavier than those applicable to private investors.[141] Taken together, the benefits and disadvantages of U.S. tax laws as applied to SWFs thus may cancel each other out, leading scholars to conclude that there is "no single and simple answer to the question of whether taxation provides SWFs with a competitive advantage when they invest in the United States."[142]

V. Conclusion: Comparative Perspective

Across the board, then, the legal and regulatory environment for SWF activity in the United States is mixed. From the SWF's navigation of opaque CFIUS requirements, to the relative tax advantages of SWF investment in the U.S. market to begin with, to the SWF's litigation risk in U.S. courts, U.S. law does not appear to have adapted to the realities of current SWF activity.

This conclusion naturally invites comparison between the U.S. approach and international alternatives. It is not difficult to imagine a competition for SWF investment encouraging a "race to the bottom"[143] to present more attractive investment opportunities to SWFs—a race the U.S. would appear to be losing. With the exception of the United Kingdom, however, it appears that the major European Union powers are pursuing policies similar to the United States'.

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[141] Knoll, *supra* note 23, at 712.

[142] *Id*. at 763–64 (concluding that "U.S. investors have an advantage over SWFs in making portfolio investments in both U.S. equities and real estate.")

[143] *Cf*. Matthew Saxon, *It's Just Business, Or Is It?: How Business and Politics Collide With Sovereign Wealth Funds*, 32 HASTINGS INT'L & COMP. L. REV. 693, 711 (2009) (noting the potential for such a "race to the bottom" within the European Union).

Though uniform in some respects relevant to SWFs,[144] the European Union generally evinces a "fragmented national regulatory response" to SWF control.[145] Despite proposals to adopt a uniform EU approach,[146] including a largely German-backed effort to establish a European Union counterpart of CFIUS,[147] European Union member states' attitudes toward and policies regulating SWFs vary widely.

Great Britain appears to be the champion of a laissez-faire approach to SWF regulation within the EU. The country has opposed SWF regulation at the EU level,[148] apparently seeking to maintain its position as a regional leader in attracting foreign investment.[149] Germany and France are at the other end of the spectrum.[150] As Germany encourages the EU to adopt a CFIUS-like system, it has redrafted its own foreign investment laws to allow German officials to monitor and prohibit transactions in which a foreign entity acquires more than a twenty-five percent state if the transaction could threaten "public security or order."[151] Though somewhat less strict in its regulatory

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[144] European Union investor disclosure regulations, for example, can be compared as a comprehensive unit to their U.S. and "major Asian" equivalents. *See* Ronald J. Gilson & Curtis J. Milhaupt, *Sovereign Wealth Funds and Corporate Governance: A Minimalist Response to the New Mercantilism*, 60 STAN. L. REV. 1345, 1361 (2008)

[145] Reed, *supra* note 6, at 129.

[146] *See* Commission Proposal for a Common European Approach to Sovereign Wealth Funds, at 9, COM (2008) 115 final (Feb. 27, 2008), *available at* http:// ec.europa.eu/commission_barroso/president/pdf/COM2008_115_en.pdf.

[147] Saxon, *supra* note 43, at 706, 708. *See also* Bertrand Benoit, Tony Barber & George Parker, Germany *Plans For Own Cfius Deal Watchdog*, FIN. TIMES, Sept. 27, 2007, *available at* http:// www.ft.com/cms/s/0/48128c56-6c82-11dc-a0cf-0000779fd2ac.html.

[148] Saxon, *supra* note 43, at 709 (citing Ambrose Evans-Pritchard, *EC to Rule on Sovereign Wealth Funds*, THE TELEGRAPH, Nov. 29, 2007).

[149] *Id.* at 704–05.

[150] Justin O'Brien, *Barriers to Entry: Foreign Direct Investment and the Regulation of Sovereign Wealth Funds*, 42 INT'L LAW. 1231, 1236 (2008).

[151] *Id*. at 1238 (citing Agence-France Presse, Germany Moves to Block Sovereign Wealth Funds, Industry Wk. (Aug. 21, 2008), available at http:// www.industryweek.com/ReadArticle.aspx?ArticleID=17121.)

approach, [152] France has also indicated that it intends to "protect its companies" from SWF acquisition as it deems necessary.[153]

These hard-line regulatory policies may reflect the limited opportunities SWFs have for investing outside of the U.S. and EU. As Professor Drezner observes,

> Part of the reason that you see sovereign wealth funds is that these countries desperately need to invest in dollar assets in order either to keep their currencies undervalued or to prevent them from appreciating. So as a result, the United States and the European Union have started promulgating regulations. My prediction is that essentially they will be able to regulate whatever they want, in large part because the countries that have sovereign wealth funds do not have a lot of other places where they can invest their money. Over 80 percent of sovereign wealth fund investment is going to either the United States or the European Union.[154]

Thus, notwithstanding Great Britain's relatively lax approach to SWF regulation, the legal and regulatory status quo in the United States and those countries that have adopted variations of the U.S. model may remain undisturbed as long as SWFs cannot find enough attractive investment opportunities to shift their resources elsewhere.

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[152] Saxon, *supra* note 43, at 707–08 (citing Rachel Ziemba, Responses to Sovereign Wealth Funds: Are "Draconian" Measures on the Way?, Roubini Global Economics Service, Nov. 2007, at 6, *available at* http://www.rgemonitor.com/economonitor-monitor/220669/responses_to_sovereign_wealth_funds_are_draconian_measures_on_the_way).

[153] *Id*. (citing Helen Beresford, Sarkozy to Use CDC to Defend French Cos Against "Aggressive" Speculators, Forbes.com, Jan. 8, 2008, http://www.forbes.com/afxnewslimited/feeds/afx/2008/01/08/afx4505120.html)

[154] Daniel Drezner, *Remarks*, 102 AM. SOC'Y INT'L L. PROC. 259, 261 (2008).