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Client Alert

International Arbitration Practice Group

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# U.S. Supreme Court Decisions Clarify Post-Judgment Remedies Against Foreign Sovereigns

On June 16, 2014, the U.S. Supreme Court issued two decisions in *Republic of Argentina v. NML Capital, Ltd.*,[1] one of the many cases to have arisen out of Argentina's 2001 default on over $100 billion in sovereign bonds. While various parties have obtained judgments against Argentina based on that default, none of those parties has managed to execute their judgments, despite ongoing and determined efforts to do so. The Court's June 16 decisions addressed, *inter alia*, whether the Foreign Sovereign Immunity Act (FSIA) restricts post-judgment discovery concerning a foreign sovereign's non-U.S. assets, and also whether U.S. courts can enter injunctive relief to enforce an equal treatment/*pari passu* provision contained in bonds issued by a foreign state. The Court ruled against Argentina in both cases, authorizing the district court's order permitting broad discovery into Argentina's non-U.S. assets, and denying its petition for *certiorari* in connection with the *pari passu* injunctions.

## A. Post Judgment Discovery

NML Capital holds judgments against Argentina totaling approximately $2.5 billion, and has been pursuing discovery of Argentina's assets since 2003. In 2010, NML served subpoenas on two non-party banks (one based in the U.S., the other based in Argentina with a branch in New York) seeking general information about Argentina's assets in the U.S. and abroad. The U.S. District Court for the Southern District of New York granted a motion to compel compliance with the subpoenas, finding that the FSIA did not categorically prohibit discovery into non-U.S. assets and holding that it would serve as a "clearinghouse for information" concerning Argentina's assets. The U.S. Court of Appeals for the Second Circuit affirmed, holding that because the district court's order was limited to discovery and did not actually seek to attach or execute any property, and further because the order was directed at third parties as opposed to Argentina itself, it did not offend Argentina's immunity.

The Supreme Court, in a 7-1 decision, affirmed. Noting at the outset of its decision that "[f]oreign sovereign immunity is, and always has been, 'a matter of grace and comity on the part of the United States, and not a restriction imposed by the Constitution,'" the majority briefly tracked the evolution of foreign sovereign immunity in the United States and noted, as it had previously, that while sovereign immunity in the United States had, prior

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to the adoption of the FSIA in 1976, been driven by the executive branch and by a loosely-defined factor-balancing test, the FSIA was adopted to prescribe a "comprehensive set of legal standards governing claims of immunity in every civil action against a foreign state." Stressing the "comprehensive" nature of the FSIA, the Court held that "any sort of immunity defense made by a foreign sovereign in an American court must stand on the [FSIA's] test. Or it must fall."

Canvassing the text of the Act, and its grants of immunity in particular, the Court found that "[t]here is no … provision forbidding or limiting discovery in aid of a foreign-sovereign judgment debtor's assets," and agreed with Argentina's concession that the FSIA does not expressly address post-judgment discovery. The absence of such language, according to the Court, meant that the FSIA did not restrict discovery. In response to Argentina's (and amicus curiae the United States') arguments that allowing broad discovery would have worrisome international relations consequences, the Court states that those "apprehensions are better directed to that branch of government with authority to amend the Act—which, as it happens, is the same branch that forced our retirement from the immunity-by-factor-balancing business nearly 40 years ago."

The Court's decision is noteworthy as the first merits decision by the Supreme Court to address discovery against sovereigns,[2] and because it resolved a clear circuit split between the Second and Seventh Circuits on the issue of discovery of non-U.S. assets.[3] The decision will make it more difficult for foreign sovereigns to avoid paying U.S. court judgments, since it will allow judgment creditors to obtain full discovery into a sovereign's assets regardless of their location, and make it more difficult for sovereigns to conceal the flow of assets through the United States, or the use of assets in a manner that might render them subject to execution in aid of a judgment. The Court's decision is also interesting insofar as it concludes that the FSIA's execution immunities—set forth in Section 1609 of the FSIA and subject to exceptions and clarifications in Sections 1610 and 1611—are narrower than the immunities that existed at common law, and in fact narrower than the immunities afforded the property of international organizations, central banks, and property of a military character. Perhaps most notably, the Court's decision stresses that Section 1609 only immunizes foreign state property that is "in the United States," a clarification that leaves open—as the Second Circuit's decision below did—the question of whether the FSIA's execution immunities prohibit a U.S. court from ordering a party who is subject to U.S. court jurisdiction and possesses assets of a foreign state outside the United States to deliver those assets in satisfaction of a judgment. Such a remedy—typically known as turnover—is routinely available in cases involving non-sovereign judgment debtors, and the Court's observation that Section 1609 immunity only covers a sovereign's property "in the United States" appears to leave room for an argument that the turnover remedy, which is not covered by Section 1609's plain text, might be available in cases against sovereigns.

### B. Equal Treatment Injunction

The Court on June 16 also denied Argentina's petition for *certiorari* in a related case, *NML Capital, Ltd. v. Republic of Argentina*, in which the Second Circuit had affirmed injunctive relief that prohibited Argentina from making payments on restructured bonds without also making ratable payments on defaulted bonds with respect to which the plaintiffs had obtained money judgments.

On two occasions after Argentina's 2001 default, it offered holders of the defaulted debt new bonds that were worth a fraction of the original, defaulted debt. Argentina told the bondholders that if they did not accept the restructured bonds, they were unlikely to be paid on the defaulted debt. It then adopted a variety of laws in Argentina designed to prevent parties who did not accept the restructuring from recovering on the original defaulted bonds. The majority, though not all, of the bondholders accepted this offer; the remaining bondholders were left to attempt to recover their investments through litigation and execution on the various money judgments that were entered against Argentina.

The original, defaulted bonds contained provisions designed to protect bondholders from being subordinated. Specifically, they provided that the bonds constituted "direct, unconditional, unsecured and unsubordinated obligations

of the Republic and shall at all times rank *pari passu* without preference among themselves. The payment obligations of the Republic under the Securities shall at all times rank at least equally with all its other present and future unsecured and unsubordinated External Indebtedness." NML Capital brought suit seeking injunctive relief requiring Argentina to honor this language, and specifically to prevent it from making payments on the restructured bonds without also making ratable payments on the original, defaulted bonds. The district court ruled in NML's favor and entered the requested injunction, which provides that "whenever the Republic pays any amount due under the terms of the [restructured] bonds, it must concurrently or in advance" pay the plaintiffs the same fraction of the amount due them.

Argentina appealed the injunction, arguing, among other things, that it violated the FSIA by ordering it to pay the plaintiffs with funds held outside the United States. It relied upon the Second Circuit's decision in *S&S Machinery Co. v. Masintexportimport*,[4] in which the court held that a district court could not grant, by injunction, relief that was tantamount to an attachment that would not be allowed under the FSIA.

The Court of Appeals rejected this argument. It noted the specific language of Section 1609 of the FSIA, which provides execution immunity to foreign states by providing that "the property in the United States of a foreign state shall be immune from attachment arrest and execution." The court noted that the injunctions did not implicate this immunity because they "would not deprive Argentina of control over any of its property" and did not "attach, arrest, or execute upon any property." The court continued:

> [The injunctions] direct Argentina to comply with its contractual obligations not to alter the rank of its payment obligations. They affect Argentina's property only incidentally to the extent that the order prohibits Argentina from transferring money to some bondholders and not others. The Injunctions can be complied with without the court's ever exercising dominion over sovereign property. For example, Argentina can pay all amounts owed to its [restructured] bondholders provided it does the same for defaulted bondholders. Or it can decide to make partial payments to its [restructured] bondholders as long as it pays a proportionate amount to holders of the defaulted bonds. Neither of those options would violate the Injunctions. The Injunctions do not require Argentina to pay any bondholder any amount of money; nor do they limit the other uses to which Argentina may put its fiscal reserves. In other words, the Injunctions do not transfer any dominion or control over sovereign property to the court. Accordingly, the district court's injunctions do not violate Section 1609.

Like the Court's ruling in the discovery case, the Second Circuit's affirmance of the *pari passu* injunctions, coupled with the Supreme Court's refusal to hear Argentina's petition for *certiorari*, appears to reflect a strong desire on the part of U.S. appellate courts to construe the FSIA strictly in accordance with its terms and to permit district courts to fashion remedies designed to allow plaintiffs who hold judgments against foreign sovereigns to collect those judgments. Indeed, in addressing the propriety of the *pari passu* injunctions from the general perspective of equity, the Second Circuit noted that injunctive relief was appropriate due to Argentina's longstanding refusal to honor the money judgments rendered against it:

> Moreover, it is clear to us that monetary damages are an ineffective remedy for the harm plaintiffs have suffered as a result of Argentina's breach. Argentina will simply refuse to pay any judgments. It has done so in this case by, in effect, closing the doors of its courts to judgment creditors. In light of Argentina's continual disregard for the rights of its FAA creditors and the judgments of our courts to whose jurisdiction it has submitted, its contention that bondholders are limited to acceleration [of the bonds] is unpersuasive. Insofar as Argentina argues that a party's persistent efforts to frustrate

the collection of money judgments cannot suffice to establish the inadequacy of a monetary relief, the law is to the contrary. *See Pashaian v. Eccelston Props., Ltd*., 88 F.3d 77, 87 (2d Cir. 1996); Restatement (Second) of Contracts § 360 cmt. d.

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There is no question that U.S. courts, and particularly those in the circuits that handle the majority of FSIA cases, have struggled and become frustrated at frequency with which foreign states, even after giving full and comprehensive waivers of both jurisdictional and execution immunity, frustrate the ability of plaintiffs to satisfy valid U.S. court judgments. The Supreme Court's decision in the discovery case and its denial of *certiorari* in the *pari passu* case may be viewed as an outgrowth of that frustration and a realization that, regardless of the manner in which foreign sovereign immunity was afforded when it was governed by executive prerogative and common law, the FSIA was designed to govern the doctrine comprehensively, and that courts are not obligated to afford foreign states immunities that the FSIA's plain text does not confer.

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[1] 573 U.S. ___ (2014), No. 12-842; No 13-990 (2014).

[2] In early 2013, the Supreme Court was asked to stay a discovery order entered against the Government of the Lao People's Democratic Republic, on the ground that that discovery would require disclosure of certain assets in the possession of Laos' central bank. The Second Circuit had refused to stay that discovery, and, after entering an initial stay pending her receipt of briefs on the issue, Justice Ginsburg, as Circuit Justice, dissolved the stay and allowed the discovery to proceed. *See Government of the Lao People's Democratic Republic v. Thai-Lao Lignite Co*., No. 12A1167 (U.S. Jun. 14, 2013).

[3] The Supreme Court's decision must be viewed as overruling the Seventh Circuit's decision in *Rubin v. The Islamic Republic of Iran*, 637 F.3d 783, 799 (7th Cir. 2011) (limiting scope of discovery to property specifically identified by the judgment creditor as potentially subject to an exception under the FSIA).

[4] 706 F.2d 411, 418 (2d Cir. 1983).