ALERT MEMORANDUM

Second Circuit Rules That FSIA Does Not Provide Execution Immunity to a Foreign Sovereign's Extraterritorial Assets

November 29, 2017

On November 21, 2017, the Second Circuit Court of Appeals issued *Peterson v. Islamic Republic of Iran*, holding that the Foreign Sovereign Immunities Act (the "FSIA")[1] does not "by its terms provide execution immunity to a foreign sovereign's extraterritorial assets."[2] In deciding whether such assets can be recalled to the United States, the court provided a two-part test: first, a district court should determine whether it has personal jurisdiction over the third party holding the assets, and second, it should consider whether any relevant state law, federal law, or principle of international comity serves as a barrier to turnover. *Peterson* complicates the jurisdictional primacy of the FSIA and potentially introduces alternative legal sources of authority when executing on sovereign assets. Nevertheless, its practical effects remain somewhat uncertain: first, the opinion is potentially subject to further review, either by the Second Circuit *en banc* or the Supreme Court; and second, under the ruling, even recalled assets will not ultimately be subject to turnover if upon arrival in the United States—where the FSIA's protections unquestionably apply—the FSIA would preclude their turnover or execution.

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[1] 28 U.S.C. §§ 1330, 1391(f), 1602-11 (2017).
[2] *Peterson v. Islamic Republic of Iran*, No. 15-0690, 2017 WL 5580324 (2d Cir. 2017) at *19.

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Background

Over the course of the past two decades, numerous plaintiffs obtained judgments against Iran and its Ministry of Intelligence and Security ("MOIS") for sponsoring the 1983 bombing of the U.S. Marine Barracks in Beirut, Lebanon. In the years following these judgments, various plaintiffs brought a string of litigations seeking to execute on assets allegedly owned by Bank Markazi, Iran's central bank, but held by other institutions, including by an entity acting on Markazi's behalf in an account with Clearstream Banking, S.A., a Luxembourg bank.

In 2013, plaintiffs filed a complaint alleging that Clearstream held $2.5 billion in Markazi-owned bond proceeds that were distinct from the assets in prior litigations.[3] The plaintiffs pursued both turnover[4] and non-turnover actions alleging that $1.68 billion dollars were held as cash in Clearstream's account at JPMorgan in New York City and that defendants avoided additional payments to plaintiffs through the fraudulent conveyance of Iran's bond proceeds to an entity acting on behalf of Markazi.

On February 20, 2015, the district court granted the defendants' motions to dismiss and motion for partial summary judgement. The district court dismissed all non-turnover claims on the grounds that they were precluded by settlement agreements in prior actions. In addition, the district court dismissed all turnover claims on the grounds that the relevant bond proceeds were not held as cash in the United States but as a right to payment in Luxembourg. The court reasoned that the "FSIA does not allow for the attachment of property outside of the United States" and concluded that it "lack[ed] subject-matter jurisdiction" because Markazi "d[id] not maintain the assets that plaintiffs seek in the United States."[5]

The Second Circuit Decision

On appeal, the Second Circuit affirmed in part, vacated in part, and remanded for further proceedings. While the court affirmed the dismissal of the non-turnover claims based on the language of the settlement agreements, the turnover claims more significantly required the court to reach broader questions about the jurisdictional bounds of the FSIA with important implications for actions against sovereigns.

Regarding the turnover claims, the Second Circuit held that "the district court prematurely dismissed the amended complaint for lack of subject-matter jurisdiction."[6] Whether the plaintiffs could obtain an order to execute on the $1.68 billion dollars, the court reasoned, depended on (1) the nature and location of the assets and (2) the jurisdictional authority of the court to compel execution on those assets. The court analyzed each issue in turn:

First, the Second Circuit agreed with the district court that the assets were not located in the United States but recorded as a right to payment in Luxembourg. The court noted that Clearstream did not hold a segregated pool of Markazi bond proceeds at JPMorgan, unlike in prior actions where there was an identifiable pool. Instead, any

[3] *See, e.g.*, *Peterson v. Islamic Republic of Iran*, No. 10 Civ. 4518 (KBF), 2013 WL 1155576 (S.D.N.Y. Mar. 13, 2013), *aff'd*, 758 F.3d 185 (2d Cir. 2014).

[4] The court defined a turnover order as "[a]n order by which the court commands a judgment debtor to surrender certain property to a judgment creditor, or to the sheriff or constable on the creditor's behalf." *Peterson v. Islamic Republic of Iran*, 2017 WL 5580324 at n.1 (citing Turnover Order, BLACK'S LAW DICTIONARY (10th ed. 2014)).

[5] *Peterson v. Islamic Republic of Iran*, No. 13-cv-9195 (KBF), 2015 WL 731221 (S.D.N.Y. Feb. 20, 2015) at 10.

[6] *Peterson v. Islamic Republic of Iran*, 2017 WL 5580324 at *23, n.6.

cash in Clearstream's JPMorgan account was in a general pool used to meet numerous customer demands. Following payment on the bonds to this account, Clearstream would record a right to payment in Luxembourg. Although the plaintiffs asserted that the UCC required Clearstream to hold financial assets corresponding to the bond proceeds in New York, the court noted that this purported legal obligation was beside the point: there was no identifiable Markazi cash in New York and hence there was nothing to turnover in New York.

Second, the Second Circuit disagreed with the district court that it lacked jurisdiction over these assets under the FSIA given their location outside the United States. While acknowledging that "the district court's assumption was reasonable in light of many judicial decisions,"[7] the Second Circuit ultimately concluded that "courts sitting in New York with personal jurisdiction over a non-sovereign third party [could] order that third-party garnishee to produce in New York an extraterritorial asset,"[8] even if that asset belongs to a sovereign.

To support this conclusion, the Second Circuit interpreted the jurisdictional reach of the FSIA and New York state law as not necessarily in conflict. On the one hand, the court reiterated that the FSIA is "comprehensive"[9] with respect to sovereign immunities and the scope of its exceptions. This means that the FSIA supersedes "preexisting common law"[10] and, following the Supreme Court's 2014 decision in *Republic of Argentina v. NML Capital*, requires any immunity defense to "stand on the Act's text."[11] On the other hand, the court noted that the FSIA does not specify "the circumstances and manner of attachment and execution proceedings,"[12] which is a matter that, under Rule 69 of the Federal Rules of Civil Procedure, should be decided "in accordance with the law of the state in which the district court sits."[13] Following the New York Court of Appeals' decision in *Koehler v. Bank of Berm. Ltd.*, the court reiterated that "a New York court with personal jurisdiction over a defendant may order him to turn over out-of-state property."[14] The key issue then turned on whether the text of the FSIA preempted such jurisdiction under state law and granted immunity to a third-party holder of a foreign sovereign's extraterritorial assets.

The Second Circuit clarified that "the Act's text" provided no such immunity. The FSIA states that jurisdictional immunity only applies to "a foreign state"[15] (*i.e.*, not Clearstream) and that execution immunity only applies to assets located "in the United States"[16] (*i.e.*, not a right to payment in Luxembourg). Under New York law, the district court could therefore direct Clearstream to bring Markazi-owned assets held by a third party acting on Markazi's behalf in a Clearstream account in Luxembourg to New York state so long as (1) it had personal jurisdiction over Clearstream and (2) no relevant state law, federal law, or principle of international comity served as a barrier to granting turnover. On

[7] *Id*. at *16
[8] *Id*. at *22.
[9] *Id*. at *18 (citing *Verlinden B.V. v. Central Bank of Nigeria*, 461 U.S. 480, 488 (1983)).
[10] *Id*. at *18 (citing *Samantar v. Yousuf*, 560 U.S. 305, 313 (2010)).
[11] *Id*. at *20 (citing *Republic of Argentina v. NML Capital, LTD.*, 134 S. Ct. 2250, 2256 (2014)).
[12] *Id*. at *18 (citing *EM Ltd. v. Republic of Argentina*, 473 F.3d 463, 474 n.10 (2d Cir. 2007)).
[13] *Id*. at *18 (citing *Koehler v. Bank of Berm. Ltd*., 544 F.3d 78, 85 (2d Cir. 2008)).
[14] *Id*. at *20 (citing *Koehler v. Bank of Berm. Ltd*., 12 N.Y.3d 533, 541 (2009)).
[15] 28 U.S.C. § 1604.
[16] 28 U.S.C. § 1609.

remand, the Second Circuit ordered the district court to make these determinations.

Conclusion

The Second Circuit reiterated that its decision did not conflict with its "long-standing view"[17] that the "FSIA provides the exclusive basis for obtaining subject matter jurisdiction over *a foreign state*."[18] Following *NML Capital*, the Second Circuit relied on "the Act's text" to explain how third-party holders of a foreign sovereign's extraterritorial assets, and the assets themselves, could remain outside the jurisdictional bounds of the FSIA without contradicting the court's previous position.

But the Second Circuit also recognized that its decision did not further the underlying goals of the FSIA. The FSIA, as the Second Circuit wrote, "aim[s] to facilitate and depoliticize litigation against foreign states and to minimize irritations in foreign relations arising out of such litigation."[19] The Second Circuit acknowledged that its interpretation of execution immunity might increase such irritations.

In spite of these concerns, the Second Circuit found comfort in its belief that this decision "is unlikely to open the proverbial floodgates to a wave of turnover."[20] As the Second Circuit correctly noted, "plaintiffs are by no means assured success upon remand,"[21] due to the potential barriers to compelling Clearstream to recall assets to the United States—including, notably, the separate entity doctrine and international comity—and to the immunity protections afforded to sovereign property located in (or here, arguably, recallable to) the United States under the FSIA. Application of the FSIA would also bring a number of important limiting principles, the most important of which is the requirement that the foreign state's assets be "used for a commercial activity in the United States"[22] in order to overcome execution immunity.

Yet whether or not such limiting principles will keep the floodgates closed remains to be seen. Other FSIA exceptions may be less forgiving: Section 1610(b), for example, withholds execution immunity for the assets of any "agency or instrumentality of a foreign state engaged in commercial activity in the United States"[23] without the specific requirement that the assets themselves be used for such an activity. Given such ambiguity and the differences in statutory protections between foreign states and their agencies, litigants on both sides of the aisle may soon find themselves increasingly frustrated about the implications of recalling a foreign sovereign's extraterritorial assets. In the meantime, the Second Circuit has found it sufficient to assert that "any such problem is one for the Supreme Court or the political branches… to resolve"[24]—perhaps a coming chapter in the continuing story of the FSIA's development.

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[17] *Peterson v. Islamic Republic of Iran,* 2017 WL 5580324 at *20.
[18] *Id*. (citing *Kirschenbaum*, 830 F.3d 107 (2d Cir 2016) at 122 (emphasis added)).
[19] *Id*. at *22 (citing *Cargill Int'l S.A. v. M/T Pavel Dybenko*, 991 F.2d 1012, 1016 (2d Cir. 1993) (internal quotation marks omitted)).
[20] *Id*. at *23.
[21] *Id*.
[22] 28 U.S.C. § 1610(a).
[23] 28 U.S.C. § 1610(b).
[24] *Peterson v. Islamic Republic of Iran,* 2017 WL 5580324 at *22.