KING & SPALDING

Client Alert

International Arbitration Practice Group

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Ninth Circuit Clarifies Scope of Commercial Activity Exception to Sovereign Immunity

On December 6, 2013, the U.S. Court of Appeals for the Ninth Circuit, sitting *en banc*, issued its decision in *Sachs v. Republic of Austria*,[1] a case presenting important questions concerning the types of commercial activities that can strip foreign states and state-owned entities of sovereign immunity and subject them to the jurisdiction of U.S. courts. The Ninth Circuit's decision in *Sachs* constitutes an important decision in the continued delineation of the "commercial activity" exception to sovereign immunity set forth in the U.S. Foreign Sovereign Immunities Act ("FSIA"),[2] and given the Ninth Circuit's importance to cross-border business and its status as a key circuit in cases involving foreign state entities, the decision should be of interest to foreign state-owned enterprises and companies doing business with those enterprises, particularly in the Pacific Rim.

1. Introduction: Sovereign Immunity in the U.S.

Since 1952, U.S. law has reflected a policy of "restrictive sovereign immunity," pursuant to which foreign states and state entities enjoy immunity from the jurisdiction of U.S. state and federal courts for claims arising out of governmental acts, but are not entitled to immunity, and are subject to U.S. court jurisdiction in connection with claims arising out of commercial activities.[3] Since 1976, sovereign immunity in the United States has been implemented through the FSIA, which reflects the policy of restrictive immunity by affording foreign states and their agencies and instrumentalities presumptive immunity from suit. Section 1605 of the FSIA then sets forth a series of exceptions to immunity that, when present, will leave the foreign state subject to U.S. court jurisdiction in largely the same fashion as non-state defendants.[4]

Of the various exceptions to immunity set forth in Section 1605 of the FSIA, arguably the most significant is the "commercial activity" exception set forth in Section 1605(a)(2), which subjects foreign states to jurisdiction in connection with any case:

> in which the action is based upon a commercial activity carried on in the United States by the foreign state; or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere; or upon an act outside the territory of

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> the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States.[5]

2. *Sachs*

In *Sachs*, the Ninth Circuit considered whether a foreign state's use of an agent to sell train tickets in the United States sufficed to trigger the commercial activity exception. The case was brought by an American tourist who was injured while trying to board a train in Innsbruck, Austria. The train was operated by OBB Personenverkehr AG ("OBB"), the Austrian state-owned railway and an Austrian member of the Eurail Group. Sachs was traveling on a Eurail pass, which she had purchased online from Rail Pass Experts ("RPE"), a travel agent located in Massachusetts. Just prior to boarding the train in Innsbruck, Sachs purchased an upgrade on her pass directly from OBB. She suffered serious injuries when attempting to board the train.

Sachs filed suit against OBB and other parties in the U.S. District Court for the Northern District of California, alleging various torts sounding in negligence and strict liability. OBB asserted sovereign immunity and moved to dismiss the case based on that assertion, as well as on other grounds. The district court dismissed the case, finding that there was insufficient evidence to support a finding that RPE was OBB's agent, and that RPE's commercial activity in the United States (*i.e.*, its sale of the Eurail pass) could not be imputed to OBB for purposes of establishing the commercial activity exception.[6] On appeal, a divided panel of the Ninth Circuit affirmed, and the court granted *en banc* review "to clarify whether the first clause of the FSIA commercial-activity exception applies to a foreign sovereign when a person purchases a ticket in the United States from a travel agency for passage on a commercial common carrier owned by the foreign state."[7]

The *en banc* court considered two issues. First, the Ninth Circuit considered whether RPE's sale of the Eurail pass could be imputed to OBB, as it would be necessary to find that OBB engaged in commercial activity in the United States. Second, if the first question was answered in the affirmative, whether Sachs's claims were based upon the commercial activity relied upon to establish jurisdiction (*i.e.*, the sale of the Eurail pass). On the first issue, the Court of Appeals held that RPE's sale of the Eurail pass was imputable to OBB, and thus that OBB had engaged in commercial activity in the United States. The court relied on the FSIA's legislative history, in which Congress stated that the commercial activity exception was intended to apply both to commercial transactions performed and executed in the United States in their entirety, as well as commercial acts having a substantial contact with the United States. The court found further that both the text and the legislative history, while silent on how commercial activity must be "carried on" for purposes of determining jurisdiction, supported the view that the "carrying on" requirement was required to be interpreted in view of broad agency principles. Having found that the FSIA permitted the imputation of a foreign state's agents' commercial acts in the United States to the foreign state, the court also found that RPE was, in fact, OBB's agent under traditional theories of agency. Specifically, the court found that

> [h]ere, Eurail Group markets and sells rail passes for transportation on OBB's rail lines, making Eurail Group an agent of OBB. Eurail Group enlists subagents, like RPE, to sell and market its passes worldwide. Eurail Group's use of these subagents establishes a legal relationship between OBB (the principal) and RPE (the subagent): "As to third parties, an action taken by a subagent carries the legal consequences for the principal that would follow were the action taken instead by the appointing agent."[8]

The court concluded the first part of its analysis by stating that "[b]ecause we conclude RPE acted as an authorized agent of OBB, we impute RPE's sale of the Eurail pass in the United States to OBB."

In holding that commercial activities by an agent could be imputed to a foreign state for purposes of establishing jurisdiction under the first clause of the commercial activity exception, the court refused to apply the agency principles applied in *First National City Bank v. Banco Para el Comercio Exterior de Cuba*[9] and *Doe v. Holy See*,[10] noting that those cases involve the imputation of liability or jurisdiction between corporate affiliates and/or states and state-owned

entities as opposed to traditional common law agency principles. The court also rejected OBB's argument that, in order for acts of a state's purported agents to be imputed to the state for jurisdictional purposes, the agent must meet the FSIA's definition of an "agency or instrumentality of a foreign state," which would cover only those entities that are majority-owned by a foreign state.[11] Finally, the court justified its decision by noting that it was consistent with prior decisions of the Second and District of Columbia Circuits, each of which had previously ruled that a travel agent's sale of tickets in the United States could be imputed to a foreign common carrier for FSIA jurisdictional purposes,[12] noting that because the FSIA was adopted to promote uniformity in the treatment of foreign sovereign immunity, it should disagree with the prior decisions of sister circuit courts only where there is compelling reason to do so.

Having concluded that the imputation of RPE's sale of the Eurail pass to Sachs could be imputed to OBB, and that the imputation resulted in commercial activity carried on in the United States, the Court of Appeals was required to determine whether that sale created "substantial contact" with the United States. Noting that the concept of "substantial contact" was not clearly defined by the FSIA or its jurisprudence, the court relied upon prior caselaw holding that a foreign state's marketing, selling, and arranging of foreign travel in the United States constituted substantial contact, and held that "[w]here a ticket for travel on a foreign common carrier is bought and paid for in the United States, we conclude that the substantial contact requirement is satisfied."

Finally, the Court of Appeals considered the question of whether Sachs's action was "based upon" the commercial activity it found had occurred in the United States, *i.e.*, that there was a nexus between Sachs's purchase of the Eurail pass and her claims. Noting that the nexus inquiry focuses on the plaintiff's theory of the case and claims pleaded, the court concluded that the requisite nexus was present because Sachs's purchase of the pass established that she had a passenger-carrier relationship with OBB, a necessary element of her negligence claim, and further provided the basis for the warranties that Sachs claimed OBB breached.

In all, the *en banc* court held that RPE's sale of the Eurail pass in the United States constituted commercial activity in the United States, that the commercial activity had a substantial connection to the United States, and that Sachs's claim was based on that commercial activity. The court therefore reversed the judgment of the district court and vacated the panel's affirmance of that judgment, and remanded the case to the district court for further proceedings.[13]

3. Conclusions

The FSIA's immunity exceptions are, in most instances, designed to ensure that U.S. courts will only have jurisdiction over cases where there is a demonstrable nexus between the events underlying the case and the United States sufficient to justify a U.S. court's exercise of jurisdiction over the foreign sovereign and mitigate the corresponding risk of offending the foreign state defendant. The Ninth Circuit's decision in *Sachs* demonstrates the extent to which U.S. courts have struggled when required to apply these nexus requirements to unremarkable and commonplace commercial transactions such as the sale of railroad tickets through a travel agent, and further the extent to which courts have had difficulty determining the proper relationship between the FSIA's specific jurisdictional rules and well-established common law doctrines such as agency.[14] As the Ninth Circuit noted in *Sachs*, its decision is consistent with those rendered by the two other circuits that have considered whether the FSIA permits a court to impute an agent's U.S. commercial activity to a foreign state, a fact that may weigh against the Supreme Court granting any petition for a writ of *certiorari* that the *Sachs* defendants may ultimately file. The Supreme Court may, however, eventually feel the need to further clarify its commercial activity jurisprudence in order to provide foreign states with greater certainty about the activities that may subject them to litigation in U.S. courts.

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[1] --- F.3d ---, No. 11-15468 (9th Cir. Dec. 6, 2013) (*en banc*).

[2] 28 U.S.C. §§ 1602-11, 1330, 1332, 1391(f), 1441(d).

[3] The U.S. first adopted the doctrine of restrictive immunity in 1952, when the U.S. Department of State issued a policy memorandum, known as the Tate Memorandum, which announced the State Department's intention to limit sovereign immunity to cases arising out of governmental acts. Because the decision to grant sovereign immunity was, prior to the FSIA's adoption in 1976, controlled almost entirely by the Department of State's recommendations filing "suggestions of immunity" in cases against foreign sovereigns, the Department's policy change was tantamount to a fundamental change in U.S. law. *See Verlinden B.V. v. Central Bank of Nigeria*, 461 U.S. 480, 486-89, 103 S.Ct. 1962 (1983) (discussing pre-FSIA policy of sovereign immunity).

[4] *See* 28 U.S.C. §§ 1604 ("Subject to existing international agreements to which the United States is a party at the time of enactment of this Act a foreign state shall be immune from the jurisdiction of the courts of the United States and of the States except as provided in sections 1605 to 1607 of this chapter") & 1605 (setting forth exceptions to immunity).

[5] 28 U.S.C. § 1605(a)(2).

[6] *Sachs v. Rep. of Austria*, 2011 WL 816854, *4 (N.D. Cal. Jan. 28, 2011).

[7] *Sachs*, 2013 WL 6333439 at *3.

[8] *Id.* at *6 (citing Restatement (Third) of Agency, § 3.14 cmt. c (2006)).

[9] 462 U.S. 611 (1983).

[10] 557 F.3d 1066 (9th Cir. 2009).

[11] *Sachs*, at *7 (citing 28 U.S.C. § 1603(b)).

[12] *Id.* at *5 (citing *Barkanic v. Gen. Admin. Of Civil Aviation of the People's Rep. of China*, 822 F.2d 11 (2d Cir. 1987); *Kirkham v. Societe Air France*, 429 F.3d 288 (D.C. Cir. 2005)).

[13] Three judges dissented, in two opinions. Judge O'Scannlain, in an opinion joined by the two other dissenters, argued that the definition of "foreign state" as used in the FSIA precluded the imputation of any agent's acts to the state, as doing so would impermissibly equate foreign states and the agents through which they act. Judge O'Scannlain argued further that any imputation of jurisdictional acts between an agent and a foreign state would have to be analyzed under the *Bancec* standard, which is generally used to determine whether the acts of a state instrumentality may be imputed to the state (or vice versa). *Id.* at *13-21 (O'Scannlain, J., dissenting). Chief Judge Kozinski agreed with Judge O'Scannlain's analysis, but contended there was "another, simpler way" to affirm, arguing that the case should have been dismissed primarily because it arose from events that occurred entirely in Austria. In essence, Chief Judge Kozinski rejected the majority's conclusion that the claims were "based upon" commercial activity in the United States, and that there was no proximate causation between Sachs's purchase of the Eurail pass and the accident that led her to sue OBB and Austria. *Id.* at *21-24 (Kozinski, C.J., dissenting).

[14] Courts' ongoing struggles with the FSIA's nexus requirements are not unlike the difficulties courts have encountered in the area of jurisdictional due process, where lower federal and state courts have struggled to consistently apply the constitution limits on personal jurisdiction established in *International Shoe Co. v. Washington*, 326 U.S. 310 (1945) and its progeny. Indeed, the U.S. Supreme Court has taken four personal jurisdiction cases since 2011, having seemingly perceived the need to clarify the constitutional limits of U.S. court jurisdiction over non-resident defendants. *See DaimlerChrysler AG v. Bauman*, 133 S.Ct. 1995, 185 L.Ed.2d 865, 80 USLW 3461, 81 USLW 3028, 81 USLW 3594, 81 USLW 3598 (U.S. Apr 22, 2013) (No. 11-965); *Walden v. Fiore*, 133 S.Ct. 1493, 185 L.Ed.2d 547, 81 USLW 3334, 81 USLW 3489, 81 USLW 3492 (U.S. Mar 04, 2013) (No. 12-574); *Goodyear Dunlop Tires Operations, S.A. v. Brown*, 131 S.Ct. 2846 (2011); *J. McIntyre Machinery, Ltd. v. Nicastro*, 131 S.Ct. 2780 (2011).