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U.S. Supreme Court Rules that Sovereign States Are Not Immune from U.S. Court Discovery into their Worldwide Assets

On June 16, 2014, the U.S. Supreme Court issued two decisions with significant implications not only for a long-running dispute between the Republic of Argentina and holders of defaulted Argentine sovereign debt, but also for any sovereign that finds itself subject to a civil judgment in a U.S. court. With respect to the substance of the dispute, the Court declined to hear an appeal of a lower court decision obligating Argentina to pay the bondholders, which means that the bondholders will very soon have an enforceable judgment for approximately 2.5 billion dollars in defaulted bonds.[1] At the same time, the Court issued a ruling that provides a powerful tool to allow the bondholders to enforce that judgment: access to the sweeping discovery process under the U.S. Federal Rules of Civil Procedure. Specifically, in *Republic of Argentina v. NML Capital, Ltd.*,[2] the Court held that the Foreign Sovereign Immunities Act ("FSIA")[3] does not limit U.S. courts' ability to authorize discovery into the worldwide assets held by a foreign sovereign in aid of enforcement of a judgment against that sovereign. In the words of the lower court, U.S. courts may now act as "clearinghouse[s] for information" regarding a sovereign's worldwide assets, with the sole limit to their inquiry being the discretion and reasonableness of the trial court.

Contacts

Steve Nickelsburg
Partner

T: +1 202 912 5108
E: steve.nickelsburg
@cliffordchance.com

Erin Louise Palmer
Associate

T: +1 202 912 5066
E: erin.palmer
@cliffordchance.com

1 *Republic of Argentina v. NML Capital, Ltd.*, No. 13-990 (U.S. June 16, 2014). For further discussion of the implications of the denial of certiorari please see the Clifford Chance memorandum of June 2014, "*Sovereign Pari Passu Clauses*."
2 No. 12-842 (U.S. June 16, 2014).
3 28 U.S.C. §§ 1330, 1602-11.

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Background of the Case

Republic of Argentina v. NML Capital, Ltd. arose out of Argentina's default on more than $80 billion of public external debt in 2001. Faced with a debt crisis, in 2005 and 2010 Argentina restructured 93% of its debt through two global exchange offers, through which creditors could exchange their bonds for new securities that paid between 25 and 29 cents on the dollar.

NML Capital, Ltd. ("NML") is a hedge fund that purchased some of the distressed Argentine bonds. NML rejected the global exchange offers, instead filing eleven lawsuits in the U.S. District Court for the Southern District of New York seeking repayment of the full amount of the debt. After lengthy proceedings, the District Court entered five money judgments in NML's favor of more than 1.6 billion dollars and granted summary judgment to NML in six other actions for claims totaling more than 900 million dollars, for a total liability of 2.5 billion dollars.

NML then sought discovery regarding Argentina's assets, including by serving subpoenas on two banks that required the banks to identify Argentina's accounts, their opening and closing dates, current balances, and transaction histories, as well as documents relating to transfers through the SWIFT system. In the U.S. legal system, "discovery" is a process that allows one party to a suit to demand information from the other party—which, with the exception of some narrow privileges, the other party is obligated to provide on pain of serious judicial sanctions. The subpoenas defined "Argentina" broadly to include its agencies, ministries, political subdivisions, and employees. NML claimed that this information was relevant to "locate Argentina's assets and accounts, learn how Argentina moves its assets through New York and around the world, and accurately identify the places and times when those assets might be subject to attachment and execution."[4]

Argentina and the banks opposed the subpoenas on several grounds—including that they infringed on the sovereignty of Argentina and were outside the scope of the exceptions to the FSIA. The District Court rejected Argentina's motion to quash and granted NML's motions to compel compliance with the subpoenas.[5] In granting the discovery order, however, the court indicated that the subpoenas should be limited to discovery that was reasonably calculated to lead to attachable property.[6] The U.S. Court of Appeals for the Second Circuit affirmed on appeal. According to the Second Circuit, U.S. courts have broad authority to order discovery against a foreign state, as it does "over any other party" under Rule 69 of the Federal Rules of Civil Procedure—and, moreover, the subpoenas did not infringe Argentina's sovereign immunity because they were directed at commercial banks.[7]

Immunity Under the FSIA

The FSIA provides the sole basis of jurisdiction in a U.S. court over a foreign state. As a general matter, the FSIA provides that foreign states "shall be immune from the jurisdiction of the courts of the United States and of the States."[8] The FSIA provides specific exceptions to the general rule of sovereign immunity. Most significantly, the "commercial activity" exception provides jurisdiction "in any case . . . in which the action is based upon a commercial activity carried on in the United States by the foreign state."[9] In addition, although the property of a foreign state generally is immune from "attachment, arrest, and execution" in the United States, "the property in the United States of a foreign state . . . used for commercial activity in the United States, shall not be immune."[10]

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4 *EM Ltd. v. Republic of Argentina*, 695 F.3d 201, 203 (2d Cir. 2012) (quoting NML Br. at 9).
5 *NML Capital, Ltd. v. Republic of Argentina*, No. 03-cv-8845 (S.D.N.Y. Sept. 2, 2011).
6 Transcript of Oral Argument at 29-30, *EM Ltd. v. Republic of Argentina*, Nos. 03-cv-2507, 03-cv-8845 (S.D.N.Y. Aug. 30, 2011).
7 *EM Ltd.*, 695 F.3d at 209-10.
8 28 U.S.C. § 1604.
9 *Id.* § 1605(a)(2).
10 *Id.* at § 1610(a).

The issue in *NML Capital* was not the District Court's jurisdiction over Argentina—Argentina had waived immunity from bondholder suits through a provision in the bonds. Nor was it the District Court's jurisdiction to attach the property of Argentina. Rather, it was the lower court's authority to issue an order requiring Argentina's banks to identify the state's property.

The Supreme Court's Ruling

In a sharply worded, seven-to-one[11] decision authored by Justice Scalia, the Court held that the FSIA does not limit the scope of discovery available to a judgment creditor in a federal postjudgment execution proceeding against a foreign sovereign—including discovery into the foreign sovereign's worldwide assets to identify property that is subject to execution.

The Court began by emphasizing that the FSIA provides the sole and "comprehensive" basis under U.S. law for sovereign immunity, and that any sovereign immunity defense raised by a foreign sovereign must therefore "stand on the Act's text . . . [o]r it must fall."[12] The Court noted that the FSIA expressly confers on foreign states two kinds of immunity—first, immunity from the jurisdiction of U.S. courts (except as provided in specific provisions of the statute); and second, immunity from attachment, arrest, and execution (except as provided in certain exceptions, such as the "commercial activity" exception[13] or when immunity has been waived).[14] Significantly, however, the Court noted that the FSIA is silent about discovery in aid of execution of a foreign-sovereign judgment debtor's assets.

Argentina made several arguments against the scope of the subpoenas—most prominently, that U.S. courts lack the authority (under the FSIA or otherwise) to execute judgments against a foreign state's assets held abroad, and therefore that U.S. courts lacked the power to order discovery into those assets. The Court rejected all of those arguments, assuming that U.S. courts would have the authority to order worldwide discovery in the ordinary case, and noting that the FSIA lacked any "plain statement" necessary to preclude application of those rules in cases involving sovereigns.

The Court also rejected Argentina's specific argument that a judgment creditor is not entitled to discovery related to assets subject to execution immunity, such as diplomatic or military property. Citing the broad purposes of U.S. discovery, the Court concluded that a judgment creditor must be allowed to seek discovery regarding all of a foreign sovereign's assets to allow a court—and not the sovereign—to determine which of those assets are subject to execution:

> [T]he reason for these subpoenas is that NML *does not yet know* what property Argentina has and where it is, let alone whether it is executable under the relevant jurisdiction's law. If, bizarrely, NML's subpoenas had sought only "information that could not lead to executable assets in the United States or abroad," then Argentina likely would be correct to say that the subpoenas were unenforceable—*not* because information about nonexecutable assets enjoys a penumbral "discovery immunity" under the Act, but because information that could not possibly lead to executable assets is simply not "relevant" to execution in the first place. But of course that is not what the subpoenas seek. They ask for information about Argentina's worldwide assets generally, so that NML can identify where Argentina may be holding property that *is* subject to execution.[15]

Finally, the Court's decision acknowledged—and ultimately disregarded—the U.S. government's concerns that broad discovery orders related to a foreign sovereign's assets will cause "a substantial invasion of [foreign states'] sovereignty," will "[u]ndermin[e] international comity," might provoke "reciprocal adverse treatment of the United States in foreign courts," and will "threaten harm

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11 Justice Sotomayor, who previously served on the Second Circuit, took no part in this decision or the Supreme Court's refusal to hear Argentina's appeal of the lower court's decision.
12 No. 12-842, at 7.
13 28 U.S.C. § 1610(a).
14 *Id*. §§ 1610(a)(1)-(7).
15 No. 12-842, at 10 (citation omitted).

to the United States' foreign relations more generally."[16] According to the Court, these concerns are better addressed by the U.S. Congress, which has the authority to amend the FSIA.

Justice Ginsburg dissented, rejecting the majority's "sweeping examination of Argentina's worldwide assets" and urging a limitation on foreign asset discovery in aid of execution of a judgment to "property used here or abroad 'in connection with . . . commercial activities.'"[17] Recognizing that other countries have much more limited discovery than is available in the United States, Justice Ginsburg argued that "[a] court in the United States has no warrant to indulge the assumption that, outside our country, the sky may be the limit for attaching a foreign sovereign's property in order to execute a U.S. judgment against the foreign sovereign."[18] No other Justice joined her dissent.

Implications

The U.S. Supreme Court's simultaneous decisions refusing to consider Argentina's appeal of the lower court decision requiring Argentina to pay the holdout bondholders and permitting worldwide asset discovery in aid of execution of these decisions certainly have implications for the Argentine case, and suggest that the case may be coming to a close. The Supreme Court's discovery decision has farther-reaching implications, however. By declining to find a statutory limit to discovery against foreign sovereigns in the FSIA itself, the Court left the scope of such discovery to the tender mercies of the district courts. Although those courts may be persuaded to act in a reasonable manner—and in this case, the District Court stated that the subpoenas should be limited to discovery that was reasonably calculated to lead to attachable property—the extraordinary breadth of their discretion, as well as the porousness of phrases such as "reasonably calculated to lead to attachable property," mean that foreign sovereigns involved in U.S. civil disputes are now substantially more at risk of far-reaching and intrusive asset discovery orders in U.S. courts.

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

Clifford Chance, 31 West 52nd Street, New York, NY 10019-6131, USA
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16 *Id*. at 11 (citing Br. for United States as *Amicus Curiae* at 18-21).
17 *Id.* at 2 (Ginsburg, J., dissenting) (quoting 28 U.S.C. §§ 1602, 1610(a)).
18 *Id.* at 2.