

# Client Alert

International Arbitration Practice Group

December 7, 2015

## Supreme Court Clarifies the Scope of Application of Commercial Activity Exception to Foreign Sovereign Immunity

On December 1, 2015, the United States Supreme Court issued its decision in *OBB Personenverkehr AG v. Sachs*<sup>1</sup> a case presenting important questions concerning the types of commercial activities that may strip foreign states and state-owned entities of sovereign immunity and subject them to the jurisdiction of U.S. courts.

The Supreme Court's decision reversed an *en banc* decision of the U.S. Court of Appeals for the Ninth Circuit, which held that a foreign sovereign entity could be subject to the jurisdiction of the U.S. courts under the "commercial activity" exception to sovereign immunity set forth in the Foreign Sovereign Immunities Act ("FSIA")<sup>2</sup> by virtue of its agent's commercial activity in the United States. The Supreme Court's decision clarified the scope of the commercial activity exception, focusing specifically on the requirement that the plaintiff's claim against the foreign state be "based upon" commercial activity carried on in the United States.

### Sovereign Immunity in the United States

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.<sup>3</sup>

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.<sup>4</sup>

Of the various exceptions to immunity set forth in Section 1605 of the FSIA, the most frequently litigated is the "commercial activity" exception set forth

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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 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.

## Proceedings Below

Sachs involved various tort claims 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, 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.<sup>5</sup>

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.”<sup>6</sup>

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, the court would have to determine 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 supported the view that the “carrying on” requirement was required to be interpreted in view of broad agency principles.<sup>7</sup> 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)...

Having concluded that RPE's sale of the Eurail pass to Sachs in the United States could be imputed to OBB for purposes of satisfying the commercial activity exception, the court of appeals then considered the question of whether Sachs' action was "based upon" the commercial activity it found had occurred in the United States, *i.e.*, whether there was an adequate 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 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.

## The Supreme Court Reverses

The Supreme Court reversed the Ninth Circuit's decision in a unanimous opinion by Chief Justice Roberts. The Court's analysis focused primarily upon whether Ms. Sachs's claims were "based upon" OBB's alleged commercial activity in the United States. Because the Court held that those claims were not based upon any commercial activity of OBB in the United States, it did not reach the question of whether common law principles of agency could be used to impute jurisdictional contacts to a foreign state under the FSIA.

Although noting that the FSIA does not define or otherwise provide much guidance on how the phrase "based upon" within the meaning of the commercial activity exception should be construed, the Court relied upon its analysis in *Saudi Arabia v. Nelson*,<sup>8</sup> in which the Court determined that the FSIA's "based upon" inquiry requires a court to "identify[ ] the particular conduct on which the [plaintiff's] action is 'based,' by looking to the 'basis' or 'foundation' for a claim, *i.e.*, 'the 'gravamen of the complaint,'" or "those elements . . . that, if proven, would entitle a plaintiff to relief."<sup>9</sup>

The Court found that the Ninth Circuit's decision did not comport with the standard set forth by the Court in *Nelson*. Specifically, the Court found that while the Ninth Circuit found that Sachs's claim was "based upon" the U.S. sale of the Eurail pass because that sale provided "an element" of her claim, "[u]nder *Nelson* . . . the mere fact that the sale of the Eurail pass would establish a single element of a claim is insufficient to demonstrate that the claim is 'based upon' that sale for purposes of (s) 1605(a)(2)."<sup>10</sup> The Court explained that a "one-element test" was flatly incompatible with *Nelson*, which required an analysis of the "gravamen" of the claim, or the "core of [the] suit." Citing Justice Holmes, the Court noted that "the 'essentials' of a personal injury narrative will be found at the 'point of contact' – 'the place where the boy got his fingers pinched.'"<sup>11</sup>

Focusing on this standard, the Court concluded that "the gravamen of Sachs's suit plainly occurred abroad," as "[a]ll of her claims turn on the same tragic episode in Austria, allegedly caused by wrongful conduct and dangerous conditions in Austria, which led to injuries suffered in Austria."<sup>12</sup>

The Court also reiterated its concern, expressed in *Nelson*, that applying a broader "based upon" test "would allow plaintiffs to evade the Act's restrictions through artful pleading" by permitting any plaintiff to "recast virtually any claim of intentional tort . . . as a claim of failure to warn, simply by charging the defendant with an obligation to announce its own tortious propensity before indulging it," which would "effectively thwart[ ] the Act's manifest purpose."<sup>13</sup>

Finally, the Court declined to hear Sachs's alternative argument that jurisdiction was justified under the second prong of the commercial activity exception – providing an exception to immunity where the claim is based on commercial activity "having substantial contact with the United States" – finding that the argument, which had not been raised below, had been forfeited. Accordingly, the Court reversed the Ninth Circuit's decision.

## Conclusion

The *Sachs* case demonstrates the extent to which U.S. courts have struggled when required to apply the FSIA's 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.

The Supreme Court's decision reaffirms the general principle that the FSIA's immunity exceptions are, in most instances, intended 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.

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<sup>1</sup> 577 U.S. \_\_\_\_ (2015).

<sup>2</sup> 28 U.S.C. §§ 1602-11, 1330, 1332, 1391(f), 1441(d).

<sup>3</sup> 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 (1983) (discussing pre-FSIA policy of sovereign immunity).

<sup>4</sup> *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).

<sup>5</sup> *Sachs v. Republic of Austria*, 2011 WL 816854, \*4 (N.D. Cal. Jan. 28, 2011).

<sup>6</sup> *Sachs v. Republic of Austria*, 737 F.3d 584, 589 (9th Cir. 2013) *cert. granted sub nom. OBB Personenverkehr AG v. Sachs*, 135 S. Ct. 1172, 190 L. Ed. 2d 929 (2015) *and rev'd sub nom. OBB Personenverkehr AG v. Sachs*, No. 13-1067, 2015 WL 7722430 (U.S. Dec. 1, 2015).

<sup>7</sup> 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 of Appeals refused to apply the agency principles applied in *First National City Bank v. Banco Para el Comercio Exterior de Cuba*, 462 U.S. 611 (1983), and *Doe v. Holy See*, 557 F.3d 1066 (9th Cir. 2009), 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.

<sup>8</sup> 507 U.S. 349 (1993).

<sup>9</sup> *OBB Personenverkehr AG v. Sachs*, No. 13-1067, 2015 WL 7722430, at \*5 (U.S. Dec. 1, 2015) (citing *Nelson*, 507 U.S. at 357-58).

<sup>10</sup> *Sachs*, 2015 WL 7722430, at \*6.

<sup>11</sup> *Id.* at \*7 (citing Holmes and Frankfurter: Their Correspondence, 1912-1934, p. 40 (R. Menkel & C. Compston eds. 1996)).

<sup>12</sup> *Id.* at \*6.

<sup>13</sup> *Id.* at \*7 (citing *Nelson*, 507 U.S. at 363).