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Direct Financial Effect Under the Foreign Sovereign Immunities Act

Texas Trading & Milling Corp. v. Federal Republic of Nigeria
647 F.2d 300 (2d Cir. 1981), cert. denied 102 S. Ct. 1012 (1982).

Four New York corporations¹ brought two separate actions under the Foreign Sovereign Immunities Act (FSIA) of 1976² against the Federal Republic of Nigeria and the Central Bank of Nigeria for anticipatory breach of contract and for breach of letters of credit. In the first action,³ the United States District Court for the Southern District of New York granted the defendants' motion to dismiss for lack of subject matter and personal jurisdiction, finding that the complaint failed to allege the level of "direct effect" described in § 1605(a)(2) of the FSIA.⁴ In the second action, the district court found jurisdiction and proceeded to trial on the merits.⁵ The United States Court of Appeals for the Second Circuit, hearing the cases together on appeal, *held*: Nigeria's breach of contract and breach of related letters of credit entered into with New York corporations constitutes commercial acts causing a direct effect within the meaning of the FSIA, and thus the foreign sovereign is not entitled to immunity from the jurisdiction of the United States District Court. *Texas Trading & Milling Corp. v.*

1. The New York corporations are: Texas Trading & Milling Corp., Decor by Nikkei International, Inc., Chenax Majesty, Inc. and East Europe Import-Export, Inc.

2. 28 U.S.C. §§ 1330, 1332(a)(2), (3) and (4), 1391(f), 1441(d), 1601-1611 (1976). The FSIA was enacted on October 21, 1976 and became effective ninety days thereafter.

3. *Texas Trading & Milling Corp. v. Fed. Republic of Nigeria*, 500 F. Supp. 320, 327 (S.D.N.Y. 1980).

4. Section 1605 provides in pertinent part:

(a) A foreign state shall not be immune from the jurisdiction of courts of the United States in any case-

* * * * *

(2) 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 (emphasis added).

5. *Decor by Nikkei Int'l, Inc. v. Fed. Republic of Nigeria*, 497 F. Supp. 893, 905-906 (S.D.N.Y. 1980). The district court awarded \$1.857 million to Nikkei, \$1.986 million to East Europe Import-Export, Inc. and nothing to Chenax Majesty, Inc.

Fed. Republic of Nigeria, 647 F.2d 300 (2d Cir. 1981), cert. denied 102 S. Ct. 1012 (1982).⁶

During the mid-1970s, Nigeria embarked on an ambitious development program, financed by revenues from exports of high-grade oil. To construct the infrastructure necessary for the program, the military government executed 109 contracts with sixty-eight suppliers to purchase huge quantities of Portland cement. The contracts, signed in 1975, were substantially similar. Each called for the sale to Nigeria by the supplier of 240,000 metric tons of cement, and required Nigeria to establish in the seller's favor an irrevocable and confirmed letter of credit with the banks named in the individual contract for the total amount due under the contract, approximately fourteen million dollars. Instead of establishing letters of credit with the named banks, Nigeria established "irrevocable" letters of credit with the Central Bank of Nigeria, an instrumentality of the government, and advised the letters of credit through the Morgan Guaranty Trust Company of New York (Morgan).

Within six months, Nigeria was confronted with a crisis common to many of the resource rich underdeveloped nations which have rushed into massive programs of development; it had considerably misjudged its ability to absorb large quantities of imports. In an attempt to deal with ports which were so congested by the daily arrival of ships loaded with cement that essential imports could not be unloaded, a new government issued regulations restricting access to the nation's ports and the Central Bank unilaterally altered the terms of the letters of credit. Although over forty suppliers accepted Nigeria's offer to cancel the contract, Nigeria repudiated the contracts with those suppliers which refused to settle, initiating one of the most enormous commercial disputes in history, from which these actions ensued.

The court of appeals found the law before it complex and

6. Hereinafter cited as *Texas Trading*. Defendants appealed from both the jurisdictional rulings and the awards on the merits in *Nikkei* and *East Europe*; plaintiffs appealed from the partial denial of damages. In *Chenax*, plaintiffs appealed from the total denial of damages and defendants cross-appealed from the finding of jurisdiction. The court of appeals affirmed in full the three judgments in *Nikkei* and reversed and remanded in *Texas Trading*. 647 F.2d at 306 n.15, 316. The Second Circuit decided three related cases on the same day: *Verlinden B.V. v. Central Bank of Nigeria*, 647 F.2d 320 (2d Cir. 1981), cert. granted 102 S. Ct. 997 (1982); *Reale Int'l, Inc. v. Fed. Republic of Nigeria*, 647 F.2d 330 (2d Cir. 1981); and *Gemini Shipping, Inc. v. Foreign Trade Org'n, etc.* 647 F.2d 317 (2d Cir. 1981). *Verlinden* and *Reale* arose from the same transaction sued upon in *Texas Trading*.

largely unconstrued. It therefore had the opportunity to "vindicate the Congressional purposes behind the Act" — "to 'restrict' the immunity of a foreign state to suits involving a foreign state's public acts"⁷ . . . in reaching its decision. The FSIA codifies the widely accepted restrictive theory of sovereign immunity limiting its exercise to cases involving governmental acts. Those acts which private persons usually perform are not protected.⁸

The *Texas Trading* decision is the first to affirm the exercise of "effects" jurisdiction over commercial claims based on financial effect under the provisions of § 1605(a)(2) of the FSIA. Prior to this decision, the due process requirement of minimum contacts of the foreign sovereign in the forum state was not satisfied by economic injury to a corporation.⁹

The court based its decision on a lengthy analysis of three issues: the availability of sovereign immunity as a defense, the presence of subject matter jurisdiction over the claim and the propriety of personal jurisdiction over the defendants.

The determination of whether a particular transaction is "commercial" within the meaning of § 1603(d)¹⁰ is the most important decision a court faces in a FSIA suit. Upon a review of the facts, the court determined that the disputed transactions did represent commercial activity. It supported this finding by referring to three sources of law: (1) statements contained in the legislative history; (2) the body of case law which existed at the time the FSIA was passed; and (3) current standards of international law. The court determined that it was the intent of the Congress that where a foreign government engages in activity in which a private entity could engage, it is not entitled to the shield of immunity.¹¹

7. *Texas Trading* at 306, 308. H.R. REP. NO. 1487, 94th Cong., 2d Sess. 18, reprinted in 1976 U.S. CODE CONG. & AD. NEWS 6605, 6605.

8. *Id.* at 6613.

9. See, e.g., *Thos. P. Gonzalez Corp. v. Consejo Nacional de Producción de Costa Rica*, 614 F.2d 1247 (9th Cir. 1980); *Harris v. VAO Intourist Moscow*, 481 F. Supp. 1056 (E.D.N.Y. 1979); *Upton v. Empire of Iran*, 459 F. Supp. 264 (D.D.C. 1978), *aff'd mem.*, 627 F.2d 494 (D.C. Cir. 1978). For a discussion of the FSIA and due process, see Note, *Effects Jurisdiction Under the Foreign Sovereign Immunities Act and the Due Process Clause*, 55 N.Y.U. L. REV. 474 (1980).

10. Section 1603(d) provides:

A "commercial activity" means either a regular course of commercial conduct or a particular commercial transaction. The commercial character of an activity shall be determined by reference to the nature of the course of conduct or particular transaction or act, rather than by reference to its purpose.

11. See, e.g., *Hearings on H.R. 11315 Before the Subcomm. on Administrative Law and*

Existing case law demonstrated that the restrictive theory of sovereign immunity had been consistently followed by the courts since it was articulated in the so-called "Tate Letter" of May 29, 1952.¹² Further, the court also concluded that the drafters of the act intended to bring American sovereign immunity practice into line with generally recognized international standards.¹³ The uniform denial of the defense of sovereign immunity to Nigeria in actions brought in foreign courts arising out of the same series of transactions persuaded the court that the international community followed the restrictive theory of sovereign immunity.¹⁴ Thus, the court concluded that the defense of sovereign immunity was not available to Nigeria in this action.

The court then focused its analysis on the meaning of "direct effect in the United States" to determine whether statutory subject matter jurisdiction was present. The House Report states only that § 1605(a) subjects commercial conduct abroad to the exercise of jurisdiction by the United States. Stating that Congress had left the responsibility of interpreting the Act to the courts, the Second Circuit turned to the relevant case law and noted that those cases involved harm to natural persons.¹⁵ The application of the FSIA to corporations was not found to be as simple because corporations can suffer only financial harm. Accordingly, the court determined that the relevant inquiry is whether a corporation suffered a *direct* financial loss.

The court found a direct financial loss (effect) in *Texas Trading* because the beneficiaries of the breached contracts were American corporations to which money was to be paid by a foreign state's agent (Morgan) in the United States. The court thus held that the third clause of § 1605(a)(2)¹⁶ conferred statutory subject matter jurisdiction. A constitutional basis for the exercise of such jurisdiction was found in the Article III grant of judicial power over suits "between a State, or the Citizens thereof, and foreign

Governmental Relations of the House Comm. on the Judiciary, 94th Cong., 2d Sess. 53 (1976) (statement of Monroe Leigh, Legal Adviser, Dep't of State).

12. 26 DEP'T STATE BULL. 984 (1952).

13. 647 F.2d at 310.

14. See, e.g., *Yousef M. Nada Establishment v. Central Bank of Nigeria*, 16 I.L.M. 501 (Frankfurt/Main D. Ct. 1976) (W. Germany); *Trendtex Trading Corp. v. Central Bank of Nigeria*, [1977] W.L.R. 356, 1 All E.R. 881; *Hispano American Mercantil, S.A. v. Central Bank of Nigeria*, [1979] 2 Lloyd's L.R. 227.

15. See note 7, *supra*.

16. 647 F.2d at 313.

States.”¹⁷

Finally, the court turned to the issue of personal jurisdiction and held that statutory personal jurisdiction existed because service was made and Nigeria had not objected to it. The court noted that essential to any finding of personal jurisdiction is the application of a constitutional due process analysis. Such an analysis was first applied by the Second Circuit in a suit against a foreign state in *Amoco Overseas Oil Co. v. Compagnie Nationale Algerienne de Navigation*¹⁸ where the court held that the presence of freight in New York, sent with the agreement of *Companie Nationale*, was a sufficient basis for asserting personal jurisdiction. The court affirmed its decision in *Amoco* and proceeded with a “minimum contacts” analysis through an application of the requisite elements provided by case law from *International Shoe Co. v. State of Washington*¹⁹ to *World-Wide Volkswagen Corp. v. Woodson*.²⁰ The Second Circuit concluded that since the activities of Nigeria through its Central Bank and the latter’s agent in New York, Morgan Guaranty Trust Company (the payor of the letters of credit) satisfied the minimum contacts test of *International Shoe*, the exercise of personal jurisdiction over Nigeria was proper.

Texas Trading is significant because it is the first case to affirm that the use of direct financial effect to establish the imposition of jurisdiction over a foreign state is the proper interpretation of the FSIA. It provides a guide for determining when the defense of sovereign immunity may be validly invoked in an action involving a commercial transaction between a corporation and a foreign sovereign. In addition, this decision fosters international commerce because corporations can enter into a contract with a foreign state with the knowledge that a remedy is available in the event of a breach of contract, without fearing that an inequitable defense will be interposed to defeat the action. Foreign states, on the other hand, will be forced to recognize that they can no longer contract with private entities with impunity.

ROBERT H. YAFFE

17. U.S. CONST. art III, § 2, cl. 1.

18. 605 F.2d 648 (2d Cir. 1979).

19. 326 U.S. 310 (1945).

20. 444 U.S. 286 (1980).