

# Client Alert

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## Second Circuit Permits Argentina to Skirt Collection on Sovereign Immunity Grounds

Argentina has thwarted debt security holders' attempts to collect on their bond default judgments stemming from the nation's 2001 economic collapse and subsequent repayment moratorium. EM Ltd. and NML Capital, Ltd.'s ("Plaintiffs") latest attempt involved casting Banco Central de la República Argentina ("Argentine Central Bank") as Argentina's alter ego under the Supreme Court's *Bancec*<sup>1</sup> analysis to extend Argentina's express waiver of sovereign immunity and enable an attachment of the Argentine Central Bank's funds located in the United States. Despite recognizing that Argentina may use its ruling to "continue shirking the debts it has the ability to pay" as a "predictable and unfortunate outcome," the Second Circuit Court of Appeals nonetheless upheld the Argentine Central Bank's right to sovereign immunity in the absence of an express waiver and reinforced the rigidity of the *Bancec* test. *EM Ltd. v. Banco Central de la República Argentina*, No. 13-3819-cv(L) (2d Cir. August 31, 2015).

### Background

In 1994, Argentina began to issue debt securities pursuant to a Fiscal Agency Agreement ("FAA") that included a waiver of its foreign sovereign immunity as to related enforcement actions. In 2001, Argentina declared a moratorium on principal and interest payments and later restructured the majority of its debt through "global exchange offers." Plaintiffs were FAA bond owners that opted out of these offers and instead brought multiple recovery actions against Argentina in the Southern District of New York. As Argentina did not dispute the FAA waiver of sovereign immunity, Plaintiffs obtained numerous final judgments against Argentina totaling approximately \$2.4 billion.

Plaintiffs have made several attempts to satisfy their judgments by attaching Argentine Central Bank funds held in the Federal Reserve Bank of New York. The first attempt relied on the basis that Argentina had expropriated funds from the Argentine Central Bank via national decrees to satisfy its own debts to international monetary authorities, but the Second Circuit upheld the trial court's ruling that the decrees did not create any such attachable interest. Plaintiffs then sought a declaratory judgment that Argentina had converted the Argentine Central Bank into its alter ego and that the FAA waiver would apply to the Argentine Central Bank. The trial court agreed and entered attachment orders against the Argentine Central Bank. The Second Circuit disagreed and vacated the attachment and remanded for further proceedings but declined to address the *Bancec* alter-ego analysis.

Plaintiffs amended their complaint to emphasize the *Bancec* alter ego claim against the Argentine Central Bank and sought to attach the Argentine Central Bank's assets held elsewhere in the world. The Argentine Central Bank moved to dismiss due to lack of subject matter jurisdiction under sovereign immunity which was denied by the trial court. An appeal followed.

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<sup>1</sup> *First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba*, 462 U.S. 611, 626-27, 629 (1983) ("*Bancec*") (creating a presumption that "government instrumentalities established as juridical entities distinct and independent from their sovereign should normally be treated as such" that may be rebutted by evidence of such "extensive[] control[] by its owner that a relationship of principal and agent is created" or of a "fraud or injustice" caused by such treatment).

## Holdings

The Second Circuit reversed the trial court's order and remanded with instructions to dismiss Plaintiffs' complaint with prejudice. In applying *Bancec*, the court found that Plaintiffs failed to plead sufficient facts of either extensive control or potential for injustice to rebut the presumption of the Argentine Central Bank's separateness from Argentina.

As to the *Bancec* alter ego extensive control analysis, the court identified several State activities that may be considered alter ego control: (1) use of the instrumentality's property as its own; (2) ignoring the instrumentality's separate status or corporate formalities; (3) depriving the instrumentality's independence from close political control; (4) requiring the instrumentality to obtain approvals for ordinary business decisions from a political actor; and (5) issuing policies or directives that cause the instrumentality to act directly on behalf of the State. While plaintiffs argued that Argentina had permitted political appointments and removals of bank officers, had directed the Argentine Central Bank to assist with selective repayment of obligations to international authorities, and had coordinated activities with the Argentine Central Bank to implement an "inflationary" policy, the Second Circuit found that these actions were common to a State's relationship with a central bank and certainly were not sufficient to satisfy *Bancec*'s alter ego analysis. As to the *Bancec* alter ego potential for injustice analysis, the court found that Plaintiffs failed to allege that Argentina had used the Argentine Central Bank to actively frustrate collection efforts or to improperly conceal otherwise actionable assets. While Plaintiffs alleged that permitting Argentina to selectively pay creditors would give rise to fraud or injustice, the court disagreed.

The Second Circuit also found that the Argentine Central Bank's potential use of dollars held with the Federal Reserve Bank of New York to finance Argentina's payments to other creditors was entirely incidental to any alleged improper conduct, and did not meet the Section 1605(a)(2) definition of commercial activity. The Second Circuit stated that to permit Plaintiffs' definition would be to improperly expand its scope to include every possible scenario wherein dollars were wrongfully used outside of the US.

## Impact

The Second Circuit has emphasized the importance of sovereign immunity and the limited nature of permissible waivers. As sovereign immunity challenges are raised in the pleadings stage, it is critical to ensure that one pleads sufficient facts in the complaint to satisfy the threshold burden.

When entering into a business relationship with a State or instrumentality, one must pay close attention to dispute resolution options as well as the possibility for judgment enforcement. The Latin America Group and International Arbitration and Transnational Litigation Group at Hunton & Williams LLP are ready to assist you with these matters and will continue to closely monitor related developments. Please contact us if you have any questions or would like further information regarding how the application of sovereign immunity may affect actions taken against States and their instrumentalities.

## Contacts

**Samuel A. Danon**  
sdanon@hunton.com

**Gustavo J. Membiela**  
gmembiela@hunton.com

**Román Ortega-Cowan**  
rortega@hunton.com