

## NOTES

### TOO SOVEREIGN TO BE SUED: IMMUNITY OF CENTRAL BANKS IN TIMES OF FINANCIAL CRISIS

States have long struggled to reconcile the public interest in avoiding judicial interference in foreign relations with the private interests of citizens who have been aggrieved by a foreign state. The American approach to this issue has been codified in the Foreign Sovereign Immunities Act of 1976<sup>1</sup> (FSIA), which provides that, as a general matter, sovereigns receive immunity when exercising the unique powers of a state, but not when participating in “commercial activity,” defined as activity that although performed by the sovereign is of a type that a private party could also engage in.<sup>2</sup>

The FSIA also offers added protections for some traditionally significant sovereign assets.<sup>3</sup> One type of entity that receives such added protection is foreign central banks. Central banks perform critical functions in the global economy, ensuring that currency markets are stable and providing emergency assistance in times of financial crisis. Over time, however, courts have eroded that special protection, applying the “commercial activity” test to virtually define away the added security for sovereign functions performed by central banks, because the same activities that central banks undertake for market regulation and intervention are also undertaken by private parties acting out of a profit motive. In addition, courts have applied common law corporate veil piercing principles to question whether central banks are even independent entities, or whether they should instead be treated as the alter egos of their sovereign states and thus no longer qualify for the special protections the FSIA provides. But this retreat from more absolute immunity for central banks is particularly dangerous. It fails to recognize that central banks often perform their sovereign, regulatory functions through open market activities, presenting especial risk during financial crises. Such crises create a “perfect storm,” during which central banks are most likely to lose their immunity protection at precisely the time they need it most. First, litigious creditors seek any liquid assets they can obtain — specifically the foreign exchange reserves of central banks. Second, central banks are more likely to be acting as private players in the market — creating credit facilities to provide liquidity previously provided by defunct private institutions. Third, central banks are acting at the direction (i.e., as the alter ego) of their

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<sup>1</sup> Pub. L. No. 94-583, 90 Stat. 2891 (codified in scattered sections of 28 U.S.C.).

<sup>2</sup> See *Republic of Argentina v. Weltover, Inc.*, 504 U.S. 607, 614 (1992).

<sup>3</sup> See, e.g., 28 U.S.C. § 1611(b)(2) (2006) (protecting military equipment from attachment).

parent governments. This “perfect storm” presents risks to the global economy, the U.S. economy, the political goals of the FSIA, and the legal consistency of the concept of sovereign immunity.

It need not be so. Courts should return to a test that protects central bank activity based on the purposes that it serves rather than on whether it is the type of activity a private party would engage in. Such an approach would ensure that central banks are protected from judicial interference in performing their sovereign financial transactions, serving both the theoretical goals of sovereign immunity and the practical needs of financial regulation and stability.

### I. ISSUES RAISED BY SUITS AGAINST CENTRAL BANKS

A variety of factors have resulted in increased litigation against sovereign governments and central banks. Two bear particular note.

First, sovereigns have, in recent years, more frequently waived their immunity.<sup>4</sup> By clearly defining when sovereign immunity applies, the FSIA encouraged private parties to contract around its default provisions, leading to more explicit waivers negotiated to “enabl[e] third parties to deal with the [sovereign] instrumentality knowing that they may seek relief in the courts.”<sup>5</sup> The existence of waivers, however, hardly settles that all of the sovereign’s various components are subject to suit. The FSIA provides for separate immunity for different juridical entities within a government, causing the particular conundrum addressed by this Note — when may the assets of one sovereign entity be seized in satisfaction of a judgment against another? As a result, to say that “sovereign debtors . . . explicitly consented to the jurisdiction of U.S. courts”<sup>6</sup> does not ensure the plaintiff’s recovery — the dollars he seeks to claim in execution of the judgment must not be protected by a separate shield as well.

Second, the evolution of government financing from private bank loans<sup>7</sup> into securitized sovereign bond issues has greatly expanded the number and types of private counterparties to transactions with foreign governments. Key among these new parties are private investment entities expressly designed to acquire sovereign debts and take advantage of immunity waivers through litigation:

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<sup>4</sup> See Horacio T. Liendo III, *Sovereign Debt Litigation Problems in the United States: A Proposed Solution*, 9 OR. REV. INT’L L. 107, 118–19 (2007).

<sup>5</sup> *First Nat’l City Bank v. Banco Para el Comercio Exterior de Cuba*, 462 U.S. 611, 625 (1983).

<sup>6</sup> Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguard? The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L.J. 1043, 1076 (2004).

<sup>7</sup> See generally Claudio Borio, *Foreign Exchange Reserve Management*, in THE NEW PALGRAVE DICTIONARY OF ECONOMICS, Online Edition (Steven N. Durlauf & Lawrence E. Blume eds., 2009), [http://www.dictionaryofeconomics.com/article?id=pde2009\\_F000325](http://www.dictionaryofeconomics.com/article?id=pde2009_F000325).

Distressed debt funds, or “vulture funds,” have commanded media attention lately due to their complicated role in the sovereign debt restructuring process. A vulture fund is not a primary lender, but instead . . . purchases . . . sovereign debt on the secondary market. It not only refuses to participate in any voluntary restructuring, but often attempts to use litigation to collect the full face value of its claim from the sovereign debtor.<sup>8</sup>

The growth of vulture funds has increasingly put sovereign immunity to the test. Their widespread acquisition of so-called “distressed” debt on the secondary market has magnified both the frequency of suit and the risk that sovereigns face in litigation.<sup>9</sup>

Central banks have not avoided this explosion of litigation. On the contrary, they frequently take the place of their sovereign governments as defendants in debt-related U.S. litigation.<sup>10</sup> Indeed, “[c]entral banks are inherently more vulnerable to an execution claim against foreign governments than any other agency or instrumentality. Central banks are likely both to hold the assets of their home governments and to have those funds present in many foreign countries in the course of their regular business.”<sup>11</sup> For U.S. counterparties to transactions with sovereign governments, central bank accounts with the Federal Reserve Bank of New York (FRBNY) are a ripe target for attachment.<sup>12</sup> The FRBNY holds “\$3 trillion in U.S. dollar-denominated assets at the Bank, more than half of the world’s official U.S. dollar reserves.”<sup>13</sup> This presence in a single entity of a substantial portion of the potential sources of income for an expanding, litigious set of sovereign creditors has made the Southern District of New York the “focal point venue in the emerging world of sovereign debt enforcement.”<sup>14</sup>

In order to attach the assets of a foreign central bank, however, a litigant must surmount the special protections the FSIA affords central banks. Section 1611(b)(1) addresses the specific immunity needs of central banks: “Notwithstanding the provisions of section 1610 of this

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<sup>8</sup> Elizabeth Broomfield, *Subduing the Vultures: Assessing Government Caps on Recovery in Sovereign Debt Litigation*, 2010 COLUM. BUS. L. REV. 473, 475.

<sup>9</sup> See Jonathan C. Lippert, *Vulture Funds: The Reason Why Congolese Debt May Force a Revision of the Foreign Sovereign Immunities Act*, N.Y. INT’L L. REV., Summer 2008, at 1, 2 (“[C]areful analysis of the application of the current language of the FSIA in these cases reveals that if the correct set of circumstances were present, a vulture fund could succeed in attaching millions of dollars . . .”).

<sup>10</sup> See Lijiang Zhu, *State Immunity from Measures of Constraints for the Property of Foreign Central Banks: The Chinese Perspective*, 6 CHINESE J. INT’L L. 67, 67 (2007).

<sup>11</sup> Jeremy Ostrander, *The Last Bastion of Sovereign Immunity: A Comparative Look at Immunity from Execution of Judgments*, 22 BERKELEY J. INT’L L. 541, 568 (2004).

<sup>12</sup> Paul L. Lee, *Central Banks and Sovereign Immunity*, 41 COLUM. J. TRANSNAT’L L. 327, 394 n.250 (2003).

<sup>13</sup> *Services for Central Banks*, FED. RESERVE BANK OF N.Y., [http://www.newyorkfed.org/banking/services\\_centralbank.html](http://www.newyorkfed.org/banking/services_centralbank.html) (last visited Oct. 30, 2010).

<sup>14</sup> Liendo, *supra* note 4, at 121.

chapter [regarding exceptions to immunity from attachment], the property of a foreign state shall be immune from attachment and from execution, . . . if the property is that of a foreign central bank or monetary authority held for its own account . . . .”<sup>15</sup>

While this provision might seem simple, the question of when a central bank’s assets are “held for its own account” has proven challenging to courts.<sup>16</sup> Indeed, “[t]he rub in § 1611(b)(1) lies in the fact that it provides no definition of this phrase.”<sup>17</sup> Congress provided some additional insight in the legislative history, noting that the funds held for the central bank’s own accounts would be those “used or held in connection with central banking activities, as distinguished from funds used solely [for] commercial transactions.”<sup>18</sup> Courts have adopted this distinction with authority.<sup>19</sup>

Litigants have adopted two major strategies in arguing that this section does not preclude attachment of central bank assets in satisfaction of their judgments. First, they have directly exploited this loophole in the legislative history: because central banks are engaged in commercial activity, the funds are not “held for [the central bank’s] own account,” and are therefore subject to seizure as an attachable interest of the parent government.<sup>20</sup> A second, parallel strategy has been to argue that § 1611 should not even apply because the central bank is not a separate juridical entity from its parent government.<sup>21</sup> This theory, derived from the common law of corporate veil piercing, posits that because the government exerts significant control over the central bank, the bank becomes the “alter ego” of the government. As a result, the bank’s assets would not be considered those of a central bank at all, but merely those of the government, attachable to satisfy a judgment against it.

These arguments have met with mixed reception thus far from courts.<sup>22</sup> The adoption of either theory, however, poses significant risks to the important immunity protections Congress afforded to cen-

<sup>15</sup> 28 U.S.C. § 1611(b)–(b)(1) (2006).

<sup>16</sup> See, e.g., *Ministry of Def. & Support for the Armed Forces of the Islamic Republic of Iran v. Cubic Def. Sys., Inc.*, 385 F.3d 1206, 1223–24 (9th Cir. 2004).

<sup>17</sup> Lee, *supra* note 12, at 377.

<sup>18</sup> H.R. REP. NO. 94-1487, at 31 (1976), reprinted in 1976 U.S.C.C.A.N. 6604, 6630.

<sup>19</sup> See, e.g., *Banque Compafina v. Banco de Guat.*, 583 F. Supp. 320, 322 (S.D.N.Y. 1984); see also *Ostrander*, *supra* note 11, at 581 (“In practice, the structure of the ‘own account’ test probably reflects a watered down version of the commercial activity test . . .”).

<sup>20</sup> See, e.g., *Weston Compagnie de Finance et d’Investissement, S.A. v. Republica del Ecuador*, 823 F. Supp. 1106, 1111 (S.D.N.Y. 1993) (describing plaintiff’s argument).

<sup>21</sup> See, e.g., *LCN Invs., Inc. v. Republic of Nicaragua*, 115 F. Supp. 2d 358, 363–66 (S.D.N.Y. 2000).

<sup>22</sup> Compare *Weston*, 823 F. Supp. 1106 (rejecting commercial activity theory), with *EM Ltd. v. Republic of Argentina*, 03-CV-2507(TPG), 2010 WL 1404119 (S.D.N.Y. Apr. 7, 2010) (finding central bank to be alter ego of government).

tral banks. Both approaches would make it possible to lock up the foreign exchange reserves of a foreign central bank in satisfaction of a judgment against the parent government.

## II. THE FSIA: ORIGINS AND EXCEPTIONS

The United States has a long and rich jurisprudence of sovereign immunity, dating to the 1812 case of *The Schooner Exchange v. M'Faddon*,<sup>23</sup> which provided absolute immunity from suit because such "interference cannot take place without affecting [the sovereign's] power and his dignity."<sup>24</sup> After more than a century of adherence to this "absolute" theory of sovereign immunity, however, the Court retreated in 1938, allowing in *Compania Espanola de Navegacion Maritima, S.A. v. The Navemar*<sup>25</sup> that foreign sovereign immunity should not be absolute, but should be available to protect a sovereign at the request of the State Department, the executive branch's representative in foreign affairs.<sup>26</sup> Following *The Navemar* and the later *Republic of Mexico v. Hoffman*,<sup>27</sup> the State Department's "'suggestion of immunity' [was] held binding on the courts."<sup>28</sup> As a result, sovereign immunity law's development shifted from the courts to the executive.

Although the State Department briefly continued to adopt an absolute view as well, in 1952, State Department Legal Advisor Jack Tate announced a policy shift. The so-called "Tate Letter" "surveyed trends in European, East Asian, and South American immunity jurisprudence,"<sup>29</sup> and concluded that "little support has been found . . . for continued full acceptance of the absolute theory."<sup>30</sup> Instead, Tate recommended adoption of the "restrictive" theory of sovereign immunity, which he described as guaranteeing that "the immunity of the sovereign is recognized with regard to sovereign or public acts (*jure imperii*) of a state, but not with respect to private acts (*jure gestionis*)."<sup>31</sup> The Tate Letter still afforded the executive considerable flexibility, al-

<sup>23</sup> 11 U.S. (7 Cranch) 116 (1812).

<sup>24</sup> *Id.* at 144.

<sup>25</sup> 303 U.S. 68 (1938).

<sup>26</sup> See *id.* at 74-75; Aaron Bernay, *Finding the Nexus: Measuring Jurisdiction Under the First Clause of the Commercial Activity Exception to the Foreign Sovereign Immunities Act*, 77 U. CIN. L. REV. 1581, 1584 (2009).

<sup>27</sup> 324 U.S. 30 (1945).

<sup>28</sup> William A. Dobrovir, *A Gloss on the Tate Letter's Restrictive Theory of Sovereign Immunity*, 54 VA. L. REV. 1, 1 (1968).

<sup>29</sup> Bernay, *supra* note 26, at 1584.

<sup>30</sup> Letter from Jack B. Tate, Acting Legal Advisor, U.S. Dep't of State, to the Attorney General (May 19, 1952), reprinted in Alfred Dunhill of London, Inc. v. Republic of Cuba, 425 U.S. 682, app. 2 at 714 (1976).

<sup>31</sup> *Id.*, reprinted in Dunhill, 425 U.S. at app. 2 at 711.

lowing the State Department to eschew formal rules and “issue a suggestion whenever foreign policy considerations so require.”<sup>32</sup>

While the Tate Letter marked the formal rejection of immunity for commercial transactions of sovereigns, courts had acknowledged the theoretical legitimacy of the restrictive theory long before. Even in dictum of *The Schooner Exchange*, Chief Justice Marshall recognized that sovereign immunity might admit a distinction between purely sovereign acts and those of a more private character:

[T]here is a manifest distinction between the private property of the person who happens to be a prince, and that military force which supports the sovereign power, and maintains the dignity and the independence of a nation. A prince, by acquiring private property in a foreign country, may possibly be considered as subjecting that property to the territorial jurisdiction, he may be considered as so far laying down the prince, and assuming the character of a private individual . . . .<sup>33</sup>

Although the State Department had formally adopted the restrictive theory, academics still expressed concern that “it may wield its power with too little regard for the rights of private litigants.”<sup>34</sup> Congress subsequently removed the determination of commercial versus sovereign activity from the executive to the courts with the FSIA. The Act, which chiefly codified the existing restrictive theory of sovereign immunity, “provides the exclusive basis for federal court jurisdiction in civil actions against foreign states, their agencies and instrumentalities, and the circumstances under which judgments rendered against foreign states can be executed.”<sup>35</sup>

The FSIA addressed jurisdiction and attachment separately, providing a default of sovereign immunity<sup>36</sup> with specific exceptions. For both forms of immunity, Congress codified the “commercial activity exception” derived from the restrictive theory. The statute’s definition of commercial activity has proved troublesome for courts, especially insofar as it does not so much specify what constitutes commercial activity as describes the analysis a court should undertake: “A ‘commercial activity’ means either a regular course of commercial conduct or a particular commercial transaction or act. 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.”<sup>37</sup> The House Report on the FSIA offered some clarification to that definition that courts have readily adopted: “[T]he fact that

<sup>32</sup> Dobrovir, *supra* note 28, at 2–3.

<sup>33</sup> *The Schooner Exchange v. M’Faddon*, 11 U.S. (7 Cranch) 116, 145 (1812).

<sup>34</sup> Michael H. Cardozo, *Sovereign Immunity: The Plaintiff Deserves a Day in Court*, 67 HARV. L. REV. 608, 608 (1954).

<sup>35</sup> *Hercaire Int’l, Inc. v. Argentina*, 821 F.2d 559, 563 (11th Cir. 1987).

<sup>36</sup> See 28 U.S.C. §§ 1604, 1609 (2006).

<sup>37</sup> *Id.* § 1603(d).

goods or services to be procured through a contract are to be used for a public purpose is irrelevant; it is the essentially commercial nature of an activity or transaction that is critical.”<sup>38</sup>

In interpreting the commercial activity exception in *Republic of Argentina v. Weltover*,<sup>39</sup> the Supreme Court adhered closely to the legislative report: it found that Argentina’s issuance of sovereign bonds, even though designed to address a domestic fiscal crisis, constituted commercial activity.<sup>40</sup> The Court offered a test for lower courts to apply in determining when activity is governed by the exception to immunity:

[T]he question is not whether the foreign government is acting with a profit motive or instead with the aim of fulfilling uniquely sovereign objectives. Rather, the issue is whether the particular actions that the foreign state performs (whatever the motive behind them) are the *type* of actions by which a private party engages in “trade and traffic or commerce.”<sup>41</sup>

This so-called *Weltover* “private player” test has dominated commercial activity analysis, morphing into the question of “whether a private person could have engaged in similar conduct.”<sup>42</sup>

The *Weltover* commercial activity test — emphasizing the transaction’s nature to the exclusion of its purpose — is perhaps inaptly applied to central banks. First, it works largely to vitiate the separate protection Congress recognized was necessary for central banks. As noted above, Congress provided an exception to the exception: notwithstanding the commercial activity rule, central banks should enjoy the added protection of § 1611(b)(1). Section 1610 would protect a central bank’s assets from attachment or execution except if they were used for commercial activity, purely on the basis of the bank’s status as an “agency or instrumentality of a foreign state.”<sup>43</sup> Applying the House Report version of “held for its own account” would simply restate this protection, rendering § 1611 mere surplusage.<sup>44</sup> The same troublesome House Report, moreover, indicates that Congress recognized the need to protect central bank reserves beyond the assets of other instrumentalities, because if attachment were permitted, “deposit of foreign funds in the United States might be discouraged. Moreover, execution against the reserves of foreign states could cause significant foreign relations problems.”<sup>45</sup> At least one court has recognized this

<sup>38</sup> H.R. REP. NO. 94-1487, at 16 (1976), *reprinted in* 1976 U.S.C.C.A.N. 6604, 6615.

<sup>39</sup> 504 U.S. 607 (1992).

<sup>40</sup> *Id.* at 617.

<sup>41</sup> *Id.* at 614 (quoting BLACK’S LAW DICTIONARY 270 (6th ed. 1990)).

<sup>42</sup> *BCI Aircraft Leasing, Inc. v. Republic of Ghana*, No. 06-C-0130, 2006 WL 2989291, at \*6 (N.D. Ill. Oct. 13, 2006).

<sup>43</sup> 28 U.S.C. § 1610(b) (2006).

<sup>44</sup> *Cf. Lee*, *supra* note 12, at 378.

<sup>45</sup> H.R. REP. NO. 94-1487, at 31 (1976), *reprinted in* 1976 U.S.C.C.A.N. 6604, 6630.

conundrum,<sup>46</sup> but this view has not achieved widespread currency. On the contrary, “[t]he district courts that have considered the central bank exemption so far have read it narrowly; in some cases, the exemption has been found not to apply even where the funds unquestionably belonged to the foreign state’s central bank.”<sup>47</sup>

Moreover, the House Report’s purported distinction between traditional central bank activities and commercial functions would offer virtually no protection to central banks if read as a kind with the *Weltover* test. The explicit provision of separate immunity recognized that a central bank’s management of foreign exchange assets in the United States is “inherently characteristic of sovereignty,”<sup>48</sup> and the management of those assets is certainly a traditional central bank activity.<sup>49</sup> Yet managing these reserves is the type of action — the touchstone of *Weltover* — that private parties frequently engage in: making investments or placing deposits with U.S. banks, usually the FRBNY.<sup>50</sup> Paul Lee, a former Treasury Department official and general counsel of banking giant HSBC, explains the conundrum this generates:

[T]he regulation of foreign exchange has been considered “paradigmatically sovereign in nature.” Based on *Weltover*, one would conclude that the *decision* by a central bank whether to sell foreign exchange or to fix the particular terms or circumstances on which foreign exchange would be sold would be a governmental act and entitled to immunity. Once a central bank enters into a *transaction* with respect to foreign exchange, however, the transaction itself becomes a commercial act.<sup>51</sup>

The *Weltover* distinction between a private party and a market regulator therefore poorly reflects the way in which central banking authorities execute monetary policy. One of central banks’ key tools is “indirectly regulating . . . through intervention in exchange markets to affect the currency exchange rate.”<sup>52</sup> Nor is this intervention limited to central banks in poor countries with exchange rate problems — the Federal Reserve’s use of “quantitative easing” (buying financial assets

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<sup>46</sup> *Weston Compagnie de Finance et d’Investissement, S.A. v. Republica del Ecuador*, 823 F. Supp. 1106, 1112 (S.D.N.Y. 1993) (“Property used for commercial activity and property of a central bank held for its own account are not mutually exclusive categories. Rather, as the structure of the FSIA makes clear, property of a central bank held for its own account is a category of property used for commercial activity.”).

<sup>47</sup> *Ministry of Def. & Support for the Armed Forces of the Islamic Republic of Iran v. Cubic Def. Sys., Inc.*, 385 F.3d 1206, 1223 n.21 (9th Cir. 2004).

<sup>48</sup> Ernest T. Patrikis, *Foreign Central Bank Property: Immunity from Attachment in the United States*, 1982 U. ILL. L. REV. 265, 286.

<sup>49</sup> See Takehiro Nobumori, *Recent Development of Sovereign Immunity Law in Japan from a Comparative Perspective of Central Banks*, 125 BANKING L.J. 885, 887 (2008).

<sup>50</sup> Lee, *supra* note 12, at 375–76.

<sup>51</sup> *Id.* at 373 (footnote omitted).

<sup>52</sup> Nobumori, *supra* note 49, at 887; see also Borio, *supra* note 7.



to increase the money supply) is well documented.<sup>53</sup> In short, central banks often regulate their currencies by acting as super-participants in the marketplace, leveraging substantial amounts of liquidity into the open market. Yet the indirect nature of such regulation receives no protection under *Weltover*, such that almost any central bank activity in the open market would be deemed that of “a private player rather than [of] a regulator,”<sup>54</sup> exposing the central bank’s assets to attachment and substantially eliminating the separate protection in § 1611.

### III. THE ALTER EGO TEST

Arguing that a central bank’s activities are commercial and therefore its funds are not “held for its own account” is hardly the only approach litigants have employed to seek attachment of central bank assets. They have also urged on courts a more complicated analysis, arguing that central bank funds do not deserve the separate protections of § 1611 because the monetary authority is in fact the “alter ego” of its parent — debtor — state. The forays of sovereign governments into open finance markets have inspired those states to seek the same protection of separate corporate entities that private parties employ to limit their own liability.<sup>55</sup> This adds another layer of complexity to FSIA analysis, raising the “separate, yet inextricably intertwined question [of] when a foreign state may be held responsible for the actions or obligations of its subsidiary, or vice versa” under an equitable theory of veil piercing.<sup>56</sup> In terms of corporate law, the question is whether “[a] government instrumentality loses its separate juridical status and becomes the alter-ego or agent of its parent government.”<sup>57</sup> Because sovereigns often include waivers in debt instruments, the alter ego analysis, or piercing the corporate veil, most “commonly arises with respect to execution or attachment, where the plaintiff seeks to collect on a judgment against a foreign state by executing upon the assets of the state’s subsidiary.”<sup>58</sup> This inquiry is particularly relevant to central banks, which, as noted above, are frequent targets of attachment in execution of judgments against their parent states.

The Supreme Court determined the standards for alter ego analysis under the FSIA in the seminal 1983 case *First National City Bank v.*

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<sup>53</sup> See, e.g., Sewell Chan, *Fed to Buy Debt to Fight Slowing of the Recovery*, N.Y. TIMES, Aug. 11, 2010, at A1.

<sup>54</sup> Ostrander, *supra* note 11, at 569.

<sup>55</sup> See generally Phillip Riblett, *A Legal Regime for State-Owned Companies in the Modern Era*, 18 J. TRANSNAT’L L. & POL’Y 1 (2008).

<sup>56</sup> *Id.* at 13.

<sup>57</sup> LNC Invs., Inc. v. Republic of Nicaragua, 115 F. Supp. 2d 358, 363 (S.D.N.Y. 2000).

<sup>58</sup> Riblett, *supra* note 55, at 13.

*Banco Para el Comercio Exterior de Cuba*<sup>59</sup> (*Bancec*). Citibank sought to offset a debt owed to Bancec, the foreign trade credit facility of the Cuban government, with money the Cuban government owed to Citibank for expropriating Citibank's assets after the 1959 revolution.<sup>60</sup> As a result, the question before the Court was whether the liabilities of the Cuban government could fairly be attributed to Bancec.

The Court held that the FSIA, while providing general principles to be followed, "is silent . . . concerning the rule governing the attribution of liability among entities of a foreign state."<sup>61</sup> As a result, the Court attempted to determine from principles "common to both international law and federal common law"<sup>62</sup> a standard for when it might set aside the presumption "that government instrumentalities established as juridical entities distinct and independent from their sovereign should normally be treated as such."<sup>63</sup> The Court concluded that two circumstances warranted that level of judicial intervention: first, "where a corporate entity is so extensively controlled by its owner that a relationship of principal and agent is created,"<sup>64</sup> and, second, when recognizing the separate corporate form would "work fraud or injustice."<sup>65</sup> The Court used this two-prong test, derived from American corporate law for piercing the corporate veil, to find that Bancec should be considered the alter ego of the Cuban government.<sup>66</sup>

Although *Bancec* established the alter ego test in the sovereign immunity context, it is hardly a bright-line standard. Lower courts have looked to "ordinary agency principles"<sup>67</sup> to determine whether alter ego attribution is appropriate. The touchstone of these principles is the extent to which the subsidiary is controlled by its parent government, but "[c]ourts have long struggled, often with confusing results, to explain how much control is required before parent and subsidiary may be deemed principal and agent."<sup>68</sup> Generally the plaintiff must show

<sup>59</sup> 462 U.S. 611 (1983).

<sup>60</sup> *Id.* at 613–16.

<sup>61</sup> *Id.* at 622 n.11.

<sup>62</sup> *Id.* at 623.

<sup>63</sup> *Id.* at 626–27.

<sup>64</sup> *Id.* at 629.

<sup>65</sup> *Id.* (quoting *Taylor v. Standard Gas & Elec. Co.*, 306 U.S. 307, 322 (1939)) (internal quotation mark omitted).

<sup>66</sup> See *id.*; Michael A. Granne, *Defining "Organ of a Foreign State" Under the Foreign Sovereign Immunities Act of 1976*, 42 U.C. DAVIS L. REV. 1, 37 (2008).

<sup>67</sup> *Transamerica Leasing, Inc. v. Republica de Venezuela*, 200 F.3d 843, 849 (D.C. Cir. 2000).

<sup>68</sup> *Id.* In applying *Bancec*, instead of clear tests, "what one typically gets in most opinions is a laundry list of factors against which the facts of the case at bar are then compared." Stephen M. Bainbridge, *Abolishing Veil Piercing*, 26 J. CORP. L. 479, 509 (2001). There are some common features to these lists, purportedly distilled from *Bancec*:

(1) the level of economic control by the government; (2) whether the entity's profits go to the government; (3) the degree to which government officials manage the entity or otherwise have a hand in its daily affairs; (4) whether the government is the real beneficiary

that the government's involvement in the subsidiary "exceeds the normal supervisory control exercised by any corporate parent over its subsidiary."<sup>69</sup> Even this inquiry does not permit easy application. Some courts have held that "when a state-controlled corporation implements state policies, its separate corporate existence does not shield the state from liability,"<sup>70</sup> whereas others have required that the government "dominate[] the operations of the company"<sup>71</sup> such that it "abuses the corporate form."<sup>72</sup>

Several concerns caution against applying alter ego analysis to central banks. First, alter ego analysis is a poor fit to determine the legal relationship between a central bank and its sovereign government — the separate protection of central banks derives from more than mere corporate separateness. If central banks only enjoyed immunity — subject to the commercial activity exception — based on their status as separate agencies or instrumentalities of the sovereign government, then veil-piercing analysis might be appropriate. Yet Congress chose to specially protect central banks from attachment through § 1611. As with the commercial activity analysis, alter ego theories fail to afford this over-and-above protection, again rendering § 1611 surplusage.

Second, as expressed in American corporate law, alter ego veil piercing is often a function of whether the principal "uses his control of the corporation to further his own, rather than the [subsidiary] corporation's, interests,"<sup>73</sup> a formulation commonly characterized as "abuse of corporate form."<sup>74</sup> Yet it makes no sense to distinguish between the interests of a parent government and those of its central bank; while bank officials and elected politicians may disagree on short-term goals and means, both entities exist for "sovereign objectives such as the advancement of health, education, and welfare of that nation's citizens."<sup>75</sup> Indeed, this unity of interest makes the traditional concept of abuse of the corporate form inapplicable. For example, while a subsidiary might easily be deemed the alter ego of its parent when the parent siphons funds from the subsidiary for its own use,

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of the entity's conduct; and (5) whether adherence to separate identities would entitle the foreign state to benefits in United States courts while avoiding its obligations.

Walter Fuller Aircraft Sales, Inc. v. Republic of the Philippines, 965 F.2d 1375, 1380 n.7 (5th Cir. 1992).

<sup>69</sup> *Transamerica Leasing*, 200 F.3d at 848.

<sup>70</sup> *McKesson Corp. v. Islamic Republic of Iran*, 52 F.3d 346, 352 (D.C. Cir. 1995).

<sup>71</sup> *BCI Aircraft Leasing, Inc. v. Republic of Ghana*, 06-C-0130, 2006 WL 2989291, at \*7 (N.D. Ill. Oct. 13, 2006).

<sup>72</sup> *LNC Invs., Inc. v. Republic of Nicaragua*, 115 F. Supp. 2d 358, 363 (S.D.N.Y. 2000).

<sup>73</sup> Bainbridge, *supra* note 68, at 483.

<sup>74</sup> See *EM Ltd. v. Republic of Argentina*, 473 F.3d 463, 478 (2d Cir. 2007) (equating alter ego finding with abuse of the corporate form).

<sup>75</sup> Joel Slawotsky, *Sovereign Wealth Funds and Jurisdiction Under the FSIA*, 11 U. PA. J. BUS. L. 967, 973 (2009).

such activity is commonplace between central banks and parent governments. The United States provides by statute that “[t]he Federal reserve banks shall transfer from the surplus funds of such banks . . . to the Secretary of the Treasury for deposit in the general fund of the Treasury.”<sup>76</sup> In short, the basic assumptions that govern the proper relationship between related corporate entities do not apply to the relationship between central banks and their parent governments, and, moreover, Congress plainly intended special protection for central banks notwithstanding these relationships.

Third, to the extent that *Bancec* purported to rely on principles of corporate organization that “our cases have long recognized,”<sup>77</sup> central bank autonomy seems more like a newfangled theory of macroeconomics than a shared understanding of proper corporate operation. The idea that monetary authorities should be partially independent from their sovereigns dates back at least to the British economist David Ricardo,<sup>78</sup> but in practice central bank autonomy is a comparatively new phenomenon.<sup>79</sup> Central bank independence is also not driven by the sort of corporate legal theories underlying the Court’s analysis in *Bancec*, but by practical factors relating to state monetary policy management. Specifically, autonomous central banks are considered superior at maintaining price stability and controlling inflation, and it was not until the 1980s and 1990s that it became “the accepted view . . . that inflation and the associated uncertainties retard growth.”<sup>80</sup> Moreover, price stability only became a dominant concern as an effect of recent developments in globalization leading to “the gradual dismantling of controls on capital flows and the associated widening of international capital markets . . . reinforc[ing] the quest for price stability and rais[ing] the importance of CBI [central bank independence].”<sup>81</sup>

Fourth, central bank autonomy is not a neutral application of the principles underlying the alter ego test — it asks courts to make a fundamentally political judgment. *Bancec* hewed carefully to “attribution principles common to both international law and federal common law,”<sup>82</sup> applying a largely undisputed theory of corporate law. The

<sup>76</sup> 12 U.S.C. § 289(b)(1) (2006).

<sup>77</sup> *First Nat’l City Bank v. Banco Para el Comercio Exterior de Cuba*, 462 U.S. 611, 629 (1982).

<sup>78</sup> See Harout Jack Samra, *Central Bank Autonomy in Latin America: A Survey and Case Studies*, 13 CHAP. L. REV. 63, 68 (2009).

<sup>79</sup> Geoffrey P. Miller, *An Interest-Group Theory of Central Bank Independence*, 27 J. LEGAL STUD. 433, 433 (1998) (“One of the most remarkable features in the recent evolution of world finance has been the emergence of independent central banks.”).

<sup>80</sup> Alex Cukierman, *Central Bank Independence and Monetary Policymaking Institutions — Past, Present and Future*, 24 EUR. J. POL. ECON. 722, 726 (2008).

<sup>81</sup> *Id.*

<sup>82</sup> *McKesson Corp. v. Islamic Republic of Iran*, 52 F.3d 346, 352 (D.C. Cir. 1995).

scholarly debate over central bank autonomy, however, has far greater political valence. While arguments in favor of central bank independence “have largely won the day among economists,”<sup>83</sup> independence still represents a “conservative . . . attitude toward monetary policy,”<sup>84</sup> and “several factions still stand in stark opposition.”<sup>85</sup> The counterarguments often focus on the effect of conservative monetary policy on social welfare and transparency.<sup>86</sup> To the extent that “[a] sovereign’s choice of macroeconomic policies is the product of a variety of political factors that may, in some cases, outweigh pressures for fiscal conservatism,”<sup>87</sup> the act of state doctrine suggests that courts should refrain from judging the political organization of a state’s monetary policy.

As originally expressed in *Underhill v. Hernandez*,<sup>88</sup> the act of state doctrine is prudential, avoiding judicially created international tensions by ensuring that “[e]very sovereign State is bound to respect the independence of every other sovereign State, and the courts of one country will not sit in judgment on the acts of the government of another.”<sup>89</sup> As the commercial activity exception to the FSIA demonstrates, the mere fact that a state is the actor does not immunize the activity, but the act of state doctrine often applies when litigants ask courts to declare that particularly sensitive national decisions give rise to liability. In *Banco Nacional de Cuba v. Sabbatino*,<sup>90</sup> the Supreme Court identified one circumstance when such factors might come into play:

The disagreement as to relevant international law standards reflects an even more basic divergence between the national interests of capital importing and capital exporting nations and between the social ideologies of those countries that favor state control of a considerable portion of the means of production and those that adhere to a free enterprise system. It is difficult to imagine the courts of this country embarking on adjudication

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<sup>83</sup> Samra, *supra* note 78, at 74.

<sup>84</sup> Miller, *supra* note 79, at 446.

<sup>85</sup> Samra, *supra* note 78, at 74.

<sup>86</sup> Timothy Canova has described the possible negative effects of increased independence: In reality, central bank autonomy is a euphemism for the capture of monetary policy by interested private banking and financial interests . . . . It is therefore not surprising that as [central banks have] gained more and more independence from the elected branches of government, [they have] increasingly followed policies that distinctly favor the interests of financial capital over industrial capital and labor, namely, a strong bias in favor of price stability and near-zero inflation over the goals of full employment and the financing of public sector programs.

Timothy A. Canova, *Financial Liberalization, International Monetary Disorder, and the Neoliberal State*, 15 AM. U. INT’L L. REV. 1279, 1294, 1296 (2000) (footnotes omitted).

<sup>87</sup> Fisch & Gentile, *supra* note 6, at 1048–49.

<sup>88</sup> 168 U.S. 250 (1897).

<sup>89</sup> *Id.* at 252.

<sup>90</sup> 376 U.S. 398 (1964).

in an area which touches more sensitively the practical and ideological goals of the various members of the community of nations.<sup>91</sup>

These same variances in theories of macroeconomic models are often at play in decisions relating to central bank autonomy. For example, in spite of the loud chorus of economists calling for autonomy, “[m]onetary independence is mostly a Western concept, one that’s still a work in progress in Asia” and in much of the developing world.<sup>92</sup> Moreover, “however independent a central bank is, the ultimate decisions on a country’s currency . . . are usually taken by the government.”<sup>93</sup> The tradeoff between conservative price stability and liberal expansion of the money supply represents a complicated political choice between the short-term benefits of expanding the economy to promote growth and the long-term costs of higher inflation.<sup>94</sup> Even highly independent banks bend to the will of political branches sometimes, reflecting the reality that “monetary policy is not the only needle in [their] compass.”<sup>95</sup> In short, to the extent that litigants employ the alter ego theory against central banks,<sup>96</sup> courts should be chary of declaring that political decisions on macroeconomic policy constitute an “abuse of the corporate form.”

#### IV. CURRENT RELEVANCE OF CENTRAL BANK IMMUNITY

These legal tests seriously threaten the effective operation of the FSIA at any time, and their risks — especially to central banks — are magnified substantially during times of financial crisis. Paul Lee has described this problem in some detail:

[T]here appears to be a relatively high correlation between the existence of a national economic or financial reversal and the initiation of litigation against a central bank. . . . [A] reversal in the economic fortunes of a country will prompt creditors to examine all their legal options for recovery. . . . In the event of a financial problem in the home country, the dollar accounts of the central bank will likely swell as the government directs its agencies, instrumentalities and private sector entities to consolidate their dollar holdings in the accounts of the central bank.<sup>97</sup>

<sup>91</sup> *Id.* at 430.

<sup>92</sup> William Pesek, *Banks' Credibility Gap*, INT'L HERALD TRIB., Feb. 15, 2007, at 19.

<sup>93</sup> JOHN NUGÉE, BANK OF ENG., FOREIGN EXCHANGE RESERVES MANAGEMENT 12 (2000), available at <http://www.bankofengland.co.uk/education/ccbs/handbooks/pdf/ccbshb19.pdf>.

<sup>94</sup> Lorenzo Bini Smaghi, *Central Bank Independence in the EU: From Theory to Practice*, 14 EUR. L.J. 446, 447 (2008).

<sup>95</sup> Steven R. Blau, *The Federal Reserve and European Central Bank as Lenders-of-Last-Resort: Different Needles in Their Compasses*, 21 N.Y. INT'L L. REV. 39, 58 (2008).

<sup>96</sup> See generally *LCN Invs., Inc. v. Republic of Nicaragua*, 115 F. Supp. 2d 358 (S.D.N.Y. 2000); see also *EM Ltd. v. Republic of Argentina*, 473 F.3d 463, 480 (2d Cir. 2007) (suggesting that plaintiff should have argued an alter ego theory).

<sup>97</sup> Lee, *supra* note 12, at 394 & n.250.

Lee's observation is particularly trenchant because not only do financial crises encourage litigants to target central bank assets, but they also make it more likely that litigants will succeed on claims that the central bank either is engaging in commercial activity or is the alter ego of its national government. Central banks serve a critical role during times of financial crisis, primarily because they maintain large quantities of liquid reserves to inject into a market frozen with financial panic. As a result, central banks often serve as the primary means by which the government engages with the private market to perform a variety of vital functions:

Central banks can absorb "solvency shocks," act as "crisis managers" by coordinating state and non-state affiliated private banks, and reduce the cost of accessing short-term liquid assets. Central banks also make emergency loans to distressed financial institutions through a discount window as a means of bolstering individual banks with additional short-term credit or cash on an as-needed basis.<sup>98</sup>

There is no doubt that these functions are "central bank functions as these are normally understood."<sup>99</sup> Indeed, maintaining foreign exchange reserves in stable currencies — such as the dollar — abroad is often done primarily to preserve liquidity in times of crisis.<sup>100</sup> Much of this role is incorporated in the description of central banks as "lender[s] of last resort."<sup>101</sup>

This critical, traditional role of central banks is also "commercial activity" as defined by *Weltover*. First, to the extent that central bank intervention is often financed with "foreign currency payment in times of emergency . . . for foreign exchange market interventions,"<sup>102</sup> it is an activity in which private entities can, and frequently do, engage.<sup>103</sup> Second, central bank actions in times of crisis often take the form of market intervention, a critical goal of which is to stimulate market recovery rather than to promote government overregulation or market

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<sup>98</sup> Kara M. Westercamp, *A Crack in the Façade and the Whole Building Came Tumbling Down: A Critical Examination of the Central Banks' Response to the Subprime Mortgage Loan Crisis and Global Financial Market Turmoil*, 18 *TRANSNAT'L L. & CONTEMP. PROBS.* 197, 201 (2009) (footnotes omitted).

<sup>99</sup> *Olympic Chartering S.A. v. Ministry of Indus. & Trade of Jordan*, 134 F. Supp. 2d 528, 534 (S.D.N.Y. 2001) (report and recommendation of magistrate judge).

<sup>100</sup> See Joshua Aizenman, *International Reserves*, in *THE NEW PALGRAVE DICTIONARY OF ECONOMICS*, *supra* note 7, [http://www.dictionaryofeconomics.com/article?id=pde2008\\_I000276](http://www.dictionaryofeconomics.com/article?id=pde2008_I000276).

<sup>101</sup> Rebecca Hicks, *A Potential New Role for Central Banks: A Comparison of Expert Proposals for Reform, Developments in Banking and Financial Law: 2009*, 28 *REV. BANKING & FIN. L.* 448, 454 (2009) (internal quotation marks omitted) (citing *GRP. OF THIRTY, FINANCIAL REFORM: A FRAMEWORK FOR FINANCIAL STABILITY* (2009); *U.S. DEP'T OF THE TREASURY, BLUEPRINT FOR A MODERNIZED REGULATORY STRUCTURE* (2008)).

<sup>102</sup> Nobumori, *supra* note 49, at 887.

<sup>103</sup> *De Sanchez v. Banco Cent. de Nicar.*, 770 F.2d 1385, 1392 (5th Cir. 1985) ("Private banks often sell foreign currency to one another . . .").

domination.<sup>104</sup> For example, in 2008 a number of developing nations “stepp[ed] into the market to sell the dollar in a bid to support their own currencies.”<sup>105</sup> Reliable data are not always available on the extent of these transactions, since many central banks “do not comment on currency interventions.”<sup>106</sup> Yet what is known suggests that they are significant. Between March and July 2008, the Bank of Thailand sold more than \$7 billion of its dollar reserves to prop up the baht, and “South Korea’s central bank was especially aggressive” during this time.<sup>107</sup> Additional reports identify major currency moves by the Philippines, Indonesia, and Taiwan,<sup>108</sup> and estimates place the amount of currency-supporting transactions by Asian central banks at about \$70 billion.<sup>109</sup> It is particularly relevant that these transactions have taken place not in some special government facility, but in the open spot currency market.<sup>110</sup> Such currency trading is definitionally the kind of activity that a private party can engage in: the central bank must purchase its own currency because private parties *choose not to*.

Even more unusual measures are not immune from consideration as commercial activity. Although central banks consider direct support operations to private entities to be extraordinary, they are nevertheless “operations [that] remain in the armoury of all central banks.”<sup>111</sup> Consider the Federal Reserve’s much maligned \$60 billion loan to AIG and the accompanying \$37.8 billion it provided in liquidity through asset borrowing to the troubled insurance giant.<sup>112</sup> The FRBNY acted to stabilize “dispositions of certain assets” and “avoid undue disruption to markets.”<sup>113</sup> The Bank of England offered similar logic to justify creating a liquidity support facility for Northern Rock,

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<sup>104</sup> See Courtney Hunter, *Financial Stabilization Measures, Developments in Banking and Financial Law: 2009*, 28 REV. BANKING & FIN. L. 490, 490–91 (2009).

<sup>105</sup> Arisa Yoshida, *Emerging Nations Intervene to Stop Drops in Currencies*, NIKKEI WKLY., Sept. 8, 2008, at 6.

<sup>106</sup> *Banks Try to Prop Up Currencies in Asia*, INT’L HERALD TRIB., May 28, 2008, at 11.

<sup>107</sup> Thiti Tantikulanan, *Central Bank Battles a Turbulent Economy*, THE NATION (Thai.), July 15, 2008.

<sup>108</sup> See Daniel Anne B. Nepomuceno, *Central Banks Sell Dollars to Defend Local Currencies*, BUSINESSWORLD (Phil.), May 28, 2008, at S2/1.

<sup>109</sup> See Alan Wheatley, *A Surfeit of Reserves? Maybe Not*, INT’L HERALD TRIB., Aug. 19, 2008, at 11.

<sup>110</sup> See, e.g., *Central Bank’s Reserves at All-Time High*, MANILA STANDARD, May 8, 2009 (describing use of spot market transactions in foreign exchange swaps).

<sup>111</sup> Press Release, HM Treasury, Bank of Eng. & Fin. Servs. Auth., Liquidity Support Facility for Northern Rock plc (Sept. 14, 2007) (internal quotation mark omitted), available at <http://www.bankofengland.co.uk/publications/news/2007/090.htm>.

<sup>112</sup> See Hunter, *supra* note 104, at 495.

<sup>113</sup> Press Release, Fed. Reserve Bank of N.Y., Statement by the Federal Reserve Bank of New York Regarding AIG Transaction (Sept. 29, 2008), available at <http://www.newyorkfed.org/newsevents/news/markets/2008/ano80929.html>.



invoking the Bank's role as a lender of last resort.<sup>114</sup> Yet even such drastic activity is not of a "type" reserved to sovereigns. Despite these governmental-seeming exercises of authority, virtually identical means and rationales were advanced when fourteen private commercial banks were the primary agents in the 1998 Long Term Capital Management bailout.<sup>115</sup> That private consortium acted to avoid "a cycle of price declines, losses, and further liquidation of [trading] positions."<sup>116</sup> These parallels have not escaped the legal community, and courts have observed in the sovereign immunity context that "private entities commonly provide financial assistance to troubled companies."<sup>117</sup> Virtually regardless of the type of action it takes, a central bank's response to a financial crisis could be considered "the same type of activity in which private parties engage. Its purpose, even if it is to safeguard the monetary reserves of its country, would be irrelevant to a commercial activity determination under *Weltover*."<sup>118</sup>

Not only does a financial crisis provide substantially more ammunition to litigants arguing that central banks are acting in commercial rather than sovereign capacities, but it also establishes far more fertile ground for an alter ego claim. Financial crises often highlight the need for short-term investment, precisely the sort of "political factors that . . . outweigh pressures for fiscal conservatism."<sup>119</sup> As one scholar of central bank independence has noted, the autonomy of monetary authorities is often an early casualty of financial meltdowns:

[G]overnment actors will be less likely to favor an independent central bank when they are facing large budget deficits that they may wish to finance through central bank borrowing, especially in the absence of developed capital markets . . . . Similarly, when private banks are strong and solvent, bankers will be interested in an authoritative and conservative central bank; but when banks are weak, they are likely to favor less independent central banks because they anticipate the need for government bailouts and subsidies and for favorable monetary policy.<sup>120</sup>

The benefits of maintaining central bank autonomy diminish during a financial crisis, when the risks of nonintervention in the market escalate significantly. While pursuing price stability may have long-term benefits, financial crises present an economic threat often "based

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<sup>114</sup> Press Release, HM Treasury, *supra* note 111.

<sup>115</sup> See Westercamp, *supra* note 98, at 211.

<sup>116</sup> *Id.* (alteration in original) (quoting U.S. GEN. ACCOUNTING OFFICE, LONG-TERM CAPITAL MANAGEMENT: REGULATORS NEED TO FOCUS GREATER ATTENTION ON SYSTEMIC RISK 13 (1999)).

<sup>117</sup> *BCI Aircraft Leasing, Inc. v. Republic of Ghana*, No. 06-C-0130, 2006 WL 2989291, at \*12 (N.D. Ill. Oct. 13, 2006).

<sup>118</sup> Lee, *supra* note 12, at 376.

<sup>119</sup> Fisch & Gentile, *supra* note 6, at 1049.

<sup>120</sup> Miller, *supra* note 79, at 448.

purely on expectations or by interbank credit risk.”<sup>121</sup> It is thus not unreasonable for central banks to act in close concert with the political branches to orchestrate recovery efforts. Indeed, the American experience during the current downturn has been one of “extensive coordination among the Federal Reserve, the U.S. Treasury and the FDIC.”<sup>122</sup> Similarly, the Korean Finance Ministry has participated in the monetary policy meetings of the Bank of Korea, noting that, “in the wake of the economic crisis, the need was heightened for policy coordination between the government and the central bank.”<sup>123</sup> Sovereign governments may also call on central banks to provide extraordinary assistance in times of financial crisis through activities outside their usual operations: “For example, national laws may contain provisions that enable national central banks to provide loans to banks, without explicitly confining such transactions to loans that are granted in connection with central banking tasks such as monetary policy, payment systems or temporary liquidity support operations.”<sup>124</sup>

There is nothing reprehensible about such coordination; indeed it is necessary, and certainly is not abuse of the corporate form. Recognizing this fact, “national governments customarily retain the ability to direct their central banks to take actions with respect to the central banks’ foreign exchange reserves.”<sup>125</sup> Yet importing corporate veil-piercing standards through *Bancec*’s alter ego test could transform this coordination into a basis for liability, removing § 1611’s protections and allowing predatory secondary creditors to attach central banks’ assets.<sup>126</sup>

The ultimate impact of financial crises, therefore, is to encourage creditors to seek attachment of central banks’ liquid assets, while simultaneously making those assets more vulnerable due to increased commercial activity and domination of central banks by their political parents. The irony of this “perfect storm” is that central banks in developing nations most need liquid assets to stabilize their economies during financial crises: “International reserves that are beyond the reach of creditors would allow such a country to smooth consumption in the event that adverse shocks trigger a default on foreign debt.”<sup>127</sup> Because of the dollar’s primacy as an international reserve currency,

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<sup>121</sup> Westercamp, *supra* note 98, at 202.

<sup>122</sup> Yadav K. Gopalan & Julie L. Stackhouse, *Views: Clarifying the Roles and the Spending: The Separate Functions of the Fed, Treasury and FDIC*, CENT. BANKER, Fall 2009, <http://www.stlouisfed.org/publications/cb/articles/?id=1659>.

<sup>123</sup> Kim Yoon-mi, *Finance Ministry to Be Represented in BOK Meeting*, KOREA HERALD, Jan. 8, 2010 (internal quotation mark omitted).

<sup>124</sup> Smaghi, *supra* note 94, at 448.

<sup>125</sup> EM Ltd. v. Republic of Argentina, 473 F.3d 463, 476 n.12 (2d Cir. 2007).

<sup>126</sup> *See id.*

<sup>127</sup> Aizenman, *supra* note 100.

the reserve assets of foreign central banks held at the FRBNY represent a significant portion of the global financial safety net against such shocks.<sup>128</sup> In short, the immunity U.S. law provides to foreign central banks is a critical safeguard of global financial stability. It would be absurd if the jurisprudence on commercial activity and alter ego could eliminate that protection at the moment it is most needed.

#### V. "SOVEREIGN PURPOSE" AS AN ALTERNATIVE TEST

This analysis encourages a more literal reading of § 1611(b)(1) that does not eliminate immunity merely because the central bank's activity is of a commercial nature or is directed by the national government. Instead of reading the legislative history as dictating that § 1611's "held for its own account" requirement is coextensive with the commercial activity exception in *Weltover*, courts should read the provision as immunizing central bank assets used for a sovereign purpose. In addition to adhering more faithfully to the purpose evinced by the structure of the FSIA, this view serves the practical aim of giving central banks substantially more immunity from attachment of reserve assets by protecting even what *Weltover* would consider commercial activity, so long as it advanced a sovereign, management function.

Analyzing the purpose of a sovereign's activity, as opposed to solely its nature, is not new. Prior to *Weltover*, at least one court endorsed this form of analysis, observing that "in differentiating sales of dollars by Banco Central from sales by private banks, we rely on the different purposes motivating the sales."<sup>129</sup> Courts should investigate the purpose for which transactions occur and, in analyzing them under the FSIA, enforce the view that "Congress adopted a per se rule that the property of a foreign central bank is not commercial in nature, at least when the property is used for central banking functions."<sup>130</sup> As discussed above, § 1611(b)(1) provides *additional* immunity to central bank assets that might be attachable under the commercial activity exception — any other reading would be redundant. It is thus not inconsistent to adopt a purpose-driven test for that provision, while still using the nature test for more common types of commercial activity.

Adoption of a "sovereign purpose" test would undoubtedly provide extensive work for expert witnesses as courts attempt to separate the

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<sup>128</sup> See Patrikis, *supra* note 48, at 265. There is little precise data available on the composition of foreign exchange reserves, since many countries keep that information a closely guarded secret. The IMF has reported, however, that U.S. dollars — held primarily at the FRBNY — represent 61.5% of the \$4.61 trillion in allocated official reserve assets as of the first quarter of 2010. *Currency Composition of Official Foreign Exchange Reserves (COFER)*, INT'L MONETARY FUND, <http://www.imf.org/external/np/sta/cofer/eng/cofer.pdf> (last visited Oct. 30, 2010).

<sup>129</sup> *De Sanchez v. Banco Cent. de Nicar.*, 770 F.2d 1385, 1393 (5th Cir. 1985).

<sup>130</sup> Patrikis, *supra* note 48, at 273.

sovereign from the commercial. States facing attachment would likely invoke sovereign purpose in virtually every case. Yet this outcome is still preferable to applying *Weltover* in a way that would read out most of § 1611(b)(1)'s protection. Indeed, to the extent that courts already rely on financial experts to determine whether complex financial operations *could* be undertaken by private parties, it simply changes the inquiry for those experts to *whether* the transaction was undertaken to obtain revenue akin to a private party or to regulate the temperature of the open market in a distinctly sovereign fashion.

In addition, courts should reject the alter ego test as applied to central banks. When a central bank performs its traditional functions, including market interventions through asset purchases, reserve sales, or private bailouts, it should be irrelevant whether such actions are directed by the foreign government or whether the bank as a whole is dominated by its political superiors. The structure of the FSIA recognizes that central bank functions are sufficiently critical to warrant additional immunity — it is the critical nature of those functions, not the central bank's separate corporate form, that warrants special protection. Even beyond that, a country's failure to adopt a conservative model of central bank independence is a political choice that the act of state doctrine counsels courts to avoid turning into a basis for liability.

This more absolute approach to central bank immunity has much to recommend it from a variety of perspectives. First, it ensures that central banks will be able to perform their critical functions:

Under [the] unpredictability [of an oft-expected immunity regime], foreign central banks cannot achieve . . . safety and liquidity. If, for instance, a central bank's assets can be seized by a judgment creditor, its safety is compromised. If a reserve asset can be immobilized by the entry of [an order of attachment or execution], its liquidity is compromised.<sup>131</sup>

To the extent that international reserves must be beyond the reach of creditors to ensure utility in a financial crisis,<sup>132</sup> providing a secure immunity regime is necessary to the global financial system's stability.

Second, a robust immunity regime is of great importance for the American economy. As a significant portion of global exchange reserves are held in U.S. dollars at the FRBNY, judicial interpretations that fail to adequately protect those reserves from seizure could cause countries to seek more protective environments for their reserves. This is hardly an unrealistic concern. The Bank for International Settlements in Basel, Switzerland, has emerged as “[t]he FED's most fierce competitor”<sup>133</sup> for foreign exchange reserve assets, and one of its

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<sup>131</sup> Nobumori, *supra* note 49, at 914.

<sup>132</sup> See Aizenman, *supra* note 100.

<sup>133</sup> Liendo, *supra* note 4, at 139.

key purposes is “to protect central bank assets held with the BIS from measures of compulsory execution and sequestration.”<sup>134</sup>

This removal of foreign exchange assets from the FRBNY could have profound consequences for the American economy, including “an immediate and adverse effect on the U.S. balance of payments.”<sup>135</sup> This flight from the dollar could also “seriously affect this nation’s ability to manage the public debt” due to the rise in interest rates from the sale of the Treasury securities in which foreign exchange reserves are held.<sup>136</sup> The U.S. government has long been aware of this concern. In 1973, Acting State Department Legal Adviser Charles Brower noted that without an effective immunity regime for central banks,

Some governments might ultimately remove all or a substantial portion of their reserves . . . [and] place their dollar reserves with commercial banks abroad, while others might seek to move their reserves into other currencies. In either event, withdrawal of foreign official funds could have an unsettling effect on foreign exchange markets, which would be contrary to the United States interest in international monetary stability.<sup>137</sup>

The Federal Reserve has also made this representation to courts, emphasizing the serious negative impact that attachment of reserves would have on the U.S. economy.<sup>138</sup> Even Congress recognized this concern in the House Report to the FSIA, acknowledging that without protection of sovereign immunity, “deposit of foreign funds in the United States might be discouraged.”<sup>139</sup> Yet little has been done to guard against this possibility. Indeed, the threat has grown; the legal and political developments discussed throughout this Note present a unique opportunity for creditors to use central bank actions during financial crises to attach their assets opportunistically at a moment when they are both vulnerable and essential to economic stability.

Third, protecting foreign central bank reserves serves the FSIA’s goal of limiting unnecessary judicial intrusion into the sovereign affairs of foreign states. As discussed above, central bank activities “strongly implicate the distinctly sovereign powers of states,”<sup>140</sup> and courts are

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<sup>134</sup> *BIS as a Bank for Central Banks*, BANK FOR INT’L SETTLEMENTS, <http://www.bis.org/banking/bisbank.htm> (last visited Oct. 30, 2010).

<sup>135</sup> Patrikis, *supra* note 48, at 266.

<sup>136</sup> *Id.*

<sup>137</sup> Letter from Charles N. Brower, U.S. Dep’t of State Acting Legal Adviser, to Elliot L. Richardson, Attorney General (July 24, 1973), *quoted in* ARTHUR W. ROVINE, DEP’T OF STATE, DIGEST OF UNITED STATES PRACTICE IN INTERNATIONAL LAW 228–29 (1973).

<sup>138</sup> *See, e.g.*, *Banque Compafina v. Banco de Guat.*, 583 F. Supp. 320, 321 (S.D.N.Y. 1984) (citing affidavit of Anthony M. Solomon, president of the FRBNY, stating that “if foreign central banks such as Banco de Guatemala become concerned that their United States assets are subject to attachment by private litigants, they might withdraw their dollar assets from this country, thereby destabilizing the dollar and the international monetary system”).

<sup>139</sup> H.R. REP. NO. 94-1487, at 31 (1976), *reprinted in* 1976 U.S.C.C.A.N. 6604, 6630.

<sup>140</sup> Ostrander, *supra* note 11, at 564.

rightly cautious about “interrupting the public acts of a foreign state.”<sup>141</sup> Indeed, the FSIA itself seems to acknowledge the decidedly sovereign character of central bank activity. The two asset classes granted particular protection by § 1611 are central bank property and property “used in connection with a military activity.”<sup>142</sup> Military activity was the quintessential sovereign bailiwick entitled to immunity throughout history, as noted in *The Schooner Exchange*.<sup>143</sup> The FSIA’s treatment of military activity as of a kind with central bank activity suggests that the danger to sovereign prerogatives posed by interposition on the former — well-recognized in the law — is equally great for interference with the latter. This too had not escaped the notice of pre-*Weltover* courts, one of which recognized that “[i]f we were to hold that a central bank is subject to suit for its actions in regulating its foreign exchange reserves, we would interfere with this basic governmental function and would thereby touch sharply on ‘national nerves,’ contrary to the policies underlying the FSIA.”<sup>144</sup>

Finally, there is a broader justification for amplifying this immunity. To the extent that sovereign immunity has long been driven by practice — recall that the American shift to the restrictive theory was heavily influenced by European moves in that regard — the global community is increasingly emphasizing the immunity of central banks. Not only is there a “general trend . . . to grant central banks immunity from measures of pre-judgment attachment and post-judgment execution,”<sup>145</sup> but there are also a variety of specific measures recommending a change in the U.S. position. In addition to the uncompromising position of the BIS already mentioned, numerous countries have either suggested or begun to strengthen the protection of central bank assets under their sovereign immunity laws.<sup>146</sup> International institutions have taken this approach as well: the International Monetary Fund has recognized the significance of central bank immunity as “a useful legal tool for orderly debt restructuring, to prevent the disorderly and disruptive competition among creditors to seize or arrest the assets.”<sup>147</sup> It is well in keeping with the tradition of sovereign immunity that countries harmonize the protections they offer each other in the name of political and financial tranquility. The United States would be well-served by joining those nations offering central banks additional protection.

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<sup>141</sup> *Conn. Bank of Commerce v. Republic of Congo*, 309 F.3d 240, 253 (5th Cir. 2002).

<sup>142</sup> 28 U.S.C. § 1611(b)(2) (2006).

<sup>143</sup> *See The Schooner Exchange v. M’Faddon*, 11 U.S. (7 Cranch) 116, 144 (1812).

<sup>144</sup> *De Sanchez v. Banco Cent. de Nicar.*, 770 F.2d 1385, 1394 (5th Cir. 1985).

<sup>145</sup> *Nobumori*, *supra* note 49, at 915.

<sup>146</sup> *See id.* at 915–22; *Zhu*, *supra* note 10, at 70–73.

<sup>147</sup> *Nobumori*, *supra* note 49, at 886.