FOREIGN RELATIONS LAW — FOREIGN SOVEREIGN IMMUNITIES ACT TERRORISM EXCEPTIONS — SECOND CIRCUIT HOLDS THAT THE TERRORISM RISK INSURANCE ACT, BUT NOT THE FSIA, ALLOWS RECOVERY AGAINST U.S. COMPANIES OWNED BY STATE SPONSORS OF TERRORISM. — *Kirschenbaum v. 650 Fifth Avenue & Related Properties*, 830 F.3d 107 (2d Cir. 2016).

In 1996, Congress enacted a law that allowed victims of terrorist attacks to sue state sponsors of terrorism.[1] This law created an exception to the immunity from suit and execution normally conferred upon foreign states and their instrumentalities by the Foreign Sovereign Immunities Act[2] (FSIA). Victims sued vigorously under the new terrorism exception and won immense default judgments,[3] but struggled to find assets to satisfy the judgments. Another roadblock was courts' refusal to attach assets formally owned by state-sponsored corporations unless the foreign state's control was sufficient to pierce the corporate veil[4] under analogous liability law. Congress modified the terrorism exception to overcome this hurdle to execution, but did so incompletely, leaving courts to construe a patchwork of FSIA amendments. Recently, in *Kirschenbaum v. 650 Fifth Avenue & Related Properties*,[5] the Second Circuit overturned a summary judgment in favor of plaintiffs who sued to attach properties owned by an Iran-backed nonprofit and several holding companies. The Second Circuit's holding allows intermediate companies that largely obscure a state sponsor of terrorism's ultimate ownership to avoid liability. However, the court's remand gave plaintiffs an alternative avenue to recovery through the Terrorism Risk Insurance Act[6] (TRIA), which the Second Circuit construed more flexibly. This construction ensured that the courts can further the purpose for which Congress created the terrorism exception while remaining within the boundaries of the text that Congress enacted.

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[1] Antiterrorism and Effective Death Penalty Act of 1996, Pub. L. No. 104-132, § 221, 110 Stat. 1214, 1241–43 (codified as amended at 28 U.S.C. § 1605A (2012)). The State Department designates state sponsors of terrorism. Currently, only Iran, Sudan, and Syria are so designated. *Sponsors of Terrorism*, U.S. DEP'T OF STATE, http://www.state.gov/j/ct/list/c14151.htm [https://perma.cc/78RF-UJAE].

[2] Pub. L. No. 94-583, 90 Stat. 2891 (1976) (codified in scattered sections of 28 U.S.C.).

[3] By 2012, plaintiffs held $8.8 billion in unsatisfied judgments against Iran just for one 1983 bombing. Estate of Brown v. Islamic Republic of Iran, 872 F. Supp. 2d 37, 45 (D.D.C. 2012).

[4] That is, to hold shareholders liable where the corporation is not distinct enough from them.

[5] 830 F.3d 107 (2d Cir. 2016).

[6] Pub. L. No. 107-297, § 201(a), 116 Stat. 2322, 2337 (codified at 28 U.S.C. § 1610 note (2012) (Satisfaction of Judgments from Blocked Assets of Terrorists, Terrorist Organizations, and State Sponsors of Terrorism)).

The plaintiffs in this case had previously won judgments against Iran under the FSIA's cause of action for victims of terrorism.[7] The FSIA and TRIA enable execution for such judgments upon property of state sponsors of terrorism or their agencies or instrumentalities.[8] The plaintiffs sought execution against 650 Fifth Avenue, which is owned by an eponymous partnership held in turn by Assa Corporation (40%) and the Alavi Foundation (60%).[9] Iran created the Foundation under the Shah, and Bank Melli (a bank owned and operated by Iran) owned and arranged the incorporation of Assa Corporation.[10] In addition to the ownership and historical ties, documents showed that Iran chose Alavi's board members in the 1990s and that Iran's Ambassador to the United Nations met with the board as late as 2007.[11] The plaintiffs argued that the property's connection to Iran was sufficient under the FSIA and TRIA to allow them to liquidate it to satisfy their judgments.[12]

Judge Forrest of the Southern District of New York granted summary judgment for the plaintiffs.[13] For the purposes of the FSIA, she held that the defendants "are" Iran, and thus that the court had subject matter jurisdiction.[14] The court looked to an executive order and Department of Treasury regulations that defined Iran as "any person . . . act[ing], directly or indirectly, for or on behalf of [Iran or its instrumentalities]."[15] Second, the defendants "are" Iran under an "alter

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[7] *See* Beer v. Islamic Republic of Iran, 789 F. Supp. 2d 14 (D.D.C. 2011); Acosta v. Islamic Republic of Iran, 574 F. Supp. 2d 15 (D.D.C. 2008); Kirschenbaum v. Islamic Republic of Iran, 572 F. Supp. 2d 200 (D.D.C. 2008); Greenbaum v. Islamic Republic of Iran, 451 F. Supp. 2d 90 (D.D.C. 2006); Campuzano v. Islamic Republic of Iran, 281 F. Supp. 2d 258 (D.D.C. 2003); *see also In re* 650 Fifth Ave. & Related Props., No. 08 Civ. 10934, 2013 WL 2451067, at *1 & n.1 (S.D.N.Y. June 6, 2013) (explaining the plaintiffs' joinder).

[8] *See* 28 U.S.C. § 1610 (FSIA, allowing execution); § 1610 note (TRIA, allowing the same).

[9] *Kirschenbaum*, 830 F.3d at 118.

[10] *Id.*; *see also, e.g.*, Weinstein v. Islamic Republic of Iran, 609 F.3d 43, 48 (2d Cir. 2010) ("Bank Melli concedes that it is an instrumentality of Iran."). Originally, Alavi held the property with a mortgage from Bank Melli, but, for tax (and sanctions) reasons, in 1989, Bank Melli forgave the loan and Alavi transferred a 40% stake to a new corporation (Assa). *See Kirschenbaum*, 830 F.3d at 118. Bank Melli employees then purchased Assa's stock for pennies on the dollar. *See In re* 650 Fifth Ave. & Related Props., 830 F.3d 66, 81 (2d Cir. 2016).

[11] *Kirschenbaum*, 830 F.3d at 118–19. However, a board member, financial manager, and program coordinator claimed that Iran did not control Alavi in the 2000s. *Id.* at 119.

[12] *Id.* at 117. TRIA, among other things, allows attachment of assets "blocked" by the executive branch for violations of economic sanctions. 28 U.S.C. § 1610 note.

[13] *In re* 650 Fifth Ave. & Related Props., No. 08 Civ. 10934, 2014 WL 1516328, at *1 (S.D.N.Y. Apr. 18, 2014).

[14] *Id.* at *8; *see also id*. at *8–9 (applying 28 U.S.C. § 1610(a)).

[15] *Id.* at *10 (quoting Iranian Transactions Regulations, 31 C.F.R. § 560.304 (2012)). The district court considered the FSIA definitions section (§ 1603) to be "barebones," *id.*, and thought the executive branch materials clarified what "Iran" means, *id.* at *10–11. *See also* Exec. Order No. 13,599, 77 Fed. Reg. 6659, 6660 (Feb. 8, 2012) (counting as "Iran" anything "owned or controlled by, or acting for or on behalf of, the Government of Iran").

ego" theory because each was "extensively controlled."[16] Third, each defendant was an "'agency or instrumentality' of Iran."[17] The court next held that the suit fit within three FSIA exceptions to execution immunity, for analogous reasons.[18] The district court also found for the plaintiffs under TRIA, explaining that the judgment was predicated on an act of terrorism,[19] the terrorist party owned the assets (partially because they "are" Iran), and the assets were blocked by executive order (which partly determines if TRIA can apply).[20]

The Second Circuit reversed. Writing for the panel, Judge Wesley[21] rejected the plaintiffs' FSIA arguments by answering *no* to the "threshold question of whether Defendants may be deemed a 'foreign state' or an 'agency or instrumentality' of a foreign state under the FSIA."[22] Looking to Supreme Court precedent, Judge Wesley found that the companies lacked "traditional sovereign characteristics."[23] He especially criticized the district court's reliance on the definition of "Iran" in Executive Order 13,599, both because that definition applies only "[f]or the purposes of this order"[24] and because the FSIA's broad purpose was to move the determination from the executive branch to the judicial branch.[25] Next, the Second Circuit held that none of the defendants were an "agency or instrumentality" of Iran, because to qualify, an entity must not be "a citizen of a State . . . as defined in section 1332(c)."[26] That section defines citizenship for diversity jurisdiction and says any company incorporated within a state is a citizen of that state.[27] Alavi and Assa were formed in New York, were therefore New York citizens, and so could not be agencies or instrumentalities of Iran.[28] Judge Wesley allowed that, in an appropriate case, a company could be an alter ego of Iran or of one of its agencies or instrumentalities,[29] but did not find enough evidence

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[16] *In re 650 Fifth Ave.*, 2014 WL 1516328, at *12 (quoting First Nat'l City Bank v. Banco Para el Comercio Exterior de Cuba (*Bancec*), 462 U.S. 611, 629 (1983)).

[17] *Id.* at *13 (quoting 28 U.S.C. § 1603(b)).

[18] *Id.* at *15–16, 20–21 (using 28 U.S.C. § 1610(a), (b), and (g)).

[19] *Id.* at *14 ("[This] element [was] easily met here.").

[20] *Id.* at *14–15 (applying 28 U.S.C. § 1610 note); *see also* Exec. Order No. 13,599, 77 Fed. Reg. 6659. Since virtually all Iranian assets are blocked, ascribing ownership to Iran effectively decided the blocked-assets issue too.

[21] Judge Wesley was joined by Judges Kearse and Raggi.

[22] *Kirschenbaum*, 830 F.3d at 123.

[23] *Id.* at 124; *see also* Samantar v. Yousuf, 560 U.S. 305, 308, 314–15 (2010).

[24] Exec. Order No. 13,599, 77 Fed. Reg. at 6660.

[25] *Kirschenbaum*, 830 F.3d at 124–25.

[26] *Id.* at 125–26 (quoting 28 U.S.C. § 1603(b)(3) (2012)).

[27] 28 U.S.C. § 1332(c)(1).

[28] *Kirschenbaum*, 830 F.3d at 126.

[29] *See id.* at 128; *see also* U.S. Fid. & Guar. Co. v. Braspetro Oil Servs. Co., 199 F.3d 94, 98 (2d Cir. 1999) (per curiam) (applying the FSIA to Brasoil even though it was formed under the laws of a third country because it was the alter ego of Petrobras).

in the record to show "Iran's exercise of *day-to-day* control over" the companies.[30] Ownership, appointment of directors, contact with the Iranian Ambassador, and possible planning influence were not enough.[31]

Turning to the TRIA, Judge Wesley rejected the district court's finding that the defendants were Iran or its alter ego for the same reasons as in the FSIA analysis,[32] but paused in considering whether they were its agencies or instrumentalities under the TRIA.[33] Judge Wesley explained that the definition of "agency or instrumentality" in the TRIA could not be determined by the FSIA's definition of that same phrase, even though the TRIA was codified within the FSIA.[34] He argued that the TRIA's definition was broader because, while the FSIA covered only agencies and instrumentalities of foreign states, the TRIA reached the agencies and instrumentalities of "terrorist[s]" and "terrorist organization[s]."[35] Without a statutory definition, the Second Circuit used standard sources such as dictionaries to construe "agency" and "instrumentality," settling on three alternatives: that a defendant "was a means through which a material function . . . [wa]s accomplished," "provided material services to, on behalf of, or in support of," or "was owned, controlled, or directed by" a terrorist party.[36] After concluding that Iran did control the defendants, the Second Circuit remanded to the district court to hear argument and collect facts on whether the defendants fit within any of the three definitions and to decide in the first instance the legal question of whether knowledge is a requisite element.[37] The court also examined whether the assets were "blocked" by executive order, distinguishing between the legal proposition that all assets owned by "Iran" as defined by Executive Order 13,599 "are automatically blocked," which it affirmed, and the factual question of whether the companies were "owned or controlled by . . . the Government of Iran"[38] under that order, which it remanded for further factfinding.[39]

Although the case's ultimate outcome will turn on the district court's factfinding, *Kirschenbaum*'s broad, flexible interpretation of "agency or instrumentality" under the TRIA provided an avenue for victims to recover. This interpretation fit somewhat awkwardly with the text but vindicated the policies behind the FSIA and TRIA. This

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30 *Kirschenbaum*, 830 F.3d at 130.
31 *See id.*
32 *Id.* at 132.
33 *See id.* at 132–33.
34 *See id.*
35 *Id.* at 133 (quoting 28 U.S.C. § 1610 note (2012)).
36 *Id.* at 135.
37 *See id.* at 136.
38 Exec. Order No. 13,599, 77 Fed. Reg. 6659, 6660 (Feb. 8, 2012).
39 *Kirschenbaum*, 830 F.3d at 137, 141.

avenue was needed because the Second Circuit applied definitions that are difficult to explain as anything but inartful drafting,[40] and that prevented recovery against any legal entity formed outside Iran.

Imagine two similar properties owned by two similar companies, both more than half-owned by Iran, a state sponsor of terrorism. One company was formed in Iran and the other in New York. Under the Second Circuit's construction of the FSIA, victims of Iran-sponsored terrorism could attach and execute only upon the property owned by the company formed in Iran — even though both companies are owned and controlled by Iran, and neither contributed to the terrorist attack. Moreover, the company formed in Iran could avoid suit by transferring its property to the New York company in return for shares.[41] This peculiar result flows from a misalignment between the FSIA's original conception and newer terrorism exceptions to immunity. When Congress first passed the FSIA, one goal was to narrow sovereign immunity by allowing suits related to commercial activities.[42] The structure was fairly simple, defining and giving both jurisdictional immunity and immunity from execution to "foreign state[s]," with certain exceptions.[43] This structure guaranteed that plaintiffs could sue foreign nations for commercial disputes *either* because the entity would not be immune (because it did not fit § 1603's definition of a "foreign state") or because it would fit into one of the commercial exceptions. This explains the otherwise anomalous third definitional prong of "agency or instrumentality" as "neither a citizen of a State . . . nor created under the laws of any third country."[44] That definition intentionally foreclosed the possibility of an instrumentality formed outside the foreign state at issue.[45] This makes some sense — a country's central bank would get sovereign immunity (subject to exceptions), but a banking subsidiary in another country would not.

Congress did not change this structure when it added terrorism as an exception to jurisdictional and execution immunity.[46] Courts construed that first attempt as only "jurisdiction conferring," with no

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[40] *Cf.* King v. Burwell, 135 S. Ct. 2480, 2492 (2015).

[41] This stylized example ignores the effect of sanctions — these transactions and the ownership would have to be secret, as Assa's and Alavi's were.

[42] *See* JENNIFER K. ELSEA, CONG. RESEARCH SERV., R31258, SUITS AGAINST TERRORIST STATES BY VICTIMS OF TERRORISM (2008).

[43] *See* 28 U.S.C. §§ 1604–1605, 1609–1610 (2012) (jurisdiction and execution immunity and exceptions).

[44] *Id.* § 1603(b)(3).

[45] "The rationale behind these exclusions is that if a foreign state acquires or establishes a company or other legal entity in a foreign country, such entity is presumptively engaging in activities that are either commercial or private in nature." H.R. REP. NO. 94-1487, at 15 (1976).

[46] *See* Antiterrorism and Effective Death Penalty Act of 1996, Pub. L. No. 104-132, § 221, 110 Stat. 1214, 1241–43.

cause of action against foreign states,[47] to which Congress reacted by putting a cause of action into the FSIA.[48] At the same time, Congress also inserted a new liability rule (as § 1610(g))[49] that allowed plaintiffs suing through the FSIA to recover from agencies or instrumentalities of foreign nations even if such recovery would be barred under ordinary liability principles.[50] Senator Lautenberg explained his hope that plaintiffs would no longer have to prove "that Iran exercised day-to-day managerial control" over an entity before attaching its assets.[51] He intended § 1610(g) to "allow[] attachment of the assets of a state sponsor of terrorism to be made upon the satisfaction of a 'simple ownership' test."[52] The ultimate text did abolish the court-made rule requiring "day-to-day managerial control," but did so *only for agencies or instrumentalities*, and retained the definition of those terms.[53] The definition originally allowed suit by withholding "agency or instrumentality" status — and thus immunity — from companies formed outside the foreign state, but this provision now protects those entities from the broad liability rule in § 1610(g). *Kirschenbaum*'s FSIA holdings follow: an entity owned by Iran and formed in Iran is liable for Iran's terrorism-related judgments, but an otherwise identical entity formed in the United States or the Cayman Islands is not.

The FSIA provides little wiggle room, but the Second Circuit found enough in the TRIA to interpret the same term ("agency or instrumentality") differently. Congress passed the TRIA to give plaintiffs access to "blocked" assets previously reserved by the executive branch for use in negotiations.[54] It provides that for any "judgment

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[47] *E.g.*, Cicippio-Puleo v. Islamic Republic of Iran, 353 F.3d 1024, 1032 (D.C. Cir. 2004).

[48] National Defense Authorization Act of 2008, Pub. L. No. 110-181, § 1083, 122 Stat. 3, 338–44 (2012) (codified as amended at 28 U.S.C. §§ 1605A, 1610(g)).

[49] *Id.* The original FSIA "[wa]s not intended to affect the substantive law of liability." H.R. REP. NO. 94-1487, at 12 (1976); *see also* 28 U.S.C. § 1606 (allowing through its exceptions "liab[ility] in the same manner and to the same extent as a private individual under like circumstances").

[50] More specifically, § 1610(g) allowed suits regardless of five factors that arose from *Bancec*, 462 U.S. 611 (1983), which held that an agency or instrumentality could not be liable for judgments against the foreign nation if it was a separate company without meeting the ordinary civil liability standard. *Id.* at 626–27. Case law developed from that holding defining when a nation and its agency were alter egos (allowing the corporate veil to be pierced), which § 1610(g) directly superseded. *See* Rubin v. Islamic Republic of Iran, 830 F.3d 470, 482–83 (7th Cir. 2016) (arguing that § 1610(g) abrogates *Bancec* but is not a standalone execution immunity exception).

[51] 154 CONG. REC. S54, 55 (daily ed. Jan. 22, 2008) (statement of Sen. Lautenberg).

[52] *Id.*

[53] *See* 28 U.S.C. § 1610(g) ("[T]he property of an agency or instrumentality . . . is subject to attachment . . . regardless of [the court-created day-to-day control factors].").

[54] More specifically, the TRIA was meant to reinforce § 1610(f), which allowed blocked assets to be attached, but included a waiver provision that the President immediately used. The TRIA "deal[s] comprehensively with the problem of enforcement of judgments . . . by enabling [courts] to satisfy such judgments through the attachment of blocked assets of terrorist parties. . . . Section 201 builds upon and extends the principles in section 1610(f)(1) of the [FSIA] . . . and eliminates the effect of any Presidential waiver." H.R. CONF. REP. NO. 107-779, at 27 (2002).

against a terrorist party on a claim based upon an act of terrorism, or for which a terrorist party is not immune under [the FSIA's terrorism exception] . . . the blocked assets of . . . any agency or instrumentality of that terrorist party[] shall be subject to execution."[55]

The court noted that the TRIA's placement within the FSIA may indicate that the terms "agency" and "instrumentality" have the same meaning, but then quoted various authorities saying placement cannot eclipse clear text and that occasionally the same words do mean different things.[56] Next, Judge Wesley argued that the definition must be different because the FSIA defines only "agencies or instrumentalities" of foreign states, while the TRIA includes those of a "terrorist party," which is broader and includes nonstate actors.[57]

However, here, the question concerns an agency or instrumentality *of a foreign state* — even if the provision is broader as applied to nonstate actors, why must it be broader as applied to foreign states? Judge Wesley argued that the FSIA definitions presume that normal sovereign countries will not hide their ownership,[58] while the state sponsors of terrorism contemplated by TRIA "may operate with less transparency," thus justifying a looser definition.[59] This argument applies with equal force to the FSIA provisions addressing only state sponsors of terrorism, yet Judge Wesley evinced no concern that the FSIA's terrorism exception may be foiled by hidden ownership. These arguments align uneasily with the Second Circuit's holding in part because they were borrowed from another case concerning only nonstate terrorist parties.[60] The TRIA nowhere indicates the creation of a new class of agencies or instrumentalities. Its structure distinguishes between terrorist groups and state sponsors of terrorism. These different sources of causes of action could imply that the liability principles are also different, with agencies or instrumentalities of nonstate actors governed by principles generally applicable to them, and those of foreign states governed by the FSIA. The Second Circuit's unitary interpretation was not compelled by the text and appears to be a novel conclusion.[61]

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[55] 28 U.S.C. § 1610 note.

[56] *Kirschenbaum*, 830 F.3d at 133. The court made no attempt to show that this text *was* clear.

[57] *Id.*

[58] This argument is perplexing after the holding that only legal entities formed in the sponsor's nation can be instrumentalities. Why bother hiding ownership that is not subject to execution?

[59] *Kirschenbaum*, 830 F.3d at 134.

[60] Stansell v. Revolutionary Armed Forces of Colom., 771 F.3d 713, 732 (11th Cir. 2014).

[61] *Stansell* similarly distinguished the FSIA from the TRIA, but was applying the TRIA's language to a nonstate entity. *See id.* In other cases, entities have met the FSIA definition or have not contested that element. *See, e.g.*, Weinstein v. Islamic Republic of Iran, 609 F.3d 43, 48 (2d Cir. 2010) (instrumentality was conceded); Weininger v. Castro, 462 F. Supp. 2d 457, 481 (S.D.N.Y. 2006) (applying the FSIA definition).

Kirschenbaum was a modest victory for victims of terrorism. While the Second Circuit's holding protected the companies from liability, it did so only because the FSIA's text required it. That text could be amended, but until then, the Second Circuit found an alternative by interpreting the TRIA functionally, a choice that broke methodologically with cases that embraced limitation after limitation upon liability[62] that Congress would subsequently overturn by statute.[63] By outlining a functional standard for agencies or instrumentalities, the Second Circuit supported the basic purposes of the terrorism exception.[64] The Second Circuit's standard also created greater flexibility, framing the analysis as whether the defendants "provided material services to" or were "owned, controlled or directed" by Iran.[65] This standard allows Alavi to demonstrate that it furthered only legitimate ends, and was not a puppet for Iran. This type of inquiry balances potential concerns that the liable entity had too little connection with a state sponsor of terrorism, while also preventing the mere corporate form and citizenship of the entity from being determinative.

In *Kirschenbaum*, victims of horrific attacks whose "judgments are largely unenforceable due to the scarcity of Iranian assets,"[66] found assets linked to Iran worth more than one hundred million dollars.[67] The Second Circuit engaged in helpful error-correction on many sections of the FSIA, but remanded the TRIA issues with a new framework. This framework presents challenges for the lower court, which must now refine and apply a new definition of "agency or instrumentality," yet these challenges are far preferable to barring recovery by tethering the TRIA to the FSIA.

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[62] *See, e.g.*, Dole Food Co. v. Patrickson, 538 U.S. 468, 474 (2003) (holding that to be an instrumentality, "direct ownership of a majority of shares by the foreign state" itself was required, disallowing indirect instrumentalities); *Bancec*, 462 U.S. 611, 626–27 (1983) (holding that an instrumentality was not liable for judgments against the foreign nation).

[63] *See, e.g.*, Estate of Heiser v. Islamic Republic of Iran, 885 F. Supp. 2d 429, 442 (D.D.C. 2012) (explaining that 1610(g) "abrogat[ed] *Dole Food* and *Bancec*"); *cf. Kirschenbaum*, 830 F.3d at 128 (applying *Bancec*'s alter ego analysis in an area not explicitly abrogated by Congress).

[64] Scholars have generally been skeptical of the TRIA for various reasons (equity, diplomatic concerns, and the role of courts, among others). *See, e.g.*, John F. Murphy, *Brave New World: U.S. Responses to the Rise in International Crime — An Overview*, 50 VILL. L. REV. 375, 419 (2005) (questioning whether the "TRIA will prove helpful to future plaintiffs trying to execute judgments against the assets of state sponsors of terrorism").

[65] *Kirschenbaum*, 830 F.3d at 135.

[66] *In re* Islamic Republic of Iran Terrorism Litig., 659 F. Supp. 2d 31, 122 (D.D.C. 2009).

[67] *In re* 650 Fifth Ave. & Related Props., 830 F.3d 66, 78 (2d Cir. 2016).