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BANKING & PROJECT FINANCE
JAM V IFC

Development banks in a jam

A recent suit has practical implications for similar organisations' immunity in the US, write Latham & Watkins lawyers

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On February 27 2019, the United States Supreme Court delivered a 7-1 opinion in *Jam v International Finance Corporation,* holding that the immunity granted to international organisations under the International Organizations Immunity Act (IOIA) is not nearly absolute, but rather evolves with the immunity available to foreign governments.

While the full legal implications of this decision on multilateral development banks' (MDB) exposure to suits in the US are not yet known, it is reasonable to expect that this decision may have some practical implications on MDBs in the near term.

In 2008, the International Finance Corporation (IFC), an international organisation headquartered in Washington DC that finances private sector development, provided construction financing to the developer of a coal-fired power plant in Gujarat, India (Plant).

In 2015, Budha Ismail Jam and other individuals living near the Plant brought several causes of action directly against IFC (including negligence, nuisance, trespass, and breach of contract) in the District Court for the District of Columbia (DC), for environmental harms allegedly caused by the Plant. IFC sought – and won – dismissal on the theory that it was immune from suit under the IOIA, which provides that certain international organisations enjoy the same immunity from lawsuits as is enjoyed by foreign governments. When the IOIA was enacted in 1945, foreign governments enjoyed nearly absolute immunity. But in 1976, Congress enacted the Foreign Sovereign Immunities Act (FSIA), whereby foreign governments are not immune from suits for actions based on commercial activity that has a sufficient nexus to the US. In 2017, the DC Circuit affirmed the District Court's dismissal, holding that the IOIA granted near-absolute immunity to IFC.

On February 27 2019, the Supreme Court reversed the DC Circuit's decision. The majority held that the immunities granted under the IOIA, which specifically references foreign sovereign immunity law, evolved with the passage of the FSIA and that international organisations enjoy the same immunity as foreign governments do under the FSIA.

First, the majority concluded that by using the phrase "same as" in the IOIA, Congress is most naturally understood to have intended to link the immunities enjoyed by international organisations to the immunities enjoyed by foreign governments, as the latter evolve over time. Had Congress intended to provide static immunity, it could have granted international organisations absolute immunity or grounded such immunity in some other fixed standard. Second, the Court employed a canon of construction whereby a statute's reference to a general subject should be interpreted to mean that such statute adopts the law on such subject as it exists whenever a question under such statute arises.

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Here, the IOIA's reference to foreign sovereign immunity required that general area of law (including the FSIA) be consulted. Third, the Court dismissed IFC's argument (based on the DC Circuit's precedent in *Atkinson v IADB*, 156 F. 3d 1335 (1998)) that the IOIA provides static, near-absolute immunity because it permits the president to modify an international organisation's immunity. The Court reasoned that such presidential power was intended for application to the immunity of individual international organisations on a case-by-case basis, and was not meant for whole-cloth modifications of the immunity of all international organisations. Finally, the Court gave weight to the opinion of the State Department, which had long opined that IOIA immunity was dynamically linked to foreign sovereign immunity as established in the FSIA.

In *Jam*, the IFC argued that adopting a restrictive interpretation of IOIA immunity would negatively affect international organisations. Firstly, allowing international organisations to be sued in the US would permit the US to second-guess the collective decisions of other organisation members. Secondly, exposing international organisations to monetary damages would hinder those organisations in fulfilling their missions to help developing nations. Thirdly, the IFC warned that international organisations could be subject to a flood of litigation in US courts. The Court found these arguments unpersuasive, noting that the IOIA's immunity is only a default rule, and that international organisations can "specify a different level of immunity" in their charters. It also noted that the lending activity of all MDBs does not necessarily qualify as commercial activity with a sufficient nexus to the US within the meaning of the FSIA's "commercial activity" exception (as discussed below).

Legal implications

Firstly, the Court did not reach the question of whether the IFC's articles of agreement conferred immunity on the IFC. The IFC's articles of agreement state that "[a]ctions may be brought against [IFC] only in a court of competent jurisdiction[.]" While the Supreme Court acknowledged that an international organisation's charter could specify a heightened level of immunity than that granted under the IOIA, the Court did not address whether IFC's articles of agreement did so.

The DC Circuit, for its part, held that while such language, read literally, seems to be a wholesale waiver of immunity, IFC had not in fact waived immunity under its articles of agreement. In reaching its conclusion, the DC Circuit applied the test it used in *Mendaro v World Bank*, 717 F.2d 610 (D.C. Cir. 1984), to interpret similar language in the International Bank for Reconstruction and Development's articles of agreement.

The *Mendaro* test asks whether (1) a suit would provide long-term benefit to the organisation, based on whether third parties would enter into negotiations with the organisation absent the waiver; and (2) a suit threatens an organisation's "core operations," such that the suit would jeopardise the organisation's policy discretion. The DC Circuit found that, based on *Mendaro*, IFC had not waived immunity under its articles of agreement because such an interpretation would subject it to a flood of litigation and threaten its policy discretion.

Secondly, the Supreme Court did not decide whether the FSIA's "commercial activity" exception applies to IFC, and the authors are not aware of any lower court decision opining on this issue. One of the exceptions to immunity afforded to foreign governments under the FSIA (which now applies to international organisations under *Jam*) is for suits based on "commercial activity" that has a sufficient nexus to the US.

The DC Circuit found that based on the commercial activity prong of this exception, the IFC would always be subject to suits because its operations are solely commercial. The Supreme Court cast doubt on this reasoning, stating that MDB lending activity may not always qualify as commercial activity under the FSIA. For an activity to be deemed commercial, in the Supreme Court's view, such activity must be the same type of commercial or trade-related activities that are engaged in by private parties. Because MDBs, for example, issue conditional loans to sovereign nations, and private parties do not generally engage in such activities, the Supreme Court posited – but did not decide – that some MDB activities may not qualify as commercial. under the FSIA. The result was that immunity would apply in such cases.

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Because the Supreme Court declined to grant review of the *Mendaro* test itself, it remains good law in the DC Circuit. Substantial doubts about it remain, however, as even the DC Circuit in *Jam* acknowledged that it is odd for the judiciary to determine what types of lawsuits benefit an international organisation. If the DC Circuit discards the doctrine entirely, it may well hold that IFC's articles of agreement do include a "categorical waiver" of its immunity. The DC Circuit may also decide to apply the *Mendaro* test only to cases in which the Court is deciding whether an organisation's charter waives the immunity provided under the IOIA, and not apply it in deciding whether an organisation's charter confers immunity where the IOIA does not already provide it. Such a holding would have serious implications for IFC and other international organisations whose charters include similar language, as discussed further below.

In addition, for the FSIA exception to apply, the Supreme Court has previously held (for example, in *OBB Personenverkehr AG v Sachs*, 136 S.Ct. 390 (2015)) that the commercial activity at issue must have a "sufficient nexus" to the US and be based upon either the commercial activity itself, or acts performed in connection therewith. Thus, where the "gravamen" of a lawsuit is tortious activity occurring outside the US, the suit is not based upon commercial activity. At oral argument, the US government expressed serious doubts as to whether the petitioners' underlying suit, which primarily related to allegedly tortious conduct occurring in India, could satisfy the "based upon" requirement.

Both the government's and the Court's observations suggest that even facially commercial activities like lending will not necessarily satisfy the commercial activity exception.

Thirdly, the Supreme Court did not decide whether *forum non conveniens* would apply in this case. IFC had argued before the District Court that *Jam* should be dismissed on *forum non conveniens* grounds. Because the District Court decided as a threshold matter that IFC was entitled to immunity, it did not address this question the first time around. The doctrine of *forum non conveniens* allows a district court to dismiss a case where, based on certain public and private factors (some of which include ease of access to evidence, potential for confusing a jury with multiple sets of laws, and forums' interests in having local cases heard at home), another court provides a more convenient forum for disposition of the case. Note that district courts can deny a motion to dismiss for *forum non conveniens* if the plaintiff is immune from the suit in the alternate forum (in *Jam*, presumably India). Alternatively, if a district court grants a motion to dismiss for *forum non conveniens*, it can condition its dismissal on the plaintiff's waiver of defences from suit in the alternate forum, including a waiver of any potential immunities from a suit in that forum. Thus, while an international organisation may be successful in having a suit dismissed from US courts on *forum non conveniens* grounds in the future, it should be aware of the attendant risk of potentially having to litigate the case in an alternative forum without any potential immunities.

Finally, IFC, as well as the African Development Bank and Asian Development Bank, who filed *amicus curiae* briefs in *Jam*, argued that restrictive immunity would make MDBs "attractive targets for 'impact litigation'," particularly under the Alien Tort Statute (ATS). ATS, which was passed shortly after the American revolutionary war, provides that federal district courts have jurisdiction over international law civil tort actions committed by non-citizens. Beginning in the 1990s, lower courts concluded that ATS authorised non-US individuals and nongovernmental organisations to bring international human rights claims against state – and non-state – actors in US courts (for example, see the 9th Circuit's ruling in *Doe v Unocal*, 395 F.3d 932 (9th Cir. 2002) and the 2nd Circuit's ruling in *Wiwa v Royal Dutch Petroleum*, 226 F.3d 88 (2d Cir. 2000)).

In recent years, however, the breadth of ATS has been restricted by the Supreme Court such that ATS might not pose as great a threat of liability to MDBs as they might imagine.

Firstly, it would be difficult for plaintiffs to argue that claims of environmental harm stemming from an MDB-funded project, which comprise a fair number of such claims, qualify as having the "international character" comparable to eighteenth century harms (which involved ambassadors, piracy or international war crimes) that is now required under *Sosa*. In *Kiobel v Royal Dutch Petroleum Co.*, 569 U.S. 108 (2013), the Supreme Court concluded that ATS generally only applies to tortious conduct that occurs inside the US. Under *Kiobel*, then, litigants may not succeed on claims arising from environmental or social harms that took place entirely outside of the US unless a court were to decide that the MDB's failure to enforce the environmental and social covenants in the relevant loan agreements occurred in the US and qualifies as the tortious conduct at issue.

Finally, under *Jesner v Arab Bank*, 138 S. Ct. 1386 (2017), the Supreme Court ruled that foreign corporations, being legally constructed entities against whom lawsuits could have serious foreign relations implications, could not be liable under ATS. Under *Jesner*, MDBs would likely not be subject to suit because (1) they too are legally constructed entities, not natural persons and (2) subjecting MDBs – international organisations comprised of scores of sovereign nations – to suits could endanger foreign relations just as much as, if not more than, litigation against foreign corporations.

Notwithstanding any of the above, unless and until the Supreme Court definitively excludes MDBs from the purview of ATS, or affirms one or more of the other defences described above, MDBs may be required to expend significant resources defending against ATS (and other) claims in US courts.

Practical implications

An international organisation seeking to assess its liability for international financial projects following *Jam* must first assess its charter's jurisdictional and immunity provisions. For example, the Inter-American Development Bank's Charter, like that of IFC, has no explicit immunity provision, but contains a similar jurisdictional provision. The African Development Bank and the Asian Development Bank, on the other hand, have explicit, albeit limited, immunity provisions. For example, the African Development Bank's charter excepts it from immunity in cases arising from its borrowing powers. The Asian Development Bank is excepted from immunity only for cases "arising out of or in connection with the exercise of its powers to borrow money, to guarantee obligations, or to buy and sell or underwrite the sale of securities[.]" At the opposite end of the spectrum entirely, the UN Charter, as interpreted by the Second Circuit, affords that organisation absolute immunity.

Both the government's and the Court's observations suggest that even outwardly commercial activities like lending will not necessarily satisfy the commercial activity exception

It is possible that the DC Circuit, and others, will interpret MDBs' jurisdictional and immunity provisions broadly under *Mendaro*, whereby courts determine whether the suit "would benefit the organisation over the long term". But given the reservations expressed by the DC Circuit about the *Mendaro* test, as described above, MDBs may consider amending their respective charters to strengthen their immunity.

This option may not be politically feasible, however. For instance, to amend IFC's articles of agreement, it would take a vote of three-fifths of member countries (as represented by their respective governors) exercising 85% of the total voting power of the corporation. In fact, since its inception in 1956, IFC's articles of agreement have been amended just four times: in 1961, 1965, 1993 and 2012. Other MDBs would likely face a similarly lengthy process to accomplish this objective.

An international organisation must next address its exposure under the FSIA's commercial activity exception by assessing whether its lending activity qualifies as commercial in nature, and whether such activity has a sufficient nexus to the US. It is possible that MDBs may elect to move their headquarters outside of the US to curb their exposure. If the headquarters' location is specified in the MDB's charter, as it is for IFC, however, that change also may not be politically feasible for the reasons described above.

Jam may also have practical effects on MDBs' existing loans and future lending priorities. Firstly, it may cause MDBs to be stricter in the negotiation of environmental and social covenants and reporting requirements for new loans, refinancings of existing loans, and amendments or waivers thereto. It is theoretically possible that *Jam* could prompt MBDs to negotiate fewer environmental and social covenants and rely on local environmental laws, which are often less strict, though this seems unlikely for policy and reputational reasons. MDBs also may be inclined to more strictly enforce such provisions, finding borrowers in default for failure to comply. In this regard, it is worth noting that the plaintiffs in *Jam* originally brought their grievances to IFC's independent accountability mechanism, the Office of the Compliance Advisor (CAO). In its review, the CAO determined that IFC had been negligent in its enforcement of Tata Power's environmental and social action plan.

Secondly, MDBs may steer away from issuing loans in perceived high-risk industries or regions. The risk may be more than just perceived, in the case of the IFC. Over the period 2001-2016, a 2018 study issued by the international nongovernmental organisation Center for Global Development found that infrastructure, including energy, and extractives projects comprised just 23% of the IFC's total portfolio when measured by commitments in USD. However, a recent study published by the International Human Rights Law Clinic and University of California, Berkeley, School of Law found that approximately 80% of all claims brought before the CAO involved projects in the oil, gas, mining, chemicals and infrastructure sectors. An MDB with a greater perceived risk of litigation stemming from *Jam* might elect to deprioritise funding in industries or countries that may well experience the greatest economic development impact from these types of projects.

Jam may prompt MDBs to strengthen their respective independent accountability mechanisms

Thirdly, *Jam* may prompt MDBs to strengthen their respective independent accountability mechanisms. In the early 1990s, the World Bank Group created its Inspection Panel, the first such grievance mechanism adopted by an MDB. Then in 1999, the CAO was created to serve as the independent accountability mechanism for World Bank's private sector arms, including the IFC and MIGA. The CAO's mission is to facilitate dispute resolution between affected parties and project owners and investigate the IFC and MIGA for failure to adhere to their own environmental and social policies or guidelines.

The CAO's decisions, however, are non-binding on IFC and MIGA, and the CAO has no authority to stop a project, no matter the gravity of the environmental, social or other harms it has or may pose. Thus, *Jam* may prompt MDBs to strengthen the ability of their independent accountability mechanisms to stop and remedy harms caused by a development project. In fact, US Treasury Secretary Steven Mnuchin seemed to indicate this might be in the works already for the IFC and MIGA when he spoke at the annual meeting of the Development Committee of the World Bank and IMF in October 2018. Secretary Mnuchin stated that the CAO at the IFC and MIGA "must also be in the best position possible to fulfill [its] mandate and provide adequate redress, especially for vulnerable communities. To this end, I look forward to...the launch of an external expert review and reform process of the CAO later this fall."

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