

## RECENT DEVELOPMENTS IN FOREIGN SOVEREIGN IMMUNITY AND TEXAS GARNISHMENT LAW: A NEW THREAT FACING U.S. OIL AND GAS COMPANIES

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In two related cases, the United States Court of Appeals for the Fifth Circuit issued a series of opinions regarding sovereign immunity under the Foreign Sovereign Immunities Act<sup>1</sup> and

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1. Sovereign immunity is a doctrine of international law under which domestic courts typically surrender jurisdiction over a foreign state. *See* H.R. REP. NO. 94-1487, at 8 \*1976). Congress enacted the Foreign Sovereign Immunities Act to provide stability and consistency in the application of sovereign immunity by courts against foreign nations [hereinafter F.S.I.A.]. *Id.* at 7. Codified at 28 U.S.C. § 1602 (2000), the F.S.I.A. applies the restrictive theory of sovereign immunity—a foreign nation’s public acts, but not its private acts, are immune from lawsuits. The F.S.I.A. is the exclusive basis under which judgments rendered against foreign states can be executed. *Id.* § 1602. A sovereign’s property is susceptible to attachment and execution if it is used for a commercial activity in the United States and it satisfies one of seven conditions. 28 U.S.C. § 1610. Some examples include the foreign sovereign expressly or implicitly waiving its immunity; the property being used for the commercial activity that gave rise

Texas garnishment law that will significantly impact how U.S. companies do business overseas. This Article provides a brief review of some of the lawsuits brought by the Congo's debt collectors, which include attempts to satisfy the debt by seizing nonmonetary obligations owed to the Congo by oil and gas companies operating in the Congo. The Article concludes with a commentary on the how these lawsuits will impact U.S. oil and gas companies operating abroad.

## I. BACKGROUND

CMS Nomeco, a U.S. oil company, is the operator of a joint venture and owns twenty-five percent of an offshore oil concession (the Yombo field) in the Republic of the Congo.<sup>2</sup> Affiliates of CMS Nomeco own another twenty-five percent of the offshore oil concession.<sup>3</sup> The remaining fifty percent of the concession is owned by Société Nationale des Pétroles du Congo ("SNPC"), the Congolese state-owned petroleum company.<sup>4</sup> As participating interest owners in the oilfield, CMS Nomeco and SNPC each receive a share of the oil production.<sup>5</sup> SNPC receives its entitlement share of the production inside the Congo.<sup>6</sup>

The concession permits the joint venture to extract oil in exchange for royalties and periodic tax payments to the Congo.<sup>7</sup> Under the terms of the concession agreement, the Congo can elect to receive either a cash royalty or its share of the

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to the claim; and the execution relating to a judgment regarding property taken or exchanged in violation of international law. *Id.* § 1610(a)(1)–(3). Additional noncommercial exceptions to immunity include property related to certain prohibited financial transactions and certain actions against vessels of foreign states. *Id.* § 1610(e), (f).

2. CMS Nomeco refers to CMS Nomeco Congo LLC.

3. These affiliates are Nuevo Congo LLC and Nuevo Congo, Ltd. CMS Nomeco's affiliates are similarly affected by the litigation. *See* *FG Hemisphere Assocs., LLC. v. République du Congo*, 455 F.3d 575, 580 (5th Cir. 2006). References to CMS Nomeco include these affiliates.

4. *FG Hemisphere*, 455 F.3d at 582.

5. *Id.* at 581.

6. *Id.*

7. *Af-Cap Inc., v. Republic of Congo*, 383 F.3d 361, 364 (5th Cir. 2004) [hereinafter *Af-Cap I*].

production in-kind within the Congo.<sup>8</sup> The Congo has elected to receive its royalty in-kind.<sup>9</sup> As the operator, CMS Nomeco is legally and contractually required to deliver to the Congo and SNPC their royalty oil and entitlement share, respectively.<sup>10</sup> The Congo has assigned the right to take (or lift) the royalty oil to SNPC, and SNPC independently markets both the Congo royalty and SNPC's entitlement share of the oil.<sup>11</sup>

The Congo defaulted on loans it made to develop its infrastructure, several resulting in judgments against the Congo.<sup>12</sup> To satisfy the debt and judgments, creditors sought to garnish CMS Nomeco's obligation to deliver to the Congo its in-kind royalties and to SNPC its entitlement share of the oil production.<sup>13</sup> CMS Nomeco and the Congo maintained that the nonmonetary obligations (royalties, entitlement share, and tax payments) are not property subject to garnishment and are protected by the F.S.I.A.<sup>14</sup> CMS Nomeco also argued that neither CMS Nomeco nor the property sought by the Congo's creditors is located in the United States and, therefore, is not subject to garnishment.<sup>15</sup>

Meanwhile, the Congo obtained multiple Congolese court orders that refuse to recognize the U.S. court orders and insisted that CMS Nomeco perform its legal and contractual obligations and allow the Congo and SNPC to lift their oil.<sup>16</sup> Additionally, the Congo threatened to detain senior-level officers of oil companies and use public force to ensure that the Congo and the SNPC receive their share of the oil production.<sup>17</sup> Against this

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8. *Id.*

9. *Id.*

10. *FG Hemisphere*, 455 F.3d at 581.

11. *Id.*

12. *Af-Cap I*, 383 F.3d at 364.

13. *Id.*

14. *Id.* at 365.

15. *Id.* at 371-72.

16. *Conn. Bank of Commerce v. Republic of Congo*, 440 F. Supp. 2d 346, 348 (D. Del. 2006).

17. *See* Ordonnance F°251 [Order 251], Role Civil N°547 Annee 2005 [Civil List No. 546 of Year 2005]; Repertoire N°476 du 04-07-05 [Register No. 477 of July 4, 2005]; *see also* Jim Landers, *Oil Firms May Pay Double to Stay Put: Operators in Congo*

backdrop, a series of recent opinions by the United States Fifth Circuit in two related Texas cases are examined to show how the court applied the F.S.I.A. and Texas law, through novel interpretations, to resolve the dispute among CMS Nomeco, the Congo, and its creditors.

## II. THE CONGO CASES

### A. *Af-Cap Inc. v. Republic of Congo*

The first case involving CMS Nomeco is currently in the United States District Court for the Western District of Texas in Austin.<sup>18</sup> For over four years, the lawsuit has passed between the district court and the Fifth Circuit, analyzing whether the Congo's royalty and the tax payments were property that could be garnished under section 1610(a) of the F.S.I.A.<sup>19</sup> During this period, the Fifth Circuit rendered several important opinions regarding the garnishment of royalties and tax obligations owed to foreign nations.

The Fifth Circuit first examined when a nonmonetary obligation can be garnished under the F.S.I.A.<sup>20</sup> The court held that the appropriate factor to consider is what the nonmonetary obligation or royalty is "used for."<sup>21</sup> To show that the royalty is

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*Squeezed by Debt-Laden Nation, Vulture Funds*, DALLAS MORNING NEWS, May 5, 2006, at 5D.

18. *Af-Cap Inc. v. Republic of Congo*, 462 F.3d 417, 422, 430 (5th Cir. 2006) [hereinafter *Af-Cap III*]. A third case, *Af-Cap, Inc. v. Republic of Congo*, 389 F.3d 503 (5th Cir. 2004) [hereinafter *Af-Cap II*], was decided by the Fifth Circuit on November 1, 2004 to clarify *Af-Cap I*; however, this Article does not examine *Af-Cap II* in detail.

19. 28 U.S.C. § 1610(a) (2000) provides, in part:

The property in the United States of a foreign state, as defined in section 1603(a) of this chapter, used for a commercial activity in the United States, shall not be immune from attachment in aid of execution, or from execution, upon a judgment entered by a court of the United States or of a State after the effective date of this Act. . . .

20. *Conn. Bank of Commerce v. Republic of Congo*, 309 F.3d 240, 251 (5th Cir. 2002).

21. *Id.*; see also *Af-Cap, Inc. v. Chevron Overseas (Congo) Ltd.*, —F.3d.—, 2007 WL 177823, \*8 (9th Cir. Jan. 25, 2007) [hereinafter *Af-Cap v. Chevron Overseas*] (adopting the Fifth Circuit's "used for" test and finding that property is "used for a commercial activity" if it is "put into action," "put into service," "availed or employed" for a commercial activity but not "in connection with or in relation to" a commercial activity).

property “used for commercial activity” under the F.S.I.A., the court adopted a holistic approach which included a review of a foreign nation’s past commercial use of the royalty.<sup>22</sup> With respect to the Congo’s royalties, the court found a commercial activity existed when the Congo previously assigned a portion of the royalty to another judgment creditor to fully satisfy a different debt and contemplated a similar settlement on yet another occasion.<sup>23</sup> Although CMS Nomeco argued that the royalty and tax payments were generated from activities in, and paid in the Congo, the court rejected consideration of how the royalty was generated and instead focused on the Congo’s past activities to decide that CMS Nomeco’s could be garnished.<sup>24</sup>

The Fifth Circuit next analyzed whether the royalty was property “in the United States” according to section 1610(a).<sup>25</sup> The court acknowledged that determining the situs of the obligations was problematic because of their intangible nature.<sup>26</sup> The court compared these obligations to debtor obligations, and despite the fact that all royalty oil was delivered within the Congo, found that a “common sense appraisal of the requirements of justice and convenience” required the location of the oil companies—the United States—to be the situs of the intangible obligations.<sup>27</sup> Because the royalty obligations were “used for a commercial activity” and “in the United States,” the Fifth Circuit concluded that the Congo’s royalty and tax receipts were not immune from garnishment under the F.S.I.A.<sup>28</sup>

The Fifth Circuit next examined whether Texas garnishment law, the prejudgment method employed by the Congo’s creditors, allowed attachment of CMS Nomeco’s nonmonetary obligations.<sup>29</sup> The Fifth Circuit noted that Texas

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22. *Af-Cap I*, 383 F.3d at 369. *But see Af-Cap v. Chevron Overseas*, 2007 WL 177823 at \*8 (declining to incorporate the Fifth Circuit’s holistic approach, finding the analysis would “unnecessarily complicate” the “used for” determination under § 1610(a)).

23. *Af-Cap I*, 383 F.3d at 368–71.

24. *Id.* at 370.

25. *Id.* at 371–73.

26. *Id.* at 371.

27. *Id.*

28. *Af-Cap I*, 383 F.3d at 373.

29. *Af-Cap III*, 462 F.3d at 423.

statutes and case law did not address whether a nonmonetary obligation can be subject to garnishment.<sup>30</sup> Because Texas' garnishment statute is to be strictly construed, the court found that CMS Nomeco's royalty and tax obligations could not be garnished under Texas law.<sup>31</sup> Although CMS Nomeco's nonmonetary obligations were not protected by the F.S.I.A., the court held that Texas law prevented their garnishment.<sup>32</sup>

*B. FG Hemisphere Associates, LLC v. The République du Congo*

The second case involving CMS Nomeco is currently before the United States District Court for the Southern District of Texas in Houston.<sup>33</sup> Temporally, this lawsuit arose after the Fifth Circuit determined in *Af-Cap II* that CMS Nomeco's nonmonetary obligations were not protected by the F.S.I.A. because they were used by the Congo for a commercial purpose and were located in the United States. As in the *Af-Cap* litigation, the Congo's creditor sought to garnish the royalties that CMS Nomeco delivers to the Congo.<sup>34</sup> In this case, the creditor also sought to garnish SNPC's entitlement share of oil

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30. *Id.*

31. *Id.* at 425.

32. *Id.* The Fifth Circuit made two other findings regarding the F.S.I.A. *Id.* at 429–30. First, the court addressed a turnover order the district court entered against the Congo. *Id.* In Texas, a court can order a judgment debtor “to turn over nonexempt property that is in the debtor’s possession or is subject to the debtor’s control.” *Id.* at 425 (citing TEX. CIV. PRAC. & REM. CODE ANN. § 31.002 (Vernon 1997)). Because this action was against the Congo and not against its property, the court looked to § 1605(a) of the F.S.I.A. to determine if the district had jurisdiction to make such an order. *Af-Cap III*, 462 F.3d at 426. The court found that the Congo had not waived jurisdiction, expressly or implicitly, and also that the Congo itself did not partake in any commercial activity in the United States. *Id.* at 426–27. Because the district court erroneously found that the Congo had waived its immunity, the Fifth Circuit found that the turnover order was improper. *Id.* at 427. In addition, the Fifth Circuit vacated a contempt order the district court entered against the Congo when it failed to comply with the court’s previous order. *Id.* at 428–29. The Fifth Circuit noted that the F.S.I.A. provides the sole method of enforcing judgments against foreign sovereigns and that monetary sanctions are not provided in the relevant sections—§ 1610 and § 1611—of the F.S.I.A. *Id.* The Fifth Circuit therefore found the contempt order was improper against the foreign nation. *Id.*

33. *FG Hemisphere Assocs., LLC v. République du Congo*, 455 F.3d 575 (5th Cir. 2006).

34. *Id.* at 580–81.

production that it receives as part of its joint venture with CMS Nomeco.<sup>35</sup>

At issue was the point in time at which the sovereign's property is subject to attachment under the F.S.I.A.<sup>36</sup> In making its determination, the court adopted a "situs snapshot" rule.<sup>37</sup> The foreign nation's property must be in the United States at the time a district court applies the exception to immunity under the F.S.I.A.<sup>38</sup> Thus, either CMS Nomeco or the property sought to be garnished must be located in the United States to properly garnish CMS Nomeco's in-kind royalties to the Congo and SNPC's entitlement share.<sup>39</sup>

The Fifth Circuit also clarified its previous *Af-Cap* decisions. The court explained that it did not analyze whether the garnishees and any intangibles in their possession were in the United States because the garnishees' presence in Texas was undisputed.<sup>40</sup> The court also never decided the applicable time period during which the obligations must be in the United States for immunity not to apply.<sup>41</sup> In addition, the Fifth Circuit explained that it only assumed, but did not determine, that the royalty obligations to the Congo were intangible property.<sup>42</sup> The court acknowledged that it relied on this assumption to determine that the situs of an intangible obligation is the situs of the garnishee.<sup>43</sup> Having never properly classified the royalty obligations at issue, the court therefore found that the CMS Nomeco's obligation to pay royalties was in the United States merely because CMS Nomeco was in the United States.<sup>44</sup>

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35. *Id.* at 580.

36. *Id.* at 588.

37. *Id.*

38. *Id.*

39. *FG Hemisphere*, 455 F.3d at 588–90.

40. *Id.* at 586.

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.*

*C. Summary of the Fifth Circuit Congo Decisions*

In summary, the Fifth Circuit made several important holdings in *Af-Cap I*, *II*, *III* and *FG Hemisphere*. The Fifth Circuit determined that:

- A totality of the circumstances test, including past use, is applied to determine whether nonmonetary obligations to a foreign nation are “used for commercial activity” in the United States;
- The situs of a garnishee is the situs for determining whether nonmonetary obligations owed to a foreign country are property “in the United States;”
- The situs of the property must be in the United States at the time a district court applies an exception to immunity under the F.S.I.A.;
- Absent an express provision, the F.S.I.A. does not allow a court to impose sanctions against a foreign sovereign; and
- Texas law on garnishment does not allow attachment of nonmonetary obligations.

These holdings related to the F.S.I.A. change how sovereign immunity is traditionally viewed with respect to U.S. companies’ obligations to foreign governments. Indeed, the *Af-Cap* and *FG Hemisphere* opinions will have a significant impact on U.S. companies that operate abroad, particularly oil and gas companies.

### III. IMPACTS OF THE CONGO CASES ON U.S. OIL AND GAS COMPANIES

CMS Nomeco was not a party to and had no involvement in the underlying loans that led to the lawsuits against the Congo.<sup>45</sup> Nevertheless CMS Nomeco, an innocent garnishee, found itself in the litigation. Had the Fifth Circuit found that Texas law allows garnishment of CMS Nomeco’s nonmonetary obligations, CMS Nomeco would have found itself in a thorny

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45. *FG Hemisphere*, 455 F.3d at 581.

situation. On the one hand, a U.S. court ordered CMS Nomeco to turn over the Congo's royalty oil and the SNPC's oil entitlement to the Congo's judgment creditors.<sup>46</sup> On the other hand, a Congolese court found that the U.S. orders were not enforceable in the Congo and demanded that CMS Nomeco deliver to the Congo its in-kind royalty oil and to the SNPC its oil entitlement as mandated by law and the concession contracts.<sup>47</sup>

In reality, however, CMS Nomeco had no choice. The oil is produced, stored and lifted from a storage facility in the Congo.<sup>48</sup> The concession or convention for the production of the oil is governed by Congolese law.<sup>49</sup> And, finally, the Congolese government could have used, as it had in the past, public force to ensure that the Congo and SNPC receive their share of the oil production. Faced with these types of demands, CMS Nomeco was forced to allow the Congo and SNPC to lift their share of the oil production.

Although CMS Nomeco may well escape the Congo's creditors in Texas, the outlook is not as clear in the remaining forty-nine states. The Fifth Circuit's conclusion that in-kind royalty obligations can be garnished under the F.S.I.A. may create serious problems for oil and gas companies. The rulings suggest that courts will allow garnishment of in-kind royalties if, at the time of application for the garnishment, the oil company and the property is "located in the United States" and used for a "commercial activity in the United States." Unfortunately, the Fifth Circuit declined to decide an issue that would have provided some guidance for future courts: whether CMS Nomeco was "in the United States" at the time of the creditors' application for garnishment by reason of its mere incorporation in Delaware.<sup>50</sup> The Fifth Circuit arguably left open the possibility for courts outside of Texas to prevent an oil and gas company with U.S. contacts from complying with its legal and contractual obligations abroad.

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46. See *Af-Cap v. Chevron Overseas*, 2007 WL 177823 at \*8.

47. See *Ordonnance F°251*, *supra* note 17.

48. *FG Hemisphere*, 455 F.3d at 581–82.

49. *Id.* at 581.

50. See *FG Hemisphere*, 455 F.3d at 590.

More importantly, the Fifth Circuit failed to explicitly address cash royalties. While the Fifth Circuit held that Texas law does not allow garnishment of in-kind royalties, the court left the door wide open for garnishment of cash royalties under Texas law. Should non-U.S. cash royalties be subject to garnishment in Texas, both the U.S. oil and gas industry and U.S. energy security, in general, are seriously exposed and in real jeopardy.

A recent, related decision by the United States Court of Appeals for the Ninth Circuit does not alleviate the threat. In *Af-Cap Inc. v. Chevron Overseas (Congo) Limited*, the Ninth Circuit found that intangible obligations of certain Chevron entities to the Congo were not subject to garnishment.<sup>51</sup> Af-Cap sought to garnish Chevron's obligations to the Congo, including bonuses and in-kind royalties. Chevron and the Congo agreed that some of these obligations would offset a prepayment made by Chevron to the Congo under a separate contract.<sup>52</sup> The Ninth Circuit determined that because of the prepayment, the offsetting obligations belonged to Chevron and not to the Congo.<sup>53</sup> Because the obligations were not "used for a commercial activity" in the United States by the Congo, Af-Cap was not able to garnish these offsetting obligations.<sup>54</sup>

In addition, the Ninth Circuit determined that an operator bonus paid by Chevron from its New York bank account to the Congo was not subject to garnishment. The Ninth Circuit reasoned that the mere relation of the operator bonus to commercial activity in the United States was not enough.<sup>55</sup> Had

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51. *Af-Cap v. Chevron Overseas*, 2007 WL 177823 at \*1.

52. Chevron and the Congo entered into an agreement for Chevron to prepay \$25 million of bonuses that, according to the Ninth Circuit, Chevron was obligated to pay to the Congo under a participation agreement. *Id.* at \*9. The Ninth Circuit found that the value of the cargoes lifted by Chevron and any bonuses payable to the Congo were offset against the prepayment amount. *Id.* The obligations Af-Cap sought to garnish included a participation bonus, a signature bonus, an operation bonus, fees and tax obligation to the Congo, a signing bonus, and in-kind royalties. *Id.* at \*2.

53. *Id.* at \*9.

54. *Id.*

55. *Id.* at \*10. The court reached a similar conclusion regarding a payment made in exchange for shares in a commercial joint venture and payments made for social programs within the Congo. *Id.* at \*9.

the Congo used the operator bonus to repay a debt in the United States, however, like the Congo has done with the royalty oil that CMS Nomeco delivered to the Congo, the Ninth Circuit may have been willing to allow Af-Cap to seize Chevron's obligations.

Oil and gas companies that operate abroad like CMS Nomeco could now find themselves "caught between a rock and a hard place." A U.S. court ordered CMS Nomeco not to deliver oil as required by law and its contract in the Congo, and the Congo ordered CMS Nomeco to comply with the law and its contract and to deliver such oil. If CMS Nomeco had not delivered to the Congo its royalty oil and to SNPC its entitlement oil, the Congo could have terminated CMS Nomeco's concession. Similarly situated oil and gas companies face the same dilemma with two untenable options: risk being held in contempt of court or pay twice. Moreover, if the company pays twice, it will be left trying to recoup the double payment from a foreign nation that has already shown an unwillingness to repay its debts.

These cases are most troubling to U.S. oil and gas companies operating overseas. Our research has shown that over 75 countries have defaulted on some form of sovereign debt since 1975, many of which are rich in natural resources.<sup>56</sup> Conducting business with those countries has now become riskier and more expensive. The mere possibility that a U.S. court might issue an order preventing U.S. companies from complying with their legal and contractual obligations abroad will cause many governments, especially those with sovereign debt issues, to think twice before doing business with a U.S. company. Consequently, U.S. oil and gas companies will suffer a serious competitive disadvantage when competing for concessions against foreign companies.

Although these cases involve the life blood of many countries, oil and gas, other industries will certainly be affected. Indeed, these decisions cast a dark cloud on the outlook for all U.S. businesses operating internationally. As a result of the Fifth Circuit's decisions, U.S. companies doing business in

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56. Specific research conducted by the Authors. For similar research conducted prior to 2000, see also Daniel Joelson, *Sovereign Debts Defaults Dip in 1999 But Not For Long*, GLOBAL FINANCE, Feb. 2000, [http://www.findarticles.com/p/articles/mi\\_qa3715/is\\_200002/ai\\_n8880465](http://www.findarticles.com/p/articles/mi_qa3715/is_200002/ai_n8880465).

foreign debtor nations can expect to be embroiled in convoluted litigation as creditors seek to make U.S. companies the guarantors of defaulted sovereign debt with no viable means of recuperation.