

Quickguides

State Immunity: an Overview

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State Immunity: an Overview

This guide highlights the key issues that should be considered when dealing with states or government entities benefiting from state immunity. In particular, it answers the following questions:

- What is state immunity?
- Why does state immunity matter?
- Who can claim it and when?
- What contractual and other protection is available?

The guide also includes a flow chart which sets out the various decisions you need to make in deciding whether state immunity issues apply and how to deal with them.

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State Immunity: an Overview

State immunity is a principle of international law that is often relied on by states to claim that the particular court or tribunal does not have jurisdiction over it, or to prevent enforcement of an award or judgment against any of its assets. In other words, it can create difficulties for a counterparty looking to enforce its contractual rights against a state. As such, state immunity should always be considered whenever dealing with states or state entities.

In order to be able to minimise the risks inherent in dealing with a particular state or state entity, it is important to have an understanding of what state immunity is and when and where it can be claimed. This guide provides guidance on those questions and then goes on to look at the steps that can be taken to help minimise any risk when contracting with a state or state entity.

What is state immunity?

State immunity, or sovereign immunity as it is often referred to, is a principle of international law that has become part of the national law of many states. It derives from the theory of the sovereign equality of states, as a consequence of which one state has no right to judge the actions of another by the standards of its national law. It protects an entity in two ways: by conferring immunity from adjudication (also known as immunity from suit) and by conferring immunity from enforcement and execution.

If a party is immune from adjudication, the court will be prevented from considering claims against that party and awarding a judgment or declaring rights and obligations against it. If a party is immune from enforcement and execution, the court will be prevented from recognising a foreign judgment or an arbitral award against the immune party and from making and executing orders or injunctions against it.

International attitudes towards state immunity vary. In general, there are two approaches: the absolute doctrine and the restrictive doctrine.

The absolute doctrine: Initially the first and only approach, the absolute doctrine still applies in some jurisdictions, notably China and Hong Kong. Under this doctrine, any proceedings against foreign states are inadmissible unless the state expressly agrees to waive immunity.

The restrictive doctrine: The increasing involvement of states in world trade activities led to the development of a more restrictive approach to state immunity, where a distinction is drawn between acts of a sovereign nature and acts of a commercial nature. Under the restrictive approach, immunity is only available in respect of acts resulting from the exercise of a sovereign power. As such, states may not claim immunity in respect of commercial activities or over commercial assets.

Although the restrictive approach is now widely adopted, state immunity continues to be an unsettled area of international law and the scope of recognised exceptions varies from state to state. Therefore, in order to analyse the level of risk in dealing with a particular state or state entity, it is important to understand which laws will apply in determining whether the state is entitled to claim immunity.

Which law will apply?

Although state immunity is a principle of international law, it is applied in accordance with the law applicable to the proceedings, the law of the forum. This means that the particular court or tribunal dealing with issues of immunity will look to its own national law, or the law of the seat if in arbitration. So, for example, if a party wants to bring proceedings against a state in the New York courts, New York law on state immunity will apply. If it then wants to enforce the New York judgment in the English courts, English law on state immunity will apply to the enforcement proceedings.

Consequently, a party not only has to check the national law of the place chosen for resolution of any disputes (so New York law in the example above), but also the law of the location of the assets, which is usually the place

of the state or state entity. You will have achieved a Pyrrhic victory if, having argued that the state is not immune from the jurisdiction of the New York courts, you are unable to enforce your judgment because immunity from enforcement is successfully claimed in the English courts.

The primary source of English law on state immunity is the State Immunity Act 1978 (SIA), which gives effect to the restrictive doctrine.¹ The rest of this Quickguide looks at the issue of state immunity as it applies under the SIA.

Why does state immunity matter?

Put simply, if a state is able to claim immunity from suit or enforcement, it will be difficult for a commercial party to enforce its contractual rights against that state. A successful plea of state immunity will mean that either the courts will refuse to hear the dispute or they will be unable to give effect to any judgment or award made against the state.

Commercial parties often try to manage the risks associated with state immunity by obtaining a contractual waiver of immunity, whereby the state waives and agrees not to claim the immunity it would otherwise be entitled to. However, increasingly states and state entities are refusing to give up their rights to immunity and in some cases, are insisting on positively asserting their entitlement to claim immunity in the contractual documents. In those circumstances, it is particularly important that any party dealing with the state understands the significant consequences of dealing with a state entity in the absence of an express waiver of immunity.

What follows are the key questions any party should ask when state immunity may be an issue. The analysis given is that applicable under English law, i.e. under the SIA. To appreciate fully the level of risk involved, it will be necessary to have an understanding of the answers to these questions in all relevant jurisdictions (see "Which law will apply?" for more detail on that point).

Who can benefit from state immunity?

State immunity can apply not only to states and governments but also to separate entities acting "in the exercise of sovereign authority". Therefore, the first question that needs to be addressed is who are you dealing with: the state, a state entity or a separate entity?

Under the SIA, the definition of **state** applies to any foreign or commonwealth state – apart from the United Kingdom – and includes the sovereign/head of that state, the government of the state and any department of the government.²

A **separate entity** is defined as any entity which is distinct from the executive organs of the government of the state and is capable of suing or being sued. Separate entities are not entitled to claim immunity unless the proceedings relate to anything done by the separate entity in the exercise of sovereign authority.³ This means that if entities such as state-owned banks, airlines or shipping lines act in the exercise of sovereign authority, they have immunity. Unfortunately, it will often not be clear whether or not an entity is acting in the exercise of sovereign authority and consequently whether or not it has immunity. The answer to that question depends on the character of the act, rather than the motives or intentions of the parties.⁴

Difficulties often arise in determining whether a state-owned entity is an organ of the state (and therefore entitled to full immunity) or a separate entity. The presumption is that a separate legal entity, formed by the state for commercial purposes and with its own management and budget, qualifies as a separate entity under the SIA unless "quite extreme circumstances" apply. For a state-owned entity to be characterised as an organ of the

¹ The SIA has not replaced the common law in its entirety, but for international commercial matters, it is the SIA which will apply. The Quickguide does therefore not cover the common law principles.

² Section 14(1) SIA. A certificate signed by the Secretary of State is conclusive evidence as to whether a particular country is a state or a person is to be regarded as the head or government of a state (section 21 SIA).

³ Sections 14(1) and 14(2) SIA.

⁴ *Tsavliris Salvage (International) Ltd -v- The Grain Board of Iraq* [2008] EWHC 612 (Comm).

state, the affairs of the entity and the state would have to be so closely intertwined and confused that the entity could not properly be regarded for any significant purpose as distinct from the state.⁵

It is usually preferable for commercial parties to transact with separate entities whose entitlement to immunity is limited only to acts of a sovereign nature. It is also sensible to secure warranties to the effect that: the entity is not an organ of the state, it is not acting in a sovereign capacity (but rather for purely commercial purposes), and is not entitled to immunity. If it is not possible to structure the transaction so that the commercial party contracts with a separate entity, waiver of immunity should be required.

A further complication arises when dealing with **international organisations**. These are not covered by the SIA and do not benefit from state immunity unless an express immunity is granted by statute, such as the International Organisations Act 1968. So, for example, organisations such as the United Nations, the Council of Europe, the North Atlantic Treaty Organisation and the World Trade Organisation are protected by legislation granting them immunity. Organisations such as the Eurasian Development Bank presently do not have immunity under English law. This means that investors should always check the status of an international organisation to determine whether it has been granted specific immunity.

What are the exceptions to state immunity?

Exceptions to immunity from adjudication

There are four main exceptions to immunity from adjudication under the SIA.⁶ However, as the burden will always be on the party seeking to rely on the exception to prove that it applies, it is important to consider these exceptions at the outset of a relationship with a state entity to ensure that appropriate safeguards are put in place.

Submission to the jurisdiction of the English courts: A state will not be immune from adjudication where it has either expressly agreed that the English courts have jurisdiction (i.e. the contract incorporates a jurisdiction clause or agreement is reached once a dispute has arisen), or the state itself starts proceedings or takes a step in any proceedings commenced in the English courts.⁷ States rarely submit to the jurisdiction of other courts and so, in practice, express jurisdiction clauses are used. This can either be a stand-alone jurisdiction clause (the parties agree that the English courts have jurisdiction), or as part of a waiver of immunity clause. The added advantage of this exception is that the state is also prevented from arguing that the English courts do not have jurisdiction under general jurisdiction rules.

Commercial transaction: The second exception gives effect to the restrictive doctrine of state immunity. It means that, even in the absence of a waiver of immunity clause or express submission to the jurisdiction of the English courts, the state will nevertheless be prevented from claiming immunity in relation to transactions that are entered into "otherwise than in the exercise of sovereign authority". Contracts for the supply of goods or services, financing transactions and associated guarantees or indemnities will be treated as commercial transactions. Employment contracts between states and individuals will not. Beyond these examples, the determination of the nature of a transaction will depend on the facts and the ability of the party claiming that the exception applies to demonstrate that the state acted like a private person and not in the exercise of sovereign authority. This is not an easy test to apply in practice. Also note that the parties can contract out of this exception. Caution should therefore be exercised in circumstances where a state is pressing for the inclusion of a contractual statement preserving its right to claim immunity to the fullest extent possible.

Proceedings related to a contractual obligation to be performed wholly or partly in the UK: The third exception applies to obligations of the state performed in the UK. In such circumstances the state in question cannot claim immunity. Unlike the commercial transaction exception, this exception applies to contractual obligations in any kind of contract, regardless of whether the state entered into the contract in exercise of its state authority. The exception does not apply if the contract was not a commercial transaction, is governed by the state's administrative law, and was made in that state's territory.

⁵ *La Générale des Carrières et des Mines -v- F.G. Hemisphere Associates LLC* [2012] UKPC 27.

⁶ Sections 2-11.

⁷ Other than a step taken purely to contest jurisdiction.

Agreement to submit to arbitration: This exception covers agreements in writing to submit a dispute to arbitration, including arbitration outside the UK, i.e. an arbitration clause. The purpose of the exception is to enable English court proceedings to be brought in support of any arbitration. However, the exception is subject to any contrary agreement and so the cautionary point made above applies. A specific exception is not required for arbitration generally as issues of state immunity do not arise; by agreeing to refer disputes to arbitration, the state is submitting itself to the jurisdiction of the tribunal appointed.

It should be noted that, just because a state is not entitled to claim immunity from suit, it does not automatically mean that the English courts will have jurisdiction over that state. The state is in the same position as any other defendant and the claimant will still need to be able to show that the English courts have jurisdiction. In addition, the courts will not have jurisdiction to resolve disputes concerning certain types of sovereign act which covers disputes involving, for example, sensitive issues of diplomacy between states, or uncertain or controversial issues of international law.

Exceptions to immunity from enforcement/execution

A state may have lost its entitlement to immunity from suit but, unless one of the exceptions to immunity from enforcement/execution apply, the state will be able to claim immunity from enforcement/execution in respect of any judgment or award against it.⁸ Two main exceptions apply under the SIA:

Consent to enforcement/execution: A state can give written consent to the enforcement of decisions or awards. The state's consent can be limited to particular circumstances or apply generally, but will not be constituted by a submission to the jurisdiction of the English courts. As a general rule, any waiver should mirror the wording of the section 13(2) immunity and should cover pre-judgment as well as post-judgment execution.

Commercial purpose: The enforcement of judgments or arbitral awards may be enforced against property that is in use or intended for use for commercial purposes. This is similar to the commercial transaction exception to immunity from adjudication, but is more narrowly applied in the context of enforcement. In order for the exception to apply, the party seeking enforcement must establish that the relevant assets are currently "in use or intended for use" for a commercial transaction. It is insufficient for the assets merely to be connected with a commercial transaction or for them to originate from a commercial transaction. A state can also raise a presumption that the assets are not used for commercial purposes by issuing a certificate to that effect.⁹

Also important is the fact that **state central banks** and other monetary authorities benefit from a more favourable immunity regime. The SIA makes it clear that these entities enjoy immunity from enforcement, even against assets that are held for commercial purposes.¹⁰ In practice this means that private investors should avoid arrangements pursuant to which state central banks or other monetary authorities hold assets that relate to the transaction.

Waiver of immunity clauses

The easiest and most efficient way of dealing with state immunity is to seek an express waiver of that immunity. The following key considerations must be kept in mind when drafting waiver of immunity clauses:

- (a) The waiver clause should be included **in all transaction documents** that involve state parties.
- (b) The clause should be **agreed by all states or state entities** likely to be part of the transaction or which hold assets relevant to the transaction.
- (c) The clause has to be an express and clear waiver of **both immunity from suit and immunity from enforcement**: merely specifying the applicable law or waiving the state's immunity without express agreement to submit to the relevant courts is unlikely to be sufficient.

⁸ Under sections 13-14 SIA.

⁹ The decision of the Supreme Court in *SerVaas Incorporated -v- Rafidain Bank and others* [2012] UKSC 40 is the leading authority on this issue.

¹⁰ Section 14(4) SIA.

- (d) The clause should state that it **applies to interim measures** (such as injunctions or orders for specific performance) as well as to final judgments and/or arbitral awards.
- (e) The clause should extend to all of the state's assets or any separate entity's assets. Ideally, the waiver should be sufficiently general to **cover all assets**, even those which might be transferred from the state involved to other state entities. If not possible, the clause should at least specify the type of assets to which the waiver will apply.
- (f) The clause has to have been **agreed by a person who has the required authority** of the state: check that they have authority to waive immunity.
- (g) The waiver provisions should include **express confirmation that the entity is not acting in a sovereign capacity**: this will avoid issues when dealing with separate entities in particular.
- (h) **Check the enforceability** of the waiver clause **in all jurisdictions where you are likely to seek the enforcement** of any judgment or award. For example, a reference to the United States Foreign Sovereign Immunities Act should be included in the waiver if proceedings in the US are likely.

Sample clause: the 2012 Model Form Joint Operating Agreement of the Association of International Petroleum Negotiators

Several sample clauses can be found in case law or in model clauses proposed by international organisations. For example, the 2012 Model Form Joint Operating Agreement of the Association of International Petroleum Negotiators includes the following sample clause.

Any Party that now or hereafter has a right to claim sovereign immunity for itself or any of its assets hereby waives any such immunity from either jurisdiction or enforcement to the fullest extent permitted by the laws of any applicable jurisdiction.

This waiver includes immunity from (i) any expert determination, mediation, or arbitration proceeding commenced pursuant to this Agreement; (ii) any judicial, administrative, or other proceedings to aid the expert determination, mediation, or arbitration commenced pursuant to this Agreement; and (iii) any effort to confirm, enforce, or execute any decision, settlement, award, judgment, service of process, execution order, or attachment (including pre-judgment attachment) that results from an expert determination, mediation, arbitration, or any judicial or administrative proceedings commenced pursuant to this Agreement.

Each Party acknowledges that its rights and obligations subject to this Agreement are of a commercial and not a governmental nature.

Issues to consider when contracting with a state

When dealing with a state or a state-owned entity, we recommend that you carefully consider the following:

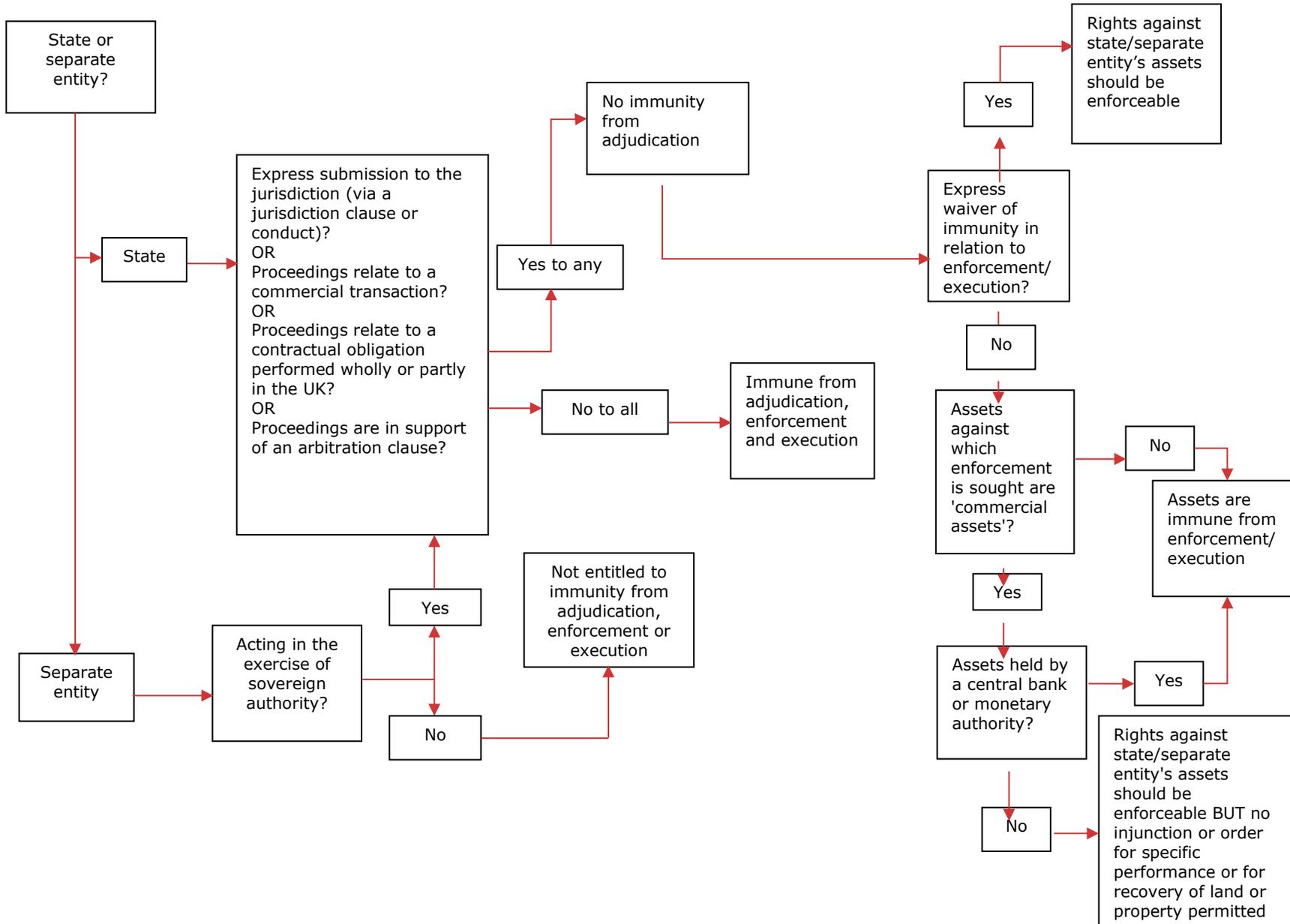
- To what extent can the state waive immunity? Check what is required for the waiver to be effective under the law of the state waiving immunity.
- If arbitration is the chosen forum, where should the place of arbitration be? Ensure that the place of arbitration is in a country which is party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and applies a restrictive approach to sovereign immunity. In addition, make sure that the agreement includes a full waiver clause: you need to be able to bring any enforcement proceedings before the courts to realise the fruits of any award.
- Can you structure the transaction through a separate entity? Where possible, structure the transaction so that it operates through a separate entity which will not benefit from state immunity, rather than through the state itself. Ideally, this separate entity should be a private incorporated body, with a separate legal personality and not be subject to the direct control of the state. Its banking facilities

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should be handled by a private bank, independent from the state. In general, avoid dealing with state central banks as they will pose greater difficulties at the enforcement/execution stage.

- Consider including a stabilisation clause in the agreement. For detail on other additional investor protection available see our Quickguide: International Investment Protection.

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