Sovereign immunity: whose assets are they freezing anyway?

This article considers the extent to which assets in which a party without immunity has a beneficial or other interest may be immune from enforcement as a result of the interests of a third party who does benefit from immunity. The recent case of Thai-Lao Lignite (Thailand) Co Ltd and another v Government of the Lao People’s Democratic Republic [2013] EWHC 2466 (Comm) highlights the difficulties that third parties can face where there is uncertainty around the status of such assets including, perhaps most notably, banks that are caught between contractual obligations and potential court sanctions.

In the case of Thai-Lao Lignite (Thailand) Co Ltd and another v Government of the Lao People’s Democratic Republic [2013] EWHC 2466 (Comm), the Central Bank of the Lao People’s Democratic Republic (Central Bank) successfully applied to vary a freezing order made against a separate state entity (Lao Government) which had impacted on assets in which the Central Bank had an interest. Similar issues have been raised in other recent cases and the approach of the Courts in these cases highlights the significant risks for parties that deal with sovereign or state assets, including banks, when assets are frozen.

It is no coincidence that most of the cases considered below relate to injunctions (often including freezing orders) against potentially immune entities – such cases have historically played a major part in the development of state immunity laws. In such cases, the Court is often set the task of deciding whether a party is subject to the Court’s jurisdiction at all (“justiciability” and “adjudication” are considered briefly below) and, if it is, whether or not the remedy sought against that party or its assets (“enforcement”, below) can be granted.

In considering the difficult points that arise when alleged immunity, whether of a party generally or in relation to particular assets, is put to the test, and the specific facts of the Thai-Lao case, it is useful first to consider the basic parameters of state immunity.

This article is principally concerned with immunity under the English State Immunity Act 1978 (the “Act”) although similar considerations apply in other jurisdictions. The Act affords immunity to “States” and “separate entities” (including “central banks”) in certain situations.

Generally, a “State” is a sovereign state, government or government department, or head of state but not a “separate entity” which is an entity that is distinct from the executive organs of the State and capable of suing or being sued independently of the State. Subject to a number of exceptions, a State has a general immunity and a separate entity will have immunity in certain specific instances including in relation to anything done by the separate entity in exercise of sovereign powers in circumstances in which the State would have enjoyed immunity.

A central bank benefits from immunity that is broadly equivalent to the immunity of a State but which goes further in relation to treatment of its assets (see further below).

Certain sovereign acts (“acts of state”) are deemed “non-justiciable” and will not be susceptible to scrutiny by a foreign court, whether or not there would be immunity for such acts under the relevant state immunity laws. In Kuwait Airways v Iraqi Airways [2000] EWCA Civ 284 at [319] the English Court summarised the doctrine as follows:

“In essence, the principle of non-justiciability seeks to distinguish disputes involving sovereign authority which can only be resolved on a state to state level from disputes which can be resolved by judicial means.”

A helpful review of the developing law on “acts of state” can be found in the recent case of (i) Abdul-Flakim Belhaj (ii) Fatima Boudchar v Rt Hon Jack Straw MP & 6 Ors (2013)).

The primary immunity afforded by state immunity laws generally and under the Act (assuming a dispute is justiciable), is immunity from adjudication. If the relevant party benefits from immunity from adjudication, the Court will not have jurisdiction to determine the dispute. The will be no immunity from adjudication under the Act inter alia in

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KEY POINTS

- State entities are generally considered to be immune from the jurisdiction of the Courts of a foreign state. This immunity can also apply to state owned entities and central banks.
- A party seeking to enforce its otherwise legitimate rights against a potentially immune party, whether in seeking to establish liability, enforce a judgment, or seek interim remedies, may be prevented from doing so by virtue of the state immunity laws of the jurisdiction in which such action is taken.
- Immunity can be waived, or may not exist at all if the underlying transaction or assets are "commercial" in nature, but the precise scope of the relevant immunity and applicable exceptions must be considered carefully before any action is taken.
- Assets that appear to belong to a party that does not benefit from immunity, or which has waived immunity in relation to those assets, may be immune if another party who does benefit from immunity has an interest in them.
circumstances where the State or separate entity submits to the Court’s jurisdiction (or to arbitration) or where the dispute relates to a “commercial transaction” to which the State or separate entity is party. Parties can waive immunity by submitting to the jurisdiction by prior written agreement albeit a bare jurisdiction clause will not suffice to waive immunity from adjudication. Equally, a subsequent submission can be sufficient including where a party institutes, or takes steps in relation to, proceedings save that a party may intervene in proceedings where it does so expressly for the purposes of asserting immunity.

Importantly, a separate entity, including a central bank, will retain its immunity even where the State has waived immunity (eg, by contract), provided of course that the separate entity has not itself separately waived immunity.

A State that is not immune from adjudication for any reason will not automatically lose its immunity from enforcement. Broadly, immunity from enforcement will be maintained unless the State expressly waives such immunity, or otherwise consents to enforcement in writing, or where the dispute in question relates to assets “for the time being used for, or intended to be used for, commercial purposes”. In this context, “commercial purposes” means used for the purposes of a “commercial transaction”. Subject to a de minimis exception, property must be (or be intended to be) used exclusively for commercial purposes. In Alcom v Republic of Colombia [1984] AC 580, no action could be taken against a bank account used for both commercial transactions and more general purposes by Colombia’s diplomatic mission in the UK.

The origin of the property against which execution is sought is irrelevant. In Servaas Inc v Rafidain Bank [2012] UKSC 40, a third party debt order was sought over debts which originally arose from commercial transactions but where the proceeds were intended to be transferred to the Development Fund for Iraq to be distributed for the benefit of the Iraqi people. The origin of the assets was held to be irrelevant when deciding whether property was used for commercial purposes at the point at which enforcement was sought.

Moreover, the property of a central bank or other monetary authority will not be susceptible to enforcement on the grounds that it is “property in use for commercial purposes” reflecting public policy concerns about interference with state monetary policy.

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In Thai-Lao Lignite v Government of the Lao People’s Democratic Republic [2013] EWHC 2466 (Comm) the Lao Government had expressly waived immunity but the Lao Central Bank had not and, in circumstances where the Central Bank had an interest in assets caught by the freezing order, the Court held that the freezing order should not have applied on the basis that the waiver by the Lao Government did not extend to the Central Bank.

The claimants and the Lao Government had entered into an agreement to mine coal and develop a power plant. Following a dispute, the Lao Government purported to terminate the agreement. The dispute was referred to arbitration in accordance with a contractual arbitration clause following which the claimants obtained an award of compensation for losses suffered as a result of the termination.

The claimants subsequently took steps to enforce the award in a number of different jurisdictions including England. At the same time, the Lao Government pursued proceedings in Malaysia to set aside the award.

The claimants obtained the freezing order that was the subject of the Judgment above on a without notice basis. The freezing order applied to the Lao Government’s assets in England and Wales up to almost $74.5m.

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As a result of the order, the Central Bank’s two London accounts with Wells Fargo were frozen. The Central Bank immediately raised concerns with the claimants about the order, in particular asserting that the Act had not been complied with. The parties could not agree on conditions for a variation of the order and the Central Bank was forced to provide a sworn declaration following which the accounts were unfrozen. The Central Bank claimed that it had suffered losses of approximately $4.5m in the three working days during which the accounts were frozen. It also sought discharge of the freezing order generally on a number of bases including that the accounts at Wells Fargo were the “property” of the Central Bank and benefited from immunity under s 13 of the Act.

The Court found that the term “property” is to be construed broadly for the purposes of the Act, and includes

“any right or interest, whether legal, equitable, or contractual, in assets, including those in which other parties also have rights: see AIG Capital Partners v Kazakhstan (supra) at [45], [61], [89]–[91], [95].”

It went on to find that

“any order directed at execution against property in the name of the central bank would be permissible only if it could be said that the bank had no interest of any of these kinds. It is difficult to see how that could be said of a bank account in the name of a central
bank, even as nominee, where at the least the central bank would have a contractual interest as the customer of the bank at which the account was held.” [23] [Emphasis added]

Clearly, the Court has set a very high standard in this case. In summary, where an immune party has “any right or interest, whether legal, equitable, or contractual, in assets, including those in which other parties also have rights”, those assets are not subject to the Court’s jurisdiction. The example given by the Court shows just how high the bar has been set.

... it may not always be possible for a claimant seeking [a Freezing Order] ... to identify which, if any, assets are potentially subject to an immune third party’s rights.

It is not clear from the Judgment whether s 6(4) of the Act was also relied upon in this regard. This provision effectively provides (some convoluted drafting aside) that assets held by a non-immune party but which are within the control of a State (which, for these purposes, it is assumed would include a separate entity – although that point appears to remain untested), or over which the State entity asserts rights, are immune to the extent that such assets would have been immune in proceedings against the State. The Court of Appeal in ETI Euro Telecom International NV v Republic of Bolivia [2008] EWCA Civ 880 recognised this as a potential basis for immunity in the context of a freezing order against both a State and a separate entity where there was a question over the true owner of the assets. However, there was no detailed consideration of the issue in that case and the Thai-Lao decision provides a welcome exploration of this area, even if the precise scope of the arguments relied upon is not clear from the Judgment.

Of particular note to banks and other institutions that are routinely affected by freezing orders, the Court also found that the part of the order that froze the accounts of the Central Bank, the same analysis would apply where any asset is subject to the rights of a third party who benefits from immunity. In such cases, it follows that a freezing order against such assets would offend the Act.

CONCLUSION

Since the decision in the Thai-Lao case, there can be no doubt that the rights of immune third parties in assets in which another (non-immune) party has a separate interest must be taken into account. Of course, whereas the freezing order in the Thai-Lao case referred to specific assets in relation to which it was known that an immune third party had at least some interest, it may not always be possible for a claimant seeking such an order to identify which, if any, assets are potentially subject to an immune third party’s rights.

In such circumstances, it might be said that the issue will be resolved when the immune party (or an affected third party such as a bank) comes to court to challenge the order but, as in the Thai-Lao case, by this point substantial damage may have been caused. The best course therefore must be to avoid the possibility of such interference so far as is reasonably possible, by expressly excluding such assets from the scope of enforcement if possible. In any event, claimants must stand ready to respond immediately to any queries that may be raised (eg, by third party banks served with an order) in order to minimise the risks of exposure to a claim under the cross-undertaking in damages.

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