Enforcing awards against States and State-owned entities

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The issue of State immunity

An important issue for any business engaged in international transactions is the ability to obtain effective relief if they become involved in legal proceedings. A key benefit of international arbitration is the ability of successful parties to enforce awards across multiple jurisdictions, which is made easier because of the 1958 New York Convention on the Enforcement and Recognition of Foreign Arbitral Awards. However, special considerations apply where the party against whom enforcement is sought is a sovereign State or a State-owned corporation. States may choose to rely on the principle of sovereign or state immunity to insulate their assets from enforcement.

Since at least the early 19th century it has been recognised that States and their entities are entitled to some immunities from the jurisdiction of the courts of other countries. However, there are also good arguments for limiting the scope of that immunity, especially in the modern era of state capitalism, where the ‘sovereign’ not only governs but engages in commercial transactions.

The uncertainties about the scope of the immunities in Australia was largely resolved, following an important reference to the Australian Law Reform Commission, by the passage of the Foreign States Immunities Act 1985.

Generally, a foreign State is not immune in a proceeding insofar as the proceeding concerns a ‘commercial transaction’ as defined by the Act. That in itself involves difficult questions of fact and law. An investor may be required to show that the property which they seek to attach is being used for commercial purposes (rather than sovereign purposes). There have been celebrated attempts to attach to State-owned property and disputes as to whether that property is being used for State or commercial purposes, when seeking to enforce investment treaty arbitral awards.

But there is often an even more fundamental question, namely whether the immunities that are recognised by the Act apply to the foreign state and a ‘separate entity’ that is an agency or instrumentality of the State.

Similar, concepts apply under general international law. The law will generally always ‘read through’ an agency relationship to determine the identity and status of the principal. It is not uncommon for investor agreements and other contractual arrangements in relation to foreign entities to be with an entity other than the State itself.

The question is, therefore, whether the entity with which you are contracting or which is engaging in conduct about which you wish to complain, is the ‘State’ or not.

In considering these issues and when contracting with States, it is important to keep in mind that there are different aspects to State immunity:

- Consent to arbitration waives jurisdictional immunity but it does not waive immunity for the purposes of proceedings for the execution of assets. At the execution stage, a national court will determine, according to the particular doctrine of State immunity that governs, whether or not execution is permissible. Thus, ratification of the Washington Convention for the Settlement of Investment Disputes (Washington Convention) must by necessity be a consent to the jurisdiction of the ICSID Tribunal., but it also expressly provides that the domestic law of immunity is not affected by its provisions. An investor seeking to execute an award in a particular State must therefore contend with the particular rules relating to sovereign immunity in that State.
Some States maintain an absolute doctrine of State immunity. For example, in Hong Kong, foreign states enjoy absolute immunity from jurisdiction in Hong Kong and there is no exception in relation to activity and assets of a commercial nature. This immunity cannot be waived by a pre-dispute agreement.

Who is the ‘State’?

A recent Privy Council case has considered the position of State owned corporations and the circumstances in which they may be held liable for a State’s debt.

The Privy Council held that there was a presumption that the State-owned corporation was a separate entity and that this presumption should only be displaced in ‘quite extreme circumstances’.

The decision has implications for investors who seek to enforce their awards against States or State owned entities – it highlights the importance of:

- understanding and identifying the counterparty to a transaction,
- the particular risks associated with contracting with States and State-owned entities, and
- the need to consider in advance what assets are available for enforcement, should that be required.

The decision has greater practical application in any transaction, including domestic transactions, where the counterparty to the transaction is owned or operating in conjunction with the state.

Privy Council Decision

In La Generale des Carrieres et des Mines v F.G. Hemisphere Associates LLC [2012] UKPC 27 (F.G Hemisphere Associates) the Privy Council considered whether La Generale des Carrieres et des Mines Sarl (Gecamines), a corporation owned by the Democratic Republic of Congo (DRC), was directly liable for debts which the DRC owed to F.G Hemisphere Associates LLC (Hemisphere).

Hemisphere is a ‘vulture fund’ which invests in distressed assets. It had purchased two substantial arbitration awards against the DRC which it sought to enforce against Gecamines, a DRC State-owned corporation.

The lower courts had approached the question of whether enforcement was permissible on the basis of determining whether Gecamines was an organ of the DRC. This was to be determined by the test in Trendtex Trading Corp v Central Bank of Nigeria [1977] 1 QB 529 (Trendtex) and looking to see if the State-owned entity could be considered an ‘alter ego or organ’ of the government because of the control exercised by the State over the entity and the entity’s constitution.

The Privy Council considered that the Trendtex approach might result in almost any State trading corporation becoming liable for State debts. The Privy Council held that a more nuanced approach to immunity was required. In particular:

- Separate juridical entities established by a State are presumed to be separate from States.
- An entity’s constitution, control and functions remain important but constitutional and factual control and the exercise of sovereign functions do not without more convert a separate entity into an organ of the State.
- Where a separate juridical entity is formed by the State for what are, on their face, commercial or industrial purposes, with its own management and budget, the strong presumption is that its separate corporate status should be respected, and that the State forming it should not have to bear the other’s liabilities. It would take ‘quite extreme circumstances’ to displace this presumption. The presumption may be displaced if in fact the entity has, despite its juridical personality, no separate existence.
- There may be particular circumstances in which the State has so interfered or behaved towards a State-owned entity that it would be appropriate to look through or past the entity to the State.
- However, any remedy should be tailored to meet the particular circumstances and need. Merely because a State’s conduct makes it appropriate to lift the corporate veil to enable a third party or creditor of a State-owned corporation to look to the State does not automatically entitle a creditor of the State to look to the State-owned corporation. Lifting the veil may mean that a corporation is treated as part of the State for some purposes, but not others.

The primary question in relation to Gecamines was whether the circumstances proved showed that its juridical personality...
and its apparently separate commercial assets and business were so far lacking in substance and reality as to justify assimilating Gecamines and the State for all purposes.

In the Privy Council’s view, there was no justification for the conclusion that Gecamines was an organ of the State and that its assets should be answerable for the State’s debts.

Commercial implications

The case has important implications for parties contracting internationally with States or State-owned entities. Companies and investors investing in or contracting with State-owned entities need to be aware of the circumstances in which the assets of a State-owned entity may be equated with the assets of a State, and in the alternative, the circumstances in which a State may be liable for the debts of a State-owned entity.

It is advisable that companies or investors conduct extensive due diligence enquiries in respect of the corporate structure of a State-owned entity, its functions, and its relationship with the State prior to making an investment and entering into a transaction. These enquiries need to be made taking into account the particular circumstances of a transaction or investment.

Specific and tailored provisions in relation to the identity and status of the entity of the contracting party ought to be considered, including (if necessary and possible) a waiver of immunity in relation to jurisdiction and execution of process. There is, however, no single solution that will be suitable for all circumstances. Much will depend on:

- the particular rules of State immunity that are applicable, and
- the location and use of the assets against which enforcement is sought.

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