

Fund Finance Friday



Sovereign Immunity – Cayman Islands

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We have been following *Fund Finance Friday's* journey through different **U.S. jurisdictions** (and last week's look at **England & Wales**) and the interesting range of approaches taken by various states to sovereign immunity. With the Cayman Islands being the largest offshore fund domicile for U.S. fund managers, we thought it was worth extending the series offshore.

In the Cayman Islands context, the immunity question usually comes into play during borrowing base diligence, where the investor's side letters and subscription documents are governed by Cayman Islands law (not uncommon for large sovereign or sovereign-linked investors who invest via an offshore feeder or alternative investment vehicle).

As a British Overseas Territory, the United Kingdom's State Immunity Act 1978 (the "Law") extends to the Cayman Islands by statutory order. Immunity generally applies to the head of state, the government of any state and any department of that government, but not to a "separate entity" distinct from the executive organs of the government that can sue and be sued. Whether or not an investor is a "separate entity" can be a complex and highly fact-specific question. Considerations include the degree of autonomy, governance structure, and legal form of the entity (among other factors). As a conservative starting point, it would be safe to proceed on the assumption that a sovereign-linked investor (such as a government pension plan or sovereign wealth fund) could be held to be a department of government rather than a "separate entity" and therefore subject to immunity from legal proceedings.

When analysing a lender's recourse to the investor, a key useful exception under the Law is the "commercial transaction" exception. This exception excludes immunity for, among other things:

- a loan or other transaction for the provision of finance and any guarantee or indemnity in respect of any such transaction or of any other financial obligation; and
- any other transaction or activity (whether of a commercial, industrial, financial, professional or other similar character) into which a State enters or in which it engages *otherwise than in the exercise of sovereign authority*.

If the investor is a special purpose investment vehicle, this also points towards the entity engaging in commercial activity as opposed to exercising sovereign authority, meaning that the exception is more likely applicable. This follows case law stating that an entity's separate corporate status should be respected when examining the scope of any immunity.

By contract, it's possible to waive immunity for legal proceedings in the Cayman Islands, and side letters may contain such waivers (either fully or on a more limited or caveated basis). Just as frequently, a side letter may expressly preserve any immunity enjoyed by the investor in question. It is also possible to expressly contract out of the "commercial transaction" exception above. Any side letter immunity language must therefore be carefully reviewed to

assess whether immunity has been waived or if it does operate to limit or obviate the commercial transaction exception.

Thanks to *Fund Finance Friday* for letting us add the Cayman Islands' perspective to the sovereign immunity series.