

Fund Finance Friday



Waiving Goodbye to Sovereign Immunity in the European Market?

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Financial institutions operating in the European fund finance market are increasingly having to familiarize themselves with sovereign or state immunity laws and how these interact across multiple jurisdictions.

Lenders advancing funds against the uncalled capital commitments of “sovereign” or “state” entities (such as public pension plans or sovereign wealth funds, for example) may have serious difficulty bringing a contractual claim for payment in circumstances where that investor is in default and is able to claim immunity. Equally, a fund will want to ensure that all investors are contractually “on the hook.” For this reason, funds will typically look to obtain a waiver of immunity from the investor in question. However, the solution is not always quite so simple.

A sovereign or state entity may have immunity from both adjudication (immunity from suit) and enforcement. This gives rise to two important issues. First, can proceedings be brought against the investor in the relevant courts? And second, having obtained a judgment against that investor, can it be enforced in the jurisdiction in which that investor holds its assets? Clearly, it is of limited benefit obtaining a favorable judgment against a defaulting investor from the courts in one jurisdiction only to be restricted from enforcing that judgment in another.

Where sovereign immunity is a concern, the laws of many countries will often provide some comfort by exempting from immunity any contracts or agreements entered into by the “sovereign” or “state” entity which are entered into purely for commercial purposes.

In the U.S., for example, the Foreign Sovereign Immunities Act of 1976 (the “FSIA”) generally shields certain foreign governments and international organizations of a quasi-governmental nature, such as the United Nations, against claims in the U.S. courts. However, while the “commercial activity” exception is a major caveat to the general premise of the FSIA that a foreign government has immunity and cannot be sued in the U.S. Under the commercial activity exception, a claimant may sue a foreign government in a U.S. court when the claim is based on (i) a commercial activity carried on in the U.S. by the foreign government, (ii) an act by a foreign government that is performed in the U.S. in connection with a commercial activity outside the U.S., or (iii) an act by a foreign government that is performed outside the U.S. in connection with commercial activity that occurs outside the U.S., if such action “causes a direct effect” in the U.S. Judicial precedent in the U.S. suggests that a valid submission to jurisdiction in the U.S. or an agreement to binding arbitration should fall into the commercial activity exception in the context of a non-U.S. governmental investor in connection with a subscription facility.

Alongside statutory protections (or in addition to them) specific waivers of immunity will often be included in a side letter. Waivers of sovereign immunity, while helpful, are not always perfect. Increasingly, as the length of investor side letters continues to grow, we are seeing side letter provisions which seek to muddy the contractual waters. For example, a waiver of sovereign immunity provision might include a requirement that all issues of law relating to sovereign immunity must be resolved and enforced according to the laws of the jurisdiction of that investor. Unless

familiar with the sovereign immunity laws in which the investor is domiciled, the fund and/or lender will be unable to determine if the waiver is enforceable. Waivers also tend to deal more with adjudication than enforcement.

Happily, funds and lenders alike may take comfort from the fact that there are various statutory exemptions and additional commercial factors at play which may prevent a sovereign investor from relying on any rights of immunity (or defaulting on their commitments). However, issues surrounding sovereign immunity are often complex, and parties would be wise to discuss these with legal counsel at the outset of any transaction.