UK Supreme Court clarifies "commercial purposes" exception to state immunity; when enforcing against property, its origin is irrelevant

The UK Supreme Court has issued a decision relating to the enforcement of state assets in *SerVaas Incorporated v Rafidain Bank and others*. This decision provides guidance on the scope of the "commercial purposes" exception from immunity from execution, and, in particular when it can be said that property is "in use or intended for use for commercial purposes" pursuant to section 13(4) of the State Immunity Act 1978 ("SIA"). It has confirmed that the origin of the property against which execution is sought is irrelevant in this analysis. In this case, it could not be said that the assets were in use for commercial purposes and, since it was not possible to look to their origins for assistance in this regard, they were held to be immune from execution.

The limitations of the exception reinforce the importance of expressly waiving immunity from execution in any dispute resolution clause when contracting with a state party, rather than relying on the commercial purposes exception. This should be done as well as waiving immunity from jurisdiction itself.

Background

In summary, the applicant, SerVaas, had obtained a judgment against Iraq which it sought to enforce in the UK. Rafidain Bank (an Iraqi state-controlled bank with a branch in London) held significant sums on behalf of Iraq. SerVaas alleged that these had been acquired through commercial transactions between the bank and its commercial creditors. Rafidain was in liquidation in England and was due, under its scheme of arrangement, to pay these sums to Iraq as part of a restructuring of debts accumulated under the Saddam Hussein regime. Iraq directed that the distribution was to be made direct to the UN established Development Fund for Iraq (DFI).

SerVaas applied for a third party debt order, that the Bank should pay to SerVaas sums otherwise payable to Iraq to satisfy the judgment. The principal question before the court was whether the sums held by Rafidain were in use or intended for use for commercial purposes. The head of mission of the Iraqi Embassy in London signed a certificate (for the purposes of section 13(5) SIA) stating that the funds Iraq expected to receive as dividends from the scheme of arrangement were not intended for or in use for commercial purposes. Under the SIA, this certificate created a presumption that this was the case, which SerVaas needed to rebut in order to be successful.

The High Court and the Court of Appeal both rejected SerVaas' application, holding that SerVaas had no real prospect of rebutting this presumption. Under the commercial purposes exception, it was not the origin of the debt that was important, but rather the present and future use of the property. It was considered that while the property was being held by the Bank it was not being used for any particular purpose, and it was

common ground that its intended use (via the Development Fund for Iraq) was sovereign, not commercial, in nature.

The Supreme Court decision

The Supreme Court, following the reasoning of the Court of Appeal, unanimously upheld the decision in the lower courts and dismissed SerVaas' appeal.

Giving the leading judgment, Lord Clarke concluded that whether property is "for the time being in use for commercial purposes" does not depend on whether it has been used for commercial purposes in the past. Therefore the origin of that property will be irrelevant when determining whether to apply the commercial purposes exception to immunity from execution. Rather than look retrospectively at the circumstances giving rise to the property, one must assess the use to which the state had chosen to put the property.

The expression "in use for commercial purposes" (section 13(4) SIA) should be given its ordinary meaning, noting in particular that the wording is narrower than other provisions of the SIA which refer to proceedings "relating to" or "in connection with" a commercial transaction. It would not be an ordinary use of language to say that a debt arising from a transaction was "in use" for that original transaction. SerVaas was therefore unable to rebut the presumption that the property was not intended for or in use for commercial purposes and could not obtain the third party debt order.

In reaching this decision, the Court relied on the House of Lords decision in *Alcom Ltd v Republic of Columbia* [1984] AC 580. The asset in that case was a debt in a current account representing the balance owed to a diplomatic mission used for meeting its day to day expenses. Even where some of the money drawn upon it might be used for commercial purposes, the debt was characterised as sovereign. An asset, the Lords held, is not divisible and should be looked at as a whole. To fall within the commercial purpose exception it would need to be "specifically earmarked by the foreign state solely for being drawn upon to settle liabilities incurred in commercial transactions". SerVaas similarly was not able to show "that the debt was earmarked for being drawn down upon in order to satisfy commercial liabilities".

Other cases were cited that drew the distinction between the source of property and its actual use, including the leading US case of *Connecticut Bank of Commerce v Republic of Congo*, 309 F 3d 240 (US Court of Appeals, 5th Circ, Texas, 2002), brought under an equivalent provision in the Foreign Sovereign Immunities Act 1976.

Characterising assets: commercial or sovereign?

Since these were summary proceedings only, there was no need for the Court to go further than deciding whether SerVaas had any real prospect of rebutting the presumption created by the certificate. Nonetheless, their analysis of the features of this particular arrangement could be helpful in characterising the commercial or sovereign purposes of any given asset.

Under s.3 SIA, a commercial transaction includes any contract for the supply of goods or services, any loan for the provision of finance and any other transaction into which a state enters "otherwise than in the exercise of sovereign authority".

On the facts, SerVaas could not show that the property was in use for a commercial purpose since any dividends received by Rafidain's administrators were to be paid to and used by the non-profit making DFI. According to SerVaas the nature of the transaction giving rise to Rafidain's liability was entirely commercial. Rafidain, though state controlled, conducted business as a commercial bank. The debt was made up of debts previously owed by Rafidain to its commercial creditors now bought by Iraq to make a profit. Although Rafidain rather claimed that Iraq had bought the debt in the exercise of sovereign authority as part of its debt restructuring, this was ultimately irrelevant in determining its purpose at the material time.

To take the example of the *Alcom* case, royalty obligations by oil companies for activities connected with the exploration and sale of Congo's oil did not constitute commercial activity. It was similarly irrelevant whether they had been purchase with a commercial source of income or with tax revenues.

Impact of the decision

Given that the commercial purpose exception is more limited than previously considered, it is likely that many judgment debts will now be more difficult to enforce against states. The decision is a useful reminder that the commercial purpose exception is an important tool when enforcing against states but has limitations that need to be borne in mind. Where no current commercial use is found, a creditor will not be able to look to any commercial origins or intentions for assistance. It is, however, conceivable that in some situations the origins of an asset may have been sovereign in nature (for example if purchased with tax revenues) whilst the current use is commercial (such as security on a loan or payment for goods). In such cases this judgment clarifies that the asset would fall within the exception and not be immune from enforcement.

It is interesting that this judgment follows closely behind the Privy Council decision in *FG Hemisphere Associates LLC* (see briefing) which limited whom state debts could be enforced against. It was held in that case that only in "quite extreme" circumstances will a state-owned entity be equated with the state and vulnerable to enforcement action by a creditor of the state. Together these cases highlight the importance of giving careful consideration both to exactly who the relevant entity is and the purpose of the assets. Where possible, these points should be considered when entering into a contract rather than at the enforcement stage.

States, for their part, will, as a result of this decision, have more chance of shielding assets from enforcement where they had an original commercial purpose but are not currently used for entirely commercial purposes. Often in a third party debt order claim the relevant funds will simply be sitting in an account, without a particular "use" by the State, so this judgment will make identification of the potential future use for the debt all the more important. As demonstrated in this case, the issuance of a certificate, and consequent creation of the statutory presumption, can also help a government's position.

Finally, it is worth remembering that the law as regards state immunity differs from jurisdiction to jurisdiction. Many jurisdictions follow similar principles to the UK, as the Supreme Court demonstrated by relying on international authorities. However, there are jurisdictions (including Hong Kong and China) which maintain the principle of absolute immunity from execution, so no exception can be made for commercial purposes. Whether it is possible to enforce in those jurisdictions will depend on whether the entity in question is in fact a state owned entity.