VULTURE FUNDS TAKE NOTE

The recent judgment of the UK Privy Council in *La Générale des Carrières et des Mines Sarl v F.G. Hemisphere Associates LLC* [2012] UKPC 27 makes it clear that the circumstances in which a state-owned corporation can be made to answer for a state’s liabilities and have its assets used to satisfy any judgment or award against the state are extremely limited. In a climate which is ever more hostile to those who acquire distressed sovereign debt and try to enforce it, as demonstrated by the UK Debt Relief (Developing Countries) Act 2010, this judgment will make it even more difficult to do so, especially as it is likely to be a highly persuasive authority in the offshore common law jurisdictions where such assets are often situated.

**Introduction**

On 17 July 2012 the UK Privy Council delivered judgment in the case of *La Générale des Carrières et des Mines v F.G. Hemisphere Associates LLC*. In this long-running litigation F.G. Hemisphere Associates LLC (“Hemisphere”) purchased two substantial ICC arbitration awards worth over $100m against the Democratic Republic of Congo (the “DRC”) over ten years ago for $3m. They have since sought to enforce those awards against Congolese assets around the world. Those efforts may well have been made more difficult by legislation passed in the UK as part of the Jubilee Debt Campaign to prevent vulture funds enforcing claims against developing countries, the Debt Relief (Developing Countries) Act 2010.

In this litigation there have been proceedings in several jurisdictions, such as Jersey and Hong Kong. The judgment of the Privy Council, delivered by Lord Mance, arises in relation to Jersey proceedings in which Hemisphere has sought to enforce the awards against assets of a state-owned corporation of the DRC, *La Générale des Carrières et des Mines Sarl* (“Gécamines”). The main assets of Gécamines which were concerned were a shareholding in a Jersey joint venture company and the income due to it under a slag sales contract with that company. Whilst the Jersey Government has announced that it will introduce similar legislation to the UK, it has yet to do so.

The issue for decision in these proceedings was whether Gécamines was an organ of the DRC and to be equated with the DRC such that the arbitration awards against the DRC could be enforced against Gécamines’ assets.

At first instance, the Royal Court of Jersey held that Gécamines was at all material times an organ of the DRC. The reasons why it reached this decision were: (i) Gécamines’ constitutional position, as to which the Royal Court held that “the exceptional degree of power accorded to the state over the affairs of Gécamines, at all levels, was such that the

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1 Arising out of supply and financing contracts entered into between the DRC and the then Yugoslavian hydroelectric company, Energoinvest DD
2 Although Hemisphere claims on its website to have spent over $20m in legal fees on this case: www.fghem.com
3 www.legislation.gov.uk/ukpga/2010/22/contents
company was no more, in truth, than an arm of the state with responsibility for operations in a sector of vital importance to the national economy”, and (ii) occasions when the DRC had taken assets belonging to Gécamines and paid no compensation. The Court of Appeal upheld this judgment, albeit with one dissenting judgment.

The test which had been applied at common law to determine whether an entity was an organ of the State was derived from the decision of the Court of Appeal in Trendtex Trading Corporation v Central Bank of Nigeria [1977] 1 QB 529. The issue in Trendtex was whether the Central Bank of Nigeria was an organ of the state and thus entitled to the state’s immunity. Lord Denning laid down the following test

“If we are still bound to apply the doctrine of absolute immunity, there is, even so, an important question arising upon it. The doctrine grants immunity to a foreign government or its department of state, or any body which can be regarded as an ‘alter ego or organ’ of the government. But how are we to discover whether a body is an ‘alter ego or organ’ of the government?...
I confess that I can think of no satisfactory test except that of looking at the functions and control of the organisation. I do not think that it should depend on the foreign law alone. I would look to all the evidence to see whether the organisation was under government control and exercised governmental functions.”

In recent years, in a string of first instance decisions involving the DRC⁵, this test has been treated as being equally applicable whether the claim was for immunity or was against a state-owned corporation for a state debt.

The correct approach

The Privy Council set out the correct approach to distinguishing between an organ of the state and a separate legal entity⁶.

a) Full and appropriate recognition of the existence of separate juridical entities established by states: there is a strong presumption that this separate existence should be respected and that the state and the separate entity should not have to bear each other’s liabilities, especially where such entities were established for trading purposes.

“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. Especially where a separate juridical entity is formed by the State for what are on the face of it commercial or industrial purposes, with its own management and budget, the strong presumption is that its separate corporate status should be respected, and that it and the State forming it should not have to bear each other’s liabilities.”

b) Separate juridical status is not conclusive but extreme circumstances will be required to rebut the presumption. The entity’s constitution, control and functions do remain relevant but are not alone sufficient and the separate existence must effectively be lacking in reality and substance: the Privy Council emphasised that control alone is not sufficient.

“It will in the Board’s view take quite extreme circumstances to displace this presumption. The presumption will be displaced if in fact the entity has, despite its juridical personality, no effective separate existence. But for the two to be assimilated generally, an examination of the relevant constitutional arrangements, as applied in practice, as well as of the State’s control exercised over the entity and of the entity’s activities and functions would have to justify the conclusion that the affairs of the entity and the State were so closely intertwined and confused that the entity could not properly be regarded for any significant purpose as distinct from the State and vice versa.”

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⁴ pp. 559C-D and 560C-D
⁶ Paras. 28 and 29
⁷ Para. 29
⁸ Para. 29
c) There may be circumstances where it would be appropriate to lift the corporate veil but not for all purposes: the Privy Council suggested that this might be the case if the state has so interfered with or behaved towards a state-owned entity that it would be appropriate to look through or past the entity to the state\(^9\). However, if the corporate veil is pierced, the remedy must be tailored to meet the circumstances and the need. The corporation may be treated as part of the state for some purposes but not for others.

The Privy Council considered that the courts below had treated the *Trendtex* test as introducing too general and too easily established an exception to the circumstances in which courts respect the separate juridical personality of a state-owned corporation\(^10\). They had been too ready to find that Gécamines was exercising governmental functions, simply because it was “constituted in such a way that its purpose is to assist, promote and, advance the industrial development, prosperity and economic welfare of the area in which it operates” so that it could “be seen as effectively carrying out governmental policy in the way that a government department does and therefore to assume the position of a government department.” This was not enough.

The Privy Council emphasised that what matters is the acts themselves and whether they are sovereign acts (*acta jure imperii*) or private/commercial activities and the courts below had failed to identify or even look for any actual sovereign acts. They had thereby diluted the *Trendtex* test. The Privy Council reiterated comments made in the *Il Congreso del Partido* case by Lord Wilberforce, who had noted that “the existence of a governmental purpose or motive will not convert what would otherwise be an act jure gestionis, or an act of private law, into one done jure imperii”\(^11\), and by Goff J, who had stated that what is required is “that the act is of its own character a governmental act, as opposed to an act which any private citizen can perform.”\(^12\)

In the Privy Council’s view, a broad concept ought not be taken of governmental activities so as to treat ordinary trading activities as governmental merely because they are ancillary to a principal function of carrying out governmental policies\(^13\).

The Privy Council went on to assess whether Gécamines could be considered an organ of the state, holding that the primary question was whether the circumstances proved show that Gécamines’ juridical personality and its apparently separate commercial assets and business were so far lacking in substance and reality as to justify assimilating Gécamines and the state for all purposes. It was held that they were not.

Although there were instances where Gécamines’ assets had been used for the DRC’s benefit, that did not justify a conclusion that they should be assimilated for all purposes. The instances referred to did not have anything to do with the underlying facts of the case, namely the facts which gave rise to the arbitration awards.

**Analysis**

The judgment of the Privy Council puts an end to the recent dilution of the *Trendtex* test and emphasises that commercial or trading activities done merely for a government purpose are not sovereign acts. It may well therefore be harder for a state-owned corporation to rely on a state’s immunity, either from suit or for its assets. This is likely to come as welcome news for those who trade with state-owned corporations.

However, it is clear that the judgment will also make it significantly harder for judgment creditors of states to enforce their judgments, as the assets of corporations owned by that state are unlikely to be available for that purpose.

The *Trendtex* test, which was originally applied to determine state immunity, is not sufficient to make the state corporation liable for the debts of the state. The separate personality and assets of the corporation must be lacking in reality and substance if the corporation is to be treated as the state for all purposes.

This is a very high hurdle which will effectively require a finding of sham. There are very few English cases in which there has been a successful finding of sham, even in the purely corporate context, and the Privy Council’s judgment makes it clear that judges should not reach that conclusion too readily where a foreign state and its corporations are concerned.
The most interesting proposition from the Privy Council’s judgment is the recognition of the potential for a state-owned corporation to be treated as part of the state for some purposes but not necessarily for all, where it cannot however be said that the separate juridical existence is lacking in substance and reality.

The circumstances where this is likely to be appropriate are where there has been extreme interference in the running of the corporation and its dealings. In these circumstances, in tailoring the remedy to the need, it might be appropriate to look through the corporate veil to the state. However, the Privy Council was reluctant for the principle to operate in reverse so as to make available the entirety of Gécamines’ assets to satisfy all the DRC’s debts.

Furthermore, there are suggestions in the judgment that there is likely to have to be some connection between the behaviour of the state which justifies looking past the corporation and the underlying substantive dispute. Hemisphere sought to argue that the fact that the DRC had no shares in Gécamines, against which execution could be sought, should “bear on the law’s willingness” to allow recourse to a state corporation’s assets in respect of indebtedness. The Privy Council had this to say:

“But, assuming the State’s interest in Gécamines to be effectively immune from execution, that was a feature that always existed, and about which Hemisphere and those from whom it acquired its present claims can make no legitimate complaint. It had and has nothing to do with the transactions on which Hemisphere now relies to seek to hold Gécamines and its assets responsible for the DRC’s debts.”

There was little sympathy for Hemisphere’s plight. The Privy Council was clearly of the view that Hemisphere had taken the risk of being unable to execute against Gécamines’ assets.

There might be circumstances in which it would be appropriate to make the state corporation liable for the state’s liabilities even though the separate existence is not lacking in reality or substance. If, for example, there had been appropriation of the judgment creditor’s assets by the state, giving rise to the judgment or award against the state, and those assets had found their way into the corporation’s hands, it would seem appropriate to make the corporation liable for the state’s debts, given that it has been used to hide misappropriated assets. But that is likely to be very difficult to prove.

The judgment in Gécamines v FG Hemisphere will mean that those who acquire distressed sovereign debt with a view to enforcing the judgment or award will have to look that much harder around the world to find assets against which there is a realistic prospect of execution. It will certainly no longer be sufficient, if it ever was, merely to identify a state-owned corporation, over which the state simply exercises a significant measure of control, and then enforce the judgment or award against any of that corporation’s assets. The assets themselves and the corporation may in practice have to have some link to the underlying substantive dispute.

The judgment will be a highly persuasive authority in many offshore common law jurisdictions, where assets of state-owned corporations are often held. Its potential scope of application is therefore very broad and is likely to limit the global enforcement of sovereign debt for years to come.
Nicholas Tse, our partner in charge of international arbitration in London, and a specialist in multi-jurisdictional litigation, is both an English barrister and a French law qualified avocat, and was retained as an expert on French law for Gécamines in the Jersey litigation, providing an expert opinion to the Royal Court concerning FG Hemisphere’s attempt to compound interest.

Brown Rudnick’s lawyers have experience of acting both for and against sovereign states and state-owned entities, both in relation to substantive proceedings before state courts and in arbitration, as well as enforcement proceedings around the world.

- Kensington International v Congo - we successfully defended an energy giant operating African natural resources from a multi-jurisdictional attack made by the vulture fund Kensington in the BVI, Jersey, Congo-Brazzaville and France, as well as the risk of RICO proceedings in New York. We succeeded in having the provisional liquidator appointed by Kensington discharged for leaking documents seized from offshore structures to other entities related to Kensington, and forced a global settlement where all Kensington's claims were dismissed.

- Acted for a UK investment bank and various other banks in relation to a range of sovereign debt claims against Zambia, Cameroon and Congo, which resulted in successful judgments against the Central Banks of all three countries and extensive freezing orders and enforcement strategies in support of those judgments.

- Acted for an Egyptian company seeking to enforce an ICC arbitration award against the Republic of Chad in respect of moneys in London bank accounts. This case involved consideration of the commercial purposes exception to a state’s immunity from execution, as well as whether article 28(6) of the 1998 ICC Rules (namely the undertaking to execute an arbitration award) constituted a waiver of immunity from execution: Orascom Telecom Holding SAE v Republic of Chad & Ors [2008] 2 Lloyd’s Rep 396.

- Acted for and against sovereign in a number of cases, including bilateral investment treaty (BIT) disputes, advising on enforcement strategies, both on the state side and on the investor side.
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