

# FUND FINANCE FRIDAY

## FFF Sovereign Immunity Series – Part VIII: England & Wales

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For our eighth installment in the *FFF Sovereign Immunity Series*, we consider the doctrine of sovereign immunity in England & Wales.

We begin with our usual disclaimer that sovereign immunity is a complex legal and tax issue, and it is vital that legal advice is sought when considering its implications. This article provides a high-level summary of the doctrine under the laws of England & Wales (or, in the case of taxation, the United Kingdom) and each sovereign entity's status must be analysed on a case-by-case basis.

### **Sovereign immunity under English law**

Sovereign immunity is the principle that a state (whether the sovereign, the government, a department of the government or any separate entity acting under sovereign authority) can claim immunity from enforcement action on the grounds that the counterparty does not have jurisdiction over it. In other words, a state actor should not be judged by the laws of another state.

Under English law, different rules determine whether (i) a dispute involving a state entity can be adjudicated and (ii) the judgment arising from that adjudication can be enforced.

*Immunity from adjudication*

The general principle is that the UK courts have no jurisdiction to adjudicate disputes against sovereign entities unless one or more of the following exceptions applies:

- the state entity has submitted to the jurisdiction of the English courts (*e.g.*, by prior written agreement or by submitting to the jurisdiction after a claim has been brought);
- the proceedings relate to a contractual obligation on the state that is to be performed wholly or substantially in the UK;
- the state entity has agreed to submit to arbitration (*e.g.*, through an arbitration provision in a contract); or
- the proceedings relate to a commercial transaction entered into by the state entity (*e.g.*, a financing transaction).

### *Immunity from enforcement*

Under English law, a party can be prevented from obtaining an injunction against a state entity and enforcing any judgment or arbitration award against the property of such entity. This principle, again, is subject to certain exceptions, as follows:

- the state entity provides its written consent to any relief or process (*e.g.*, an explicit waiver of immunity as to enforcement); and
- with specific reference to judgments or arbitration awards, such judgments or awards may be enforced against property that is in use or intended for use for commercial purposes.

While this article focuses on the English law approach to sovereign immunity, a lender should consider the jurisdiction in which proceedings are brought, as well as the governing law elected by the parties in their agreements. In addition, the rules of all the jurisdictions where that sovereign entity has significant assets or where courts may have jurisdiction over it may also be relevant.

### **Concern for lenders under subscription credit facilities**

When a state-linked investor (such as a sovereign wealth fund or governmental pension plan) subscribes to a fund, they may also enter into a side letter with the general partner and/or manager of the fund. The side letter will often vary the general terms of the fund's limited partnership agreement (LPA) and may contain a provision under which the investor claims rights to immunity from adjudication and/or enforcement.

As part of the security package, a lender under a subscription credit facility will typically take an assignment of the borrower/general partner/manager's rights under the LPA to call and receive capital from investors and enforce all rights in respect thereof. In an enforcement scenario, therefore, a security agent (or the lender in a bilateral facility) may look to directly or via a receiver step into the shoes of the borrower/general partner/manager and issue capital call notices to investors directly. If an investor fails to comply with such capital call notice and the security agent/lender chooses to take enforcement action in respect of that investor, it will first need to obtain a judgment against that investor for a failure to comply with its obligations under the LPA. If that investor has entered into a side letter claiming sovereign immunity, the terms of that provision will need to be carefully analysed in order to determine its impact on both the

ability to obtain a judgment against that investor as well as the enforceability of that claim against the investor/its assets.

## Key considerations

In all subscription credit facilities, lender's counsel should review the applicable LPA(s), subscription agreements and side letters in order to advise as to whether immunity is relevant to an investor. We set out below some of the key considerations that we would expect as part of the review, noting again that this analysis is in respect of the position under English law only:

- **Does the LPA contain a waiver of immunity?** If the answer to this question is yes and an investor has not separately agreed in a side letter to retain its rights to immunity, then in many jurisdictions this will operate as an effective waiver of sovereign immunity rights. If the LPA does not contain any such waiver, an investor may still have implicitly waived its immunity by virtue of the exceptions described above.
- **Does the waiver of immunity in the LPA apply in respect of “adjudication” and “enforcement”?** If an investor waives its immunity in respect of “adjudication” (*i.e.*, immunity from a judgment being issued against it following a failure to fund a capital call) and “enforcement” (*i.e.*, following the obtaining of a judgment, the enforcement of that judgment against the assets of the investor), this should operate to permit a security agent/lender to bring a claim and enforce its judgment against the assets of an investor. However, if the waiver does not apply with respect to both “adjudication” and “enforcement,” a security agent/lender may be able to obtain a judgment against an investor but unable to enforce against all or any of its assets.
- **Has an investor expressly reserved its rights to immunity from “adjudication” and/or “enforcement” in a side letter?** If a side letter does not contain any such provision, the position will depend on any waiver in the LPA, as well as whether the exceptions referred to above apply. If a side letter does contain an immunity provision, consider whether the provision also contains mitigating language. In some cases, an immunity clause will be accompanied by language clarifying that the reservation of immunity is not intended to limit the investor's obligations to fund its commitments under the LPA. Such language should provide comfort to lenders, as it will make it more difficult for an investor to refuse to fund commitments if there is a clear agreement to comply with its obligations under the LPA. Mitigating language can, however, provide varying levels of comfort depending on its precise wording and, as mentioned above, it is vital that legal advice is sought in each instance.

It is worth noting that even where an investor has retained its immunity rights in this type of situation, failure to comply with a capital call would likely cause that investor severe reputational damage, particularly given the vast usage of subscription facilities across the private markets globally.

## Sovereign immunity from UK direct taxation

Sovereign immunity from UK direct taxation reflects an international law principle that one sovereign state should not seek to apply its law to another sovereign state. This doctrine has been developed in the UK by case law and HM Revenue & Customs (HMRC) practice.

This means that, broadly, sovereign persons are exempt from UK direct taxes (*i.e.*, income tax, capital gains tax and corporation tax) on all UK-source income and gains from their commercial activities. Therefore, UK-source interest payable to a sovereign immune person should be exempt from UK withholding tax.

Additionally, under the UK tax legislation, eligible sovereign investors are treated as “Qualifying Investors” (for the purposes of the real estate investment trust (REIT) regime and the qualifying asset holding company (QAHC) regime) and as “Qualifying Institutional Investors” (for the purposes of the substantial shareholding exemption from corporation tax on chargeable gains). The aim is to encourage certain institutional investors to invest into the UK by allowing them to benefit from these tax regimes, while permitting sovereign investors to invest alongside them.

HMRC is responsible for assessing the availability of sovereign immunity. Decisions are made on a case-by-case by reference to the particular applicant’s circumstances.

In July 2022, the UK government launched a consultation to “modernise and improve the tax treatment it provides to foreign sovereign investors, such as heads of state and sovereign wealth funds.” However, the UK government announced at the Budget 2023 that the position was reversed. In other words, the UK government decided that there will be no change to the current exemption, and that it will continue to operate as it does now.

## **Conclusion**

Care must be taken during the diligence process to understand which investors in a fund have elected to retain sovereign immunity rights and exactly which rights those are. Lenders should consider (i) the terms, including the governing law, of the LPA, subscription agreements and side letters, (ii) the type of investor and their identity and (iii) the jurisdiction in which that investor is incorporated.

Lender’s counsel should review all applicable constituent documents to determine whether there is a waiver or any mitigating language and, in the latter case, the extent to which it provides comfort around the investor’s obligations under the LPA.

Depending on the commercial agreement between a lender and the fund, a lender may be able to take advantage of certain protections, including removing investors from the borrowing base or conducting a more detailed analysis of the investors in question. A lender may take further comfort from a sovereign investor’s track record of funding and the commercial risk associated with failing to fund a capital call.

It is welcoming that the UK government decided to retain the relatively generous rules for sovereign immunity from UK direct taxation. Funds that are within the QAHC regime or the REIT regime or that intend to benefit from the UK substantial shareholding exemption can be assured that eligible sovereign investors will continue to be treated as “Qualifying Investors” or “Qualifying Institutional Investors,” as applicable. A sovereign immune lender can continue to have their UK-source interest exempt from UK withholding tax (and other UK direct taxes). However, as mentioned above, decisions on the availability of sovereign immunity are made by HMRC on a case-by-case basis, so care must be taken to determine a sovereign investor’s tax status.