



# ENGLISH COMMERCIAL COURT DECISION ERODES STATE IMMUNITY DEFENCE

**In a case set to have significant impact for international traders seeking to rely on immunity defences, the English Commercial Court has held that Iraq's national oil trading company, SOMO, has a separate corporate status from the Iraqi State and is therefore not entitled to rely on State immunity to avoid payment of a final arbitration award of US\$9 million.**

***Taurus Petroleum Ltd v State Oil Marketing Company of The Ministry of Oil, Republic of Iraq.***

In a judgment handed down on 18 November, Field J has held that *“there is no sovereign immunity that prevents the operation of the Third Party Debt Orders and the receivership orders in respect of the promise to pay made to SOMO under the letter of Credit”*, rejecting SOMO's insistence that it may rely on State immunity to avoid paying demurrage bills dating from 2004-2007.

This decision represents the potential erosion of the State immunity defence for all state-owned trading companies seeking to evade payment of their debts.

## **Background**

HFW acts for Taurus Petroleum Ltd (Taurus) in an enforcement action for a final arbitration award obtained by HFW for US\$8,716,477 in respect of demurrage, war risk premiums, a performance bond, interest and costs (the Award) delivered by Ian Hunter QC against the State Oil Marketing Organisation of Iraq (SOMO) dated 13 February 2013. SOMO was legally represented throughout the arbitration.

On 11 March 2013, the English Commercial Court granted Taurus permission to arrest a sum of £5,808,150 plus costs by way of an Interim Third Party Debt Order. Those funds have been paid into Court.



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### The judgment

SOMO made a Part 11 Application to set aside the Third Party Debt Order for “want of jurisdiction on grounds of State Immunity”. SOMO’s State immunity argument was rejected by the Court in a decision with potentially profound industry impact.

SOMO argued that in entering into sale contracts with Shell and procuring Letters of Credit, SOMO was acting as the duly authorised agent for the State of Iraq, which could enforce Crédit Agricole’s promise to pay as an undisclosed principal. The Court rejected SOMO’s argument.

SOMO advanced a number of further arguments:

1. The *situs* of the debts constituted by the letters of credit is the State of New York; pursuant to the decision of the House of Lords in *Société Eram Shipping Co Ltd v HSBC*<sup>1</sup>. Only debts situated within the jurisdiction can be the subject of an order in the nature of a Third Party Debt Order (the *situs*/jurisdiction issue).
2. Crédit Agricole owed no debt to SOMO under the letters of credit since the contract related to the sale of Iraqi oil and under Iraqi law, debts due for the purchase of Iraqi oil are owed to the State of Iraq and not to SOMO (the true promisee issue).
3. The debts due under the letters of credit constituted “property of the state” within the meaning of s. 13 (2) (b) of the *State Immunity Act 1978* (the SIA) and accordingly they are immune from execution (the s. 13(2) (b) issue).
4. The debts under the letters of credit had to be paid into the account of the Central Bank of Iraq (CBI) held at the Federal Reserve Bank of New York (FRBNY) by reason of which CBI had legal interest in the debt and thus a qualifying interest in the money owed by Crédit Agricole so as to trigger the protection afforded by s. 14(4) of the SIA (the s. 14(4) issue).
5. Under the law of Iraq, SOMO had no right to benefit from Crédit Agricole’s promise to pay under the letters of credit, but instead was bound to ensure the money was paid into the account of the CBI at FRBNY and accordingly no Third Party Debt Order should be made under CPR Part 72 since SOMO could not honestly deal with the debt sought to be attached other than by allowing it to be discharged by payment into CBI’s account at FRBNY (the honest dealing issue).
6. If SOMO is a separate entity from the Iraqi State, its sale of Iraq’s petroleum reserves could only be performed in the exercise of sovereign authority where the State itself would be immune and thus SOMO’s property is immune from execution pursuant to s.14(2) of the SIA (the s.14 (2) issue).

The Court reviewed SOMO’s corporate structure in detail, including its ‘Declaration of Incorporating’, its official mandate of activities, its State-derived rights, Board of Directors, and SOMO’s decision-making process, given its relationship with the Iraqi Ministry of Oil. SOMO maintained in evidence addressed to the Court by the Iraqi *Chargé d’Affaires* that it is “wholly owned, funded by, and an integral part of the Ministry of Oil of the Republic of Iraq” and that in consequence, SOMO is part of the Republic of Iraq.

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The Court ruled against SOMO on each of these issues, providing clear guidance to international traders:

*“It is beyond argument that SOMO is a separate juridical entity formed by the State for commercial or industrial purposes, with its own management and budget and accordingly, pursuant to the approach ordained by the Privy Council, there is a strong presumption that its separate corporate status should be respected.*

*On the evidence before me, whilst the Ministry of Oil exercises a close overall supervisory function over the operations and affairs of SOMO, SOMO is not part of the State of Iraq but is an entity separate from the Iraqi state. I conclude therefore that there is no sovereign immunity that prevents the operation of the TPDOs and the receivership orders in respect of the promise to pay made to SOMO under the letters of credit.”*

The Court however held that the debt due under the letters of credit could not be attached by a TPDO pursuant to CPR Part 72.2 (1) because the words “any debt due or accruing due to the judgment debtor from the third party” connote a debt owed solely to the judgment debtor. Otherwise, since payment to the judgment creditor in compliance with a TPDO discharges the debt owed to the judgment creditor (CPR 72.9 (2)), the joint promisee would be cut out of his interest in the debt. The Court held that the *wording of the particular LC constituted a contractual promise to pay the debt due under the Credit into the CBI’s account as well as to SOMO, as a joint promise*. Hence the debt was not due solely to the debtor and the TPDOs could not properly be made and were accordingly ordered to be discharged (the joint debtor issue).

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## The long-term impact of this judgment against SOMO, stripped of its State immunity defence, should be of interest to the commodity trading world at large and to international oil traders in particular.

### Appeal

Taurus was given permission to appeal on the joint debtor issue. SOMO were refused permission to appeal any of the sovereign immunity issues, but were given permission to appeal on two limited issues. Taurus also obtained a stay of execution against the Judgment Order to discharge the TPDOs. Unusually, only 30% of SOMO’s costs of the Application were allowed, reflecting its limited success on the issues it argued. The order for payment of those costs is stayed and the costs are to be set-off against the Award owed to Taurus, with SOMO allowed to appeal on the question of the set-off.

SOMO requested leave to cross-appeal on all of the Court’s findings on SOMO’s State immunity. However, permission to appeal those issues was refused and SOMO’s cross-appeal was limited to (1) the correct *situs* of the debt created by the letter of credit and (2) the set-off of Taurus’ costs against the Award.

### Commercial impact

Field J’s judgment has ramifications on the question of the immunity of state-owned companies worldwide.

International traders, particularly those doing business with nationally owned companies, stand to benefit from the Court’s ruling on State immunity. The long-term impact of this judgment against SOMO, stripped of its State immunity defence, should be of interest to the commodity trading world at large and to international oil traders in particular.

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