The Commercial Activity Exception Stands Strong

October 24, 2023 Timothy Powers

PRACTICES Finance

The below article was published in *The Banking Law Journal.*

Recent concerns over foreign sovereigns contracting out of a similar commercial activity exception under English law raised the question as to whether foreign parties may also do so in the United States. The authors of this article explain the law on both sides of the pond.

Foreign sovereign investors continue to have significant investment in private equity in the United States and abroad. As with U.S. sovereign investors, foreign sovereign investors require special attention when analyzing a lender's ability to enforce the obligation of such foreign sovereign investor to fund capital calls. In the United States, the commercial activity exception1 to the Foreign Sovereign Immunities Act (FSIA) is a fundamental provision for subscription line credit facility lenders, as it ensures that foreign sovereign investors remain liable to their obligation to fund capital calls despite any claims of sovereign immunity.

Recent concerns over foreign sovereigns contracting out of a similar commercial activity exception under English law raised the question as to whether foreign parties may also do so in the United States. Unlike under the State Immunity Act 1978 (SIA), the FSIA contains no explicit language permitting parties to contract around this exception. Even if foreign sovereign investors assert that the commercial activity exception shall not apply to their investments, for example via a side letter provision, their attempts at retaining sovereign immunity should be unenforceable on grounds of a conflicting statutory provision.

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Similar to the commercial activity exception in the United States, Section 3(1)(a) of the SIA states that a state entity is not immune from proceedings relating to (a) a commercial transaction entered into by that state entity, or (b) an obligation of a state entity which by virtue of a contract (whether a commercial transaction or not) falls to be performed wholly or partly in in the United Kingdom. However, Section 3(2) of the SIA permits parties to agree inwriting that Section 3(1)(a) of the SIA will not apply. Certain foreign investors have incorporated language into their side letters whereby they submit to English law and utilize Section 3(2) to retain sovereign immunity from suit and/or enforcement.

The FSIA governs the circumstances under which a foreign state, as well as its political subdivisions, agencies, and instrumentalities, may be immune from suit in the United States. The FSIA contains several enumerated exceptions, including the commercial activity exception (with no express language permit- ting parties to contract around this exception). Without this exception, which denies immunity for sovereign entities engaging in commercial activity inside of or with a direct effect in the United States, lenders would likely face significant challenges to obtaining legal recourse against these parties. The commercial activity exception provides lenders in the fund finance industry assurance that foreign investors are unable to claim immunity to suit in the United States in the event, for example, they fail to fund their capital commitments.

Read the full article in *The Banking Law Journal* here.