

THE RISE OF SOVEREIGN ASSET TRACING



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While a return to some form of commercial normality is anticipated in a small number of wealthy nations, the economic impact of the COVID-19 pandemic will continue to be felt across the globe. The effect has been particularly acute for the debt profiles of many nation states, especially in the developing world. According to World Bank estimates, in 2020 government debt of emerging markets and developing economies reached 60.8% of GDP, an increase from 52.1% in 2019.

As a result, disputes involving sovereign states are on the rise. Now more than ever, understanding a sovereign state's asset profile will form a critical part of the dispute resolution strategy for any party pursuing a remedy for contract frustration via litigation or alternative dispute resolution.



Navigating enforcement challenges

Enforcing an award against a sovereign state presents unique challenges for counsel and investigators. The sovereign immunity doctrine protects most state-owned assets – including properties held by diplomatic missions abroad and central bank assets – from being seized.

That said, sovereign immunity does not typically extend to a state's commercial activities, such as:

- The acquisition of immovable property
- The purchase of stakes in private companies
- Investments in government-owned airlines
- The repayment of commercial loans
- Military procurement

A well-planned asset recovery strategy will therefore prioritise the identification of assets most likely to fall beyond the protections of sovereign immunity. Investigators will consider an asset's commercial use, liquidity, transferability, location and prestige value to inform how resources can be allocated in the most cost-effective manner.



SOE Ownership and proximity

Another challenge involves potentially seizeable assets that are not directly owned by a sovereign state, but rather by a separate legal entity such as a state-owned enterprise (SOE). SOEs often own a state's most valuable assets and many have footprints outside their national jurisdictions.

In such a case, a party must demonstrate that the entity is sufficiently interconnected with the state that its assets can be seized to satisfy

an award against the sovereign. For example, in July 2019, the US Court of Appeals found that Petróleos de Venezuela (PDVSA), Venezuela's state-owned oil company was "so extensively controlled" by the Republic of Venezuela that it was an alter ego of the sovereign, allowing the creditor to attach PDVSA's assets in the US.

Information obtained from the public domain can help legal teams to build alter ego arguments by unpicking the corporate structures used to hold government assets or showing the extent of the role played by the sovereign in the management of SOEs. Targeted enquiries among contacts with direct knowledge of a target SOE's internal workings can also be critical to understanding its management and level of independence, especially in jurisdictions where public records are not widely accessible.



Asset mapping

A crucial early step in any sovereign asset trace is to map

out the assets that are likely exempt from traditional sovereign immunity protections. The most attractive targets tend to be immovable assets, such as real estate located in debtor-friendly jurisdictions – which, depending on the award, would typically include common law and Western European jurisdictions – and movable ones such as vessels and aircraft that travel outside of the country's national borders.



Immovable assets

Immovable assets, such as real estate held outside the sovereign entity's home jurisdiction, are particularly attractive as they are usually exempt from state immunity. This is in marked contrast to liquid assets, for which targeted governments have often successfully argued in court that they cannot be seized as they are being used for sovereign purposes.

Investigators can leverage transparency initiatives such as the UK's 2018 Registration of Overseas Entities Bill, which has created a publicly accessible register of beneficial owners of overseas entities that own UK land, to link sovereign states to immovable assets that can then be frozen. Planning applications or tenders for improvement works can also be used to connect property to a government and

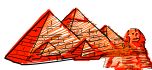
provide further context on its use. In the tax dispute between Cairn Energy Plc and the Government of India, the former successfully used public tender documentation to win an application in the French courts to freeze EUR 20m of property in July 2021.



Movable assets

Movable assets such as aircraft or vessels are another desirable asset class. In addition to the monetary value they hold, and the possibility of seizing them as they move into friendly jurisdictions, they may also hold symbolic importance for the country.

A pertinent example is the seizure of a Falcon 7X aircraft used by the Republic of the Congo's president Denis Sassou Nguesso as it landed in the airport of Bordeaux in June 2020. The French courts authorised the seizure of the plane to help satisfy a USD 1.5bn debt owed by Congo-Brazzaville to Lebanese businessman Mohsen Hojeij. Hojeij's legal team had successfully argued that the plane fell outside of diplomatic immunity as it was mostly used by President Denis Sassou Nguesso for personal trips rather than official visits.



Other assets

Beyond the asset classes discussed above, other attractive assets include:

- Foreign subsidiaries of SOEs
- A sovereign state's shareholdings in foreign companies
- Shipments of valuable export goods documented by bills of lading
- Overseas accounts used by the sovereign

For creditors, overseas bank accounts held by government are, at face value, appealing targets. However, banking privacy laws in most jurisdictions prevent private outfits from accessing bank account details. One potential work around is to look for accounts used for specific activities such as servicing interest payments on bonds it has issued or paying overseas royalties.

By reverse engineering the receipt of funds by, for example, a bondholder, we can identify the account used to make these payments and thus associate it conclusively with the sovereign, regardless of the entity that is legally

registered as holder of the funds. This allows investigators to leap over complex corporate structures built around shell companies and attach the assets directly to the debtor.



Obtaining the most from a client's award

The ultimate goal of an asset tracing exercise is to maximise the funds recovered by a creditor following an award. In cases where a State has few assets held outside its home jurisdiction, or where it has successfully argued in court that they are covered by sovereign immunity, a creditor's best option may be to apply pressure on the State that pushes them towards settlement.

One effective way is by targeting high profile flagship assets. Freezing assets that paralyse an SOE's operations can cut off vital revenue streams for a State and alienate potential business partners who are sensitive to the risks of working with the sovereign debtor. Or, successfully seizing movable assets used by senior government officials, such as the Head of State's private jet, can create embarrassment, gain media traction, and deprive a key decision maker of the use of a luxury asset. These can all be instrumental in bringing the sovereign debtor to the negotiating table, and ultimately forcing it to agree to a favourable settlement for the creditor.

