

International Arbitration

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SOUTH AFRICA

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Become immune to immunity: Negotiating international arbitration agreements with a state

Private entities frequently enter into contracts with states or state-owned entities in public-private partnerships and other commercial transactions. This is especially common in major infrastructure and energy projects where significant foreign direct investment interrelates with state-owned assets and licencing.

By its nature a state-affiliated entity may be vulnerable to, or influenced by, political or economic instability or changes to regulatory and legislative frameworks. These factors could directly impact contractual performance, including events of default, expropriation or force majeure, which in turn increases the likelihood of disputes arising.

When such disputes arise, they are commonly resolved through international arbitration proceedings, and the number of state parties to international arbitration is growing. For example, the London Court of International Arbitration recorded a doubling in the number of state parties from 2021 to 2022, and in 2023 11% of its arbitrations involved a state or state-owned party.

Negotiating arbitration agreements with states can present unique legal and commercial challenges. By carefully considering these challenges at the negotiation stage, commercial entities may be able to better protect their legal position and mitigate against potential risks.

State immunity

If a dispute arises against a state, commercial contractual counterparties may face the challenge of state immunity. This is a principle that derives from international law and can be invoked by states to assert that a court or arbitral tribunal does not have jurisdiction to hear and determine a claim against them. The immunity can apply throughout proceedings, from commencement to enforcement. In some circumstances the immunity may extend to state-owned or affiliated entities, even if the state itself is not a party to the transaction.

State immunity can create challenges for a party that is seeking to enforce its contractual rights against a state or state-affiliated entity. Consequently, when negotiating an arbitration agreement with a state, consideration should be given to how to mitigate against any risks of a state asserting immunity in any future arbitration if a dispute arises. For example, waivers could be requested from the state including:

- **Waiver of immunity from suit.** This waives a state's immunity from having legal proceedings commenced and heard against it.
- **Waiver of immunity from recognition and enforcement.** This waives a state's immunity from courts issuing orders to allow enforcement of an arbitral award against it. This waiver should include a waiver of the right to claim immunity in respect of any interim or injunctive decisions made by an arbitral tribunal or supervisory court.



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- **Waiver of immunity from execution.** This waives a state's immunity from having an award executed, which may include the practical seizure of assets or collection of sums due, against it. This waiver should include references to specific assets or categories of commercial assets that can be enforced against, or alternatively a performance bond or letter of credit could be requested. This is because some jurisdictions may not permit execution against state assets if they are used for sovereign purposes (such as assets used for military or diplomatic functions), rather than commercial purposes.

The scope of immunity will depend on the applicable law and many jurisdictions recognise exceptions from immunity if the state was acting in a wholly commercial capacity in the transaction. It is therefore advisable to expressly confirm in the contract if the state is acting in a commercial capacity.

Arbitral process and procedure

When negotiating the process and procedure that will apply to an arbitration with a state, commercial entities should be aware of certain distinctive considerations. For example:

- **Arbitral seat:** Commercial entities may prefer that the arbitration be seated in a different jurisdiction to the state if there are concerns about judicial bias or state influence over the courts.
- **Arbitral rules:** In some jurisdictions state counterparties are subject to specific arbitral processes. For example, Rwandan public institutions can only agree to arbitrate under the rules of the Kigali International Arbitration Centre unless special dispensation is given.
- **Arbitral tribunal:** Specific requirements about arbitrator nationality or qualifications may be imposed where a state or public body is a party.
- **Confidentiality:** Different transparency requirements may apply in arbitral proceedings involving states or public bodies. For example, in South Africa the default position is that arbitrations involving a public body are held in public.



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- **Available relief:** Some jurisdictions will not allow the granting of injunctive relief or specific performance against a state.
- **Service:** The arbitration agreement should confirm if there are specific service requirements to commence proceedings against a state as some jurisdictions require service via diplomatic channels.

Parties and authority

Arbitration agreements are generally only binding against the parties to them. Consequently, when negotiating with a public body:

- If a state-owned entity is the contractual counterparty, consider if the state should also be made a counterparty, especially where the state will be involved in the negotiation or performance of the contract. This will avoid disputes as to whether or not the state is bound by the arbitration agreement.
- Check if any jurisdiction-specific requirements apply regarding the public entity's capacity and authority to enter into an arbitration agreement. For example, in Saudi Arabia government bodies can only agree to arbitrate with prime ministerial permission or if provided for by law.

- Consider whether the corporate structure of the contractual parties can be used to bring the investment within the scope of additional protections and avenues of recourse against a state, such as international investment agreements and treaties.

Considering and taking advice on these issues at the contractual stage can help to mitigate the unique risks and challenges that arise when concluding arbitration agreements with states.

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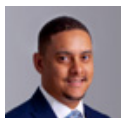
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BBBEE STATUS: LEVEL ONE CONTRIBUTOR

Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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