2006

CICA No. 7 of 2006
GCCI No. 478 of 2004

IN THE COURT OF APPEAL OF THE CAYMAN ISLANDS

17/7/06

BETWEEN:

TASARRUF MEDUDUATI SIGORTA FONU

APPELLANT (Plaintiff)

AND:

WISTERIA BAY LIMITED, UTTERTON LIMITED, ABDALLAH IBRAHIM ABDALLAH AL-AYED and THE REGISTRAR OF SHIPPING

RESPONDENTS (Defendants)

Before: The Right Hon. E. Zacca, President
The Hon. M.R. Taylor, Justice of Appeal
The Hon. E.D. Mottley, Justice of Appeal

Geoffrey Cox, Q.C., Richard Davidson, Martin Jones and Ben Hart, for the Appellant
Richard Millett, Q.C. and Nigel Sanders, for 1st and 2nd Respondents
Matthew Morrison, for 3rd Respondent

Heard: April 12 & 13, 2006 Decision Given: April 27, 2006
Reasons for Judgment Released: 17th July 2006.

CAYMAN ISLANDS COURT OF APPEAL

REASONS FOR JUDGMENT

TAYLOR, J.A.

As a result of misunderstanding, error or oversight the appellant, an agency of the Turkish government, has found itself enjoined by an order of the Grand Court obtained on

its own *ex parte* application from carrying out part of its official function in Turkey, and been held in contempt of the Cayman court for continuing to do so.

As part of a statutory scheme for regulation of the Turkish banking system and protecting depositors against the consequences of bank failure, the appellant TMSF is authorized to recover deficiencies in the accounts of insolvent banks by seizure and sale of assets of their managers, shareholders or auditors. In March 2004 TMSF seized in Turkish waters two motor yachts registered on the Cayman Islands Shipping Registry in the names of the corporate respondents, each valued at more than $23,000,000 (U.S.), which are said to belong in fact to the controlling shareholders of a leading Turkish bank rendered insolvent by massive misapplications of funds, the subject of criminal charges before the Turkish courts. In December 2004 TMSF brought action in the Grand Court of the Cayman Islands to prevent the completion of registration of mortgages for amounts in excess of their total value granted against each vessel in favour of the personal respondent. It immediately thereafter obtained *ex parte* interim relief not only against completion of registration of the mortgages but also against all further dealings with the vessels. TMSF claims that the mortgages were granted fraudulently for the purpose of frustrating a then imminent auction of the vessels in Turkey and says that its purpose in seeking the *ex parte* order was to prevent these and similar dealings, and thus to facilitate – and certainly not to impede – its efforts to sell the vessels.

The Grand Court judge refused three days afterwards to vary the order restraining further dealings, so as to permit TMSF to proceed with the auction, and by a later order authorized completion of registration of the mortgages.

The judge continued the original order insofar as it restrained the appellant, as well as the first three respondents, from any dealings with the vessels until further order and later held TMSF in contempt of court for continuing with its scheduled auction and effecting a sale of one of the ships, a transaction that thereafter collapsed. At the time of the hearing before us, more than two years after their seizure, the vessels remained subject to the Grand Court restraining order and unsold.

Only on this appeal has the appellant raised for the first time the fundamental point, of domestic and international law, that our courts have no jurisdiction except by specific written consent to enjoin a foreign state or foreign state entity carrying out governmental functions from discharging such functions in its own country. We concluded that the case falls within ss. 13(2)(a), 13(3) and 14(3) of the U.K. *State Immunity Act* 1978, brought into effect in the Cayman Islands by the *State Immunity (Overseas Territories) Order* 1979. These provisions forbid the granting of injunctive relief against a foreign state or foreign state entity, even though it has submitted to the jurisdiction of the court, without specific consent in writing of the state or state entity to the granting of such relief. We were of the view that the consent contemplated by the Act is one addressed to waiver of the procedural privilege recognized by s. 13(2)(a), and that no document to which we

were referred met this important requirement. We concluded that insofar as it purports to restrain the appellant itself, even though initiated by a request made – in haste, unwittingly and unintentionally – by the appellant's own then counsel, the order must be regarded as having been made without jurisdiction.

Before us the appellant sought variation of the order so as to restrain only future registration of transactions concerning the vessels by the Registrar of the Cayman Islands Shipping Registry. The appellant recognized that the order as so varied would require that registration of any transfer of title resulting from a sale that it might itself make must first receive approval of the Court, in addition to requiring similar prior approval for any transfer or charge that others might seek to register.

We allowed the appeal and varied the order accordingly, saying that we would provide written reasons and in so doing deal with the matter of costs.

(a) The Background

The appellant TMSF is a statutory authority, administered by the Turkish Banking Regulation and Supervisory Agency, whose functions include the management and restructuring or liquidation of unlawfully administered or insolvent banks and the operation of an insurance fund to protect depositors of such banks.

The insurance fund is maintained through premiums paid by banks licensed by the Banking Regulation and Supervisory Agency, fees paid by shareholders of such banks based on licensed capital, and fees paid on the transfer of bank shares based on the value of such shares. When obliged to make payments from the fund for the benefit of depositors of an insolvent bank, TMSF is authorized to recover the amount paid through seizure and sale of assets of shareholders, former managers or auditors of the bank. It also has authority to recover in this way any difference that it may find between the deposits declared by the bank and the actual amount of such deposits, whether insured or not. In exercising its power of seizure TMSF seeks assistance of the Turkish courts and is subject to their jurisdiction in respect of any challenge to its exercise of this power, but the power itself does not appear to be one given by the court.

The corporate respondents are companies incorporated in the British Virgin Islands said to belong to members of the Uzan family, principal shareholders in T. Imar Bankasi T.A.S., the fourth or fifth largest bank in Turkey, which is now being managed by TMSF. The two vessels concerned, known (in English translation) as *Frequency* and *Airwaves*, are registered respectively in the names of these companies.

The respondent Abdallah Ibrahim Abdallah Al-Ayed is a Jordanian national in whose favour the deeds of mortgage secured on the two vessels were filed with the Registrar in December 2004, and have since been registered.

As a result of failure of the Imar bank to conform with banking regulations, the Banking Regulation and Supervisory Agency revoked its licence in July 2003 and placed its affairs in the hands of TMSF. A difference between reported and actual deposits of approximately $5,100,000,000 (U.S.) is said to have thereafter been discovered, and criminal proceedings brought against two members of the Uzan family for fraud, misappropriation of funds and banking law violations. In August 2003 TMSF obtained an order of a Turkish criminal court restraining assets of the defendants in those proceedings, including the vessels *Frequency* and *Airwaves*. This "precautionary injunction" was thereafter the subject of several applications or petitions to the Turkish criminal courts, but finally upheld and continued in January 2004. In March 2004 TMSF seized the two vessels and the owners initiated further proceedings to challenge the seizures, but these proceedings were dismissed for non-appearance. The vessels were then offered for sale. On November 26, 2004, TMSF advised the Cayman Islands Shipping Registry of its intention to sell the vessels the following month.

On December 1, 2004, the two mortgages in favour of Mr. Al-Ayed were received by the Registrar of Shipping and processed for registration except for transmission to the owners and mortgagee of a transcript from the register evidencing registration together with the mortgage documents, the final step in the process. TMSF takes the position that the mortgages were not entered into in good faith, the vessels having by then been subject

to the Turkish restraint and seizure process for 16 months, but a fraudulent device to disrupt sale of the vessels by auction, scheduled for December 10, 2004.

It was in these circumstances that TMSF sought assistance of the Grand Court in the exercise of its jurisdiction over the Cayman Islands Shipping Registry.

(b) The Proceedings

The present proceedings were commenced by originating summons dated December 6, 2004, which sought orders declaring the two mortgages fraudulent and void and directing the Registrar to expunge them from the register.

Attorneys for TMSF appeared that day in chambers and sought and obtained the interim *ex parte* order. Its terms went beyond the scope of the originating summons, containing, as Clause 2, a direction that: "There be no dealings with the motor vessels known as Frequency and Airways [sic] registered under registration numbers 732377 and 732824 respectively or any share therein without further order of this Court". On being served with this order, attorneys for the first two respondents took the position that it restrained TMSF itself from holding the auction of the vessels which had been advertised for December 10, 2004. Both sides appeared before the Grand Court judge on December 9, 2004, without summons or application, and attorneys for TMSF requested amendment of the order to remove any restraint on dealings with the vessels by TMSF.

The judge declined to vary the order, saying that restraint of dealings by all parties was necessary to preserve the *status quo* and protect the position of the respondents pending adjudication by the Court on the merits.

Faced with the choice of breaching the Cayman order or suspending its effort to sell the vessels, TMSF decided in favour of the former, and the auction proceeded in Istanbul on the following day. No buyer was found for *Airwaves*. A sale of *Frequency* was arranged, but this was not to prove capable of completion.

On the day of sale a further *inter partes* hearing took place before the Grand Court judge at which TMSF was found *prima facie* in contempt of court for proceeding with the scheduled auction and the matter adjourned to provide TMSF with an opportunity to explain its conduct. It came on again four days later. On December 16, 2004, the judge handed down a reserved decision finding TMSF in blatant contempt, varying the injunction so as to direct the Registrar to complete registration of the mortgages, directing that proceeds of the sale of *Frequency* be held in escrow, and requiring TMSF to pay $500,000 by way of security for costs. The judge also directed that TMSF ensure that *Frequency* was maintained in good repair and that the proposed purchaser was served with this and the original order. The judge further ordered that the injunction, and particularly Clause 2, continue in force, that the proceedings be reframed as an action brought by writ of summons, that discovery be made by TMSF, and that a penal notice be endorsed on the formal order, as varied.

On December 22, 2004, an amended formal order was filed endorsed with a warning addressed not only to all parties, including TMSF, but also to Fethi Calik, a senior officer of TMSF whose affidavits had been read in the proceedings, giving notice to each that in the event of disobedience they would be liable to fine, sequestration of assets or imprisonment for contempt. In its Statement of Claim in the reframed action TMSF extended the relief sought, claiming a declaration of its right to sell the vessels, a declaration that both mortgages are fraudulent and void, and an order that the Registrar expunge both mortgages from the register. Much later, on January 9, 2006, the judge dismissed an application by TMSF for discharge of the orders of December 6 and 16, 2004, on the ground of lack of subject-matter jurisdiction.

Two appeals were brought, one from the original *ex parte* order of December 6, 2004, the other from the January 9, 2006, decision by which the judge refused to discharge that order for lack of subject-matter jurisdiction.

(c) The State Immunity Issue

On this appeal TMSF for the first time took the position that the Grand Court judge lacked jurisdiction to enjoin it from performing its official functions under Turkish law by reason of its entitlement to state immunity.

The basis on which this argument rests is the recognition by domestic law of the fundamental public international law rule that the government of a state will not through its judicial arm interfere in the conduct by another state of that state's governmental affairs. Failure to bring this point to the attention of the Grand Court judge resulted in an order being made that could impose on a foreign state entity substantial economic penalties, and impose a sentence of imprisonment on its senior officer, should they fail to obey the directions of the Cayman Court in conducting their duties. The fact that such conduct by one state toward another may lead to reciprocal action against the former and its citizens provides ample practical justification for the rule that such orders do not lie within the jurisdiction of domestic courts.

Section 1 of the *State Immunity Act* 1978 lays down the general rule that a state is immune from the jurisdiction of the courts of the United Kingdom (and hence of the Cayman Islands) except as thereinafter provided. It requires that effect be given to this immunity of the court's own motion should the state not appear.

Sections 2 to 11 deal with "Exceptions from Immunity" in cases involving submission to the jurisdiction, commercial transactions, contracts to be performed in the U.K., employment contracts, personal injury and property damage claims, ownership and use of property, patents, state membership in corporations, arbitration, commercial vessels, and taxes and duties. Sections 12 and 13 deal with "Procedure", the latter being of principal importance in this case. Section 12 requires that service of originating process

and judgment in default on a foreign state be made through the Foreign and Commonwealth Office, and extends time for appearance and for applying to set aside a default judgment. Section 13, headed "Other procedural privileges", forbids by s-s. (1) the imposition of any penalty against a foreign state litigant for failure to disclose or produce documents or information. Section 13(2) and (3) provide:

> (2) Subject to subsections (3) and (4) below –
>
> (a) relief shall not be given against a State by way of injunction or order for specific performance or for the recovery of land or other property; and
>
> (b) the property of a State shall not be subject to any process for the enforcement of a judgment or arbitration award or, in an action *in rem*, for its arrest, detention or sale.
>
> (3) Subsection (2) above does not prevent the giving of any relief or the issue of any process with the written consent of the State concerned; and any such consent (which may be contained in a prior agreement) may be expressed so as to apply to a limited extent or generally; but a provision merely submitting to the jurisdiction of the courts is not to be regarded as a consent for the purposes of this subsection.

Subsection (4) has no bearing on the present case. Since under s-s. (3) neither submission to the jurisdiction nor oral consent will suffice to waive the procedural privilege against injunctive relief, it did not appear to us that an error on the part of counsel in requesting relief which unintentionally enjoins a state entity could suffice to confer on the court jurisdiction to grant injunctive relief interfering with the conduct by such an entity of its governmental duties. It seems wholly inconsistent with the principles underlying the

provision that a country's foreign relations should be put at risk by an oversight on the part of counsel, who must sometimes, as here, proceed in haste.

Section 14(2) and (3) deal with the position with respect to immunity of state agencies, that is to say governmental agencies that are not departments of government, but rather separate entities acting on its behalf. The sub-sections provide:

> (2) A separate entity is immune from the jurisdiction of the courts of the United Kingdom if, and only if –
>
> > (a) the proceedings relate to anything done by it in the exercise of sovereign authority; and
> >
> > (b) the circumstances are such that a State (or, in the case of proceedings to which section 10 above applies, a State which is not a party to the Brussels Convention) would have been so immune.
>
> (3) If a separate entity (not being a State's central bank or other monetary authority) submits to the jurisdiction in respect of proceedings in the case of which it is entitled to immunity by virtue of subsection (2) above, subsections (1) to (4) of section 13 above shall apply to it in respect of those proceedings as if references to a State were references to that entity.

Reading "Cayman Islands" for "United Kingdom", the questions of importance in the present case are: (i) whether the proceedings "relate to anything done" by TMSF "in the exercise of sovereign authority"; and (ii) whether "the circumstances are such that a State . . . would have been so immune". If both of these questions are answered

affirmatively, TMSF would be entitled to the procedural immunity recognized by s. 13(2)(a) from injunctive relief not consented to by it in writing.

The question whether the seizure and sale of the vessels was done by TMSF in "the exercise of sovereign authority" translates in the language of public international law into whether the relevant actions of TMSF are to be regarded as acts *jure imperii*, which traditionally attract foreign state immunity, or acts *jure gestionis* which, although done by a state or a state entity, are not acts of a governmental nature and thus do not attract immunity. The distinction is discussed in *Kuwait Airways Corpn. v. Iraqi Airways Co.* [1995] 1 W.L.R. 1147, a case in which the position of a state entity under the same statute is considered by Lord Goff of Chiveley. Lord Goff there makes particular reference to the following excerpts from the speech given by Lord Wilberforce in *I Congreso del Partido* [1983] 1 A.C. 244 (at p. 262):

> When therefore a claim is brought against a state . . . and state immunity is claimed, it is necessary to consider what is the relevant act which forms the basis of the claim: is this, under the old terminology, an act 'jure gestionis' or is it an act 'jure imperii:' is it (to adopt the translation of these catchwords used in the 'Tate letter') a 'private act' or is it a 'sovereign or public act,' a private act meaning in this context an act of a private law character such as a private citizen might have entered into?

And later (at p. 267):

> The conclusion which emerges is that in considering, under the 'restrictive' theory, whether state immunity should

> be granted or not, the court must consider the whole context in which the claim against the state is made, with a view to deciding whether the relevant act(s) upon which the claim is based, should, in that context, be considered as fairly within an area of activity, trading or commercial, or otherwise of a private law character, in which the state has chosen to engage, or whether the relevant act(s) should be considered as having been done outside that area, and within the sphere of governmental or sovereign activity.

Lord Wilberforce later (at p. 269) stresses, in the words of the judge at first instance in that case, that the fact that the act in question is intended to serve a state purpose will not alone be sufficient, and that the act must also be "of its own character a governmental act, as opposed to an act which any private citizen can perform". Summarizing these observations, Lord Goff says in the *Kuwait Airways* case (at p. 1160):

> It is apparent from Lord Wilberforce's statement of principle that the ultimate test of what constitutes an act jure imperii is whether the act in question is of its own character a governmental act, as opposed to an act which any private citizen can perform. It follows that, in the case of acts done by a separate entity, it is not enough that the entity should have acted on the directions of the state, because such an act need not possess the character of a governmental act. To attract immunity under section 14(2), therefore, what is done by the separate entity must be something which possesses that character.

This appears to be the test that must be applied to the functions being performed in the present case by TMSF under Turkish banking law.

No case was drawn to our attention in which the test has been applied to a body having similar functions. Proceeding on the basis of general principle, as stated in the above cases, it seemed to us that TMSF functions not only as an institution established by the state for the benefit of the Turkish public, but as an arm of a governmental agency responsible for licensing and regulating Turkish banks, and that it exercises governmental authority over banking institutions and persons involved in their ownership and management, and the assets of such persons.

It was suggested before us that so far as the deposit insurance fund is concerned TMSF functions in the same way as a commercial insurance company. That view has support in terminology used concerning the fund. In substance, however, this aspect of the function of TMSF differs markedly from that of a commercial insurer. The fund is not maintained by premiums paid either voluntarily or by persons at risk of loss; it is maintained through levies imposed under governmental compulsion on banking institutions themselves and their shareholders. Liability for amounts paid out of the fund is moreover imposed on the same parties obliged to support the fund, and the means of recovery employed by TMSF – including confiscation of assets – involve an exercise of state powers against such persons and their property. TMSF has no apparent trading or profit-making function. Its functions involve the exercise of governmental powers for the protection of bank depositors generally, whether or not their deposits fall within the scope of the insurance scheme, and the maintenance of public confidence in the banking system,

matters of obvious importance to national economic stability. In so doing it exercises powers which private individuals obviously do not have.

The requirements of the *jure imperii* test set out in the *I Congreso* and *Kuwait Airways* appear in this case to be met. The functions performed by TMSF as part of a banking regulatory system are governmental in nature, functions by which the state exercises authority over persons and property within its jurisdiction.

The first question posed by s. 14(2) is therefore answered affirmatively – the proceedings relate to acts done "in the exercise of sovereign authority".

The second question contemplates the possibility that a state entity exercising such sovereign authority may in some circumstances not be entitled to claim immunity, for the reason that the state itself would not be able to claim immunity. One such situation would be a case in which the state had submitted to the jurisdiction of the court, but s. 14(3) makes it clear that this would not be a ground on which procedural immunity from injunctive relief could be lost. For reasons already stated, it cannot be said that the present proceedings relate to a transaction or activity "entered into otherwise than in the exercise of sovereign authority" so as to be a "commercial transaction" within the meaning of s. 3(3)(c) of the Act, and its activities could not otherwise fall within that, albeit broad, definition. There is no other provision of the Act providing exemption from state immunity that appears to have relevance in this case.

We conclude that the second question posed by s. 14(2) must also be answered affirmatively – in these circumstances the state "would have been so immune".

The enjoined activity in issue in this case – disposal of title to the two vessels – must be regarded as an exercise of governmental authority undertaken by a separate entity of government in association with the administration of that state's criminal law, in respect of which immunity could have been established had it been undertaken by the state itself, thus entitling the entity to immunity against injunctive relief in a Cayman court under s. 13(2)(a) of the *State Immunity Act* 1978.

The fact that the present problem has its origin in oversight on the part of counsel for TMSF, and that immunity was claimed only at a late stage, are factors relevant to the disposition of costs, but cannot suffice to give validity to an order made without jurisdiction under a fundamental principle of international law.

(d) Conclusion

It was for these reasons that we allowed the appeal against the original order of December 6, 2004, and varied that order so as to enjoin only the registration by the Registrar of Shipping of any further dealings with either of the two vessels, whether by way of transfer of title, mortgage, lien or otherwise. We did not find it necessary to deal

with the appeal against the decision of January 9, 2006, by which the Grand Court judge declined to vary the original order of December 6, 2004.

Since state immunity was raised only in this court, and at a late stage, we conclude that the appellant should have one-half of its costs of the appeal, to be taxed if not agreed, and that the orders as to costs below should not be disturbed.

E. Zacca, P.

M.R. Taylor, J.A.

E.D. Mottley, J.A.