

# The King Can Do Wrong... in Certain Circumstances: Some Observations on the Sovereign Immunity of Antigua in the Stanford Financial Group Scandal

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**I**n my work representing private individuals in lawsuits against governments and government officials, I have discovered that for the most part, potential claimants, even relatively sophisticated ones, assume they have no right to sue the government. As the jurist Sir William Blackstone wrote in his 18th Century *Commentaries on the Laws of England*, "That the king can do no wrong, is a necessary and fundamental principle of the English constitution." There was a time, in fact, when God alone judged the actions of the sovereign, and not the courts. The historians tell us, for example, that as Holy Roman Emperor, Henry IV knelt in sackcloth in the snow for three days, fasting, in order to obtain absolution from Pope Gregory VII.

With the Protestant Reformation and the secularisation of the state, the supervisory role of the church defaulted to the state itself, which commenced self-supervision. This forced the judiciary and the legislature in each western state to develop rules that abolished the absolute sovereign immunity historically enjoyed by the state, and replaced it with more limited, restrictive sovereign immunity, thereby allowing private persons to seek legal redress against the state in certain defined circumstances. In each western state, two sets of rules emerged – one set applicable to the domestic sovereign where the court or legislature making the rules was sitting, and another set applicable to foreign sovereigns in foreign states. The rules of sovereign immunity vary widely from state to state, however, within a given state, the rules regulating foreign sovereign immunity track, even if they do not precisely

mirror, those regulating domestic sovereign immunity.

Enter Allen Stanford. Most aspects of the Stanford Financial Group debacle have been reviewed extensively elsewhere, with one exception. The commentary thus far has more or less overlooked *Joan Gale Frank et al. v. The Commonwealth of Antigua and Barbuda*. This is a civil lawsuit commenced in July 2009 in a Federal District Court in Texas. The case is framed as a class action. It has been brought on behalf of an estimated 28,000 Stanford International Bank Ltd. (SIBL) depositors and investors hailing from 113 different countries, and seeking USD8 billion in monetary damages from the Commonwealth of Antigua for its alleged role in the Stanford Financial Group's misdeeds. The Complaint states: "Antigua is sovereign, but not above the law. It became a full partner in Stanford's fraud, and reaped enormous financial benefits from the scheme."

The Complaint alleges more specifically that Leroy King, in his capacity as the Chief Executive Officer of the Antigua Financial Services Regulatory Commission (FSRC), the government agency with regulatory oversight over SIBL, facilitated a Ponzi scheme that was based upon investment in fraudulent Certificates of Deposit (CDs) issued by SIBL. He is said to have ensured that FSRC "looked the other way" by failing to conduct sham audits and examinations of SIBL books and records, failing to examine the SIBL investment portfolio that was meant to back the high yield CDs issued by SIBL, and providing SIBL with access to FSRC's confidential regulatory files. The FSRC allegedly knew that

representations made by SIBL and others in the Stanford Financial Group to customers and regulators in other countries, including the US Securities and Exchange Commission, were false and misleading<sup>1</sup>, assisted in the concealment of these false and misleading statements, and misrepresented to depositors and investors that it had performed certain audits of SIBL and its financial statements, which in fact, it had not performed. Importantly, for the purposes of sovereign immunity analysis, the FSRC, created by and under the Antigua International Business Companies Act, is said to be an agency or instrumentality of Antigua, so that Antigua itself is deemed to have acted in the Stanford affair by and through the FSRC, and is charged with crucial information and knowledge in the possession of FSRC.

Historically, Antigua has derived over half of its gross domestic product from tourism. But in the 1990s hurricanes ravaged its tourism infrastructure, and then the global financial slowdown further reduced the number of tourist visitors and tourism revenues to Antigua. The Complaint alleges that, unable to attract legitimate sources of investment and counterparty relationships, Antigua turned to Allen Stanford and the Stanford Financial Group. "Antigua therefore entered into a corrupt and illegal partnership with the Stanford Co-Conspirators, in which Antigua became an integral part of, and beneficiary of, Stanford's multi-billion dollar international fraudulent conspiracy."

USD36 million in unauthorised SIBL personal loans to Allen Stanford were used to subsidise Antigua's annual 20-20 cricket tournament, a major international marketing and tourism event for Antigua. SIBL also made an investment of USD63.5 million in undeveloped Antigua property. Stanford also made a direct loan of USD85 million to Antigua, which Antigua used, *inter alia* to pay the salaries of Antigua government employees and to fund their pensions. Stanford and Antigua joint ventured the expansion and development of the V. C. Bird International Airport in an arrangement that gave Stanford "near total control" over the country's airport. The development included the creation of two restaurants, a stadium and offices near the airport. Leeward Islands Air Transport Services, a company majority owned by Antigua, used funding made available by Stanford to purchase Caribbean Star Airlines (a Stanford company) and

individual aircraft owned by Stanford on favourable terms. Antigua partnered with Stanford in the construction of the Mount St. John Medical Centre, and as part of the arrangement received a USD30 million loan from Stanford to cover the construction costs, which Antigua promised to repay using funds taken directly from Antigua's social security system. Stanford underwrote the construction of executive offices for Antigua government officials and employees. Stanford donated money to build a national library...and so on, and so forth<sup>2</sup>.

What of Antigua's sovereign immunity from the jurisdiction of US courts? The *Frank* plaintiffs have invoked various sections of the Foreign Sovereign Immunities Act, the US federal legislation that provides the limited, defined statutory exceptions to the immunity of foreign states from the jurisdiction of US courts. The most important of these sections is known as the "Commercial Activities Exception"<sup>3</sup> and it provides:

- (a) *A foreign state shall not be immune from the jurisdiction of courts of the United States or of the States in any case - ...*
- (2) *in which the action is based upon a commercial activity carried on in the United States by the foreign state; or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere; or upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States...*

In support of their access of the Commercial Activities Exception to Antigua's sovereign immunity, the *Frank* plaintiffs argue that Antigua's acts in furtherance of the Stanford Ponzi scheme occurred outside of the United States, and caused direct effects inside the United States. The direct effects include (i) the sale to US citizens of the fraudulent SIBL CDs, and their subsequent financial loss (US investors represent the largest investor group by nationality), (ii) the unsatisfied claims of the US Internal Revenue Service for millions of dollars in taxes, interest and penalties, (iii) the collapse of certain businesses in the US and (iv) resulting criminal investigations and litigation in the US.

Antigua has not yet responded to the assertion by the US court of jurisdiction over it, a foreign sovereign, in the *Frank* litigation. When it does, it may be expected to challenge the assertion of jurisdiction on the basis that its acts were *jure imperii*, not *jure gestionis*, in other

words, not commercial acts of a private nature, but rather non-commercial, public or governmental acts. The case law in this area is convoluted and conflicts.

One line of cases applies a "nature" of the act test. The test is meant to be an objective inquiry into whether a private, ordinary person could have performed the act in question. If so, then the act must be *jure gestionis*, private, and jurisdiction is available; if not, and the act is one that only a public authority could perform (such as legislating, adjudicating or providing national defence) then the act must be *jure imperii*, public, and jurisdiction is not available. The test has limited utility in the modern world, where, for example, national defence and military actions can be and increasingly frequently are undertaken by private contractors like Blackwater, and where private parties frequently contract for private dispute resolution mechanisms such as the International Chamber of Commerce mediation or arbitration<sup>4</sup>. In the *Frank* case, Antigua could argue that the fulcrum of all of its activity was the FSRC, a regulatory agency, and regulation is a quintessentially public act. There may have been regulatory failure, but that is not in "nature" a private act. The plaintiffs could counter that there were direct dealings between the Stanford Financial Group and other elements of the Antiguan government for the purpose of promoting Antiguan tourism and commerce, and that these dealings certainly were not ones that only a public authority could perform.

A conflicting line of cases applies a "purpose" test. Under this test, an act is classified as being private or public according to whether it serves a private or public purpose<sup>5</sup>. As one commentator has noted, the "purpose" test has spawned its own set of complexities: "[a]rguably a state's contract is immune if it serves a public purpose, and a state's legislative act is not immune if it is intended to have commercial effect." There is also the problem that, regardless of the way in which a state structures its activity, the activity can always be said to be for a public purpose since a state is doing it<sup>6</sup>. In the *Frank* case, Antigua could argue that all of its actions in connection with Stanford were for the public purpose of developing the Antiguan economy. Individual decisions and actions may have been ill considered, but all were taken as a last resort for the greater public purpose of developing the Antiguan economy and pulling it out of the economic

slump caused by the hurricanes and global financial woes. The plaintiffs might counter that there cannot possibly be a public purpose when all of the dealings were only possible in the first place as a result of regulatory failure and the criminal acts of government officials, including *inter alia* the misappropriation of social security funds.

Ultimately, it is not possible to anticipate the outcome of these and other likely legal arguments in advance of their actual adjudication. It is possible, however, to draw a few systemic lessons from the Antiguan quagmire. First, any international financial centre that grows overly dependent on one, two or a limited number of powerful financial interests is making itself vulnerable to the kinds of arguments made by the *Frank* plaintiffs. In these circumstances, it will be easier for plaintiffs to argue that the offshore jurisdiction is not merely a host of the commercial activity of others, but has crossed the line and has become a participant for profit in its own right. Secondly, the international financial centres cannot legislate their own immunity from the jurisdiction of courts in the home countries of fraud victims. Offshore jurisdictions typically include in their

offshore legislation clauses that purport to immunise the financial regulator and the jurisdiction itself from liability for the claims of investors, depositors and others transacting with the financial institutions they regulate. There may be a choice of law argument or defence based on such clauses, but before that can be raised, the offshore jurisdiction will have to endure lengthy and costly litigation in US courts over jurisdictional issues, and very damaging publicity as all of the facts are aired. Finally, financial regulators must be insulated from political pressures if they are to have and exercise the kind of regulatory independence that can prevent Stanford-like Ponzi schemes from developing in the first place.

It is grotesquely ironic that Stanford and Antigua chose the game of cricket as their marketing edge. Cricket, with its many rules and gentle customs, has always been used as a symbol of fair play and honest dealing in commercial matters. It may have been exciting while this particular game lasted, but Antigua will spend years and a fortune trying to overcome the damage done to its reputation and economy by the Stanford scandal.

#### END NOTES:

1. For example, FSRC allegedly knew that whereas SIBL had represented to its depositors and investors that (i) the portfolio of assets backing the deposits and CDs consisted of well-diversified, marketable securities managed by professional third parties, when in fact more than half of the portfolio was invested in undisclosed "private equity real estate" and a substantial part of the remaining portfolio consisted of investments in speculative, unprofitable businesses controlled by Stanford, and (ii) SIBL did not engage in risky lending activity, when in fact it had made more than USD 1.6 billion in undisclosed and unsecured personal loans to Allen Stanford.
2. The allegations concerning Antigua's alleged wrongdoing contained in the preceding paragraphs and throughout this article have been extracted from the Complaint filed in the *Frank* case, and are not the allegations of the author of this article.
3. 28 U.S.C. § 1605(a)(2).
4. H. Lauterpacht, *The Problem of Jurisdictional Immunities of Foreign States*, 28 *Brit. Y. B. Int'l. L.* 220, 222-26 (1951); J.W. Dellapenna, *Suing Foreign Governments and Their Corporations*, p. 360 (Transnational Publishers, Inc., 2d Ed., 2003).
5. *Roumania v. Guaranty Trust Co.*, 250 F. 341 (2d Cir.), cert denied, 246 U.S. 663 (1918).
6. Dellapenna, at p. 361.