Linklaters

August 2011

Sovereign Immunity in Greater China.
Where do we go from here?

Introduction

In June 2011, the Hong Kong Court of Final Appeal ("**CFA**") handed down its judgment in *FG Hemisphere Associates LLC v. Democratic Republic of the Congo & Ors* FACV 5, 6 & 7 of 2010 (the "**Congo case**"). This judgment has aroused much debate and confusion in Hong Kong, as the CFA provisionally decided that, after the handover, sovereign States enjoy absolute immunity in the courts of Hong Kong which cannot be waived in pre-dispute contractual documents. When read together with the judgment of the Court of First Instance in *Intraline Resources Sdn Bhd v The Owners of the Ship or Vessel "Hua Tian Long"* [2010] 3 HKLRD 611 (the "**Intraline case**"), it would appear that the Hong Kong courts are absolutely debarred from entertaining any claim against a foreign State or the PRC state entities. These two cases have called into question whether a dispute resolution clause in favour of Hong Kong courts remains appropriate where the counterparty is a State or sovereign entity.

The Congo case

The Congo case concerns the enforcement of arbitration awards against the Democratic Republic of Congo ("**Congo**"). FG Hemisphere sought to apply for equitable execution in the Hong Kong courts against certain sums owed by Chinese state-owned enterprises to Congo, such that the sums owed to Congo would be paid directly to FG Hemisphere in satisfaction of Congo's liability under the arbitration awards. Congo sought to claim sovereign immunity in these enforcements proceedings.

By a three to two majority, the CFA held that Hong Kong cannot, as a matter of legal and constitutional principle, adhere to a doctrine of state immunity that is different to that adopted by the PRC. The CFA noted (albeit provisionally) that under Articles 13 and 19 of the Basic Law, issues of foreign affairs relating to Hong Kong fall within the responsibilities of the Central People's Government, and that the Hong Kong courts cannot make their own decisions over "acts of state", which term would include matters such as sovereign immunity. It being common ground among the parties that China's policy on state immunity is that of absolute immunity, the CFA concluded that a sovereign State also enjoys absolute immunity in the Hong Kong courts.

Contents

The judgment overturns the decision of the Court of Appeal who held that at the time of the handover in 1997, restrictive immunity applied in the absence of legislation to change the position. However, the CFA examined Legislative Council papers which showed there was an intentional decision not to apply UK legislation regarding state immunity at the time of the handover.

FG Hemisphere also argued that, even if Congo enjoys absolute immunity, such immunity has been waived by Congo by virtue of its agreeing to an arbitration clause. The CFA also held that an agreement to arbitrate does not constitute an express or implied submission to any other State's jurisdiction; it merely gives rise to a contractual obligation on the part of the foreign State to honour the terms of the arbitration agreement. Where a party seeks to enforce an arbitration award in the Hong Kong court against a foreign State, it must establish that the foreign State has waived both its jurisdictional immunity from suit and the immunity of its property from execution. Under common law, such waiver must be given to the court itself at the time when the court is asked to exercise jurisdiction over the foreign State. A contractual agreement to waive immunity entered into prior to the commencement of proceedings is not an effective waiver.

As noted above, the CFA considered a number of questions of interpretation regarding Articles 13 and 19 of the Basic Law. The majority expressed a provisional view on these questions, but found they were obliged to make a reference to the Standing Committee of the National People's Congress ("**SCNPC**") for a definitive interpretation. The appeal will be restored in the CFA once the SCNPC has issued its interpretation.

The Intraline case

In the Intraline case, the Guangdong Salvage Bureau ("**GZS**") sought to claim sovereign and Crown immunity in an effort to avoid proceeding to trial. The Court of First Instance held that:-

(a) Insofar as the PRC government is concerned, sovereign immunity does not apply in Hong Kong, the applicable immunity being Crown immunity.

(b) The common law principles with respect to Crown immunity survived the promulgation of the Crown Proceedings Ordinance (which applies only to the Hong Kong government) and the handover.

(c) The modern benchmark for the attribution of Crown immunity is the control test, which looks primarily to whether the entity in question is able to exercise independent powers of its own. Whether the entity is performing a State function (i.e. the function test) is one of the many factors to take into account when determining whether an entity is part of the Crown.

(d) The GZS is part of the Crown because of various reasons, including the following:-

    (i) The GZS is under the control of the Ministry of Communications ("**MOC**"), which in turn discharges a function

of the State. In particular, the GZS can only perform operations that are commissioned by the MOC, and operations commissioned by private clients but subject to a reporting obligation in relation to transactions which exceed RMB3 million.

(ii) The GZS only has the right to possess and use assets that are allocated to it.

(iii) The GZS has nil paid-up capital.

(iv) The GZS has no right to dispose of assets.

(v) The GZS has no ability to assume civil liabilities.

These characteristics are contrasted with state-owned enterprises in the PRC ("**SOEs**") which are established by the State-owned Assets Supervision Committee; enjoy independent management and freedom from interference; have ownership of assets; and have the capacity to assume civil liabilities.

(e) Crown immunity can be waived, the starting point being the common law principle of waiver in respect of sovereign immunity, i.e. it can only be waived in the face of the court and not by a prior contract to submit to the jurisdiction. As GZS actively participated in the proceedings with knowledge of its rights to claim some form of immunity, it has waived its Crown immunity.

Where do we go from here?

In essence, the Congo case (subject to the SCNPC's interpretation of the relevant provisions of the Basic Law) and the Intraline case established the following principles:-

(a) A sovereign State and the PRC government both enjoy absolute immunity before the courts of Hong Kong.

(b) An arbitration clause will be binding on a sovereign State, and because it is a contractual dispute resolution process, no issue of sovereign immunity from suit arises.

(c) To determine whether an entity is part of the Crown, the material consideration is the degree of control the Crown assumes over the entity. Other considerations include whether the entity performs a function of the Crown. Applying the control test, a SOE is not likely to be treated as part of the Crown.

(d) A waiver of immunity must be given to the Hong Kong court itself at the time the court is asked to exercise jurisdiction over the foreign State or the Crown, such that any pre-dispute contractual waiver or arbitration clause will not be recognised by the Hong Kong court as an effective waiver of immunity. On the other hand, active participation in the proceedings with knowledge of its right to claim immunity would be sufficient.

In the light of these principles, there is a legitimate concern that, where a counterparty is a foreign State or the PRC government, the Hong Kong courts may not be the best forum for any potential dispute. In considering the appropriate dispute resolution clause in a transaction involving a foreign State or the PRC government, the following might be borne in mind:-

1. An arbitration clause is effective and binding on the foreign State and may still be used. (Although the cases did not rule on this point, there is no reason why the same principle would not apply to the PRC government as well.) However, it should be noted that if and when the Hong Kong court is approached for interim relief pending / in support of the arbitration (which is more likely to be the case if, although not only if, the arbitration is seated in Hong Kong), the foreign State / the PRC government *may* have immunity from such proceedings. (This is a point that was not addressed in the Congo case and the Intraline case, as the issue did not arise.)

2. As an alternative to arbitration, the parties may consider agreeing to English courts jurisdiction in their contract with a foreign State or the PRC government. The UK State Immunity Act 1978 adopts the qualified immunity position and would allow English proceedings to be brought against a foreign State in respect of "commercial transactions" and only confers immunity from suit where the State is performing a sovereign function.

3. Whatever dispute resolution mechanism or jurisdiction is adopted in the contract, the issue of sovereign / Crown immunity may still arise at the enforcement stage if the assets of the foreign State / the PRC government are situated in Hong Kong, or where enforcement proceedings are brought in Hong Kong for any reason. In these circumstances, unless there is waiver of immunity in the face of the court, the Congo case / the Intraline case would present a currently insurmountable problem.

4. The above concerns probably do not arise if the counterparty is a SOE, which is neither a foreign State nor likely to be considered as part of the PRC government. (This is also consistent with the position in the PRC where, as a matter of PRC law, SOEs do not enjoy immunity and may be sued in the PRC courts.) However, given the fact-sensitive and subjective nature of the control test, each case must be considered on its own in determining whether the SOE concerned might enjoy Crown immunity in the Hong Kong courts.

5. The same comment applies to legal entities that have no connection with a foreign State. Unless such entity is carrying out a function of the State, it is not likely to be considered as / as part of the foreign State, and absolute sovereign immunity is not likely to be an issue.

Linklaters

Contacts

For further information please contact:

Marc Harvey
Partner

(+852) 2842 4122

marc.harvey@linklaters.com

Melvin Sng
Partner

(+852) 2901 5234

melvin.sng@linklaters.com

Tom Lidstrom
Partner

(+852) 2842 4108

tom.lidstrom@linklaters.com

10th Floor, Alexandra House

Chater Road

Hong Kong

Telephone
(+852) 2842 4888
Facsimile
(+852) 2810 8133/2810 1695

Linklaters.com

A13850053/0.5/24 Aug 2011