

# Alerts & Publications

## Foreign States “Absolutely Immune” from Suit in Hong Kong

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On 8 June 2011, Hong Kong’s Court of Final Appeal handed down a much anticipated decision in *The Democratic Republic of the Congo and others v FG Hemisphere Associates LLC*<sup>1</sup>. The key issues were whether (1) foreign States enjoyed a “restrictive” or ‘absolute’ immunity from suit in Hong Kong in respect of their commercial activities, and (2) whether the Hong Kong courts had jurisdiction to determine the doctrine of sovereign immunity which applies in Hong Kong, or needed to refer the matter to the Standing Committee of the National People’s Congress of the PRC (“SCNPC”).

The case has received international attention, due to both the important constitutional law questions it raises, and the commercial and political issues relating to the recovery of awards against a sovereign state.

In this alert, we briefly review the major legal issues in this case, and the potential ramifications.

## Background

The proceedings arose from an attempt by FG Hemisphere (“FGH”), a US distressed debt fund, to enforce two ICC arbitration awards (made in Paris and Zurich) in Hong Kong against the Democratic Republic of Congo (“DRC”) by attaching funds owed to the DRC by the PRC State-owned China Railway Group. The issues before the Court were:

1. whether the DRC enjoyed immunity from suit (i.e. sovereign immunity) in Hong Kong in respect of its commercial activities (i.e. whether the doctrine of *absolute* State immunity or *restrictive* State immunity was applicable in Hong Kong) and, in particular, whether Hong Kong could validly adhere to a doctrine of State immunity which was inconsistent with the doctrine adopted by the PRC;
2. whether the DRC had waived its immunity; and
3. what steps, if any, the Court should take in light of certain provisions of the Hong Kong Basic Law (“**Basic Law**”) which allocate responsibility for matters of foreign affairs to the Central People’s Government of the PRC (“CPG”) and restrict the Court’s jurisdiction in respect of such matters.

## Do Foreign States Enjoy an ‘Absolute’ or ‘Restrictive’ State Immunity from Suit in Hong Kong?

The 3 judges in the majority (Justices Chan PJ, Ribeiro PJ and Mason NPJ) (“**Majority**”) and the 2 judges in the minority (Justices Bokhary PJ and Mortimer NPJ) (“**Minority**”) all agreed that prior to the return of Hong Kong’s sovereignty to the PRC on 1 July 1997 (“**Handover**”), foreign states enjoyed only a *restrictive* immunity in Hong Kong. This *restrictive* immunity did not extend to immunity from suit in respect of their commercial activities.

However, the Majority and Minority differed in their views in the post-Handover environment. The Majority held that, post-Handover, foreign States have enjoyed an *absolute* immunity from suit in Hong Kong. They cited that the doctrine of *absolute* immunity has been consistently applied by the PRC in its dealings with foreign States. Therefore, as an inalienable part of China, Hong Kong cannot adhere to a doctrine of State immunity which deviates from that applied by the PRC. The Majority noted the doctrine of State immunity concerns relations between States (rather than regions or municipalities) and only the State can decide the scope of such an immunity.

Within the PRC, this power remains with the executive. The Majority took pains to summarize a number of letters from the Office of the Commissioner of the Ministry of Foreign Affairs of China in Hong Kong (the “**OCMFA**”) to show that, the principle of *absolute* immunity has been consistently applied by the PRC in its relations with other sovereign States. For that reason, the Majority made a preliminary determination that the DRC enjoyed immunity from suit in Hong Kong in respect of both its governmental and commercial activities.

In reaching that conclusion, the Court rejected FGH’s arguments that (1) leaving such matters to the executive would run the risk of unprincipled decisions based on political expediency, and (2) and that the acceptance of *absolute* immunity as practiced in the PRC would be regressive. It noted that such arguments ignore the fundamental issue, which is whether the HKSAR can validly adopt a legal doctrine of state immunity which is inconsistent with the doctrine adopted by China. It also noted that it is not the place of the Court to express its opinion about the appropriateness of PRC policy and rejected FGH’s argument that such a position would be a threat to judicial independence.

## Waiver

Having decided that the DRC enjoyed an *absolute* immunity from suit in Hong Kong, the Majority next considered whether the DRC had waived this immunity by agreeing to submit the disputes to arbitration and/or by signing terms of reference in the arbitration which were drafted on the footing that both parties would carry out the award without delay.

The Majority held that, although it is possible for a State to waive its *absolute* immunity, the DRC had not done so in this case. At common law, a party seeking to enforce an arbitration award against a foreign State must establish a waiver at two distinct stages – a waiver of its immunity *from suit* in the forum State (i.e. Hong Kong) and a waiver of the immunity of its property *from execution* by the forum State’s processes. In this case, the Majority took a narrow view, finding that the DRC’s agreement to arbitrate the dispute could not be deemed an implied waiver of its immunity *from suit* because the suit in question was not the arbitration itself, but rather the proceedings commenced by FGH in Hong Kong seeking leave to enforce the award in Hong Kong. The Majority considered that such a waiver could only occur closer to the time upon which the proceedings were commenced in Hong Kong.

## The Application of the Basic Law

Having found that there had been no waiver of State immunity by the DRC, the Court took the view that it could not decide the case without making a formal ruling on whether the doctrine of *absolute* immunity or *restrictive* immunity applied in Hong Kong. However, the Majority reasoned that a determination of this question was a matter of foreign affairs, the responsibility for which was reserved for the CPG under Article 13 of the Basic Law. Given that the Court had no jurisdiction over such matters under Article 19 of the Basic Law, the Majority found that it was under a duty pursuant to Article 158(3) of the Basic Law to refer the issue to the SCNPC. On that basis, the findings of the Court were stated to be provisional.

## The Minority View

Unsurprisingly, given the issues in dispute, both judges in the Minority handed down forceful and reasoned judgments setting out their views on the key issues. In summary, the Minority found that:

- whether the immunity available in the courts of Hong Kong is *restrictive* or *absolute* is a matter of Hong Kong common law, not a matter of foreign affairs, meaning that the issue could be decided by the Hong Kong judiciary pursuant to Article 19(2) of the Basic Law without reference to the SCNPC. In this respect, the position had not changed post-Handover - prior to that date, the courts in Hong Kong could not determine matters of foreign affairs, yet had considered which doctrine of State immunity applied in Hong Kong on numerous occasions;
- the doctrine of *restrictive* immunity continues to apply in Hong Kong post-Handover, it being more consonant with justice that individuals having commercial transactions with states be entitled to bring such transactions before the courts;
- the transactions in question are commercial in nature and, consequently the DRC has no immunity from suit in the courts of Hong Kong; and
- in any event, by agreeing to submit disputes to arbitration and by signing terms of reference which were drafted on the footing that both parties would carry out the award without delay, the DRC had waived any immunity which it had under the law of Hong Kong.

## Comments and Ramifications

At first glance, the judgment might be considered quite conservative in that the Majority decided to 'play it safe' and refer the matter to the SCNPC. However, upon closer inspection, the decision seems to have turned on the key issue of whether the determination of the doctrine of State immunity to be applied in Hong Kong was a matter of foreign affairs to be determined by the State, or a matter of common law to be determined by the courts. Having determined that the matter was a policy issue concerning relations between States, the Majority was left with little option but to refer the matter to the SCNPC.

The Majority view could be criticised for failing to adequately protect the rights of individuals to bring suits against government entities with which they had agreed to do business, or for failing to take a commercial approach in determining whether immunity had been waived. The Minority had pointed out the possibility of an unfair situation whereby a State initially agrees to participate in an arbitration, which inevitably incurs costs for both parties, only to rely on its immunity to prevent enforcement of an award.

Nevertheless, given the OCMFA's view that the State immunity regime adopted by the PRC should apply to Hong Kong, it is likely that the SCNPC will confirm the interpretation of the Basic Law adopted by the Majority. If so, the most obvious ramification of the Court's decision is that awards obtained against foreign states are unlikely to be enforceable in Hong Kong unless there is a clear waiver of the foreign State's immunity at the time proceedings are commenced.

Longer term, express 'waivers of immunity from suit' covering such proceedings might be negotiated at the time of entering into contracts with State-owned entities. However this is of little comfort for parties currently engaging in business with such entities in Hong Kong who had perhaps entered into such contracts on the assumption that the State-owned entities would be unable to assert immunity in respect of the commercial activities being undertaken.

1. (FACV No. 5, 6&7 of 2010)