One Country, One Immunity: Hong Kong Court of Final Appeal Holds Foreign States Have Absolute Sovereign Immunity

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In our June 2010 edition of Stay Current, we discussed the Hong Kong Court of Appeal’s decision in *FG Hemisphere Associates LLC v. Democratic Republic of Congo*, in which the Court of Appeal held that, while China continues to follow the absolute approach to sovereign immunity, its failure to impose its immunity doctrine on Hong Kong through legislation justified a finding that the common law restrictive immunity doctrine, which had been developed prior to the 1997 transformation of Hong Kong from a British overseas territory to a special administrative region of the People’s Republic of China, continued to apply in Hong Kong. The decision was appealed to the Hong Kong Court of Final Appeal.

On June 8, 2011, the Hong Kong Court of Final Appeal, in a 3-2 split, reversed that ruling and held that foreign states enjoy absolute immunity from suit in Hong Kong and that no exception from immunity for commercial activity or arbitration matters exists. The majority held that absent an explicit and unequivocal waiver of immunity—manifested by a voluntary submission to the jurisdiction of the forum state—a Hong Kong court cannot exercise jurisdiction over a foreign state. This long-awaited and significant decision aligns Hong Kong common law regarding immunity with the laws of the People’s Republic of China and, in so doing, discards a key component of pre-handover jurisprudence. Though *FG Hemisphere* resolved the split between the competing immunity doctrines, the resolution will undoubtedly engender concern for corporations and individuals doing or considering doing business with a foreign nation and/or from financing such undertakings in Hong Kong, as well as lead companies making foreign investments (particularly in Asia) to consider the suitability of Hong Kong as a potential forum for investor-state arbitrations, since the Court’s ruling will make it virtually impossible to seek judicial assistance in aid of arbitration against foreign states in Hong Kong.

Despite the Court of Final Appeals’ ruling, one more step remains before the decision becomes final. The Court, for the first time since China’s 1997 assumption of sovereignty over Hong Kong, referred its ruling to the Standing Committee of the National People’s Congress for an interpretation of several key provisions of the Basic Law, the organic statute that defines Hong Kong’s relationship with China. Pursuant to the Basic Law, the Court has a duty to refer to the Standing Committee questions of interpretation which implicate affairs that are the responsibility of the People’s Republic of China or concern the relationship between the People’s Republic and Hong Kong. The Standing Committee’s interpretation of the provisions will be final and binding on the court.
The Dispute

The case arose from FG Hemisphere’s attempt to enforce two arbitration awards against the Congolese government in Hong Kong. The Democratic Republic of Congo entered into credit agreements with FG Hemisphere’s predecessor to finance the construction of a hydroelectric facility and high-tension electric transmission lines in the Congo. Construction was completed; however, Congo ultimately defaulted on their repayment obligations.

Pursuant to the arbitration clause contained in the credit agreement, FG Hemisphere referred its claims against Congo to arbitration. The arbitration clause contained language that specifically called for the parties to waive their right to any form of recourse against the arbitration award. Two arbitrations ensued; Congo did not participate in either and substantial default judgments were rendered in both. FG Hemisphere unsuccessfully sought repayment from the Congolese government and thereafter filed suit in Hong Kong, among other places, to enforce the award.

The Democratic Republic of Congo claimed that the enforcement action was barred by the doctrine of sovereign immunity. While the majority of nations (including the United States) have abandoned the doctrine of absolute sovereign immunity (in which a state is considered to be immune from jurisdiction regardless of the subject matter of a cause of action against it) in favor of restrictive sovereign immunity (in which states retain their immunity for acts that are consistent with their status as sovereigns, but not for commercial acts), the People’s Republic of China has continued to apply the doctrine of absolutely immunity. In essence, the Congolese government was seeking to extend the doctrine of absolute immunity to cases against foreign nations in Hong Kong.

FG Hemisphere responded to these arguments by pointing to the common law of Hong Kong, which, prior to 1997, had embraced a restrictive approach to sovereign immunity insofar as it contained a commercial exception. Since the common law continued to be enforced after the handover and since no legislation instructing Hong Kong courts to apply absolute immunity was ever adopted, FG Hemisphere argued that restrictive immunity should be scope of sovereign immunity applied by the Hong Kong courts.

Absolute or Restrictive Immunity?

One of the foundations of Hong Kong’s post-1997 legal system is an organic statute known as the Basic Law, which defines Hong Kong’s status as a special administrative region of the People’s Republic. Specifically, the Basic Law confers upon Hong Kong a high degree of autonomy, independent legislative and judicial powers subject to certain restrictions regarding foreign affairs and defense, the ability to retain a market-based economic system, and the authority to continue to enforce the common law developed prior to 1997.

Prior to the 1997 handover, the restrictive immunity doctrine had become well-established in Hong Kong’s common law. The emergence and application of restrictive immunity in the Hong Kong common law can be traced back to a series of decisions beginning in the early twentieth century, culminating in *Trendtex Trading Corporation v. Central Bank of Nigeria* [1977] 1 QB 529 and eventually codified in the United Kingdom’s State Immunity Act of 1978. As noted above, however, the People’s Republic of China has resisted the global trend toward abandoning absolute immunity, and has consistently held that foreign states are absolutely immune from suit. FG Hemisphere presented the question of whether this conflict between the doctrines of state immunity followed by Hong Kong and the People’s Republic was reconcilable under the Basic Law. The Court of Final Appeal concluded that it was not.

The Court opened its analysis by noting that that it is the province of the executive to determine how states are to treat other states, and that such a determination must be adhered to by the entire territory over which the executive exercises jurisdiction. Permitting
otherwise, the Court held, "would embarrass and prejudice the State in its conduct of foreign affairs"\(^4\). Thus, since "China has consistently adhered to the doctrine that a state and its property enjoy absolute immunity from jurisdiction and from execution"\(^5\) the Court concluded that Hong Kong must similarly adhere to that doctrine.

The Court then turned to the Basic Law, which sets forth and governs, among other things, the relationship between Hong Kong common law and the laws of the PRC. Article 13 establishes that the Central People’s Government has exclusive control over the foreign affairs of Hong Kong. Moreover, Article 19(3) removes from the Hong Kong courts jurisdiction “over acts of state such as defence and foreign affairs”.\(^6\) Having previously proclaimed that state immunity is unquestionably related to foreign affairs, the majority concluded that they are “bound to respect and act in conformity” with the decisions of the Central Government regarding the treatment of foreign States.\(^7\)

**Waiver**

Irrespective of the Court’s decision on the scope of immunity, FG Hemisphere also promulgated the argument that the Democratic Republic of Congo, by agreeing to the arbitration provisions in the credit agreement, had impliedly waived its state immunity defense. Agreements by states to arbitrate disputes are typically considered implicit waivers of immunity with respect to claims encompassed by the arbitration agreement, since the ability to enforce an arbitration award judicially is considered an essential element to an effective and enforceable arbitration award.\(^8\) The Court rejected this argument, holding that an agreement to submit claims to arbitration is not tantamount to the submission to another State’s jurisdiction and thus does not constitute a waiver. Rather, the Court of Final Appeal held that any waiver of immunity must be explicit in order to be effective. According to the Court of Final Appeal, a state waives immunity “by voluntarily submitting to the exercise of jurisdiction by the courts of the forum State over the waiving State’s governmental entities or property.”\(^9\) Thus, waiver must be explicit, either through language or conduct, and occur after the dispute has arisen.

**Conclusions**

As noted above, while the Hong Kong Court of Final Appeal is the court of last resort in Hong Kong, its ruling will not be the final word in this case. No doubt considering the weighty impact of its decision and the significant effect it may have on Hong Kong’s status as a global center for finance and arbitration, and noting interpretative ambiguities within the Basic Law, the Court submitted several questions to the National People’s Congress Standing Committee, which has the authority to overrule the decision. Specifically, these questions concern the interpretation of Article 13 and Article 19, and therefore are central to the Court’s holding. The Court, realizing the existence of these questions, stated that their decision is provisional pending receipt of the Standing Committee’s interpretation. This marks the first time since the 1997 handover that the Court of Final Appeal has submitted questions to the Standing Committee.

If the decision is left undisturbed by the Standing Committee, the Court of Final Appeal’s decision could have significant ramifications for companies and individuals doing or seeking to do business with a foreign state. At the very least, the decision is likely to discourage companies considering entering into commercial agreements with foreign states from designating Hong Kong – a major Asian legal center whose courts have an excellent reputation for enforcing arbitral awards – as an arbitral seat, since there would be no way to obtain judicial assistance in aid of any arbitral proceeding. The decision may also have impacts on Hong Kong’s financial industry, as parties engaged in projects with foreign states may seek to establish project accounts (which often serve as an important source of security in major project finance agreements, since project accounts may be attached in aid of local judgments) outside of Hong Kong. For their part, foreign investors concerned about states’
invocation of absolute immunity may seek alternative forms of security, and states are likely to encounter significant business pressure to waive their immunity, lest they gain a reputation (as Congo, partially as a result of this case and several others in which it has refused to pay arbitral awards and resulting judgments) as unacceptably risky business partners.10

1 Chris Jalian, a summer associate in the firm’s New York office, assisted in the preparation of this newsletter.
2 [2009] 43 CACV.
3 See, e.g., Samantar v. Yousuf, 130 S.Ct. 2278, 2284-86 (2010) (explaining that prior to 1952, the State Department followed a general practice of requesting immunity in all actions against friendly sovereigns, but in that year the Department announced its adoption of the “restrictive” theory of sovereign immunity, which provided that “immunity is confined to suits involving the foreign sovereign’s public acts, and does not extend to cases arising out of a foreign state’s strictly commercial acts”). For a fuller discussion of the sovereign immunity doctrine, see James E. Berger & Charlene C. Sun, Sovereign Immunity: A Venerable Concept in Transition?, International Litigation Quarterly, Spring 2011, at 1.
5 Id. at ¶ 260.
6 Id. at ¶ 339.
7 Id. at ¶ 324.
8 See, e.g., 28 U.S.C. § 1605(a)(6)(A)-(B) (“arbitration exception” under the U.S. Foreign Sovereign Immunities Act, providing that no state shall be immune from jurisdiction in respect of an action “either to enforce an agreement made by the foreign state with or for the benefit of a private party to submit to arbitration all or any differences which have arisen or which may arise between the parties with respect to a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration under the laws of the United States, or to confirm an award made pursuant to such an agreement to arbitrate” if the “arbitration takes place or is intended to take place in the United States,” or “the agreement or award is or may be governed by a treaty or other international agreement in force for the United States calling for the recognition and enforcement of arbitral awards”).
10 Notably, the Court’s decision did not address the immunity of state-owned companies or instrumentalities, leaving some uncertainty about whether such entities – which frequently engage in business on behalf of a state – are entitled to the absolute immunity that the Court held applies to states. Many states, including the United States, afford state instrumentalities the same basic immunity as applies to states themselves, subject to certain exceptions. See, e.g., U.S. Foreign Sovereign Immunities Act, 28 U.S.C. § 1602(a) (defining “foreign state” to include states themselves, as well as their organs and instrumentalities). It will remain to be seen whether state-owned enterprises will, in the wake of FG Hemisphere, seek absolute immunity and if so, whether the courts will find that they are entitled to that immunity. In this connection we note that the Hong Kong courts have already held that Chinese state-owned companies are not entitled to claim immunity from suit in Hong Kong, on the ground that Hong Kong and the People’s Republic of China are not separate states. SDN BHD V the Owners of the Hua Tian Long, [2008] HCAJ 59.