



FILLING THE STATE IMMUNITY LACUNA IN HONG KONG: THE CONGO CASE

In mid-2008, a Delaware company called FG Hemisphere Associates LLC (“FG Hemisphere”) commenced proceedings in Hong Kong to enforce two arbitration awards (“Awards”) against the Democratic Republic of Congo (“DRC”) and obtained an injunction freezing US\$104 million that was purportedly destined to be paid to the DRC. This triggered a complex legal debate over the extent to which the Hong Kong court has jurisdiction over foreign states in respect of lawsuits and enforcement proceedings arising out of commercial contracts between the foreign state and a non-state party.

The central issue in the proceedings was whether the regime of state immunity applicable in Hong Kong today is one of “restrictive” immunity, as was the case prior to Hong Kong’s return to the People’s Republic of China (“PRC”) on 1 July 1997 (“the Handover”), or whether it is one of “absolute” immunity in line with the regime adhered to by the Central People’s Government (“CPG”). If the former, FG Hemisphere could potentially proceed to enforce the Awards in

Hong Kong. If the latter, DRC’s assets in Hong Kong were immune from execution.

Although successful in persuading Hong Kong’s Court of First Instance (“CFI”) and subsequently the Court of Appeal (“CA”) that the doctrine of restrictive state immunity had survived the Handover, FG Hemisphere was forced to retreat back to Delaware empty-handed following a “provisional” judgment delivered by Hong Kong’s Court of Final Appeal (“CFA”) on 8 June 2011. The CFA reversed the CA’s decision and held that the “one country, two systems” principle did not extend to the doctrine of state immunity.

BACKGROUND OF STATE IMMUNITY

A fundamental tenet of customary international law is that all states are equal. A corollary of this is that the acts and property of a state are immune from the territorial jurisdiction of the courts of another state. Up until the mid-20th century, this immunity was absolute

in that there was no exception, save where the foreign state had expressly waived its immunity and consented to being subject to the jurisdiction of the foreign court.

With the increase in international trade following the Second World War, and with states increasingly entering into commercial transactions with non-state foreign parties, it became apparent that the doctrine of absolute state immunity was not only unfair to the non-state party to the commercial transaction, but that it was deterring companies from entering into commercial relationships with foreign states. A number of states in the developed world, therefore, began to allow a so-called “commercial exception” to the doctrine of absolute state immunity, thus preventing a foreign state from being able to avoid its legal obligations by invoking the defence of state immunity. This “commercial exception” gave rise to what is commonly referred to as the doctrine of restrictive state immunity.

Many states that adopted the doctrine of restrictive state immunity regulated it by statute in order to depoliticize determinations on state immunity. In the UK, the commercial exception was enshrined in the State Immunity Act 1978 (“SIA”).

Notwithstanding widespread acceptance of the doctrine of restrictive immunity by developed states, a large number of developing states, including the PRC and the DRC, nonetheless continued to adhere to the doctrine of absolute state immunity. The doctrine of restrictive state immunity therefore falls short of having obtained sufficient acceptance by states to have become part of customary international law.

THE STATE IMMUNITY LACUNA CREATED BY THE HANDOVER

The SIA was applied to Hong Kong in 1979 and continued to apply up until the Handover. No state immunity legislation was enacted to replace the SIA following the Handover. Moreover, the Basic Law was silent on the issue of state immunity. In view of this, it was unclear as to whether the doctrine of restrictive state immunity continued to apply in accordance with the common law situation, or whether Hong Kong had reverted back to a regime of absolute state immunity, as had always been the case in the PRC.

SUMMARY OF THE FACTS IN THE CONGO CASE

The Awards related to disputes arising out of credit agreements associated with power projects dating back to the 1980s, under which Energoinvest, a Yugoslavian power provider, had provided financing to the Republic of Zaire (as the DRC was then called) to develop its power infrastructure. The DRC defaulted on its payments. In April 2003, Evergoinvest invoked the arbitration clauses in the credit agreements and, following international arbitration proceedings held in France and Switzerland under the ICC rules, obtained the Awards. The DRC did not participate in the arbitrations.

FG Hemisphere, whose principal business is in investing in distressed assets, purchased Evergoinvest’s interest in the Awards in 2004 (presumably at a substantial discount) and has subsequently attempted to enforce the Awards in a number of jurisdictions around the world.

On 15 May 2008, FG Hemisphere obtained an *ex parte* order from the Hong Kong Court granting leave to enforce the Awards against the DRC and, at the same time, was granted an injunction freezing US\$104 million held by the China Railway Group of companies. According to FG Hemisphere, the US\$104 million was destined to be paid to the DRC pursuant to an agreement between the PRC and the DRC under which the PRC had agreed to finance and build extensive infrastructure in the DRC in return for the rights to exploit copper and cobalt reserves in the DRC.

The Secretary for Justice joined in the proceedings in the capacity of an “intervener” on the grounds of public interest.

DECISION OF THE CFI

In the CFI, Reyes J decided that, regardless of whether state immunity in Hong Kong is absolute or restrictive, FG Hemisphere was not entitled to enforce the Awards by executing against the US\$104 million payable by the China Railway Group to the DRC because the transaction to which the monies related was, in effect, a cooperative venture driven by governments as opposed to private entities and could not be characterized as a commercial transaction that fell within the contemplation of the restrictive approach.

Reyes J did nonetheless venture to express an arbiter opinion on the issue of state immunity in Hong Kong, opining that, following the Handover, the common law as it had developed prior to the extension of the SIA to Hong Kong was revived and continued to apply. Thus, in his view, Hong Kong continued to be subject to a regime of restrictive state immunity.

DECISION OF THE CA

The CA disagreed with Reyes J's reasoning and held that, in deciding whether or not the payments from China Railway to the DRC are available for execution, it is necessary to look at the use for which the payments will be used, not the transaction to which they relate. Since there was evidence that the payments were to be used for a commercial purpose, this issue should be remitted to the CFI for determination.

On the broader issue of state immunity, the CA held by a 2–1 majority (Hon Stock VP and Yuan JA in the majority with Yeung JA dissenting) that, following the Handover, state immunity in Hong Kong reverted back to the common law position, which was one of restrictive immunity. In arriving at this decision, the CA was persuaded by the fact that no action has been taken to fill the lacuna left by the lapse of the SIA and, given that Hong Kong is a centre of international commerce, a reversal from restrictive state immunity to absolute state immunity could not simply be implied. The majority of the CA were also of the view that, since a claim for state immunity is not in itself “an act of state”, it is not inconsistent with article 19 of the Basic Law to have one country and two systems of state immunity.

The CA accepted that the situation in the Mainland of China is one of absolute state immunity. However, the majority were of the view that adopting a restrictive approach in Hong Kong does not cause prejudice or embarrassment to the PRC's sovereignty.

In his dissenting opinion, Yeung JA opined that there is no room for “two systems” on the issue of state immunity and that the position and practice of the PRC is of paramount and overriding importance. In his view, therefore, state immunity in Hong Kong changed from being restrictive to absolute following the Handover.

DECISION OF THE CFA

The CFA held, by a 3–2 majority (Chan PJ, Ribeiro PJ, and Sir Anthony Mason in the majority with Bokhary PJ and Mortimer NPJ dissenting), that as a matter of legal and constitutional principle, it is not open for Hong Kong to adopt a different regime of state immunity to that practiced by the CPG. The CFA reasoned that state immunity is, by its very nature, a doctrine concerned with the relations between states and as such is a matter of policy to be determined by the executive. The executive may permit the legislature to take over this responsibility (as is the case in the UK and USA); however, in the absence of such delegation, the executive and the courts should “speak with one voice”.

The CFA noted that there was nothing in the common law jurisprudence to support an argument that a region that forms part of a unitary state can disregard the policy of executive and establish its own practice on state immunity. The CFA also noted that it was accepted by all parties to the proceedings that Hong Kong lacks the attributes of a state and could not claim immunity for itself in the courts of a foreign state—such state immunity would have to be claimed by the PRC.

The CFA considered three letters from the Office of the Commissioner of the Ministry of Foreign Affairs (“OCMFA”), two of which had been placed before the lower courts in the previous hearings. These letters essentially set out the PRC's policy and practice as regard to state immunity. The CFA considered that the letters were to be treated as establishing “facts which are peculiarly within the cognizance of the Executive” and rejected the suggestion that the letters sought to dictate to the Hong Kong courts how state immunity cases should be decided. In view of these letters, the CFA accepted that the PRC had consistently adhered to the doctrine of absolute state immunity. Accordingly, the practice of state immunity that applied in Hong Kong was held to be one of absolute immunity.

The CFA considered in detail the relevant provisions of the Basic Law and concluded that the Basic Law fully supported the view that the CPG was responsible for determining Hong Kong's policy on state immunity. In particular, Article 13 of the Basic Law expressly reserves the conduct of foreign affairs to the CPG. Furthermore, papers from the Legislative Council

(not previously adduced at the hearing before the CA) made it clear that a proposed bill tabled in December 1996, which sought to localize many of the provisions of the SIA, had been rejected by the CPG over concerns to retain the commercial exception to absolute immunity. This fact was very damaging to FG Hemisphere's argument that since no local legislation on the issue of state immunity had been enacted pursuant to Article 18(3) of the Basic Law, it must have been intended that the restrictive approach under common law would prevail in Hong Kong following the Handover.

The dissenting minority of the CFA were essentially of the same mind as the majority in the CA: that the state immunity regime in Hong Kong following Handover had reverted back to the common law position of restrictive state immunity

REFERENCE TO THE STANDING COMMITTEE OF THE NATIONAL PEOPLE'S CONGRESS

Notwithstanding having made its own interpretation of the Basic Law, the CFA felt compelled to refer certain questions of interpretation to the Standing Committee of the National People's Congress ("SCNPC") under Article 158 of the Basic Law. This is the first time since the Handover that the CFA has taken this step. The judgment of the CFA is therefore "provisional", pending the response from the SCNPC.

COMMENTARY

The Congo case uncovered a lacuna that was created in Hong Kong's state immunity laws following the Handover, thus sparking an in-depth legal analysis of the nature of state immunity and its application in Hong Kong in the face of the one country, two systems principle. The one country, one system of state immunity arguments prevailed, and the lacuna has been filled, albeit subject to endorsement by the SCNPC. Given the position of the CPG as set out in the OCMFA letters, however, the interpretation of the SCNPC is highly unlikely to disturb the decision of the CFA.

The judgment will be welcomed by the DRC and other debt-ridden states. They know that Hong Kong is now a safe haven through which they can transfer their assets without fear of them being snatched by so-called "vulture funds" recovering bad debts. The judgment will also be welcomed by the CPG, which feels that allowing foreign states to be impleaded in Hong Kong would undoubtedly prejudice the sovereignty of China and hamper normal intercourse and cooperation with other states.

The CFA judgment in the Congo case followed closely in the wake of Hong Kong's new Arbitration Ordinance, which came into effect on 1 June 2011 and was widely applauded for promoting Hong Kong as an international arbitration centre. The Congo case highlights that, regardless of how arbitration-friendly the new legislation may be, it has its limits when it comes to enforcing awards against foreign states. It also highlights the need for parties, when contracting directly with foreign states, to not only obtain a waiver of state immunity in respect of suit, but also to get an express waiver to submit to any enforcement proceedings that may subsequently follow.

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