State Immunity in Post-Handover Hong Kong

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Under the “restrictive” rule of state immunity, a sovereign state is not immune in respect of the jurisdiction of the courts, or from the processes of execution, for its commercial activities. In England, the rule now takes statutory form in the guise of the State Immunity Act of 1978 (SIA) but its application in the Hong Kong Special Administrative Region (HKSAR) has been uncertain following Hong Kong’s handover to the People’s Republic of China (PRC). The SIA was extended to colonial Hong Kong by the State Immunity (Overseas Territories) Order of 1979 but lapsed at midnight on July 1, 1997. Unlike the United Kingdom, the PRC adopts a theory of “absolute” sovereign immunity instead, but has never sought to extend that position to the HKSAR by legislation. It is debatable whether the HKSAR could have enacted its own legislation, since the Basic Law (BL) states that Beijing is responsible for “foreign affairs”, and that the HKSAR courts “shall have no jurisdiction over acts of state such as defence and foreign affairs”. In the latter case, such “questions of fact concerning acts of state” are also subject to certification by the Chief Executive, who shall, first, obtain Beijing’s approval.

In 2004, Energoinvest, a Yugoslavian company, assigned to FG Hemisphere (FG), a Delaware company with its place of business in New York, the benefit of two ICC arbitral awards issued in Switzerland and France against the Democratic Republic of Congo (DRC). The awards concerned a dispute over certain credit agreements entered into between Energoinvest and the DRC’s Société National d’Électricité in the 1980s, regarding the construction of a hydro-electric facility and high-end electric transmission lines (hereafter, “financing agreements”). In unrelated events, the China Railway Group acquired certain mining rights in the DRC sometime in 2008 for which they were to pay entry fees in return (hereafter, “mineral agreements”). The plaintiff, FG, somehow became aware of the China Railway Group’s recent mineral agreements and sought satisfaction of the ICC
awards by way of their enforcement in Hong Kong followed by execution against
the entry fees payable to the DRC by the China Railway Group: *FG Hemisphere

By a majority decision (Stock V.-P and Yuen J.A.), the Court of Appeal of
Hong Kong has upheld the restrictive immunity rule at common law. Reversing
Reyes J. in the court below ([2009] 1 H.K.L.R.D. 410), the Court of Appeal applied
two separate tests. Immunity from suit would depend upon a determination of the
commercial nature of the financing agreements originally entered into between
Energoinvest and the DRC, whereas immunity from execution would depend upon
the commercial use or intended use by the DRC of the fees imposed upon the
China Railway Group. A sovereign state can also waive its immunity, but it is in
this respect that the Court of Appeal’s acceptance of the restrictive rule became
critical, since the DRC’s submission to arbitration in its dispute with Energoinvest
was held to amount neither to a waiver of immunity from suit nor from execution.
Reyes J. had considered that, at best, submission to arbitration amounts to a waiver
of immunity from suit, but the Court of Appeal took a different view. Had the
Court of Appeal gone on to reject a restrictive theory of immunity, its jurisdiction
would have been precluded, and the entry fees payable to the DRC by the China
Railway Group would also have been immune from execution.

The Court of Appeal’s treatment of the waiver issue will be addressed before
dealing with its acceptance of the restrictive immunity rule at common law.

While some authorities suggest that submission to arbitration amounts to a
waiver of immunity from both suit and execution, the Court of Appeal considered
the current position to be highly unsettled. Stock V.-P considered the view that
submission to arbitration amounts to waiver of immunity from suit and execution
largely to have been the product of statutory intervention. This leaves the HKSAR’s
obligation to recognise and enforce foreign arbitral awards under the New York
Convention of 1958 (NY Convention), and the court proceeded to discuss *Creighton
Ltd v Government of the State of Qatar* 181 F.3d 118 (DC Cir. 1999) which closely
resembles the facts of the present case. There an ICC arbitral award issued in a
state party to the NY Convention was unsuccessfully sought to be enforced in
another state party, namely the United States. As with the DRC in the present case,
the foreign state in *Creighton* against which the award was sought to be enforced
was also not a party to the Convention. In the present case, Switzerland, France
and the HKSAR are all parties to the NY Convention but—following Creighton
on this point—both Stock V.-P and Yuen J.A. refused to read Art.III of the NY
Convention to mean that the HKSAR has an obligation to treat the DRC’s
submission to arbitration as a waiver of immunity where the DRC is not a party
to that Convention. To do otherwise would amount to a violation of the *pacta
tertiis* rule (that a treaty is not binding upon non-parties).

Turning to the application of a restrictive immunity rule, this requires a two-part
analysis. The first part addresses immunity from suit, and the second part addresses
immunity from execution. Regarding the first part, immunity from suit, it is the
“nature of the relevant act” which matters (“nature” test), not its purpose or
underlying motive. Reyes J. had considered that, if he had been required to express
“a provisional view”, he would have preferred applying the restrictive rule of
immunity but that the issue was moot since the DRC’s mining agreements with
the China Railway Group constituted a sovereign act (*acta jure imperii*). Reversing Reyes J., Yuen J.A. would look instead to the DRC’s actions which had been the subject of the ICC awards—i.e. the nature of the original financing agreements between Energoinvest and the DRC, as opposed to the unrelated mineral agreements between the China Railway Group and the DRC—and found that the financing agreements involved commercial acts (*acta jure gestionis*) of the DRC. This view must be correct, since enforcement of the ICC awards concerns immunity from suit. The nature of the DRC’s actions in entering into the mineral agreements with the China Railway Group does not even come into it.

As for immunity from execution, which does relate to the monies payable under the mineral agreements, the Court of Appeal explained that, unlike immunity from suit, this stage does not require the determination of the nature of any act (namely, the DRC’s actions in entering into the mineral agreements for which entry fees became payable). Instead, a different formulation and application of the restrictive immunity rule is required. According to the Vice-President and Yuen J.A., once it is established that the entry fees were owed to the DRC, immunity would turn on their use or intended use by the DRC for some commercial purpose (i.e. a “purpose” test). Some readers might recall that, in England, the origin of this rule lies in s.13(4) of the SIA, which also applies the purpose test during the execution stage (H. Fox, *The Law of State Immunity*, 2nd edn (2008), at p.296). Why Reyes J. did not address this second question is a puzzle, once we accept that applying the restrictive rule could have removed immunity from execution where he had considered a submission to arbitration probably sufficient to waive immunity from suit. The learned judge either assumed that the nature test applied equally to the execution stage, or by a more subtle confusion upheld the absolute theory at the execution stage despite a stated preference for the restrictive theory.

Applying the purpose test to the entry fees, Yuen J.A. divided the monies into two tranches, one of which, arguably, had been earmarked for sovereign use (the “budget tranche”) and the other for commercial use. The DRC would enjoy no immunity from execution in respect of the latter tranche. The Court of Appeal’s reasoning recalls s.13(4) of the SIA but is notably sparse when we consider that *Alcon v Columbia* [1984] A.C. 580 HL might still have something to say about the difficulty of dividing “mixed accounts” according to the use or intended use of separate “tranches”. That point seems not to have been argued. Nonetheless, the Court of Appeal’s meaning is clear—the common law has evolved, independently of the UK Act, to embrace the restrictive rule: *Trendex Trading Corp v Central Bank of Nigeria* [1977] Q.B. 529 CA per Lord Denning M.R.; affirmed in *Holland v Lampen-Wolfe* [2000] 1 W.L.R. 1573 HL per Lord Millett.

Finally, there was the DRC’s argument that these are foreign affairs matters and that Hong Kong’s courts are precluded from inquiring into “acts of state” (Basic Law, arts 13, 19). Stock V.-P. considered that the present case neither involves an act of the PRC nor of any foreign state. The Court of Appeal had skillfully avoided contradicting the PRC’s position under national (i.e. PRC) or international law by finding the PRC’s adherence to a rule of absolute immunity to be valid despite its finding that the restrictive rule is a rule of customary international law, and is therefore a part of the common law by virtue of the automatic incorporation of customary international law into the common law: as held in *Trendex* per Lord
Denning M.R. and Shaw L.J. The court did so by finding that the PRC had, for its part, consistently and persistently objected to the emergent customary international law rule of restrictive immunity. Managing in this way to preserve the distinction between the application of the common law in Hong Kong and the mainland legal system, Stock V.-P. and Yuen J.A. went on to confirm the contents of two letters from Beijing stating that the PRC adheres to the rule of absolute immunity, and considered that if the PRC wished to extend the absolute immunity rule to the HKSAR, it could easily do so by legislation.

The magnitude of Chinese ventures in Africa today is well known, while more generally, enterprises using Hong Kong for their financial and other operations who wish to do business with sovereigns in default of their private law obligations should now engage in more rigorous due diligence. There will be acute concern amongst those sovereigns and enterprises seeking the protection of absolute immunity for such transactions and operations, and for monies and other assets located in Hong Kong. Some have asked whether Beijing’s Standing Committee of the National People’s Congress (NPCSC) should issue a “final interpretation” under art.158 of the Basic Law, overruling the Court of Appeal’s decision. To date, Beijing has done so only in relation to the right of abode controversy, the pace of democratic reform in Hong Kong, and the term of office of the Chief Executive. A conversant reading of the Court of Appeal’s judgment suggests that such intervention would lack legal purpose. Currently, Beijing preserves its position, Hong Kong preserves the common law, and Beijing could always have and may yet turn to simple legislation. Leave has since been granted to appeal to Hong Kong’s Court of Final Appeal, but on all these fronts, the Court of Appeal’s judgment is unassailable.

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DE FACTO DIRECTORS

THE facts of Revenue and Customs Commissioners v Holland [2010] UKSC 51 (“Paycheck”) lent themselves to a reassertion of Chancery orthodoxy on the subject of de facto directors. The majority of the Supreme Court largely obliged, finding that the eponymous Mr Holland was not a de facto director. It is only because we have become so conditioned to viewing creditors as victims, whatever the circumstances, that the result might cause some surprise.

The case involved an old-fashioned breach of trust; in particular, the breach of trust that arises when company directors pay, or recommend the payment of, dividends when there are not profits to meet them. The form of action brought by the Revenue on the company’s behalf to deal with this wrong was also a 19th century one, in its current guise of s.212 of the Insolvency Act 1986. Liability on directors for a breach of trust of this sort is traditionally strict (or, at least, no quarter is given to fiduciaries in comprehending the scope of their duties). This was a point on which Lord Hope of Craighead, one of the majority, agreed with the minority, although he did not need to rule on it since he had already concluded that Mr Holland was not a director, de facto or de jure (Lord Collins of Mapesbury