

Lessons Learned from the
FG Hemisphere vs DRC and Huatianlong Case

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1. The case of *FG Hemisphere Associates LLC v. Democratic of the Congo & Ors*³ has attracted discussions on the national policy and practice of state immunity and its relationship or impact, if any, on international arbitration.

2. This paper will first set out the findings and reasoning in the court judgments in the case of *FG Hemisphere*. A review of the relationship of state immunity and international arbitration and enforcement proceedings will be conducted together with a discussion on whether the entities of “state owned enterprise” registered under the laws of the People’s Republic of China (“the PRC”) can assert and enjoy immunity.

Brief facts of the *FG Hemisphere* case

3. In the 1980s, a Yugoslave company, Energoinvest, entered into contracts to construct a hydro-electric facility and high-tension electric

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³ The citations of the decisions are: [2009] 1 HKLRD 410 (Court of First Instance), [2010] 2 HKLRD 66 (Court of Appeal) and FACV 5-7/2010 (Court of Final Appeal).

transmission lines in Democratic Republic of the Congo (“the DRC”). In connection with these contracts the DRC entered upon certain credit agreements with Energoinvest whereby Energoinvest provided to the DRC, through the intermediary of the latter Société Nationale d’Eletricité, a substantial percentage of the cost of the work. The credit agreements incorporated the ICC arbitration clauses. The DRC defaulted on its repayment obligations.

4. There followed two arbitrations, one in Switzerland, the other in France. They culminated in two final awards dated 30 April 2003 in favour of Energoinvest against the DRC and Société Nationale d’Eletricité in the sum of US\$11,725,844.96 and US\$18,430,555.47 plus interest (“**the Awards**”).
5. By an Assignment dated 16 November 2004, Energoinvest’s interest in the Awards was transferred to FG Hemisphere. By the time the Hong Kong Court of Final Appeal heard the appeal, the DRC remained indebted to FG Hemisphere in the sum of US\$125,924,407.72 by way of principal and interest.
6. In a separate transaction, the DRC entered into a cooperation agreement with, *inter alios*, China Railway Group Limited (the 5th defendant in the proceedings). Pursuant to the cooperation agreement, a joint venture agreement was entered into between a Congolese state-owned mining company La Generale des Carriers et des Mines, a Mr G K Banika and a Chinese consortium. This Chinese consortium included the subsidiaries of China Railway Group Limited (the 2nd-4th defendants in the proceedings). Under the joint venture agreement, which would come into effect upon the satisfaction of certain conditions precedent, the China

Railway group of companies would pay US\$221 million as part of the entry fees for a mining project in the DRC (“**the Entry Fees**”).

7. FG Hemisphere claimed the Entry Fees constituted monies payable to the DRC and sought to enforce the Awards against the DRC by executing against part of the monies alleged to be due to the DRC as Entry Fees.

Summary of the *FG Hemisphere* case

8. On 15 May 2008, FG Hemisphere obtained an *ex parte* Order from the Court of First Instance to enforce the Awards as a judgment of the HKSAR court and enjoined the China Railway Group from paying US\$104 million out of the Entry Fees to the DRC.
9. The DRC applied to set aside the Order on grounds, amongst others, that it enjoyed state immunity and the courts of the HKSAR did not have jurisdiction to adjudicate the claims of FG Hemisphere against the DRC.
10. It is to be noted that the China Railway Group was dragged into the proceedings because by the Order it was restrained from paying the Entry Fees. At no stage of the proceedings had the China Railway Group Limited and its subsidiaries asserted any immunity.
11. The fundamental question to be determined, as framed by the majority of the Court of Final Appeal, is first what is the doctrine of state immunity practised in the PRC, and secondly whether, after the PRC’s resumption of the exercise of sovereignty over Hong Kong on 1 July

1997, it is open to the courts of the HKSAR to adopt a legal doctrine of state immunity which recognizes a commercial exception to absolute immunity and therefore a doctrine on state immunity which is different from the principled policy practised by the PRC.

I. The Court of First Instance ([2009] 1 HKLRD 410)

12. At the beginning both FG Hemisphere and the DRC relied on Section 6 of the International Organisations and Diplomatic Privileges Ordinance (Cap. 190) (“**IODPO**”), which provides that “*the international custom relating to the immunities and privileges as to person, property or servants of sovereigns, diplomatic agents, or the representatives of foreign powers for the time being recognized by the People’s Republic of China shall, in so far as the same is applicable mutatis mutandis have effect in Hong Kong*”.
13. The Secretary for Justice, which was allowed to intervene, argued that IODPO was irrelevant and FG Hemisphere upon reflection also disavowed reliance thereon. The Court accepted that IODPO did not concern state immunity.
14. The Secretary for Justice referred the Court to the PRC’s position, which was expressed in the letter issued by the Office of the Commissioner of the Ministry of Foreign Affairs (“**the OCMFA**”) of the PRC dated 20 November 2008 (“**the 1st Letter**”), in which it was stated that “[t]he consistent and principled position of China is that a state and its property shall, in foreign courts, enjoy absolute immunity, including absolute immunity from jurisdiction and from execution, and has never

applied the so-called principle or theory of ‘restrictive immunity’.”

15. In respect of the PRC’s position, the Court found itself “at a loss” on how the stance stated in the 1st Letter was to be reconciled with the PRC’s signing of the 2004 United Nations Convention on Jurisdictional Immunities of States and Their Property (“**the 2004 UN Convention**”).⁴
16. The Court considered that even if restrictive immunity was to apply, the relevant act, which the Court identified to be the contracts giving rise to the Entry Fees, was not a purely commercial transaction within the contemplation of the restrictive approach. Rather, it held that the relevant act was “*more the hallmarks of the exercise by states of sovereign authority in the interests of their citizens*”.
17. The Court therefore held that the DRC was entitled to, and had not waived, state immunity and the Court had no jurisdiction over it.

II. The Court of Appeal ([2010] 2 HKLRD 66)

18. At the hearing of the Court of Appeal, the OCMFA issued the second letter addressing the CFI’s query and explaining the PRC’s signature of the Convention was to express support to the coordination efforts made by international community in harmonising international relations. It is further stated that unless and until the PRC ratified the Convention and the Convention entering into force, the PRC was not bound by the

⁴ The 2004 UN Convention shall not be in force until the thirtieth day following the thirtieth state delivering the instrument of ratification, acceptance, approval or accession. To date, 28 states have signed the said Convention, of which 13 states have ratified, accepted, approved or acceded to the same.

Convention and it could not be the basis of assessing the PRC's principled position on state immunity.

19. The Court of Appeal unanimously held that the practice of state immunity applicable to the PRC was of absolute immunity.

20. Yeung JA, the dissenting judge, held that “[w]hen it comes to foreign affairs of which state immunity is one aspect, there is simply no room for ‘two systems’ at all” and that “Hong Kong SAR courts, having regard to the provisions of the Basic Law, should not adopt a legal position concerning state immunity incompatible with the position of the PRC.” Accordingly, the learned Judge held that the absolutist approach of state immunity, as practised by the PRC, applies to the HKSAR.

21. Stock VP, who delivered the leading majority judgment (save for one aspect), gave a detailed analysis as to the relationship between the HKSAR and the PRC on state immunity:

- (1) After 1 July 1997, the law in Hong Kong on state immunity was to be determined by reference to the common law;
- (2) For a practice to constitute a rule of customary international law, what is required is not only that the practice is a settled and generally accepted one but also a belief on the part of States that the practice is obligatory as a matter of law;
- (3) Customary international law becomes part of the common law by reason of the doctrine of incorporation and only if it is not in conflict with domestic laws: e.g. *C v Director of Immigration*

[2008] 2 HKC 165, *R v. Jones (Margaret)* [2007] 1 AC 136;

- (4) The generality of States have subscribed to the doctrine of restrictive immunity⁵, and the common law of Hong Kong immediately prior to 1 July 1997 recognised the doctrine of restrictive immunity;
- (5) The constitutional and societal setting of Hong Kong has been changed after 1 July 1997 because Hong Kong is no longer a dependent territory of the sovereign power of the United Kingdom that had abandoned the doctrine of absolute immunity but is rather “an inalienable part of the PRC”.⁶ In matters touching upon sovereignty, there is precedent for the approach that the courts and the executive should speak with one voice;
- (6) The Court must have close regard to the PRC’s attitude to the doctrine of absolute and restrictive immunity, a duty emphasized in the Basic Law, in particular, Article 13⁷;

⁵ See e.g. Sir Ian Brownlie’s preliminary report to the International Law Commission “*Contemporary Problems Concerning the Jurisdictional Immunity of States*”; *Oppenheim’s International Law*, Vol. 1 at pp. 357, 360 and 361; Fox, *The Law of State Immunity*, 2nd ed. (2008) at pp.235-236; and Harris, *Cases and Materials on International Law* 6th ed., (2004) at p. 307.

⁶ See *A Solicitor (24/07) v. Law Society of Hong Kong* (2008) 11 HKCFAR 117 where the Hong Kong Court of Final Appeal held that whilst it was still the greatest importance that Hong Kong courts should derive assistance from overseas jurisprudence. However, after 1 after 1 July 1997, the decisions of the House of Lords and Privy Council, whilst should be treated with great respect, their persuasive effect would depend on all relevant circumstances, including in particular, the nature of the issue and the similarity of any relevant statutory or constitutional provision.

⁷ Articles 1, 12 and 13 of the Basic Law provides:

Article 1

“The Hong Kong Special Administrative Region is an inalienable part of the People’s Republic of China.”

Article 12

(7) The PRC's persistent objection to the restrictive doctrine was consistent and unequivocal, and hence the PRC is not bound by the restrictive doctrine. The PRC's being a signatory to the UN Convention (but pending ratification) and/or acceding to certain international treaties is not to be taken as an abandonment of its stance

22. Pausing here, in the light of Stock VP's analysis summarised above, one would have thought that on the law of state immunity Hong Kong should follow the consistent and principled position of the PRC, namely the absolutist approach.

23. The majority of the Court (based on Yuen JA's judgment to which Stock VP agreed) however went further to consider whether two conflicting doctrines of state immunity could co-exist within a state (in this case the PRC) and held that the continued application of the restrictive immunity in the HKSAR in consonant with it being an international financial centre and that it would neither cause prejudice or embarrassment to the PRC nor undermine the PRC's persistent objection

"The Hong Kong Special Administrative Region shall be a local administrative region of the People's Republic of China, which shall enjoy a high degree of autonomy and come directly under the Central People's Government."

Article 13

"The Central People's Government shall be responsible for the foreign affairs relating to the Hong Kong Special Administrative Region.

The Ministry of Foreign Affairs of the People's Republic of China shall establish an office in Hong Kong to deal with foreign affairs.

The Central People's Government authorizes the Hong Kong Special Administrative Region to conduct relevant external affairs on its own in accordance with this Law."

to restrictive doctrine. The Court of Appeal, by majority, therefore held that the restrictive doctrine continued to apply in the HKSAR notwithstanding the holding of the absolutist position of the PRC.

24. The Court of Appeal, by majority, held:

- (1) that no prejudice or embarrassment would cause to the PRC for the HKSAR to practice restrictive doctrine of state immunity notwithstanding the PRC practicing absolute immunity;
- (2) that the DRC had not waived immunity before HKSAR courts by entering into an arbitration agreement providing for ICC arbitration (see below for more details);
- (3) that at the immunity from suit stage, the relevant act to be considered is the contracts giving rise to the arbitrations, which were held to be *acta jure gestionis*; and
- (4) hence, that the DRC could not assert immunity from suit.

III. The Court of Final Appeal (FACV 5-7/2010)

25. At the hearing before the Court of Final Appeal, the OCMFA issued the third letter rebutting the Court of Appeal's suggestion that adoption of a divergent policy on state immunity by the HKSAR would cause no prejudice or embarrassment to the PRC.

26. At the Court of Final Appeal, there was no real contention that the PRC practices an absolutist approach. The main contention of FG Hemisphere was after the UK State Immunity Act 1978 ceased to apply in Hong Kong, the common law revived and applied to the HKSAR. FG Hemisphere referred to English cases such as *Trendtex Trading Corporation Ltd v Central Bank of Nigeria* [1978] 1 QB 529, *Re I Congreso Del Partido* [1983] 1 AC 244 and *Holland v. Lampen-Wolfe* [2000] 1 WLR 1573 and contended that the common law of the HKSAR had incorporated the doctrine of restrictive immunity. In the premises, it urged that the majority decision of the Court of Appeal should be upheld.

27. The Court of Final, by majority (3:2) allowed the appeal and held:

- (1) Conferring or withholding of state immunity is a matter which concerns relations between states, forming an important component in the conduct of a nation's foreign affairs in relation to other states: e.g. *Duff Development Co. Ltd. v. Government of Kelantan* [1924] AC 797, also *Mighell v. Sultan of Johore* [1894] 1 QBD 149;
- (2) In determining which branch of the government is responsible for laying down the State's policies on state immunity, the answer must depend on that State's own constitutional allocation of powers;
- (3) Where constitutional responsibility for the conduct of foreign affairs is allotted to the executive, and where the courts accepts a "one voice" principle, there is no reason to exclude that approach in relation to the executive's policy

regarding the recognition or non-recognition of a commercial exception to absolute state immunity: e.g. *Duff Development Co. Ltd. (supra)*, *Rio Tinto Zinc Corporation v Westinghouse Electric Corporation* [1978] AC 547 (UK), *Republic of Mexico v. Hoffman* (1945) 324 US 30, *United States v Lee* 106 U.S. 209; and *Ex parte Peru* 318 U.S. 588 (USA);

- (4) In the case of the HKSAR, it lacks the very attributes of sovereignty which might enable a State or province to establish its own policy or practice of state immunity, independently of the policy or practice of the State of which it forms part: e.g. *Favour Mind Ltd. v. Pacific Shores Inc. & Ors* (98 Civ 7038);
- (5) It is self-evident that any attempt by such a region or municipality to adopt a divergent state immunity policy would embarrass and prejudice the State in its conduct of foreign affairs;
- (6) Different from the United Kingdom, which has no written constitution and hence has left to its courts to determine the proper allocation of constitutional responsibilities, the constitutional allocation of powers in the HKSAR has been set out in the Basic Law;
- (7) The high degree of autonomy to be enjoyed by the HKSAR does not encompass the conduct of foreign affairs or defence. Article 13 of the Basic Law provides that the Central

People’s Government (“CPG”) shall be responsible for the foreign affairs relating to the HKSAR, and the determination by the CPG of the relevant rule of state immunity to be applied in the HKSAR is properly viewed as an “act of state such as...foreign affairs” within Article 19(3) of the Basic Law⁸.

28. In the premises, the majority of the Court of Final Appeal came to the view that the HKSAR could not, as a matter of legal and constitutional principle, adhere to a doctrine of state immunity which differed from that adopted by the PRC. The doctrine of state immunity practised in the HKSAR, as in the rest of the PRC, was accordingly a doctrine of absolute immunity;

29. The above view, which the majority of the Court held to be tentative and provisional, was confirmed by the Standing Committee of the National People’s Congress (“**the Standing Committee**”) upon judicial reference made in accordance with Article 158(3) of the Basic Law⁹.

⁸ Article 19(3) of the Basic Law provides:

“The courts of the Hong Kong Special Administrative Region shall have no jurisdiction over acts of state such as defence and foreign affairs. The courts of the Region shall obtain a certificate from the Chief Executive on questions of fact concerning acts of state such as defence and foreign affairs whenever such questions arise in the adjudication of cases. This certificate shall be binding on the courts. Before issuing such a certificate, the Chief Executive shall obtain a certifying document from the Central People’s Government.”

⁹ Article 158(3) of the Basic Law provides:

“The courts of the Hong Kong Special Administrative Region may also interpret other provisions of this Law in adjudicating cases. However, if the courts of the Region, in adjudicating cases, need to interpret the provisions of this Law concerning affairs which are the responsibility of the Central People’s Government, or concerning the relationship between the Central Authorities and the Region, and if such interpretation will affect the judgments on the cases, the courts of the Region shall, before making their final judgments which are not appealable, seek an interpretation of the relevant provisions from the Standing Committee of the National People’s Congress through the Court of Final Appeal of the Region. When the Standing Committee makes an interpretation of the provisions concerned, the courts of the Region, in applying those provisions, shall follow the

Hence, the Court held that the courts of the HKSAR did not have jurisdiction over the DRC.

IV. Summary

30. Enforcement proceedings involve a two-staged approach, the “recognition stage” and the “execution stage”.¹⁰ The relevant state immunity that is under consideration would be that of immunity from suit as it is the *lex fori*’s jurisdiction over a foreign state that is under consideration. When it comes to execution, in the sense of seizing assets of foreign states, the issue of immunity from execution would arise. This two-staged approach is well established and the court's role, once jurisdiction is established, is to "mechanically" convert the orders of the arbitral tribunal set out in the award into a court judgment.¹¹

31. Under Article III of the Convention, the enforcing court applies its national rules of procedures in dealing with the enforcement proceedings. As a result, when Convention awards are sought to be enforced in Hong Kong the procedures laid down in Order 73 of the Rules of High Court become applicable and the applicable laws of state immunity would be applied in considering whether or not the court has jurisdiction over a

interpretation of the Standing Committee. However, judgments previously rendered shall not be affected.”

¹⁰ See *Shandong Hongri Acron Chemical Joint Stock Co. Ltd. v. Petrochina International (Hong Kong) Corporation Ltd.* [2011] 4 HKLRD 604 (CA) *per* Cheung CJHC at paragraph 11, referring to the Court of Final Appeal’s judgment in the *FG Hemisphere* case at paragraphs 382-383

¹¹ See *Gater Assets Ltd. v. NAK Naftogaz Ukrainiy* [2007] 2 Lloyd’s LR 588 (CA) *per* Rix LJ at paragraph 59; and *Norsk Hydro Asa v. State Property Fund of Ukraine & Ors* [2002] EWHC 2120 (Comm) *per* Gross J. at paragraphs 17-19. This line of cases was adopted by Reyes J. in *Xiamen Xinjingdi Group Ltd. v. Eton Properties Ltd.* [2008] 4 HKLRD 972 and affirmed on appeal: [2009] 4 HKLRD 353.

foreign state.

32. The courts in Hong Kong exercise its jurisdiction to consider what the applicable laws of state immunity are and concluded that it is absolute immunity. This is comparable to the Kompetenz-Kompetence principle. If, for instance, the practice of the state of the PRC has become one of restrictive immunity, then the courts of Hong Kong would have jurisdiction over foreign states. It is unfortunate that commentators have commented that the Hong Kong court has surrendered its jurisdiction in this matter when in fact it is exercising its jurisdiction to look at the laws in coming to the conclusion that it has no jurisdiction over foreign states.
33. The decisions in *FG Hemisphere* did not consider the question of the seat of the arbitration.
34. Neither did the courts in *FG Hemisphere* consider the question of the supervisory jurisdiction of the courts of Hong Kong over parties to an arbitration seated in Hong Kong.

International Arbitration

35. Article 1(3) of the UNCITRAL Model Law lays down the universally adopted definition of international arbitration:

“An arbitration is international if:

- (a) the parties to an arbitration agreement have, at the time of the conclusion of that agreement, their places of business in different States; or

(b) one of the following places is situated outside the State in which the parties have their places of business:

(i) the place of arbitration if determined in, or pursuant to, the arbitration agreement;

(ii) any place where a substantial part of the obligations of the commercial relationship is to be performed or the place with which the subject-matter of the dispute is most closely connected;

or

(c) the parties have expressly agreed that the subject matter of the arbitration agreement relates to more than one country.”

36. This definition lays a firm and clear rule for distinguishing domestic and international arbitrations in Model law jurisdictions that maintain the two regimes of arbitrations.¹² There can be no doubt that this definition does not adequately describe the true nature, ambit and complexities of international arbitration.

37. The New York Convention (“the Convention”) provides a “constitutional” framework by which international arbitration is fortified. It makes a distinction between international and domestic arbitration providing that only the former would qualify for the protection under its provisions. Article I of the Convention provides:

“This Convention shall apply to the recognition and enforcement of arbitral awards made in the territory of a State other than the State where the recognition and enforcement of such awards are sought, and

¹² E.g. Singapore has two regimes, domestic arbitrations governed by the Arbitration Act, and international arbitrations governed by the International Arbitration Act.

arising out of differences between persons, whether physical or legal. It shall also apply to arbitral awards not considered as domestic awards in the State where their recognition and enforcement are sought.”

It leaves it to the states that have acceded to the Convention to decide what domestic arbitration is, respecting the state’s autonomy on the extent to which it submits to the jurisdiction under the Convention.

38. By Article III it further expressly recognises and respects the enforcing state’s national rules of procedure, stating:

“Each Contracting State shall recognize arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon, under the conditions laid down in the following articles. There shall not be imposed substantially more onerous conditions or higher fees or charges on the recognition or enforcement of arbitral awards to which this Convention applies than are imposed on the recognition or enforcement of domestic arbitral awards.”

39. Yet neither of these vitally important instruments on its own fully and fairly lays the legal foundation for international arbitration. The wide ambit and the diversity of the variants in international arbitration can be discerned from many nationalities of the arbitrators, the parties and their legal representatives, the difference in the relevance and interpretations of the *lex arbitri* and the substantive laws governing the contract or the capacity of the parties, the cross-over of private and public international law, the jurisdictions in which enforcement proceedings may take place and hence the invocation of unknown number of the national laws, are

but some of the common features in international arbitration.

Seat of arbitration

40. Concepts such as the seat of the arbitration have always attracted much discussion and debates on the development of the law of the seat and the rules and operation of the arbitral institutions located in such jurisdictions.
41. The national arbitration laws of a seat are based primarily on statutes and in common law jurisdictions, also case law. Proponents for the “territorial” theory that national laws being the only legal order for international arbitration may contend that no other laws or order would govern or underpin this social institution that has played an important role in resolving international commercial disputes.
42. Is that view too restrictive? Does it truly give a proper jurisprudential basis for the legality, efficacy and authority of international arbitration?
43. National arbitration laws no doubt govern and dictate the conduct of the process, the source of powers of arbitral tribunals when arbitrating in the seat and the role of the supervisory courts. But it is submitted that other features may underpin the legality and efficacy of international arbitration: the Convention and arguably the system of “norms” that have manifested through practice by those who voluntarily opt out of national courts and into international arbitration.
44. International arbitration could not have been in the ascend purely by reason of it being a territorial institution, as it might once thought to be.

Its characteristics, legality and efficacy do not flow solely from the seat being fixed as jurisdiction A or B no matter how perfect its national arbitration laws may be. It is not just the national laws of the seat nor the rules of any national arbitration institution that give international arbitration its ultimate authority.

45. The potential fallacy of the pure territorialist's view may be gleaned from reviewing how the final and binding effect of an award manifests itself internationally. Enforcement proceedings of international arbitration are typically not confined to the place of arbitration. Whilst most national laws and rules still provide the contractual basis for one to sue on an award on the basis of a breach of implied terms¹³ it may not be adequate if the action has to be brought through enforcement proceedings in courts of a foreign state other than the seat. The backing to an award from the *lex arbitri* or the institutional rules may not always be adequate to impose the enforceability of an award upon a foreign court, in reality an unknown number of foreign courts in states where assets of a losing party may be found. These *fori* may have different procedures and laws applicable in the enforcement proceedings.

46. The international conventions, the Geneva Convention and later the Convention provide for a summary procedure in place of an otherwise lengthy and may even be a tortuous route for the winning party to enjoy the fruits of arbitration. The Convention gives the efficacy and actual (not merely theoretical) binding effect (not just the theoretical legality) to awards rendered in many states.

¹³ See e.g. *Bremer Oeltransport GmbH v. Drewry* [1933] 1 KB 753; *Bloemen v. Gold Coast City Council* [1973] AC 115

47. The Convention may therefore be regarded as the “constitutional” framework for international arbitration. Where voluntary compliance of awards fails, recognition and enforcement of awards are and remain the national prerogative of the judiciary or government and of the national laws as the Convention clearly assumes in its provisions:

- (1) the national definition of domestic arbitration agreement (Article I),
- (2) the enforcing forum’s own rules of procedures (Article III);
- (3) the enforcing forum’s entitlement to apply its own laws on issues of public policy and arbitrability (Article V(2)); and
- (4) Arguably even arbitration practice of the *lex arbitri* or the institutional rules may be ignored when the award is subject to the fundamental principle of due process.¹⁴

48. It also appears that the enforcing court may also apply laws different from that determined by the arbitral tribunal in deciding the validity of the arbitration agreement. By way of example, the case of *Dallah Real Estate and Tourism Holding Company v Ministry of Religious Affairs, Government of Pakistan*¹⁵ decided by the Court of Appeal of England in 2009 illustrates the point. In that case, the Saudi company brought an ICC

¹⁴ See e.g. *Paklito Investment Ltd. v. Klockner East Asia Ltd.* [1993] 2 HKLR 39 (CA); *Shandong Hongri Acron Chemical Joint Stock Co. Ltd. v. Petrochina International (Hong Kong) Corporation Ltd.* [2011] 4 HKLRD 604

¹⁵ [2010] 1 All ER 592

arbitration against a Pakistan trust which has been dissolved after entering into the contract. The claimant contends that the state of Pakistan is the *de facto* respondent and that issue was to be decided under Saudi Arabian laws. Pakistan contended that it should be decided by Pakistan laws. The seat was in Paris. The Tribunal chaired by Lord Mustill decided that the applicable law governing that issue is “*those transnational general principles and usages which reflect the fundamental requirements of justice in international trade and the concept of good faith in business*”¹⁶. The award was brought before the English courts for enforcement and as the validity of the arbitration clause was, according to the Convention to be decided in accordance with the laws of the seat of arbitration, the English court embarked upon an exercise to ascertain what the French law was quite despite what the arbitral tribunal itself applied.

49. As to the other potential factor fortifying this institution of international arbitration, it may be said to be norms, not theoretical analysis or abstract principles of law, but those which the international arbitration community have expressed through practice and considered as “binding”. It is not suggested that an over-arching legal order divorced from all national laws can be the sole basis of the institution of international arbitration. The need to at least identify the supervisory jurisdiction and the means of recourse available to challenge an award are good reasons why the seat and hence that national laws must form part of the legal order.

50. Hans Kelsen’s theory that law is made of norms, and all norms are

¹⁶ At paragraph 24 of the Court of Appeal’s judgment

made according to procedures described by higher norms, probably remains applicable in most legal systems whereby the constitution defines its “sources of law”, written or unwritten. International arbitration is clearly not a national legal system. It exists on the principle of *pacta sunt servanda* to serve the international business as a form of dispute settlement ousting the jurisdiction of the national courts. It relies on national laws and treaties adopted by states for its procedural and substantive rules of arbitration. Such laws often afford party autonomy a primary role in defining the broad scope of operation in international arbitration provided such autonomy does not vitiate the relevant principles or rules of public policy.

51. So is the choice of the legal seat of the arbitration as pivotal or fundamental to international arbitration as the territorialists once thought it to be?
52. The convergence of the rules of various national arbitration institutions and national laws such as the increasing number of states adopting the UNCITRAL Model Law may well have the effect of reducing the importance of the seat.
53. It must be repeated that the choice of the seat remains important, at least for ascertaining the proper supervisory jurisdiction and therefore the available recourse against an award.¹⁷ .

¹⁷ See: English Arbitration Act provides for leave to appeal on points of law; Hong Kong Arbitration Ordinance provides only for annulment proceedings in accordance with Article 34 of the UNCITRAL Model Law; Singapore Arbitration Act provides for leave to appeal for domestic arbitration and its International Arbitration Act provides for annulment proceedings for its international arbitration.

54. In dealing with the concept and legal significance of the arbitral seat, Gary Born concludes that¹⁸ “...[i]ndeed, as discussed below, even ardent proponents of ‘a-national’ or ‘de-localised’ arbitrations regard the possibility of a de-localised arbitral award as exceptional, with the law of the arbitral seat ordinarily and presumptively playing a central role in defining the legal framework for international arbitral proceedings.¹⁹ In particular, whatever the ultimate validity of particular mandatory requirements of the law of the arbitral seat, these requirements will almost always have a profound practical impact on the course of an arbitration and the parties’ conduct - with arbitral institutions, arbitrators and parties almost always seeking means to comply with the mandatory requirements of the arbitral seat.”²⁰

55. The concept of the seat gives the international arbitration and awards the fundamental legality. The Convention and the system of norms recognised and adopted by the international arbitration community, it is submitted, give international arbitration its full efficacy and authority.

56. Irrespective of the seat, the enforcing courts will apply its own rules of procedures to enforce a Convention award. The efficacy of an award is therefore not so much affected by its seat but by the application of the rules of procedures of the enforcing jurisdictions. Awards that may be viewed as law-compliant and valid may still not be enforced if it, for

¹⁸ See *International Commercial Arbitration Volume I*, Gary B. Born, Kluwer Law International, pp 1304

¹⁹ Referring to *inter alia* papers from Paulsson, *Delocalisation of International Commercial Arbitration: When and Why It Matters* 32 Int'l & Comp. LQ 53, 57-58 (1983), but see also Paulsson's lecture in London School of Economics on 30 November 2009 on “Arbitration's Fluid Universe”.

²⁰ The reference was made to Jan Paulsson's paper prior to the promulgation of the UNCITRAL Model Law. See Jan Paulsson's lecture to the LSE on 30 Nov 2009 on “Arbitration's Fluid Universe”.

instance, breaches due process as understood by the international arbitration community.²¹

State immunity in international arbitration?

57. Can a state claim and be granted immunity by arbitral tribunals?

State immunity is a doctrine that relates to affairs between states: whether a home state, be it through its executive or judiciary, may grant immunity to a foreign state when it is sued in its courts. Only a state can assert and grant state immunity. A state party may assert immunity before an arbitral tribunal but an arbitral tribunal is not a national court and has no relationship with any states. The arbitrators are not state organs and it is submitted that they cannot grant state immunity to any state party. This is true, it is submitted, if the proper ambit and nature of state immunity, a matter of foreign affairs, is properly understood. Nothing in the *FG Hemisphere* case suggests that a state party to an arbitration agreement will be or can be afforded state immunity in an arbitration. The power of granting state immunity simply is not vested in arbitral tribunals.

58. On this, it is noted that the authors of *Comparative International Commercial Arbitration* (2003) said at paragraph 27-39:

“The defence of immunity from jurisdiction has been raised in arbitration as well as in national courts acting in support of arbitration. Concerning the jurisdiction of the arbitration tribunal, the private nature of arbitration raises the question whether the doctrine of sovereign immunity applies at all. It is primarily

²¹ See footnote 14

directed against the exercise of a sovereign power of one state over another state.”

59. Can a state resile from its agreement to arbitrate based on its own domestic laws? Should the national laws of that state or the system of norms that underlies international arbitration prevail? These are different questions pertaining to state immunity. They in substance relate to the national laws of the state party governing its capacity to arbitrate and the authority of the signatory to bind the state.²²

60. Jan Paulsson in his paper *May a state invoke its internal law to repudiate consent to international commercial arbitration?*²³ stated:

“The prevailing view is that it would be contrary to fundamental principles of good faith for a State party to an international contract, having freely accepted an arbitration clause, later to invoke its own legislation as grounds for contesting the validity of its agreement to arbitrate. This principle of good faith has been applied by international arbitrators S. and in character the norm perceived without reference to any specific national law.” .

61. States are regarded as having submitted to the jurisdiction of the arbitral tribunal through the arbitration agreements they entered into or in the case of compulsory arbitration through treaties entered into between states. The bilateral investment treaties (BITs) providing for ICSID

²² See e.g. *SPP v. Egyptian Tourist Organisation (EGOTH)*, Award of 11 March 1983, IX YB CA 111 (1984) 115 and the ensuing French decisions Cour d’ Appeal Paris, *The Arab Republic of Egypt v. SPP* 23 ILM 1048 (1984); Interim Award in ICC case No. 7263 XXII YB CA 92 at 100 (1997)

²³ (1986) 2 Arbitration International pp90-103

arbitration is a classic example of the latter.

62. In the context of BITs arbitrations involving states, the treaties provide the basis by which a state is bound. In the context of international commercial arbitrations, it is submitted that the jurisdiction of tribunals over state party is premised on party autonomy.

63. International arbitrations involving states should not be affected by the law and practice of state immunity adopted by national courts of the seat. The concept of state immunity applies when a foreign state is impleaded in the courts of a home-state. Immunity is pleaded and granted before and by the national courts, not arbitral tribunals.

64. It is submitted that confusion or concerns created by suggesting that the *FG Hemisphere* case affects the choice of HKSAR as a seat of arbitration is therefore misconceived or unfounded. The *FG Hemisphere* case will have an impact on enforcement before the HKSAR courts. But the same rule of absolute immunity will apply irrespective of the seat of arbitration.

Supervisory Jurisdiction

65. There may be concerns on whether the national courts of the seat can have jurisdiction over a state which has submitted to the jurisdiction of an arbitral tribunal seated in that jurisdiction. Views from the learned authors cited below may provide some assistance on this issue:

At paragraphs 27-42 of *Comparative International Commercial Arbitration* (2003):

“If one considers the arbitration agreement to be a waiver of immunity the answers to all these questions depend on its interpretation. The extent of this waiver is determined by the actual or imputed will of the parties. Only in very exceptional circumstances can it be assumed that the waiver is limited to the proceedings before the arbitration tribunal. In all other cases the waiver could also cover the court proceedings necessary for a proper and efficient conduct of an arbitration. If no court assistance was possible for reasons of sovereign immunity the state could easily circumvent any agreement to arbitrate. By not participating in the appointment it could prevent the establishment of the tribunal and frustrate the arbitration proceedings. It is difficult to imagine a commercial party entering into such a contract. On the other hand, taking into account the importance attached to sovereign immunity. It is questionable whether by entering into an arbitration agreement a state party intends to waive its immunity for proceedings everywhere in the world.

and Lady Fox in *The Law of State Immunity*, 2nd ed. (2008) at p.501:

“The general conclusion must be that, in jurisdictions other than the US, UK and Australia, practitioners at the present time should consider that the exception for arbitration agreements operates solely to remove state immunity from the first stage of arbitration in which the national courts exercise supervisory powers.

66. The *FG Hemisphere* case was considering the question of waiver before the enforcing jurisdiction by reason of the state party entering into

the arbitration agreement. It did not consider that question as to whether by agreeing to arbitrate at a particular seat, the state party would be deemed to have waived the supervisory jurisdiction of the national court at the seat of the arbitration. It would be arguable, as opined by the learned authors cited above, that the extent of the waiver as determined by the actual or imputed intention of the parties would include that before the supervisory jurisdiction. The question however was not considered nor determined in the *FG Hemisphere* case but the opinions cited above may shed light on this issue.

Enforcement

67. Articles I and III of the Convention expressly afford states the autonomy to apply its own laws on what amount to domestic arbitration and to adopt its own rules of procedures in enforcement proceedings. In some jurisdictions, for instance, the decree of a particular department of the government has to be obtained as opposed to a court order for execution measures to be levied against assets within its territory.²⁴
68. The enforcement proceedings comprise of two stages: the recognition of the award and conversion into a court order (the recognition stage); and the execution measures to be taken out based on that court order (the execution stage). In the context of state immunity, a state may plead immunity from suit at the recognition stage and immunity from execution at the execution stage.

²⁴ Vietnam for instance, the application has to be filed with the Ministry of Justice.

69. The decision of the court to decide if it has jurisdiction over a foreign state falls within its own rules of procedures as envisaged in Article III of the Convention. The ascertainment of the applicable law of state immunity in each sovereign state is a matter left to the enforcing state.
70. This can be understood from the premise of state immunity. Non-intervention into the internal affairs of another state (subject to matters of *jus cogens* which are not relevant here) is a basic principle in the context of international law, a world legal order that states amongst themselves have established.²⁵ Underlying the principle that no states shall have jurisdiction over another state, or states have immunity before foreign courts, is that of equality of states. The Convention as it now stands, does not purport to usurp these principles.
71. The *FG Hemisphere* case holds that the HKSAR, being part of the PRC, adopts and applies the same doctrine of absolute immunity in matters where foreign states are impleaded before the PRC courts, including the HKSAR courts. Stock JA's judgment sets out that as a matter of public international law that the PRC is an absolutist. The recognition of the constitutional framework of the Basic Law by the CFA completes the task and concluded that HKSAR cannot have a different doctrine.

²⁵ See the decisions of the International Court of Justice: e.g. *the Corfu Channel Case (United Kingdom v. Albania)* (1949) ICJ 4 at pp.34-35; *Military and Paramilitary Activities in and against Nicaragua (Nicaragua v. USA)* (1986) ICJ 14 at paragraphs 201-209, and *Case Concerning Armed Activities on the Territory of the Congo (Democratic Republic of the Congo v. Uganda)* (2005) ICJ 116 at paragraph 164. The principle of non-intervention is also enshrined in international documents such as Article 2(7) of the Charter of the United Nations, and the Declaration on Principles of International Law Friendly Relations and Co-operation among States in accordance with the Charter of the United Nations approved by the General Assembly of the United Nations on 24 October 1970.

72. It is to be observed that states are becoming more and more involved in commercial transactions and the lack of remedies against a state, a recalcitrant respondent in an arbitration, may create injustice to other law abiding parties. In some states, they have legislated to introduce exceptions to state immunities. Commercial exceptions and arbitration exceptions are created. This is the sovereign power of a state and it may do so within its own territory.
73. When would the PRC legislate to provide commercial and/or arbitration exceptions and what would be the boundaries of such exception is not a matter that the authors are able to predict and comment. Suffice it to note that, in the section below, it is argued that the “state owned enterprise” or “*Guoyou Qiye*” of the PRC that are conducting cross-border commercial activities are most unlikely, if not definitely, unable to plead state immunity in defence of claims arising from such commercial transactions.
74. An award rendered against a state party can be enforced in states where the commercial exception and arbitration exception have been legislated by the state immunity legislations. It has been said that the introduction of these more equitable principles of state immunity in domestic legislations would attract more financial and commercial activities and hence assets of states in such jurisdictions. If that be the case, the fruits of the arbitration can be recovered in these states through enforcement proceedings in the light of the Convention, the all important constitutional framework of the institution of international arbitration.
75. It has been suggested that if the seat of an arbitration is in State A which practises absolute immunity, then the enforcement of that award in

State B, which has created a commercial exception to state immunity, may, on public policy grounds, be refused.

76. This proposition begs a few questions. First, in the light of the growing trend in the international arbitration community of narrowing the meaning of public policy and the trend towards adopting an international public policy when enforcing awards under the Convention, it may have to be a courageous national court to seek to widen the concept of public policy in such manner. The national courts of State B may be said to be defying its own state immunity legislation when relying on such "public policy" ground.

77. Secondly, this approach may also infringe upon Articles I and III of the Convention in the light of the pro-enforcement bias as recognized under the international jurisprudence in dealing with the Convention as well as the autonomy afforded to each enforcing state in applying its own rules of procedures, which would include its state immunity laws, in enforcement proceedings.

78. Thirdly, Article VII of the Convention may preclude State B from exercising such a ground. Article VII provides:

“1. The provisions of the present Convention shall not affect the validity of multilateral or bilateral agreements concerning the recognition and enforcement of arbitral awards entered into by the Contracting States nor deprive any interested party of any right he may have to avail himself of an arbitral award in the manner and to the extent allowed by the law or the treaties of the country where such award is sought to be relied upon.”

79. Article VII can be invoked by the enforcing party. An award made in other Convention states that is rendered against any other state can be enforced in that jurisdiction by reason of its domestic legislation on state immunity. As a result a Convention award made in State A against a foreign state should be afforded the same treatment.
80. Fourthly, many states have adopted a reciprocity reservation when acceding to the Convention. If State B seeks to refuse to enforce an award on the basis that the award was rendered by State A, a state which practises absolute immunity, it may face consequences that awards made in State B may not be enforced in State A. The reciprocity reservation made by states when entering into the Convention makes no distinction between awards involving a state party or otherwise. The consequences may be dire.
81. Lastly, one may further consider this issue from the perspective of the winning party. Does a Convention state (say State C) have legitimate expectation that State B, upon application of a national of State C, will duly enforce the awards rendered in State A irrespective of the state immunity practised by State A? The issue is moot and beyond the ambit of this article. However, if such legitimate expectation exists, State B, in refusing to enforce the award made in State A, may as well face retaliation from State C.
82. It would appear, therefore, that this proposition would not be attractive or may not stand scrutiny under arbitration laws pertaining to the interpretation of the Convention and public international law.

Does the entering into arbitration agreement amount to a waiver of state immunity before enforcing jurisdictions?

83. Is there a customary international law that a state party to an arbitration has waived immunity before all Convention states? In this context one must have in mind the distinction between *lex lata* and *lex ferenda*, and the elements²⁶ necessary for a practice of states to become a rule binding on all states subject to the doctrine of persistent objection.
84. In this context two principles need to be first considered: *pacta tertiis* and the applicable law on waiver in the relevant national court.

Pacta tertiis rule

85. One argument is that by choosing to conduct the arbitration in a Convention state, the impleaded state has waived its state immunity before all other Convention states when enforcement proceedings are brought against it. This argument makes no reference to nor considers the position of whether the foreign state defendant is a Convention state or not.
86. The *pacta tertiis* rule is a fundamental principle in international law which means that treaties do not create either obligations or rights for the third states without their consent. This is also set out in Article 34 of the Vienna Convention on the Law of Treaties.

²⁶ These elements include a settled and consistent practice of States generally, and the *opinion juris* underpinning the practice: see *The North Sea Continental Shelf* case (*Germany v. the Netherlands*) (1969) ICJ Rep 3 at paragraph 77; *Military and Paramilitary Activities in and against Nicaragua* (*Nicaragua v. USA*) (1986) ICJ Rep 14 at paragraphs 185-186.

“A treaty does not create either obligations or rights for a third State without its consent.”²⁷

87. In *Creighton Ltd. v. Government of the State of Qatar* 181 F 3d 118 (DC Cir 1999), the US Court of Appeal considered the argument that was advanced whereby it was said that given the fact that the execution measures is sought under the Convention, and given the enforcing jurisdiction, the United States, and the State in which the award was made, namely France are both Convention States, the question of state immunity could not be raised. The court unhesitatingly rejected such arguments as “bootstrap argument”. It held:

“While the analogy is imperfect, we think it instructive to compare the New York Convention to the Full Faith and Credit Clause of the United States Constitution: ‘Full Faith and Credit shall be given in each State to the...judicial Proceedings of every other State’. It is implausible that a defendant in Connecticut who had agreed to arbitrate all disputes in New York, and thereby implicitly waived any objection to personal jurisdiction in a suit brought in New York to enforce the resulting arbitral award, also waived its objection to personal jurisdiction in such an action brought in California merely because the full faith and credit clause would make a valid New York judgment enforceable in the courts of California. Indeed, to accept such a bootstrap argument, under which the courts in every state would have personal jurisdiction over a defendant who had

²⁷ There are established exceptions to this rule as that set out in Articles 35 and 36 of the Vienna Convention, both of which require the assent of the third State.

waived its objection in any one state, would in this context eviscerate an important limitation upon the principle of full faith and credit – that ‘a judgment need not be honored if it was entered by a court that lacked personal...jurisdiction.’ It seems to us likewise implausible that Qatar, by agreeing to arbitrate in France, a signatory to a treaty containing a similar reciprocal ‘recognition and enforcement’ clause, should be deemed thereby to have waived its right to challenge personal jurisdiction in the United States.”²⁸

88. Dhisadee Chamlongrasdr in *Foreign State Immunity and Arbitration*, dealt with these arguments in the context of public international law:

“However, it should be noted that where the foreign State defendant is not a party to the international agreement providing for an obligation to recognize and enforce an arbitration agreement or award, it is unlikely that the US courts will find that the foreign State defendant has waived its immunity even though the arbitration agreement or award is governed by the international agreement, or even though the State where the arbitration took place (in cases where the arbitration did not take place in the defendant’s State) and the US are parties to the international agreement. This...is consistent...with [the] view that international agreements cannot be interpreted as waiving immunity of a state which is not a party to the international agreement ‘since it would violate the pacta tertiis rule’

For example, in the case of the New York Convention, even if the award is governed and otherwise enforceable under the Convention,

²⁸ At pp.5-6 of the judgment

where the foreign State defendant is not a party to the Convention, it is unlikely that courts will find that a foreign State defendant has waived its immunity by agreeing to arbitrate under section 1605(a)(1). This is the case of Creighton v. Qatar, where...[t]he Court of Appeals rejected the plaintiff's claim on the ground that Qatar was not a signatory to the New York Convention, and that only the agreement to arbitrate in France (a contracting State to the convention) without more, could not be regarded as an indication by Qatar that it intended to waive its immunity in the US.”²⁹

89. The courts of different jurisdictions take different position as to whether participation in arbitration proceedings held in a Convention State amounts to waiver of immunity before the enforcing courts of other Convention states. French and Swedish courts took the view that by participating in arbitration the impleaded State has waived its immunity before the enforcing courts. On the other hand, the UK and the USA courts held that a waiver could not be implied from the impleaded state by participating in arbitration and/or agreeing to conduct the arbitration under institutional arbitration rules. Instead, the UK and USA respectively by way of their own national legislations create an “arbitration exception”, which deprives the impleaded state which has participated in arbitration proceedings from asserting state immunity.

90. The following table summarises cases, to which the Court of Appeal was referred in the *FG Hemisphere* case, that the issue of implied waiver had been discussed:

²⁹ At paragraphs 4.60 and 4.61.

Case	State of the Enforcing Court	Impleaded State	Arbitration Forum	Implied Waiver?
<i>Duff Development Co. v. Government of Kelantan</i> [1924] AC 797	UK	Kelantan (before the Convention)	Unknown	No
<i>Svenska v. Lithuania (No. 2)</i> [2007] QB 886 ³⁰	UK	Lithuania (Convention state)	Denmark	No
<i>TMR v. Ukraine</i> 2003 FC 1517	Canada	Ukraine (Convention state)	Sweden	N/A ³¹
<i>État français v. S.E.E.E</i> (Cour de Cassation 18.11.1986	France	Yugoslavia (not a Convention State at the time of arbitration)	Probably France	Yes
<i>Libyan American Oil Co. v. Libya</i> (Svea Court of Appeal 18 June 1980 Case No 0261/79)	Sweden	Libya (non-Convention state)	Switzerland	Yes (3:2 majority)
<i>Creighton v.</i>	USA	Qatar (non-	France	No ³²

³⁰ In *Svenska v. Lithuania (No.2)*, the English Court of Appeal held that the arbitral award could be enforced under Section 9 of the State Immunity Act, which deprives the impleaded court of its right to assert immunity. The loss of immunity is a result of an exception created by national law.

³¹ In that case, Ukraine conceded on the point of waiver

³² The US Court of Appeal held that an arbitration award can be enforced against the impleaded state pursuant to Section 1605(a)(6) of the Foreign State Immunity Act. Similar to the UK position, this is an exception created by national law.

<i>Qatar</i> 181 F 3d 118 (DC Cir 1999)		Convention State)		
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91. In considering the question of waiver, the courts in *FG Hemisphere* has followed the approach in the English cases in concluding that a waiver has to be made in front of the forum.³³ The consideration was whether a state party to an arbitration agreement has waived its immunity before enforcing courts when agreeing to arbitrate with a seat in a Convention state. It must however be emphasised that this consideration was made in the context of the enforcement proceedings before the Hong Kong courts. There was no consideration of whether or not a waiver by reason of the arbitration agreement amounts to a waiver before the supervisory jurisdiction. Counsel for *FG Hemisphere* urged the Court of Final Appeal in Hong Kong to depart from these English principles but was rejected. The Court of Final Appeal rejected the proposition.

92. The extent of waiver before enforcing jurisdictions by reason of a state party agreeing to arbitrate has a much wider scope and effect than the contention that the waiver is limited to the national court of the seat of arbitration, that is the supervisory jurisdiction. A waiver to all national courts in enforcement proceedings under the Convention would mean that a state party has waived its immunity before an unknown number of Convention states, arguably including those which have not acceded to the Convention at the time of the arbitration agreement.

³³ See the Court of Final Appeal's judgment at paragraphs 384-392 referring to *Duff Development Co Ltd. v. Government of Kelantan* [1924] AC 797, *Mighell v. Sultan of Johore* [1894] 1 QB 149 and *A Company Ltd. v. Republic of X* [1990] 2 Lloyd's Rep 520

93. The extent of the waiver to be ascertained from the arbitration agreement may also depend on whether the state party to the arbitration is itself a Convention state. This latter point was not considered in the *FG Hemisphere* case. DRC is not a Convention state and therefore the *pacta tertiis* rule may be said to be applicable when it seeks to assert state immunity before a Convention state. The extent to which the *pacta tertiis* rule may be prayed in aid by a state party who itself is a Convention state may be different but that was not an issue that was considered by the court in the *FG Hemisphere* case.

“State owned enterprise” and “state entities” of the PRC

94. The consideration of when an entity is entitled to plead and enjoy state immunity must be apposite to the discussion of state immunity. Different states may have different rules and the discussion below focuses on the context of PRC.

95. “State owned enterprises” in the PRC are called “*Guoyou Qiye*” in Chinese. This should be contrasted with another type of entities which may be properly called state entities “*Shiye Danwei*”. Both these entities have business registration certificates. They both embark on commercial activities. But as a matter of PRC law and administrative rules they are different in the context of state immunity.

96. Can PRC “state owned enterprise” plead, assert and enjoy state immunity under the auspices of the state of the PRC when sued in a foreign court? Are these two types of entities “*Guoyou Qiye*” and “*Shiye Danwei*” different? Are they both under the control of the state and hence

can be considered as the state of the PRC?

97. In *Hua Tian Long (No. 2)*³⁴, the plaintiff alleged that the defendant owners of the “Hua Tian Long” (“**the Vessel**”) had breached the contract in failing to honour its commitment under a Memorandum of Agreement entered into by the plaintiff with the Guangdong Salvage Bureau (“**the Bureau**”) to make available the Vessel to work on offshore Malaysian and Vietnamese projects for the installation of pipelines and oil platforms. The plaintiff claimed damages against defendant owners in the sum of some hundreds of millions of US dollars for fraudulent misrepresentation and/or breach of contract.
98. On 21 April 2008 the plaintiff invoked the Admiralty jurisdiction of the courts of the HKSAR and secured the arrest of the Vessel in Hong Kong waters. The Bureau, whilst having flagged up the issue of “immunity” at an early stage of the proceedings, had not asserted immunity until 21 October 2009 by way of summons applying for a stay and/or dismissal of this action on the ground that “*the Defendant enjoys, and has not waived, the sovereign and/or crown immunity and hence this Honourable Court has no jurisdiction over the Defendant*”.
99. In respect of the Bureau’s claim of crown immunity, the Court held that at common law the Crown enjoys immunity from being sued in its own courts. The meaning of “Crown” has been extended from the person of the Sovereign to a body corporate established by the executive arm of the Crown. Prior to 1 July 1997 as a matter of constitutional structure

³⁴ [2010] 3 HKLRD 611

effectively there were two distinct ‘Crowns’ in Hong Kong – Her Majesty’s government in the then colony and Her Majesty’s government in the United Kingdom - and that the Hong Kong Crown Proceedings Ordinance (Cap. 300) did not remove the ‘crown immunity’ of the Queen in the UK enjoyed in Hong Kong courts. The new constitutional order did not alter the aforesaid position, and hence the CPG enjoys the like crown immunity hitherto accorded to the British Crown.

100. Insofar as the position of the Bureau is concerned, the court has to consider whether it is part of the CPG. In assessing whether a corporation can be said to be part of the CPG at common law, the material consideration is the control which the CPG has over that corporation, albeit the objects and function of that corporation also go into the evaluative ‘mix’. In terms of ‘control’, the salient question to be asked is whether the corporation in question is able to exercise independent powers of its own.

101. The Court then turned to the status of the Bureau, namely whether it was “a separate legal entity undertaking commercial *activities independent from the PRC government*” or it was “*a part of the governmental entity...[and] possess the attributes of an entity of the PRC...*”.

102. The Bureau contended that the Bureau did not exist independently as a *Guoyou Qiye*. It was in fact Guangdong Salvage Bureau of the Ministry of Communications (“MOC”), which was a *Shiye Danwei* at all times indirectly under and controlled by the MOC. In support of the contention, the judge’s attention was drawn to the following special features of the Bureau:

- (1) The Bureau has no shareholders and has no paid-up capital;
- (2) The Bureau was not set up by the State-owned Assets Supervision Committee (“SASC”), which is the body representing the State of the PRC as investor;
- (3) All vessels under the Bureau’s banner form part of the State’s salvage and rescue team and the Bureau has no right to dispose of such assets;
- (4) Unlike state owned enterprise (*Guoyou Qiye*) which as a matter of PRC law enjoy powers of independent management and freedom from interference, with ownership of its assets and the capacity independently to assume civil liabilities, the Bureau was established as a *shiye danwei* (institutional organisation) and has been under the control of the MOC; and
- (5) The Bureau is obliged to carry out operations commissioned by MOC. In respect of private commercial operations, the Bureau has to apply to the MOC for approval for overseas operations prior to conclusion of any binding contracts.

103. The Court found as a matter of fact that the Bureau was not a separate legal entity but a part of the MOC, which in turn is a part of the CPG, and that the Bureau was controlled by the MOC. Hence, the Judge concluded that but for waiver the Bureau’s plea of crown immunity

would have been upheld.

104. The Court accepted that the material consideration in deciding whether a particular entity is a state is the “control” test.³⁵ The Bureau is a *Shiye Danwei*. There is no suggestion, and rightly so, that it is a *Guoyou Qiye*. The factors by which the control was considered included financial control, investment into constructing Huatianlong, human resources control, approval for entering into commercial contracts, and department papers in setting up of the Bureau and the main aim of the Bureau. The critical considerations, it is submitted, are the nature and primary purpose of the Bureau and the vessel, the subject matter of the charter. The Bureau whilst having a business registration does not have any shareholders or board of directors unlike a normal commercial corporation or *Guoyou Qiye*. *Shiye Danwei* is not subject to the control of the PRC Company Law. This approach of analysis as to whether an entity amounts to a state is probably no different from most other jurisdictions such as England and Wales where the authority relied on for the “control test” emanates.

105. What then in the light of the control test is the position of *Guoyou Qiye*?

106. It is suggested that under the PRC laws, a *Guoyou Qiye* bears the following salient and important features, which are distinctive from a *Shiye Danwei*:

³⁵ See discussion at paragraphs 50-52, referring to *Bradken Consolidated v. Broken Hill Proprietary Co. Ltd.* (1979) 53 ALJR 452 (applying the “functional test”), *Townsville Hospitals Board v. Council of the City of Townsville* (1982) 56 AJLR 789 and *Chadee v. Norway House First Nation* (1996) 113 Man. R. (2d) 110 (applying the “control test”).

- (1) The SASC is the only body to apply for setting up of state-owned enterprises: see Article 20 of the Regulations of the PRC on the Administration of Company Registration;
- (2) A state-owned enterprise enjoys full ownership of its assets, including the right to dispose of such assets: Article 16 of the Law on the State-Owned Assets of Enterprises of the PRC;
- (3) A state-owned enterprise enjoys powers of independent management and freedom from interference: Articles 6 and 14(2) of the Law on the State-Owned Assets of Enterprises;
- (4) A state-owned enterprise has ownership over its assets and is capable of assuming civil liabilities independently: see Article 14 of the Rules for Implementing of the Regulations for Controlling the Registration of Enterprises as Legal Persons; and
- (5) The shareholders of a limited company (including state-owned enterprises) is required to pay up not less than 20% of the registered capital and the remaining must be paid in full within 2 years. The capital payment must be subject to capital verification: Articles 26, 29 and 30 of the Company Law of the PRC.

107. The Ministry of Foreign Affairs of the PRC (“**the MFA**”) has publicly said that *Guoyou Qiye* does not enjoy state immunity. In the statement “*China and the UN Ad Hoc Committee on Jurisdictional*

Immunities of States and Their Property” dated 28 October 2003, the MFA stated:

“With regard to the relationship between a State and a State enterprise, the Chinese Delegation maintained that in principle a State enterprise or any other entity set up by a State should not enjoy State immunities, so long as the State enterprise or the other entity has independent act and the capacity to sue or be sued and has the capacity to acquire, possess or own or dispose property, including the property they operate and manage authorized by the State. At the same time, the Chinese Government maintained that it was necessary to differentiate clearly a State and a State enterprise or any other entity set up by a State and that a State enterprise or any other entity set up by a State should independently bear civil liabilities and a State, in principle, should not bear joint and several liabilities for commercial acts and liabilities or debts of a state enterprise or any other entity.”

108. On that alone, it would appear that there is little if any doubt on the position of *Guoyou Qiye*. Two other points may help to reinforce the view that *Guoyou Qiye* should not normally be entitled to plead or enjoy state immunity before foreign courts. The first is the application of the control test would not be met. The state of the PRC is a shareholder but *Guoyou Qiye* is managed by a board of directors in accordance with the PRC Company Law making it no different from any other commercial entity that is owned by way of shareholding by a family or an individual. The directors have fiduciary duties to the company and the shareholders do not have control directly on the running of *Guoyou Qiye*.

109. Secondly, immunity can only be claimed if the state concerned

asserts it on behalf of the entity. It would be strange or inconceivable that the state of PRC would, contrary to the position it has been openly holding to the international community as well as before foreign courts to now assert state immunity for *Guoyou Qiye*.

110. Indeed one may remember what Li Fei, Deputy Director of the Legislative Affairs Commission of the Standing Committee said in the press conference on 26 August 2011³⁶ after the Standing Committee's interpretation of the Basic Law pursuant to Article 158(3) of the Basic Law upon CFA's reference in the *FG Hemisphere* case that *Guoyou Qiye* are independent enterprise entities and they in such capacity interact with other commercial entities in the HKSAR or overseas; and that *Guoyou Qiye* assume liability and responsibility in accordance with the law and contracts and could not claim immunity to avoid the same.³⁷

Conclusions

111. Based on the cases of *FG Hemisphere* and *Huatianlong* and the framework of international arbitrations, the authors would summarise the

³⁶ His speech can be found at: <http://big5.cri.cn/gate/big5/gb.cri.cn/news/other/news20110826001.htm> (Chinese only)

³⁷ [李飛] 按照現在內地的法律，特別是從 1986 年頒布民法通則以後，就確立了我們的企業法人制度。經過 20 多年的改革，我們的國有企業都按照市場經濟的要求進行了改制。國有企業包括央企，都成為了獨立的企業法人。特別是頒佈公司法以後，都是負有限責任的公司。

[李飛] 在他們和其他的商業主體打交道的時候，不管是在香港還是在其他地方，他們都是以企業主體的法律地位出現的，他們都是要依照有關的法律和合同的約定對債務承擔相應的責任，所以不存在在香港國企濫用國家豁免權逃債的問題。今天在這個場合有需要澄清這個問題。謝謝。

views above as follows:

- (1) The decision of *FG Hemisphere* that the state of the PRC and therefore Hong Kong which forms part of it, practises and applies the doctrine of absolute immunity has no relevance to the choice of the seat of arbitration.
- (2) Whilst the seat of the arbitration remains important in deciding what is the relevant supervisory jurisdiction and methods of recourse against an award, it is no longer as pivotal to the legality, efficacy and authority of international arbitration as the territorialists would argue at one stage. The choice of the seat is usually governed by availability of competent arbitrators, comprehensive and up-to-date arbitration laws or institutional rules and an arbitration-friendly judiciary. Depending on the wishes of the parties they may want to choose the seat by taking into account the ways of recourse against an award. If leave to appeal on points of law is viewed as a good way in ensuring justice to be properly dispensed with or that a proper award is rendered, then seats such as England would be suitable. If on the other hand, parties truly want finality of awards, then Model law states which only permit annulment proceedings only on ground of procedural defects would be appropriate.
- (3) The question of whether the supervisory jurisdiction in a state practising absolute immunity have jurisdiction over a state party to an arbitration seated there is a question that was not addressed nor considered in the *FG Hemisphere* case. Opinions from learned commentators suggest that by agreeing to arbitration at a particular

seat, it is likely that it would amount to a waiver of the supervisory court at the seat of arbitration. This question however has not been authoritatively decided and may be the subject of further discussions or decisions in many jurisdictions.

- (4) Arbitral tribunals have no relation to any particular state. Further, unlike national courts, arbitral tribunals do not have the authority as a matter of international law to afford state immunity to any states appearing before it.
- (5) As a matter of international law, each state is entitled to decide on its own laws on the applicable doctrine of state immunity, and Article III of the Convention recognizes that.
- (6) Awards rendered in a Convention state, be applying absolute or restrictive immunity within its own territory, should be treated in the same way by any courts of other Convention states.
- (7) Public policy grounds to refuse enforcement on the basis that the award was made in a seat which practises absolute immunity is unlikely to be acceptable in the international arbitration community. Such arguments may be contrary to the provisions in the Convention, thereby rendering the enforcing state to be in breach of its treaty obligations.
- (8) Insofar as “state-owned enterprises” registered in the PRC (“*Guoyou Qiye*”) is concerned, they are most unlikely to be treated as the state of the PRC and would therefore not be entitled to any immunity. *Guoyou Qiye* is to be distinguished from another form

of state entity under PRC laws called *Shiye Danwei*.

- (9) Hence, commercial transactions with *Guoyou Qiye* remain unaffected by the decisions in *FG Hemisphere* or *Huatianlong*.
- (10) In commercial transactions dealing with states, it is advisable therefore to include arbitration agreements so as to avoid questions of immunity before national courts. Arbitration agreements of course may still be subject to challenge in jurisdictional proceedings before the arbitral tribunal on the grounds of lack of arbitrability, be it objective or subjective arbitrability, as well as the contention that the entity which entered into the arbitration agreement did not have the authority to bind the states according to the relevant applicable laws. These questions of jurisdiction of the arbitral tribunal over state parties are different in nature from the issue of state immunity.
- (11) Risks when contracting with states may not be easily avoided. Practical solutions will have to be found by appropriate risk assessment and allocation, inclusion of a comprehensive and wide ambit of waiver clauses and possibly by providing for collateral contracts such as the provision of refund guarantee or performance guarantees issued by commercial banks. Claims may have to be brought under auspices of ICSID.³⁸

³⁸ Article 54(1) and (3) of the Convention on the Settlement of Investment Dispute between States and Nationals of Other States (“the Washington Convention”) provides that ICSID awards are to be treated as judgments of the highest court in the relevant state. It therefore removes the question of state immunity during the recognition stage, that is the conversion of an award into a court judgment. The said Article provides:

“(1) Each Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it

112. With a view to secure compulsory enforcement against state parties, a review of the Convention may be appropriate. In 2008, in the ICCA Conference in Dublin, this was suggested and debated. It may be high time that this question be reviewed again in the light of the issues that were considered then and the growing number of international arbitrations involving state parties in various jurisdictions.

were a final judgment of a court in that State. A Contracting State with a federal constitution may enforce such an award in or through its federal courts and may provide that such courts shall treat the award as if it were a final judgment of the courts of a constituent state.

(3) Execution of the award shall be governed by the laws concerning the execution of judgments in force in the State in whose territories such execution is sought.”

However, the Washington Convention does not remove the impleaded state’s immunity from execution. Article 55 of the said Convention provides:

“Nothing in Article 54 shall be construed as derogating from the law in force in any Contracting State relating to immunity of that State or of any foreign State from execution.”