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A Tale of Two Systems: Hong Kong vs. The People's Republic of China

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By
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I. INTRODUCTION

On May 16, 2008, FG Hemisphere Associates ("Hemisphere") initiated a suit in Hong Kong against the Democratic Republic of the Congo ("the DRC").[1] The second, third, and fourth defendants were companies incorporated in Hong Kong. The state-owned China Railway Company Limited, the fifth defendant, collectively owned those companies.[2] Hemisphere sought an injunction to prevent these Chinese companies from paying concession fees to the DRC, who were in the midst of launching a large investment program in the DRC. As part of that program, they had to pay the DRC entry fees for mineral exploitation rights. As the holder of an award against the DRC, Hemisphere went after the entry fees in an "equitable execution of the arbitral awards."[3]

II. BACKGROUND AND PROCEDURAL HISTORY

This case began as a simple business deal in the 1980s between the Democratic Republic of the Congo and Energoinvest, a company based in Yugoslavia.[4] Energoinvest was to help finance the construction of a "hydro-electric facility and high-tension electric transmission lines in the DRC."[5] The credit agreements between the two parties included International Chamber of

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[1] FG Hemisphere Assocs., LLC v. Democratic Republic of the Congo & Others, CACV 373/2008 & CACV 43/2009, (10 February 2010) [hereinafter *FG Hemisphere*].
[2] *Id.* at ¶ 9.
[3] *Id.* at ¶ 8.
[4] *Id.* at ¶ 3.
[5] *Id.*

Commerce ("ICC") arbitration clauses. The DRC defaulted on its payment and Energoinvest commenced arbitral proceedings.

Energoinvest launched separate arbitral proceedings in Switzerland and France. Both tribunals issued their decisions on April 30, 2003, awarding Energoinvest "US$11.725 and US$22.25 million respectively plus interest."[6] The DRC did not challenge either award and Energoinvest eventually assigned its awards to Hemisphere in 2004.[7]

FG Hemisphere Associates is a limited liability company that focuses on "investing in emerging markets and distressed assets" and its principal place of business is in New York State.[8] Energoinvest assigned the entire award against the DRC, including interest, to Hemisphere on November 16, 2004.[9] In its attempt to collect award, Hemisphere sued the DRC in other jurisdictions, accumulating US$2.783 million of the award.[10] At the time of the current proceedings, the DRC owed Hemisphere US$102,656,647.96.[11]

Hemisphere filed an *ex parte* application for leave to enforce the judgment in Hong Kong. On May 15, 2008, Justice Saw issued the following orders:

> (a) the second, third, and fourth defendants be restrained from making payments (the entry fees) allegedly due from them to the DRC and/or Congo Mining under the joint-venture agreement up to a maximum of US$104 million;
> (b) the DRC be restrained from receiving the entry fees up to that maximum sum;

[6] *FG Hemisphere* at ¶ 4.
[7] *Id.* at ¶ 6
[8] *Id.* at ¶ 5.
[9] *Id.* at ¶ 6.
[10] *Id.* at ¶ 7.
[11] *FG Hemisphere* at ¶ 7

> (c) the plaintiff have leave to enforce in Hong Kong the two arbitration awards the parties should attend a judge in chambers on a date to be fixed to hear an application by the plaintiff for the appointment of receivers by way of equitable execution to receive the payments.[12]

The DRC acknowledged receipt of the originating summons on June 16, 2008, "for the sole purpose of disputing jurisdiction and for the avoidance of doubt" insisting that "nothing . . . shall be construed as waiver of any rights of Democratic Republic of the Congo."[13] On July 7, 2008, the DRC moved to preclude the ruling of the Court of First Instance, claiming that the court had no jurisdiction over the subject matter of the claim or the remedy sought, that there had been no service on the DRC, and to ensure "the discharge of the various orders thus far made against the DRC."[14] On August 23, 2008, the Court of First Instance gave Hemisphere leave to include the China Railway Group, Limited as a fifth defendant and to serve notice on the DRC's Hong Kong solicitors. On November 12, 2008, the court granted the Secretary for Justice leave to intervene in the proceedings.[15] The hearings took place in November and December 2008. Justice Reyes rendered judgment on December 12, 2008. The issues presented before the Court of First Instance were:

> (1) whether on and after 1 July 1997 Hong Kong common law recognized the doctrine of restrictive immunity whereby a state could not lawfully be impleaded in the courts of this jurisdiction in relation to acts in its sovereign capacity (*acta jure imperii*) but was not

[12] *Id.* at ¶ 11.
[13] *Id.* at ¶ 14.
[14] *Id.* at ¶ 16.
[15] *Id.* at ¶ 18.

> immune from suit in respect of those of its acts of a private law or commercial character (*acta jure gestionis*) or whether, on the other hand, immunity from suit in this jurisdiction was absolute;
>
> (2) if the restrictive doctrine applied, into which category the relevant act in this instance fell; and
>
> (3) if immunity was absolute or the relevant act was in any event an *act jure imperii*, whether the DRC had waived immunity by submitting itself to arbitration.[16]

Judge Reyes concluded that the court "had no jurisdiction over the DRC in these proceedings; discharged the *ex parte* injunction against the DRC . . . and set aside leave to enforce the arbitral awards . . . "[17] On February 29, 2009, Judge Reyes set aside the injunctions against the Chinese companies set to invest in the DRC. Hemisphere appealed these two judgments.

III. THE PRESENT CASE

The DRC, with the support of the Chinese government, claimed absolute immunity from the enforcement of any arbitral action. The issue of immunity became the salient point in the proceedings as the courts of Hong Kong grappled with whether they should apply the doctrine of restrictive immunity, or its less forgiving counterpart, absolute immunity. Running parallel to that inquiry was the question of whether the DRC waived its right to sovereign immunity by agreeing to refer any disputes under its contract with Energoinvest to arbitration under the rules of the ICC. In a split opinion, The Court of Appeal of Hong Kong held that Hong Kong was a restrictive immunity jurisdiction and, therefore, had the

[16] *FG Hemisphere* at ¶ 20.
[17] *Id.* at ¶ 24.

authority to enforce an arbitral award against the DRC. The court then ruled that agreeing to arbitration does not waive a sovereign state's immunity.[18]

IV. WHETHER THE DOCTRINE OF RESTRICTIVE IMMUNITY APPLIES TO HONG KONG COURTS

Whether Hong Kong employs the doctrine of restrictive immunity represented the central issue to this claim. The DRC contended that restrictive immunity was not a custom of international law, nor was it part of Hong Kong law at any point in its history. In response, Hemisphere asserted that restrictive immunity rose to the level of customary international law and, as such, became part of Hong Kong common law prior to the July 1, 1997 transfer of sovereignty to China (Prior to the transfer, Hong Kong was a British Colony).[19] Prior to the transfer, Hong Kong was a British Colony. The Chinese government, intervening solely on the question of sovereign immunity, insisted that China employed absolute sovereign immunity. The Chinese government's position would require Hong Kong to apply the doctrine of absolute immunity, as Hong Kong is subject to Chinese sovereignty.[20] To answer this question, the Court of Appeal: 1) looked to customary international law and whether the doctrine of incorporation applied those customs to Hong Kong prior to the 1997 handover, and 2) whether the common law in Hong Kong survived the transfer of power to China.

A. Customary International Law

The court looked to a number of cases in international law to discern the current custom of state immunity. Judge Stock, in writing the majority opinion, placed great emphasis on R (European Roma Rights Centre) v. Prague

[18] *Id.* at ¶ 180.
[19] *Id.* at ¶ 50.
[20] *Id.* at ¶ 51.

Immigration Officer in defining what constituted a custom of international law.[21] Lord Bingham, author of the opinion in *Prague Immigration Officer*, cited the American Law Institute's Restatement of the Law, Foreign Relations Laws of the United States, 3d (1986).[22] The restatement considers customary only those rules that states follow "from a sense of legal obligation."[23] Additionally, agreements between states can become customary international law when those "agreements are intended for adherence by states generally and are in fact widely accepted."[24]

The court found agreement for this analysis in The North Sea Continental Shelf case, which reasoned that the consent of a "generality of states" creates custom.[25] This led the court to conclude that a custom "accepted as law by the international community generally . . . [crystallizes] into customary international law . . . (even though) not every [s]tate observes the custom and accepts it as law."[26] State action, such as ministerial statements and treaties, must demonstrate a "belief on the part of [s]tates that the practice is obligatory as a matter of law."[27]

With this in mind, the court had to decide whether state immunity, a specter in international arbitration for private individuals, remained absolute or if the doctrine of restrictive immunity had become a custom of international law.

B. Restrictive Immunity as Customary Law

The legal maxim *par in parem non habet imperium* (equals do not have authority over one another) has influenced English common law since the early

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[21] *FG Hemisphere* at ¶ 56.
[22] *Id.* (quoting R (European Roma Rights Centre) v. Prague Immigration Officer [2005] A.C. 1).
[23] *Id.* at ¶ 56.
[24] *Id.*
[25] *Id.* at ¶ 57, (quoting The North Sea Continental Shelf Case [1969] ICJ Rep. 3).
[26] *FG Hemisphere* at ¶ 57.
[27] *Id.* at ¶ 60.

twentieth century.[28] ". . . The courts of a state will not implead a foreign sovereign, that is, they will not make it party to legal proceedings against its will, whether the proceedings involve process against the sovereign or seek to recover from it specific property or damages."[29]

The court acknowledged that the absolutist approach to sovereign immunity eventually withered as national governments waded into international commerce and now "[n]early every country . . . engages in commercial activities."[30] Accordingly, whether or not state-led commercial activity eviscerates the legal custom of absolute immunity was ultimately unimportant to the court. The court instead determined that the salient point was one of fairness.[31] Was it fair to allow states to press their claims against private companies in courts while simultaneously prohibiting private companies, or individuals, from pressing claims against states? The majority thought not: "in acting in a private law or commercial capacity, the State divests itself of its sovereign character . . ."[32]

The majority did not see the move toward restrictive immunity as a trend away from absolute immunity, but rather a step toward leveling the playing field.[33] The court stressed that absolute immunity will always signify the starting point, holding that by "acting in a private law or commercial capacity, the state divests itself of its sovereign character."[34] Therefore, the court reasoned that an "inquiry by a court in the forum state is not then an inquiry into an act of sovereignty.[35] For Justice Stock, however, whether or not countries around the world accepted the

[28] *Id.* at ¶ 29.
[29] *Id.* at ¶ 61 (quoting The Cristina [1938] A.C. 485).
[30] *Id.* at ¶ 64 (quoting Trendtex Trading Corp v. Central Bank of Nigeria [1977] QB 529 (CA)).
[31] *FG Hemisphere* at ¶ 65.
[32] *Id.*
[33] *Id.*
[34] *Id.* at ¶ 65.
[35] *Id.*

doctrine of restrictive immunity as a custom of international law was ultimately irrelevant.[36]

Rather, the relevant issue was the nature of the English common law and how it flowed to Hong Kong prior to the reunification of July 1 1997.[37] In 1979, Britain extended the State Immunity Act of 1978 to Hong Kong, which allowed two exceptions to absolute immunity: 1) where the state submitted to the court's jurisdiction or, 2) where the government engaged in commercial activity.[38] In I Congresso and Holland v. Lampen-Wolfe, the House of Lords brought the common law position in-line with the statutory provisions of the State Immunity Act; "(We have) adopted the so-called restrictive theory of state immunity under which acts of a commercial nature do not attract state immunity . . ."[39]

Justice Stock dismissed the fact that Hong Kong had no precedents of her own regarding restrictive and absolute immunity.[40] Instead, he reasoned that Hong Kong courts would not have contradicted the decisions of the House of Lords, which enjoyed "great authority" in Hong Kong.[41] While he conceded the difficulty in ascertaining Hong Kong's common law on this issue, the influence of the House of Lords and English precedent proved that "the common law of Hong Kong as at 30 June 1997 recogni[z]ed the doctrine of restrictive immunity."[42]

C. Remnants of the Common Law in Post-Colonial Hong Kong

The Hong Kong common law remained intact following the transfer of sovereignty to China on July 1, 1997.[43] Article 8 of the Basic Law provided for the

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[36] *FG Hemisphere* at ¶65
[37] Britain formally handed Hong Kong back to the People's Republic of China on this date.
[38] *FG Hemisphere* at ¶ 69.
[39] *Id.* at ¶ 71 (quoting Holland v. Lampen-Wolfe, [2000] 1 W.L.R. 1573, at 1584 (H.L.)).
[40] *Id.* at ¶ 77
[41] *Id.*
[42] *Id.* at ¶ 78.
[43] *FG Hemisphere* at ¶ 79.

continuation of the common law, "except for any (laws) that contravene this Law, and subject to any amendment by the legislature of the Hong Kong Special Administrative Region ("SAR")."[44] Article 19 addressed the judiciary specifically in requiring that "the Hong Kong Special Administrative Region . . . be vested with independent judicial power," and that the "courts of the Hong Kong Special Administrative Region shall have no jurisdiction over acts of state such as defen[s]e and foreign affairs."[45] What China failed to do, Justice Stock pointed out, was enact "local legislation to replace the State Immunity Act 1978 as extended to Hong Kong or to alter the common law position" to reflect China's position on sovereignty.[46]

The transfer of power left a statutory void that the State Immunity Act of 1978 had previously filled.[47] To start retroactively filling that void, the government of China sent two letters to the Hong Kong courts demonstrating The People's Republic of China's historical commitment to absolute sovereignty.[48] It is in this instance that Hong Kong's motto, "One Country, Two Systems" becomes most problematic. As a common law territory, the PRC government does not necessarily bind Hong Kong, and as such, the PRC letters were only advisory, bringing the court's attention to the PRC's tradition of absolute sovereignty and its dominion over foreign affairs.[49] While giving the letters their due respect, Justice Stock ultimately saw no indication that refusing the DRC full immunity and enforcing the awards against it "would affect an infringement of the sovereignty of the PRC."[50]

While not conceding the argument to the plaintiffs, the PRC Secretary for Justice argued that, based on the PRC's two letters, even if the doctrine of

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[44] *Id.* at ¶ 79; HKSAR Basic Law, Art. 8. The Basic Law is the constitution of the Hong Kong Special Administrative Region.
[45] *FG Hemisphere* at ¶ 79 (citing The Basic Law, Art. 19).
[46] *Id.* at ¶ 80.
[47] *Id.*
[48] *Id.* at ¶ 86.
[49] *Id.* at ¶ 88.
[50] *FG Hemisphere* at ¶ 118.

restrictive immunity blossomed into customary international law, China's long-standing commitment to absolute immunity in the face of this trend proscribed the enforcement of the custom in China.[51] In international law, persistent, unwavering objection at the outset of the formation of a new custom exempts that country from fulfilling that new custom's obligations.[52] This compelling argument is muddied by China's signature to the 2004 United Nations Convention, which endorsed the doctrine of restrictive immunity.[53]

In assessing the impact of China's signature to the UN Convention, Justice Stock consulted the two letters sent by China.[54] These letters explained that China had not yet ratified the Convention.[55] The second letter addressed the UN Convention explicitly, maintaining China's opposition to the doctrine of restrictive immunity and stressing China's refusal to ratify it.[56] Hemisphere responded by pointing to other multilateral conventions to which China is a party and where the PRC softened its hostility toward restrictive immunity.[57] Hemisphere contended that these treaties demonstrated China's less than steadfast opposition to restrictive immunity; without complete, unwavering objection to the custom, China could not claim exemption.[58]

The Chinese Secretary for Justice argued that China's apparent inconsistency was not inconsistent at all.[59] Even though the PRC has historically objected to accepting the doctrine of restrictive immunity as customary international law, it has always condoned strategic decisions to waive immunity when it suits them.[60] This argument persuaded Justice Yeung, the lone dissenter.

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[51] *Id.* at ¶ 97.
[52] *Id.* at ¶ 89.
[53] *Id.* at ¶ 91.
[54] *Id.* at ¶ 86.
[55] *FG Hemisphere* at ¶ 91.
[56] *Id.*
[57] *Id.* at ¶ 107.
[58] *Id.* at ¶ 93.
[59] *Id.* at ¶ 109.
[60] *FG Hemisphere* at ¶ 109.

Justice Yeung pointed out that Hong Kong, per the Basic Law, is "an inalienable part of the People's Republic of China."[61] As such, Hong Kong's common law only applies where the domestic law does not.[62] Thus, "[t]he absolute immunity doctrine, adopted by the PRC as part of its international legal obligation, applies to the Hong Kong SAR."[63] Justice Yeung then took this argument to its logical conclusion, asserting,

> [w]hen it comes to foreign affairs of which state immunity is one aspect, there is simply no room for 'two systems' at all. 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.[64]

Justice Yuen, in a concurring opinion, disagreed with the general notion that issues of state immunity inhere to the domain of "foreign affairs."[65]

Justice Yuen urged that "[s]tate immunity . . . not be regarded as solely executive-driven, as simply an act in a state's conduct of its relations with foreign states, but as a matter of law which falls to be decided by the courts of the forum state."[66] As the forum state here was Hong Kong, Justice Yuen went on to support the conclusion that Hong Kong's common law survived the transfer of sovereignty to China.[67]

Justice Yuen also pointed to the lack of federal legislation reversing Hong Kong's common law custom of restrictive immunity after 1997.[68] This did not surprise Justice Yeung, as Hong Kong had long been a "centre of international

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[61] *Id.* at ¶ 219 (quoting the HKSAR Basic Law, Art. 1).
[62] *Id.* at ¶ 219.
[63] *Id.* at ¶ 224.
[64] *Id.* at ¶ 226.
[65] *FG Hemisphere* at ¶ 249.
[66] *Id.* at ¶ 249.
[67] *Id.* at ¶ 260.
[68] *Id.* at ¶ 260.

commerce" and China would have been smart to avoid disrupting the flow of international trade.[69] Like the plaintiffs, Justice Yuen suggested that China's signature to the 2004 UN Convention and its readiness to waive absolute immunity in recent treaties evidenced a slow reversal toward the acceptance of restrictive immunity.[70]

Vice President Stock echoed Judge Yuen's sentiments. Had China wanted Hong Kong to adopt the doctrine of absolute immunity, "that intention would (have) be[en] given effect by legislation."[71] Furthermore, these two judges agreed that allowing Hong Kong to employ restrictive immunity would not adversely affect the decision-making abilities of the PRC.[72] The PRC had shown continued commitment to the absolute doctrine, notwithstanding its noticeable, yet subtle, move toward the restrictive doctrine, and would continue to be able to do so.[73] Indeed, Justice Stock did "not see application of the restrictive doctrine in this case as prejudicing such objection as the PRC might . . . advance in the future."[74]

The court concluded that the common law as it existed in Hong Kong in 1978 included the doctrine of restrictive immunity.[75] Hong Kong reverted back to the common law after the transfer back to China lifted Britain's State Immunities Act of 1978, which had frozen the common law as it existed in Hong Kong in 1978.[76] After July 1, 1997, the PRC did not propose any legislation to fill the statutory void that the State Immunity Act of 1978 once filled. Therefore, the court reasoned, when Hong Kong transferred back to China, it also transferred back to

[69] *Id.* at ¶ 261.
[70] *FG Hemisphere* at ¶ 262.
[71] *Id.* at ¶ 121.
[72] *Id.* at ¶ 118.
[73] *Id.* at ¶ 266.
[74] *Id.* at ¶ 118.
[75] *FG Hemisphere* at ¶ 78.
[76] *Id.* at ¶ 78.

its common law.[77] As a common law jurisdiction, then, FG Hemisphere Associates could enforce its award against the DRC in Hong Kong.[78]

V. WHETHER AGREEING TO ARBITRATION CONSTITUTED A WAIVER OF SOVEREIGN IMMUNITY

Hemisphere argued that the doctrine of immunity did not ultimately matter because the Democratic Republic of the Congo waived access to immunity when it agreed to arbitration under the rules of the ICC.[79] In general, the court agreed with this premise; especially when the arbitrator "is not an organ of the state."[80] At common law, however, the implied waiver of immunity only applied to jurisdiction, not the execution of the judgment.[81] The court reasoned that the common law, "at least in England, was that waiver (for the execution of the judgment) was only effective if it was express and in the face of the court."[82]

The court conceded that the issue of sovereignty was the deciding factor, holding that, "[i]t is common ground in this case that the New York Convention applies to the awards made in favour of the plaintiff and that, subject to the question of sovereign immunity, they are enforceable in Hong Kong."[83] Under the rules of the ICC, Article 28(6) states:

> Every award shall be binding on the parties. By submitting the dispute to arbitration under these rules, the parties undertake to carry out any award without delay and shall be

[77] *Id.* at ¶ 80.
[78] *Id.* at ¶ 81.
[79] *Id.* at ¶ 125.
[80] *FG Hemisphere* at ¶ 127.
[81] *Id.* at ¶ 129.
[82] *Id.* at ¶ 130.
[83] *Id.* at ¶ 152.

> deemed to have waived their right to any form of recourse insofar as such waiver can validly be made.[84]

Hemisphere argued that Article 28(6) bound the DRC to the decision of the tribunal and waived any right to immunity.[85] But Justice Stock discounted Hemisphere's reliance on the Rules of the ICC. Hong Kong's return to a common law jurisdiction following the transfer of power to China required express waiver of immunity.[86] Justice Stock cited to Creighton Limited v. Government of Qatar (tried in the United States).[87] There, like here, a private entity attempted to enforce an award against a foreign state. Similarly, the foreign state had agreed to arbitrate in a state that had signed the New York Convention, along with the forum state, but the foreign state itself was not a party to the Convention.[88]

The US Court of Appeals for the District of Columbia found no waiver where the allegedly waiving state is not a signatory to the New York Convention:

> Qatar not having signed the Convention, we do not think that its agreement to arbitrate in a signatory country, without more, demonstrates the requisite intent to waive its sovereign immunity in the United States. As Creighton directs us to no other evidence of such an intent, we hold that [s.] 1605(a)(1) does not confer subject matter jurisdiction upon the district court.[89]

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[84] *Id.* at ¶ 153; ICC, Art. 28(6).
[85] *FG Hemisphere* at ¶ 153.
[86] *Id.* at ¶ 164.
[87] *Id.* at ¶ 165 (citing Creighton Ltd v. Government of the State of Qatar, 181 F.3d 118 (DC Cir 1999)).
[88] *Id.* at ¶ 165.
[89] *Id.* at ¶ 168, (citing *Creighton Ltd*., 181 F.3d at 123).

In agreeing with this outcome, Vice President Stock mentioned the maxim pacta tertiis, as "reflected in art. 34 of the Vienna Convention: 'A treaty does not create either obligations or rights for a third state without its consent.'"[90]

Judge Yeung, in his dissent, came to the same conclusion, but for different reasons. Judge Yeung presented a number of cases that adopted the rule that "submission to arbitration does not constitute a waiver of state immunity."[91]

All three judges agreed that the DRC did not waive its rights to sovereign immunity when it agreed to arbitration under the rules of the ICC.[92] While the ICC specifies that by agreeing to arbitrate the state is waiving immunity from jurisdiction, it does not apply that waiver to the execution of judgment.[93] Under the common law of Hong Kong, the foreign state must expressly waive its right to immunize itself against an award.[94]

VI. CONCLUSION

FG Hemisphere v. The Democratic Republic of the Congo will prove to be a seminal case in assisting future courts deciding on issues of sovereign immunity. This case resolves the debate over whether the doctrine of restrictive immunity is customary international law. This has significantly leveled the playing field for private entities attempting enforce arbitral awards against states not party to the New York Convention. This alone could have a wide-ranging impact, giving would-be investors the confidence to invest in developing countries.

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[90] *FG Hemisphere* at ¶170.
[91] *Id.* at ¶ 230. (relying upon Duff Development Co. v. Government of Kelantan [1924] A.C. 797; Mighell v. Sultan of Johore [1984] 1 QB 149; Kahan v Pakistan Federation [1951] 2 KB 1003).
[92] *Id.* at ¶ 177.
[93] *Id.* at ¶ 129.
[94] *Id.* at ¶ 164.