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Who wears the crown? Immunity and the identification of the sovereign in Hong Kong

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Almost every country of the world has seen an enormous increase in the involvement of the State in economic activity over the past century. This trend is particularly pronounced in those economies, China foremost among them, in which the State takes an active role in commercial life. But can State owned entities and other private law vehicles in which the State holds a stake avail themselves of the sovereign immunity which attaches to the State itself? This question understandably causes headaches to businesses transacting with such entities on a daily basis, since the answer may have a significant impact upon the evaluation of the overall business risk of entering such transactions in the first place.

This issue has come to particular prominence in Hong Kong recently following judgments in the cases of *Democratic Republic of the Congo v. FG Hemisphere Associates* FACV Nos. 5, 6 & 7 of 2010 and *Intraline Resources SDN BHD v. The Owners of the Ship or Vessel "Ha Tian Long"* HCAJ 59 of 2008, holding that both sovereign immunity and crown immunity are absolute in this jurisdiction. Immunity will be relevant where a contract provides for dispute resolution by the Hong Kong courts or the counterparty has assets located in Hong Kong. The upshot is that if the counterparty is a State entity, it will be able to invoke its immunity to resist the assumption of jurisdiction over it by the Hong Kong courts, including enforcement proceedings in Hong Kong against its assets, regardless of whether the transaction or assets in question are sovereign or commercial in nature. (There is some good news –immunity will not operate as a bar to arbitration seated in Hong Kong, and is unlikely to affect the supervisory jurisdiction of the Hong Kong courts over arbitral proceedings.)

One of the consequences of an absolute (as opposed to a restrictive) doctrine of sovereign immunity, particularly in light of the restrictive rules on waiver of immunity which now apply in Hong Kong, is that the status of a contractual counterparty assumes central importance in determining whether or not it will be entitled to invoke immunity. Because absolute immunity makes no exception for purely commercial transactions or assets, the key question in determining whether immunity applies in a given case will be whether or not a particular entity is, or is not, a State or a State entity. Identifying the sovereign or the crown becomes paramount.

So which entities will be accorded sovereign or crown status in Hong Kong? The question to be asked is whether the entity is an "arm or alter ego", or "part and parcel", of the State, such that it should be identified with the State like a government department. In answering this question, the legal tests which will be applied in the cases of sovereign immunity and crown immunity are

different, although in practice the results will often be the same. In order to apply the right test, the applicable immunity must first be identified. Sovereign immunity will apply where the counterparty is a foreign (i.e. non-PRC) State or State entity, whereas crown immunity will apply where the counterparty is the PRC State or a PRC State entity. Crown immunity is therefore most likely to be relevant to typical China-related contracts and transactions, although there may of course be exceptions.

In the case of **sovereign immunity**, the key factors in determining whether an entity is entitled to immunity are likely to be the function of the entity and the nature of the activities which it carries out (i.e. a "functional" test), although other factors may be taken into account. Where the entity carries out activities of a sovereign or governmental nature, it will be entitled to immunity, but where it carries out ordinary commercial trading activities, sovereign immunity is unlikely to apply. The control test (discussed next) may also be relevant, but is unlikely to be determinative.

In the case of **crown immunity**, control, rather than function and activities, will be the benchmark for the attribution of crown immunity (i.e. a "control" test). Crucially, whether the crown has control over the entity will depend upon whether the entity is able to exercise independent powers of its own. The control required is therefore of a "ministerial" nature rather than mere ownership giving rise to voting control – the relevant question is whether or not the entity concerned is controlled by, or must act on the direction of, a minister of State or a government department. This approach to control is also likely to apply where control is a factor taken into account in determining whether an entity is entitled to sovereign immunity.

What are the results when these tests are applied to SOEs? Whilst each case must be treated on its own facts, it seems that where an SOE is purely engaged in activities of an ordinary commercial trading nature and is not subject to significant direction by a government minister or department, it will be unlikely to be entitled to immunity, even where it is majority or wholly-owned by a State. On the other hand, where an entity is engaged in activities of a governmental or public nature, potentially under the direction or oversight of a government department, it is much more likely to be entitled to immunity. It therefore appears that many, or even most, SOEs will not be entitled to sovereign or crown immunity in Hong Kong (a question for another day is whether the analysis would be different, at least under the functional test for sovereign immunity, in the case of a sovereign wealth fund, which could be argued to carry out functions of an inherently sovereign or governmental character directed towards public aims).

It would of course be prudent for businesses and their advisors to bear the tests above in mind at the pre-contractual stage when considering transacting with entities which might be entitled to immunity. Should a dispute arise in which one party attempts to invoke sovereign immunity in Hong Kong, however, it will ultimately be the Central People's Government that has the final say on whether an entity is entitled to immunity. This is because Article 19(3) of Hong Kong's Basic Law provides that the courts of Hong Kong shall have no jurisdiction in relation to acts of state such as defence and foreign affairs, which includes the decision as to whether or not to recognise an entity as a foreign sovereign. In such cases, the courts must obtain a binding certificate from the Chief Executive of the Hong Kong SAR, who will in turn obtain a certifying document from the CPG before issuing the certificate. There is clearly, therefore, potential for disputes as to the application of sovereign immunity to assume a political dimension.

There is no equivalent procedure in relation to crown immunity, and the decision remains that of the Hong Kong court (although the Court of First Instance in the Intraline case indicated that it

would favour a procedure for certification by the CPG). In practice, it is likely that the courts will consider carefully any representations which they receive from the CPG in relation to the status of a PRC entity, albeit they will not be obliged to follow them.

Despite the very understandable concerns of the business community about the impact of absolute sovereign and crown immunity in Hong Kong when contracting with SOEs, the application of the legal tests for immunity should offer comfort that in many cases, immunity will not be applicable (provided, in the case of sovereign immunity, that any rulings by the CPG accord with the legal principles which would be applied by the courts). Obviously, even where an entity will not be entitled to immunity, it cannot be prevented from incurring the trouble and expense of taking the point, and that possibility, as well as the broader risk that immunity might apply, should be priced into the overall risk evaluation at the outset of a transaction.

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