



From Absolute Immunity to Restrictive Immunity

The implication of the Foreign State Immunity Law on cross-border disputes in the PRC and Hong Kong

The long-standing practice to adopt the principle of absolute foreign state immunity by the People's Republic of China (the PRC) and Hong Kong is coming to an end as the PRC's Foreign State Immunity Law (the FSIL) is coming into effect on 1 January 2024. Introducing commercial exceptions to and allowing express advance waiver of foreign state immunity, the FSIL broadens the circumstances in which foreign states may be sued, and expands the scope to enforce arbitral awards and court judgements against foreign states' assets in the PRC and Hong Kong. This welcomed development brings the PRC and Hong Kong position in line with other major jurisdictions, and enhances the attractiveness of these jurisdiction as dispute resolution fora for state-related commercial disputes.

In this bulletin, we will:

- start with a brief refresher on the concept of state immunity (**Section 1**);
- provide an overview of the key provisions of the FSIL on sovereign immunity from suit and enforcement (**Section 2**);
- consider how the FSIL affects the application of state immunity in Hong Kong (**Section 3**) and arbitration and arbitration-related proceedings (**Section 4**); and
- conclude by highlighting the key implications of the FSIL on state-related cross-border commercial transactions (**Section 5**).

1. Refresher of state immunity

There are two types of state immunity: foreign state immunity and domestic state immunity (or Crown immunity in Hong Kong). Foreign state immunity concerns the immunity of a state from proceedings in another state, while the latter concerns the immunity of the sovereign from proceedings in its own courts.

Foreign state immunity protects a state in two aspects. First, it protects a state from being sued in the courts of another state (immunity from suit). Second, it protects its properties from being subject to judicial enforcement in that other state (immunity from enforcement).

Each of foreign state immunity and domestic state immunity may be described as “absolute” or “restrictive”. Where a sovereign state enjoys absolute immunity, it is shielded from court proceedings or enforcement regardless of the nature of the dispute, even in commercial matters. Under restrictive immunity, however, the sovereign state is only immune in relation to activities involving an exercise of sovereign power. Most jurisdictions around the world, including the US, the UK, Canada, Singapore, Australia, New Zealand and most member states of the European Union adopt the restrictive doctrine of state immunity.

Before the FSIL, the PRC had very few legislations on the immunity of foreign states and their properties. For example, the PRC Law on Judicial Immunity from Compulsory Measures Concerning the Property of Foreign Central Banks grants foreign central banks’ properties immunity from enforcement. According to diplomatic and judicial practice, the PRC has long taken the position of absolute immunity.

Hong Kong follows the position of the PRC in adopting absolute immunity for both foreign state immunity and Crown immunity prior to the enactment of the FSIL. While the FSIL is due to change the position in relation to foreign state immunity, the Central People’s Government (the **CPG**) will continue to enjoy absolute immunity in the PRC and Hong Kong. For the avoidance of doubt, the Crown immunity enjoyed by the CPG would unlikely extend to Chinese state-owned enterprises (**SOEs**).



2. Overview of the FSIL – what are the changes introduced?

The Standing Committee of the National People's Congress (the **NPCSC**) adopted the FSIL on 1 September 2023. It will come into effect on 1 January 2024. Being the first comprehensive PRC legislation dealing specifically with state immunity, the FSIL marks a significant shift in the PRC's foreign state immunity policy from absolute to restrictive immunity, bringing it into "alignment with international practices" as described in a **statement** made by the PRC Ministry of Foreign Affairs (the **MFA**).

In this section, we will highlight the key features of the FSIL, including its scope of application and the key exceptions to immunity.

Framework of the FSIL

As a general principle, the FSIL affirms that a "foreign State" shall enjoy immunity from suit (Art 3) and its properties shall enjoy immunity from enforcement (Art 13) in the PRC, subject to the exceptions discussed below.

Apart from the key exceptions, the FSIL provides for the principle of reciprocity which states that the protection afforded to a foreign state may be reduced if that state grants to the PRC and its properties a lower level of immunity (Art 21), and clarifies that the provisions of an international treaty concluded or acceded to by the PRC shall prevail to the extent they differ from the FSIL (Art 22).

Scope of foreign state immunity

A "foreign State" is defined to include the foreign sovereign state itself and its organs or constituent parts (such as government departments or ministries). It also covers any organisation or individual that is authorised by the state to exercise sovereign authority and conducts activities accordingly (Art 2).

SOEs and international organisations do not automatically enjoy foreign state immunity under the FSIL. A literal reading of the FSIL indicates that their immunity status depends on whether they have the authority to exercise sovereign powers on behalf of the foreign state. Consistent with the existing position under the PRC and Hong Kong law, SOEs that do not carry out sovereign functions are not immune from suit or enforcement.

Significantly, under the FSIL, the MFA can determine conclusively who is a "foreign State" by issuing certificates (Art 19). This gives the MFA a significant role in the foreign state immunity framework.

Exceptions to immunity from suit

The FSIL provides for four major exceptions to immunity from suit:

– **Commercial activity exception:** the most significant change introduced by the FSIL is to provide that a foreign state may not enjoy immunity from suit in respect of proceedings arising out of a "commercial activity" if the commercial activity (i) is between the state and an entity or person of another state (including the PRC) and (ii) either (a) takes place or (b) causes a direct effect within the territory of the PRC (Art 7). A "commercial activity" is defined broadly to mean any act of transaction of goods

or services, investments, lending or any other act of a commercial nature other than an exercise of sovereign authority. In making such determination, the PRC courts would take both the nature and the purpose of the act into account. It remains to be seen how the PRC courts would apply the commercial activity exception in practice.

- **Express waiver of immunity:** the FSIL recognises the ability of foreign states to waive their immunity expressly before or after the dispute has arisen, by way of, among others, international treaty or a written agreement (Art 4).
- **Implied waiver of immunity:** the FSIL confirms that foreign states may also waive their immunity implicitly by bringing claims, or filing responses or counterclaims in the proceedings (Art 5). However, foreign states would not have waived their immunity merely by filing state immunity objections, sending representatives to testify before Chinese courts, or choosing PRC law as the governing law of the dispute (Art 6).
- **Specified categories of disputes:** foreign states may not enjoy immunity from suit if the dispute concerns (i) labour or services contract performed wholly or partly in the PRC (Art 8), (ii) compensation for personal injury or death or loss of properties due to conducts within the PRC (Art 9), or (iii) certain movable, immovable or intellectual properties in the PRC (Arts 10, 11). These exceptions are broadly similar to those provided for under the relevant legislation in the UK. The FSIL also provides an exception for arbitration matters (Art 12), which will be discussed in Section 4 below.

Exceptions to immunity from enforcement

A foreign state not having immunity from suit does not automatically lose immunity from enforcement. To enforce against the assets of a foreign state, one of the exceptions to immunity from enforcement must be established:

– **Commercial activity exception:** the commercial activity exception to immunity from enforcement relates to the nature of the assets rather than the dispute. Assets of

the foreign state may be subject to enforcement if they meet three conditions simultaneously. The asset must be (i) located in the PRC, (ii) used for a commercial activity and (iii) connected to the proceedings (Art 14(3)). The FSIL excludes certain categories of assets from being commercial assets, including diplomatic, military or central bank properties (Art 15).

– **Express waiver of immunity:** generally, a waiver of immunity from suit does not automatically

constitute a waiver of immunity from enforcement (Art 13). However, similar to immunity from suit, a foreign state may expressly waive its immunity from enforcement by written agreements, by entering into an international treaty, by a written document filed with a PRC court or by other means (Art 14(1)).

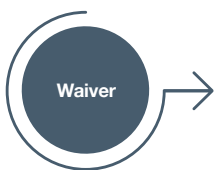
– **Earmarked properties:** enforcement action may also be brought against properties that have been allocated or earmarked by the foreign state for such purpose (Art 14(2)).

Key exceptions to immunity



If the proceeding arises out of a commercial activity which (i) is between the state and an entity or person of another state (including the PRC) and (ii) either takes place or causes a direct effect within the territory of the PRC (Art 7).

If the assets are (i) located in the PRC, (ii) used for a commercial activity and (iii) connected to the proceedings (Art 14(3)).



Immunity may be waived expressly by, among others, written agreement or treaty (Art 4) or impliedly by actively participating in court proceedings (Art 5).

Immunity may only be waived expressly by, among others, written agreement or treaty (Art 14(1)).

Immunity would not be waived impliedly by a waiver of immunity from suit (Art 13).



If the dispute concerns labour or services contract performed wholly or partly in the PRC (Art 8), compensation for personal injury or death or loss of properties due to conducts within the PRC (Art 9), certain movable, immovable or intellectual properties in the PRC (Arts 10, 11).

If the assets are specifically earmarked or allocated for enforcement purpose (Art 14(2)).

3. How does the FSIL affect Hong Kong's position

After the FSIL comes into effect on 1 January 2024, Hong Kong will follow the PRC policy and shift from an absolute to a restrictive approach in applying foreign state immunity.

Although any promulgation or local legislation under Article 18 of the Hong Kong's Basic Law would provide welcomed clarity on the FSIL's scope of application in Hong Kong, it appears that the restrictive foreign immunity policy in the FSIL would apply automatically in Hong Kong in any event pursuant to the NPCSC interpretation (the **NPCSC Interpretation**) provided to the Hong Kong Court of Final Appeal in the landmark case of *Democratic Republic of the Congo v FG Hemisphere Associates LLC* (the **Congo Case**). The NPCSC Interpretation states that the principles of state immunity are matters of foreign affairs which the CPG enjoys the sole power to determine and should apply uniformly within the whole territory of the PRC, and Hong Kong courts must not depart from them. Applying this reasoning, Hong Kong courts would

accept (or seek a certification from the Chief Executive under Article 19(3) of the Basic Law to confirm) that the FSIL represents the principles of state immunity adopted by the PRC, and apply its rule accordingly.

As explained above, a shift from absolute immunity to restrictive immunity would mean that foreign states would no longer be immune from suits for their commercial activities and their commercial properties may be subject to enforcement. The Congo Case, in which the Court of Final Appeal adopted the doctrine of absolute immunity and rejected the claimant's application to enforce an arbitral award against the asset of the Republic of Congo in Hong Kong, may be decided differently if it were to come before the court after the FSIL comes into effect.

Furthermore, the FSIL, in providing that immunity from suit and enforcement may be waived by written agreement, may also change the previous Hong Kong position that advance waiver is not effective. Waiver of immunity clauses in contracts may be given effect after 1 January 2024.

However, as the FSIL does not affect the position of domestic state immunity or Crown immunity, the position in the case of *Hua Tian Long (No. 3)* would continue to apply and the CPG would enjoy absolute immunity in Hong Kong. Nonetheless, Chinese SOEs would unlikely be able to claim any immunity save in exceptional circumstances in light of the findings of the Hong Kong court in the case of *China National Coal Group Corp*, and the related letter issued by the Hong Kong and Macau Affairs Office of the State Council which categorically affirmed the independent function and operation of Chinese SOEs from the CPG.



4. How does the FSIL affect arbitration

Arbitration proceedings are not directly affected by state immunity as they do not involve the exercise of jurisdiction by the court of one state over another state. Thus, where a state has submitted itself to arbitration by way of an arbitration agreement or an international treaty, it may not rely on state immunity to object to the tribunal's jurisdiction. In other words, states do not enjoy immunity from suit in relation to arbitration proceedings.

However, state immunity is also relevant for arbitration-related court proceedings. In this regard, the FSIL clarifies that foreign states may not claim immunity from suit against certain court proceedings in relation to arbitration arising out of commercial activities or investment disputes (including those under investment treaties), including those concerning the validity of the arbitration agreement, the recognition and enforcement of arbitration awards, and setting aside of arbitration awards (Art 12). The reach of Article 12 of the FSIL is not limited to arbitrations seated in the PRC or Hong Kong, such that foreign states would

no longer enjoy immunity from suit in these arbitration-related proceedings before the PRC or Hong Kong courts regardless of the seat of arbitration. This provides a long-awaited domestic legal basis for investors to seek recognition and enforcement of investor-state arbitration awards (including ICSID awards) against foreign states in the PRC.

For the avoidance of doubt, to execute an arbitral award against assets of foreign states successfully, the situation must still fall under one of the exceptions to immunity from enforcement as discussed above.

5. Practical implications on state-related cross-border disputes

The FSIL represents a welcomed change of the PRC's foreign state immunity policy, bringing it in line with the position adopted by most other jurisdictions.

The FSIL opens up the possibility of suing foreign states for their commercial activities in the PRC or Hong Kong. Together with the expansion of scope to enforce arbitral awards and court judgments against their commercial properties within the jurisdictions, the FSIL enhances the PRC's and Hong Kong's attractiveness as dispute resolution fora for foreign states-related commercial disputes.

To maximise the prospect of successful enforcement against foreign states and their assets, parties entering

into contracts with foreign states or state-related entities, regardless of whether the contract provides for arbitration or litigation in the PRC or Hong Kong, should include an express waiver of both the immunity from suit and immunity from enforcement in their contract. It would also be prudent to include a provision confirming that the agreement is of a commercial nature and arises out of commercial activities, to increase the likelihood that the parties can benefit from the restrictive immunity doctrine.

From a transactional perspective, the FSIL also facilitates the choice of Hong Kong law as governing law for transaction documents in cross-border commercial transactions relating to state entities or PRC SOEs and the use of Hong Kong courts or Hong

Kong arbitration for resolving disputes. Coupled with the benefits arising out of the Arrangement Concerning Mutual Assistance in Court-ordered Interim Measures in Aid of Arbitral Proceedings by the Courts of the Mainland and of the Hong Kong Special Administrative Region, and the upcoming Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters which will take effect in January 2024, there may be additional benefits in choosing Hong Kong law as the governing law for commercial contracts of transactions involving PRC state-related entities with assets in the PRC, and Hong Kong as a place for disputes resolution.

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