

China's New Foreign State Immunity Law Targets Commercial Assets and Transactions

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Introduction

On 1 January 2024, the Foreign State Immunity Law (the “FSIL”) came into effect in the People’s Republic of China (the “PRC”).

The FSIL is a new law passed by the Standing Committee of the National People’s Congress of the PRC on 1 September 2023. The FSIL represents a landmark change in the PRC’s foreign state immunity doctrine from absolute immunity to restrictive immunity, which is already applied in many jurisdictions. The new law permits foreign states to be sued in PRC courts in relation to their commercial transactions and parties to enforce judgments against foreign states’ commercial assets. Hong Kong is constitutionally required to follow the new law. The FSIL starts with the basic premise that, as a general principle, foreign states have immunity from suit and enforcement against their assets in PRC courts, subject to the exceptions set out in the FSIL. We highlight below the key provisions of the FSIL and the consequences for foreign states, parties transacting with foreign states and state-owned enterprises (“SOEs”).

Commercial Activities and Transactions

The FSIL introduces a commercial activities exception to foreign state immunity from suit and execution. It is now possible to commence proceedings in PRC courts against foreign states in relation to commercial transactions and to bring enforcement actions in respect of their commercial assets. Previously, this was prohibited under the absolute immunity doctrine.

Where a foreign state conducts commercial activities with an organisation or individual of another state, and this either takes place in the PRC or another place that has a direct impact on the PRC, the foreign state no longer has immunity from suit in any PRC court proceedings connected to the commercial activities. In determining what a

commercial activity is, PRC courts are required to take into consideration both the nature and purpose of the act. The FSIL contains a broad definition of commercial activities, including any transactions of goods or services, investments, borrowing and lending or other commercial acts that do not involve the exercise of sovereign authority.

Under the FSIL, a foreign state's assets are no longer immune from execution where they have been used in commercial activities, and execution is for the purpose of enforcing a judgment or ruling of a PRC court. Certain categories of foreign state property remain expressly protected. These include diplomatic property, military property, property of a foreign central bank and any other property that the PRC court concludes does not have any commercial use.

The Position in Hong Kong

Prior to the PRC's resumption of the exercise of sovereignty over Hong Kong on 1 July 1997, Hong Kong had followed a doctrine of restrictive immunity, as applied in many common law jurisdictions. In *Democratic Republic of Congo v. FG Hemisphere Associates*,¹ the Hong Kong Court of Final Appeal held that Hong Kong law must have close regard to the PRC's approach to foreign state immunity. This duty stems from Article 13 of Hong Kong's Basic Law. State immunity falls within the remit of the Central People's Government because it constitutes an "act of state" and "foreign affairs" within the meaning of Article 19(3) of the Basic Law. The Court held that Hong Kong could not, as a matter of legal and constitutional principle, adopt a doctrine of foreign state immunity that differs from that adopted by the PRC. Since this ruling, Hong Kong has followed the PRC's doctrine of absolute immunity.

The Central People's Government has stated that Hong Kong (and Macau) must follow the rules and policies set out in the FSIL. However, the FSIL is silent on its practical application to Hong Kong. In accordance with the approach followed in the *Congo* decision, Hong Kong courts must now follow a doctrine of restrictive immunity consistent with the provisions of the FSIL.

This will not enable parties to sue the PRC or the Central People's Government in Hong Kong courts. Hong Kong is a special administrative region of the PRC, which is not a foreign state. Both the PRC and the Central People's Government remain immune from suit in Hong Kong under the common law doctrine of absolute Crown immunity. Enforcement or execution against the PRC or PRC state entities in respect of assets

¹ [2011] 14 HKCFAR 496.

located in Hong Kong is not permitted unless immunity has been waived in the face of the court.² If the PRC state entity is deemed not to be controlled by the Central People's Government but can instead exercise independent powers of its own, then it is not entitled to assert Crown immunity.³

Foreign States and State-Owned Enterprises

Following the adoption of the FSIL, it is expected that Mainland Chinese and Hong Kong courts will continue to scrutinise the degree of control and intervention a state exercises over an SOE to determine whether it falls within or outside the definition of a “foreign state”.

Under the FSIL, a “foreign state” includes a foreign sovereign state, its state organs or constituent parts, and organisations and individuals authorised by the state to exercise sovereign authority or conduct authorised activities. If the foreign state, state organ, SOE, or state-authorized organisation or individual does not carry out any sovereign functions, it is not a “foreign state” within the meaning of the FSIL and thus does not enjoy immunity from suit or enforcement. The FSIL empowers the PRC's Ministry of Foreign Affairs to determine whether an entity constitutes a “foreign state” under the FSIL and to issue a certificate to set out the Ministry's position.

Various PRC laws and regulations already draw a distinction between states and SOEs. Even prior to the FSIL, foreign SOEs that do not carry out sovereign functions could already be sued and their assets enforced against in PRC courts. Under PRC law, foreign SOEs that possess operational autonomy and do not carry out sovereign functions are generally treated as separate entities from the state and do not enjoy state immunity, even where the state exercises a reasonable degree of control over them. It follows that awards issued against a foreign state cannot be enforced against SOEs operating in this way, as their assets are not treated as commercial assets of the foreign state.

The State Council of the PRC has previously clarified that a PRC SOE (a) is an independent legal entity carrying out activities on its own with no special status superior to other enterprises and (b) is not considered to be part of the Central People's Government or deemed as performing functions on behalf of the Central People's Government when carrying out commercial activities (save for in exceptional circumstances). This position is not impacted by the FSIL.

² *Intraline Resources SDN BHD v. The Owners of the Ship or Vessel “Hua Tian Long”* [2010] 3 HKLRD 611.

³ *TNB Fuel Services SDN BHD v. China National Coal Group Corp* [2017] 3 H.K.C. 588.

Hong Kong has already followed a similar approach in respect of PRC SOEs. In *TNB Fuel Services SDN BHD v. China National Coal Group Corporation*,⁴ the Hong Kong High Court adopted the common law “control test” by ascertaining the nature and degree of control exercised by the PRC authorities over the PRC SOE in question to determine whether it was a separate entity from the state. The Court concluded the PRC SOE in question was a separate entity, and issued an order for enforcement of an arbitral award against it.

Waivers of Immunity

On occasion, foreign states are willing to waive immunity when entering into commercial transactions. Such waivers are typically recorded in an underlying contract or an applicable investment treaty.

Under the FSIL, a foreign state’s express waiver of immunity from suit and/or execution must be given effect, whether that waiver is given by contract or by international treaty. However, the FSIL stipulates that a waiver of immunity from suit does not automatically imply a waiver of immunity from execution. This means that parties who wish to include a waiver of immunity provision in their contracts should ensure that its scope extends to both immunity from suit as well as execution. It remains to be seen whether contractual waivers of immunity given prior to the FSIL coming into force will be deemed effective or if such waivers must have been given only after the new law came into force.

In addition, the FSIL provides that a foreign state may be deemed to have waived its immunity if it brings, participates in or answers a claim (or counterclaim) in PRC court proceedings. Immunity will not be deemed to be waived if the foreign state commences a lawsuit only to invoke state immunity, sends representatives as witnesses before a PRC court, or agrees to the application of PRC law as the governing law of a dispute.

In Hong Kong, following the *Congo* decision, foreign state contractual waivers of immunity were no longer effective. The Court of Final Appeal held that immunity could only be waived in the face of the court after the lawsuit or enforcement action had been commenced and the court was requested to exercise jurisdiction. This will no longer be the position under the FSIL, as pre-dispute waivers of immunity will now be effective.

⁴ [2017] HKCFI 1016.

Arbitration Proceedings

Generally, foreign states do not have immunity from arbitration proceedings where the state has submitted to arbitration either by entering into an arbitration agreement or an international treaty providing for arbitration as a dispute resolution mechanism. Any such submission is generally viewed as an implied waiver of immunity.

Arbitration-related matters can also end up before courts. Typically, this occurs where interim measures are sought in support of an arbitration or at the stage of recognition, enforcement or setting aside of an arbitral award. The FSIL recognises this and expressly stipulates that the commercial activities exception applies in respect of arbitration-related court proceedings. Under the FSIL, foreign states are not immune from suit in respect of arbitration-related court proceedings that arise out of commercial activities or investment disputes, including proceedings commenced pursuant to investment treaties. This will entail significant benefits for award creditors, who will now be able to enforce awards from commercial or investment arbitrations against commercial assets of foreign states in both Mainland China and Hong Kong by registering the awards as judgments, provided that the awards arise out of the foreign state's commercial activities. It remains to be seen whether awards obtained prior to the FSIL coming into force will be deemed enforceable, or if awards must have been issued only after the new law came into force.

Conclusion

The FSIL represents a new chapter for foreign states in Mainland Chinese and Hong Kong courts. The adoption of the restrictive immunity doctrine increases significantly the scope for proceedings to be pursued against foreign states in respect of their commercial transactions and for enforcement actions to be taken against foreign states' commercial assets within the PRC.

Parties entering into commercial transactions with foreign states will benefit from the FSIL in the event that a dispute arises and it becomes necessary to enforce their rights against the state in PRC courts. Including express waivers of immunity that extend to both immunity from suit and enforcement, and that confirm that the contract is considered by the state to be of a commercial nature arising out of commercial activities, will provide additional protection to non-state actors and mitigate the risk of a PRC court concluding that immunity remains available.

Please do not hesitate to contact us with any questions.

Debevoise & Plimpton LLP, like other international firms in China, is not admitted to practice PRC law. Our views are based on our general experience in dealing with similar matters and consultation of published compilations of Chinese law. We would be pleased to arrange for assistance from licensed Chinese counsel should you require a formal opinion as to any of the matters set forth in this update.



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