

Hong Kong court refuses to grant Crown immunity to PRC state-owned enterprise

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In *TNB Fuel Services SDN BHD v. China National Coal Group Corporation* HKCFI 1016 ("**TNB Case**"), the Court of First Instance ("**CFI**") ruled that a PRC state-owned enterprise ("**SOE**") was not entitled to Crown immunity.

It upheld an arbitration award to be enforced against the SOE's assets in Hong Kong.

The TNB Case clarifies the position that any assertion of Crown immunity must come from the Crown; in this case by the Central People's Government ("**CPG**"). SOEs will unlikely be granted Crown immunity, entitlement to which will be assessed by the degree of control asserted on an SOE by the CPG.

The TNB Case suggests that an SOE with mainly commercial activities will unlikely be able to invoke Crown immunity.

Crown immunity

Crown immunity refers to a doctrine that the Crown enjoys immunity from being sued in its own courts. Such immunity was previously enjoyed by the British Crown and was transferred to the CPG when Hong Kong returned to China in 1997.

In the TNB Case, China National Coal Group Corporation ("**Respondent**") was an SOE. It tried to invoke Crown immunity to resist the enforcement of an arbitration award against its assets in Hong Kong. It claimed to be an entity under full control of the State-Owned Assets Supervision and Administration Commission ("**SASAC**"), which acted on behalf of the CPG.

The CFI rejected the Respondent's argument based on two grounds:

1. The Respondent failed to show that it had authority to assert Crown immunity on behalf of the CPG, and that no such claim had been validly made on behalf of the CPG; and
2. The CFI found as a matter of fact that under PRC law, the Respondent was neither a part of the CPG, nor SASAC. In this regard, the Respondent failed to satisfy the "control test".

Assertion of Crown immunity

Any assertion of Crown immunity must come from the Crown, in this case, the CPG as the highest executive body as defined in Articles 85 and 86 of the Chinese Constitution.

In *The Hua Tian Long* (No.2) [2010] 3 HKLRD 611 ("**HTL Case**"), Justice Stone (as he then was) advocated the adoption of a certification procedure; it was unsatisfactory for the court to referee a dispute on Crown immunity based on adversarial expert evidence.

In this case, there was no assertion made by the Respondent that it was authorised by SASAC or the CPG, or any other authority than the Respondent itself, to make the claim of Crown immunity.

The CFI highlighted that even in the HTL Case, the evidence from the manager of the defendants was that he was authorized and instructed by the Ministry of Communications, Guangzhou Salvage Bureau of the CPG, and not just by the defendants, to support the defendants' entitlement to Crown immunity.

In rejecting the Respondent's assertion of Crown immunity, the CFI placed great weight on a letter issued by the Hong Kong and Macao Affairs Office of the State Council ("**HK Office**"), which is an administrative office under the State Council, the highest organ of state power and administration under the PRC Constitution.

The letter stated that the Respondent is an independent legal entity carrying out activities of production and operation on its own, with no special status or interests superior to any other enterprises. As a SOE, the Respondent was not considered as a part of the CPG, nor was it deemed as performing functions on behalf of the CPG, when the Respondent carried out commercial activities.

Control test

In the TNB Case, the CFI applied the "control test" to determine the degree of control asserted by the CPG on the Respondent. The CFI listed relevant factors which have been considered by the courts in applying the control test:

1. independent discretion enjoyed by the entity;
2. control exercised by the Crown as investor;
3. the separate legal personality of the entity;
4. the power of the Crown to appoint and remove senior officers of the entity; and
5. the financial autonomy of the entity.

The CFI ruled that the Respondent had full autonomy and extensive independence in making decisions regarding its business, financial and management matters. For example, the board had powers and authority under the Articles (approved by SASAC) to determine its own investment plans, approve its annual financial budget, exercise management rights and appoint or dismiss its management team. It functioned just like other business enterprises and did not require approval from the SASAC or CPG in carrying out its daily activities or operations. The CFI stated it was significant that the Respondent had the right under the Assets Law to possess, use, profit from and dispose of its property. Although the Respondent was wholly owned by SASAC, SASAC only acted like a normal controlling shareholder of any company. Therefore, the Respondent was an independent legal entity separated from the CPG.

Distinguished from *The Hua Tian Long (No.2)*

The HTL Case was the first case that addressed the issue on "Crown immunity". In that case, the CFI granted Crown immunity to a public institution after applying the "control test".

Nevertheless, the TNB Case can be distinguished from the HTL Case. In the latter case, the public institution had no shareholder and no paid up capital. It had no right to use or dispose its assets. Therefore, the CFI decided that the public institution formed part of the Ministry of Communications. This decision is consistent with the TBN Case.

Key points

1. Crown immunity remains available to PRC public institutions in respect of suits, enforcement, and the execution of assets before the Hong Kong courts.
2. The entity relying on the Crown immunity claim has to satisfy the "control test", which will be determined by the Hong Kong courts on a case-by-case basis.
3. An SOE will unlikely enjoy Crown immunity as it is not a part of the CPG in the execution of any government function.
4. SOEs with mainly commercial business will unlikely be able to invoke Crown immunity if they enjoy a high degree of independence and autonomy in the overall decision making process.
5. If a Chinese entity intends to assert Crown immunity, it should seek endorsement from the CPG beforehand.
6. For companies that want to do business with a PRC entity, they should consider the following measures:
 - Identify whether the entity is an SOE or a public institution. If it is the former, it is unlikely that an SOE will enjoy Crown immunity. If it is the latter, Crown immunity will more likely be available.
 - Regardless what the answer is, waivers of the right to claim Crown immunity should be sought from the entity. However, it has not been tested whether such pre-contractual waivers are enforceable against entities that enjoy Crown immunity in Hong Kong.
 - Identify the main activities conducted by the entity. Is it mainly commercial or governmental?

Conclusion

1. The TNB Case suggests that Crown immunity will unlikely be available to PRC state-owned entities. Hence, they can be sued in the Hong Kong courts, and enforcement and execution can be made against their assets. This decision should provide comfort to international investors doing business with Chinese SOEs.

2. The position may, however, be different with regards to SOEs in foreign states, central banks, and sovereign wealth funds, which may be able to claim state immunity in the Hong Kong courts if they are deemed to be part of the 'state' or a state organ. How a Hong Kong court would

decide whether a foreign SOE, central bank and sovereign wealth fund is a state entity is, however, untested.

3. This is another arbitration friendly decision by the Hong Kong courts confirming the enforcement of an arbitral award by way of charging order. Awards have consistently been enforced against Chinese SOEs by the Hong Kong courts. For example, Hogan Lovells acted for Shandong Hongri Acron Chemical, a subsidiary of a Russian entity, in the enforcement of a CIETAC award against Petrochina International (HK) Corporation, a subsidiary of a large Chinese SOE: *Shandong Hongri Acron Chemical. Joint Stock Co v. PetroChina International (HK) Corp* [2011] HKCA 168.

4. The consistent enforcement of arbitral awards against Chinese SOEs by the Hong Kong courts aligns with a recent survey on Judicial Independence released by the World Economic Forum for 2016-2017. Hong Kong is ranked 8th overall but 1st in Asia, ahead of other arbitration friendly jurisdictions such as London (the U.K. is ranked 9th) and Singapore (ranked 23rd).

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