

# ANALYSIS



## Stateless Hong Kong Corporations

The United States Court of Appeals for the Second Circuit ruled in June 1997 in *Matimak Trading Co v Albert Khalily*<sup>1</sup> (by a decision of two to one) that Hong Kong corporations have no jurisdiction to sue in the federal courts of the United States of America. The matter was finally put to rest in January 1998 when the United States Supreme Court refused to hear an appeal from the decision.<sup>2</sup> The Court of Appeals decision, which was delivered after careful consideration of the relevant case law, brings about serious consequences for Hong Kong corporations and its business community. On a wider interpretation, the decision may extend to certain classes of individuals living in Hong Kong. Although the decision related to Hong Kong corporations and citizens in the period when Hong Kong was still a British colony, it cannot be predicted with confidence that a different conclusion would be reached subsequent to the reunification of Hong Kong with the People's Republic of China.

The facts were as follows. The plaintiff Matimak Trading Co Ltd ('Matimak') is a Hong Kong registered corporation with its principal place of business in Hong Kong. Matimak sued an individual and a New York corporation for breach of contract invoking the court's 'alienage jurisdiction,'<sup>3</sup> which provides jurisdiction over any civil action arising between 'citizens of a State and citizens and subjects of a foreign State.' The principal issue for determination was whether a Hong Kong registered corporation was a citizen or subject of a foreign state. The District Court judge raised the issue *sua sponte* and ruled that the court had no jurisdiction on the grounds that a Hong Kong corporation was not a citizen or subject of a foreign state.<sup>4</sup> Matimak appealed to the Court of Appeals which upheld the decision of the District Court. As noted above, the Supreme Court refused to entertain a further appeal.

### Alienage jurisdiction of the US federal courts

According to Article III of the US Constitution the federal courts have jurisdiction over 'all cases ... between a State, or the Citizens thereof, and foreign States, Citizens or Subjects.' The US Code reproduces this provision by providing that 'alienage jurisdiction' exists over any civil action arising between 'citizens of a State and citizens and subjects of a foreign state.'

<sup>1</sup> 118 F 3d 76 (2d Cir 27 June 1997) ('*Matimak*').

<sup>2</sup> 97-893; 1998 US LEXIS 693; 66 USLW 3491. To be more precise, the Supreme Court denied Matimak's petition for a writ of certiorari. A writ of certiorari is an order by the appellate court which is used when the court has discretion on whether or not to hear an appeal. If the writ is denied, the court refuses to hear the appeal and, in effect, the judgment below stands unchanged: *Black's Law Dictionary* (West Publishing Co, 5th ed 1979), p 1443.

<sup>3</sup> Under 28 USC Sec 1332(a)(2) (1994).

<sup>4</sup> 936 F Supp 151 (21 August 1996).

In their majority decision McLaughlin and Jacobs JJ identified three issues for determination: (1) whether Hong Kong was a foreign state such that Matimak was a citizen or subject of that foreign state; (2) whether Matimak was a citizen or subject of the United Kingdom; (3) whether any and all non-citizens of the United States might ipso facto invoke the court's alienage jurisdiction against a US citizen.

### Is Hong Kong a foreign state for the purposes of alienage jurisdiction?

The court was of the view that the first test for determining whether an entity was a foreign state was whether the entity had been granted formal recognition by the executive branch of the US government.<sup>5</sup> As to this, the parties agreed that Hong Kong had not been formally recognised as a foreign state. Counsel for Matimak then argued that there had been de facto recognition of Hong Kong, since the United States enjoyed diplomatic and economic ties with the territory. Whilst recognising that de facto recognition would suffice for the purposes of alienage jurisdiction, the majority ruled that the de facto test also depended heavily upon whether the executive regarded the entity as an 'independent sovereign nation.'<sup>6</sup> Case law showed that deference had been paid on many occasions to the views of the executive for the purpose of determining the extent of the courts' alienage jurisdiction.<sup>7</sup>

Hong Kong was a British dependent territory at the time the action was brought but maintained some independence in its international economic and diplomatic relationships. In matters of defence and foreign affairs, however, it remained dependent upon the government of the United Kingdom. The Justice Department had informed the court as amicus that 'the State Department no longer urged treatment of Hong Kong as a de facto foreign state.' Their Honours went on to point out that the courts had to respect the role of the executive branch in foreign affairs, both by acknowledging its evaluation of a foreign entity's sovereignty, and thus international standing, and by respecting its determination as to whether a foreign entity or its government should be

<sup>5</sup> See *Iran Handicraft and Carpet Export Center v Marjan International Co*, 655 F Supp 1275 (SDNY), aff'd 868 F 2d 1267 (2d Cir 1988).

<sup>6</sup> See *Jones v United States*, 137 US 202, 212 (1890); *Vermilya-Brown Co v Connell*, 335 US 377, 380 (1948); *United States ex rel D'esquiva v Uhl*, 137 F 2d 903, 906 (2d Cir 1943); *Calderone v Naviera Vacuba S/A*, 325 F 2d 76 (2d Cir 1963), modified on other grounds 328 F 2d 578 (2d Cir 1964). This same stance has been taken by the English courts: *Gur Corporation v Trust Bank of Africa Ltd* [1987] 1 QB 599, 625 (the general rule is that the judiciary and executive must speak with one voice) and by the courts of Hong Kong: *Ting Lei-miao v Chen Li-hung* (1997) HCt, Action No A5808 of 1991 ('the certificate of the executive remains conclusive').

<sup>7</sup> See *Abu-Zeinh v Feceral Labs Inc*, No 91-2148 at 3-5 (WD Pa Dec 7, 1994) (refusing to recognise Palestine as a foreign state for alienage jurisdiction purposes); *Bank of Hawaii v Balos*, 701 F Supp 744, 746-47 (D Haw 1988) (recognising the Republic of Marshall Islands as a foreign state); *St Germain v West Bay Leasing Ltd*, No 81-CV-3945 (EDNY Sept 30, 1982) (refusing to recognise the Cayman Islands as an independent foreign state); *Klausner v Levy*, 83 F Supp 599, 600 (ED Va 1949) (refusing to recognise Palestine as a foreign state); and *Betancourt v Mutual Reserve Fund Life Association*, 101 F 305, 306 (CCSDNY 1900) (recognising Cuba as a foreign state).

permitted to sue in a US court. Although several district courts had earlier concluded that Hong Kong was a foreign state for purposes of alienage jurisdiction,<sup>8</sup> these decisions had been arrived at in a cursory manner. Moreover, other courts had held that Hong Kong was not a sovereign state for alienage purposes.<sup>9</sup> The majority concluded that Hong Kong was not a foreign state for the purposes of alienage jurisdiction.

### Is Matimak a citizen or subject of the United Kingdom?

The next issue to be answered by the court was whether a corporation registered in Hong Kong was a citizen or subject of the United Kingdom. The United States had formally recognised the United Kingdom as a foreign state and foreign states were entitled to determine the scope of its citizens and subjects.<sup>10</sup> A corporation, for purposes of diversity jurisdiction, was a citizen or subject of the entity under whose sovereignty it was created. The Second Circuit, therefore, looked at the law of Great Britain to decide whether or not Matimak was a British citizen or subject. According to the British Nationality Act of 1981, which delineated British citizenship in detail, a corporation could not be a citizen or subject since the Act applied only to natural persons and not to corporations. Further, the British Nationality Act distinguished between citizens of the United Kingdom and citizens of British dependent territories; the latter had first to complete the citizenship application procedure and fulfil certain residency requirements in the United Kingdom before they could be designated as British citizens. The court held that Matimak was a corporation registered in Hong Kong and was entitled only to the protection of Hong Kong law.<sup>11</sup> Matimak was not, therefore, a citizen or subject of the United Kingdom and was, as a consequence, stateless. A stateless person might not invoke the alienage jurisdiction of a US federal court.<sup>12</sup>

<sup>8</sup> See *Timco Engineering Inc v Rex*, 603 F Supp 925, 930 n 8 (ED Pa 1985); *Refco Inc v Troika Investments Ltd*, 702 F Supp 684, 685 n 2 (ND Ill 1988); *Creative Distributors Ltd v Sari Niketan Inc*, No 89 C 3614, 1989 WL 105210 (ND Ill Sept 1, 1989); *Tetra Finance (HK) Ltd v Shaheen*, 584 F Supp 847 (SDNY 1984) ('it would seem hypertechnical to preclude Hong Kong corporations from asserting claims in our courts simply because Hong Kong has not been formally recognised by the United States as a sovereign in its own right'); *Cedec Trading Ltd v United American Coal Sales Inc*, 55 F Supp 722, 724 (SDNY 1983) (cited by Altimari J in his dissent in *Matimak*); and *Wilson v Humphreys (Cayman) Ltd*, 916 F 2d 1239, 1242 (7th Cir 1990) (cited by Altimari J in his dissent in *Matimak*).

<sup>9</sup> *Windert Watch Co v Remex Electronics Ltd*, 468 F Supp 1242, 1245 (SDNY 1979) (refusing to recognise Hong Kong as a foreign state but concluding that it was a Crown Colony of the United Kingdom).

<sup>10</sup> *United States v Wong Kim Ark*, 169 US 649, 668 (1898); *Ruggiero v Compania Peruana de Vapores 'Inca Capac Yupangui'*, 639 F 2d 872, 875 (2d Cir 1981); *Murarka v Bachrack Bros Inc*, 215 F 2d 547, 551-3 (2d Cir 1954).

<sup>11</sup> *St Germain v West Bay Leasing Ltd*, No 81-CV-3945 at 9 (EDNY Sept 30 1982 (corporation in Cayman Islands, whose corporate law is clearly independent from the United Kingdom's, is not a citizen or subject of the United Kingdom). Cf *Cedec Trading Ltd v United American Coal Sales Inc*, 556 F Supp 722, 723-4 & n 2 (SDNY 1983) (corporations in the Channel Islands, which are part of the United Kingdom proper, governed by British law and whose foreign affairs are entirely controlled by the United Kingdom, are citizens and subjects of the United Kingdom).

<sup>12</sup> *Kantor v Wellesley Galleries Ltd*, 704 F 2d 1088, 1092 (9th Cir 1983); *Sadar v Mertes* 615 F 2d 1176, 1183 (7th Cir 1980); *Standing Rock Sioux Indian Tribe v Dorgan*, 505 F 2d 1135, 1140 (8th Cir 1974); *Shoemaker v Malaxa*, 241 F 2d 129 (2d Cir 1957).

### Does 'citizen or subject' describe any or all persons who are not subjects of the United States?

Counsel for Matimak finally argued that the purpose of the legislation was to confer alienage jurisdiction over all suits between a US citizen and a non-US citizen. The court concluded that this argument was flawed. The court ruled that the Judiciary Act was subordinate to the Constitution of the United States and had to receive a construction consistent with the Constitution. The clear language of the Constitution and Judiciary Act did not support the conclusion contended for by counsel for Matimak. The plain language could only be overcome if there was 'a clearly expressed legislative intention to the contrary.'<sup>13</sup> No such contrary intention was shown in the legislative history of the Constitution. The idea of statelessness was not in the contemplation of the drafters of the Constitution. The overriding rationale of alienage jurisdiction was to accord foreign citizens a neutral forum in a federal court rather than to require aliens to litigate in state courts which might be perceived by a foreigner as biased in favour of their own citizens. This would avoid entanglements with foreign states and sovereigns. According alienage jurisdiction to a stateless person did not serve this rationale; there was no danger of foreign entanglements, as there was no sovereign with whom the United States could become entangled. The difficulties faced by stateless persons were somewhat mitigated by the fact that they could always sue in state courts.<sup>14</sup> The court held that the legislation could not properly be construed as extending the courts' alienage jurisdiction to all persons who were not citizens of the United States.

The majority, therefore, concluded that Matimak was not a citizen or subject of a foreign state and that there was no other basis for the court assuming alienage jurisdiction over Matimak's suit.

### The dissenting judgment of Judge Altimari

Judge Altimari dissented and put forward several arguments in favour of applying alienage jurisdiction to Hong Kong corporations. He began by illustrating the serious consequences of the majority decision. He pointed out that this decision sounded the death knell for Hong Kong corporations seeking access to the federal courts of the United States under their alienage jurisdiction. The purpose of alienage jurisdiction was to provide a neutral forum for disputes involving United States citizens and foreigners and to avoid entanglements with foreign sovereigns. The majority decision would have the effect of

<sup>13</sup> *Toibb v Radloff*, 501 US 157, 162 (1991).

<sup>14</sup> See *Romanella*, 114 F 3d 15 (2nd Cir 1997) and *Blair Holdings*, 133 F Supp 501.

antagonising two world forces, the United Kingdom and the People's Republic of China. The other remaining British Crown colonies<sup>15</sup> would also be placed in jeopardy. He asked rhetorically whether the majority decision would lead British courts to close their doors or limit access to United States corporations. Such an outcome could not have been the intention of the framers of the United States legislation.

His second argument was based upon the construction of the legislation. When the Judiciary Act had been first enacted in 1789, the expressions 'foreigner' and 'alien' had been used. The words had only been changed nearly one hundred years later to 'subject' and 'citizen' in conformity with the words used in the Constitution. The original words clearly showed that the intention of the framers of the Judiciary Act was to grant access to federal courts to all aliens involved in litigation with a US citizen. There was no indication that the subsequent change of wording was intended to limit the jurisdiction. The idea of statelessness was not in the contemplation of the drafters and it was likely that they envisioned 'citizens or subjects of foreign states' to be anyone who was not a United States citizen.

The judge's third argument was that a stateless corporation was 'an oxymoron' — in other words the concept was inherently contradictory. Corporations could only be established with the imprimatur of states. Under British law companies incorporated outside Great Britain without establishing a place of business there were governed by the corporate legislation in force in their place of incorporation. It could not have been the intention of the British legislature thereby to create stateless corporations. It was quite clear that when Great Britain had enacted its companies legislation, whereby Hong Kong corporations were not classified as British corporations, it did not contemplate that, as a result, Hong Kong corporations would be denied access to United States federal courts by reason of their statelessness.

Further, the judge asked rhetorically whether it was time to re-evaluate whether foreign laws should determine who was and was not a foreign citizen for the purposes of United States alienage jurisdiction and thereby deny privileges permitted by the Constitution. By so doing, there was a grave danger that discrimination might be unintentionally promoted against certain classes of people or entities.

There was also a strong case for maintaining that Hong Kong corporations should be considered to be citizens or subjects of Great Britain up to 1 July 1997. For the last 155 years Hong Kong had been inextricably linked to Great Britain; until reversion Hong Kong remained a British colony. Hong Kong law was not merely traceable to Great Britain but it existed only through the Queen, since the Governor of Hong Kong was appointed by the Queen and was empowered

<sup>15</sup> For example Bermuda, St Helena, Falkland Islands, British Virgin Islands, Cayman Islands, and Gibraltar.

by the Letters Patent to make laws. These ties should lead to the result that Hong Kong corporations were citizens and subjects of Great Britain.

Finally the judge contended that the United States and the international community had long recognised Hong Kong as an autonomous force. It had been so recognised for certain purposes by the US Congress<sup>16</sup> and was recognised as an autonomous entity for economic and trade purposes. Hong Kong was a contracting party to the General Agreement on Tariffs and Trade and was accorded most favoured nation status by the United States. It was a member of the Organisation for Economic Co-Operation and Development and a founding member of the World Trade Organisation. It had also acceded to several international conventions.<sup>17</sup> The federal courts had on several occasions recognised Hong Kong as well as other British dependent territories for the purposes of alienage jurisdiction.<sup>18</sup> Hong Kong was a unique and critical component in the scheme of international policies and global economic expansion and access to United States federal courts should be justified without exceeding the boundaries of judicial authority.

Judge Altimari concluded that there were adequate grounds for (i) recognising Hong Kong as a 'foreign state' for the limited purposes of alienage jurisdiction; (ii) recognising Hong Kong as a political subdivision of a foreign state; or (iii) recognising Hong Kong's people and entities as citizens or subjects of the United Kingdom and, after 1 July 1997, of the People's Republic of China.

### The consequences of the decision upon Hong Kong corporations

The ratio decidendi of the decision is confined to the jurisdiction of the US federal courts to adjudicate upon claims by corporations registered in Hong Kong. Its effect is that Hong Kong corporations cannot sue in US federal courts. Litigants may still, however, sue in the state courts depending upon the limits of the particular court's jurisdiction.<sup>19</sup> The court's holding causes serious consequences for Hong Kong corporations and places a new burden upon solicitors representing Hong Kong corporations in their business dealings with

<sup>16</sup> For example, for per-country numerical immigration limitations under s 202 of the Immigration and Naturalisation Act.

<sup>17</sup> For example, the Paris Convention on Industrial Property, the Berne Copyright Convention, and the Geneva and Paris Universal Copyright Conventions.

<sup>18</sup> See *Netherlands Shipmortgage Corp Ltd v Madias*, 717 F 2d 731 (2d Cir 1983).

<sup>19</sup> The advantage to foreign litigants of commencing action in the US federal courts is that they are presumed to be more impartial than state courts, a consideration which led to the enactment of the 'alienage' provisions of the US Code (see *Matimak*, p 13). Moreover, federal judges are considered to be more knowledgeable in commercial cases and are normally appointed from the higher ranks of the US legal profession. Judges in many state courts are elected and are not necessarily from the top levels of the legal profession, although in many states such as New York, California, and Illinois, the level of professionalism and knowledge of commercial matters of the state judiciary is often quite high, in part resulting from the fact that these states are host to cities which historically have been major commercial and trading centres.

US corporations. There was no foreign jurisdiction clause<sup>20</sup> in the contract upon which suit was brought providing that all disputes were to be resolved in the courts of the United States. Would the inclusion of such a clause improve the position of Hong Kong corporations? Could it be argued that by inserting such a clause in a contract the parties would clothe the US federal court with a jurisdiction that it would not otherwise have? The authors suggest that it is unlikely that a clause of this nature would clothe the court with jurisdiction it does not otherwise enjoy.<sup>21</sup> Of course, if this conclusion is wrong, the inclusion of a clause of this nature would be most desirable in the interests of Hong Kong contracting corporations. It would, however, be of no avail in the context of suits by Hong Kong corporations in tort.

A further issue is whether the effect of the decision will extend to US litigants suing Hong Kong corporations in US federal courts. None of the judges made mention of this situation. Although there are many instances of Hong Kong corporations being successfully sued in the US federal courts, it is difficult to see why this conclusion should not logically follow. According to the majority decision, the courts' jurisdiction is limited to actions between citizens of a state and citizens of a foreign state; since Hong Kong is not a foreign state and corporations registered in Hong Kong are not citizens of China, it would follow that a Hong Kong corporation could not be sued in the federal courts. Of course, the claimant could always choose to commence action in a state court.

Another consideration is whether a Hong Kong corporation could simply select Hong Kong as the forum in which to commence the action. Were this course of action to be adopted, the US defendant might argue that Hong Kong would not be the forum conveniens for the action.<sup>22</sup> If we assume that the US courts would be the more appropriate forum for the action, the plaintiff would then contend that, since litigation in the forum conveniens (let us assume the US federal courts) would fail on jurisdictional grounds and the plaintiff would, therefore, be deprived of a distinct juridical advantage if required to sue in the United States of America, the action in Hong Kong should, in the exercise of the court's discretion, be permitted to proceed.<sup>23</sup>

<sup>20</sup> That is, a clause whereby the contracting parties conferred jurisdiction on the US federal courts to settle any disputes arising between the parties.

<sup>21</sup> The position in England and Hong Kong is that the question of locus standi of the parties to proceedings goes to the jurisdiction of the court and, where the court has no such jurisdiction, the parties are not entitled to confer jurisdiction by consent: *Secretary of State for Social Services, ex p Child Poverty Action Group* [1989] 1 All ER 1047, 1056, cited with approval in *Killenny Ltd v Attorney-General* [1996] 1 HKC 30 (CA).

<sup>22</sup> See *Spiliada Maritime Corp v Cansulex Ltd, The Spiliada* [1987] AC 460 (HL) and the cases cited in *Halsbury's Laws of Hong Kong, Civil Procedure*, Vol 5, para [90.0907]. The forum non conveniens doctrine is also applied by the US courts: *Gulf Oil Corp v Gilbert* 330 US 501 (1947); *Piper Aircraft Co v Reyno* 454 US 235 (1981).

<sup>23</sup> *Halsbury's* (note 22 above), para [90.0907] n 15, especially *Power Curber International Ltd v National Bank of Kuwait SAK* [1981] 1 WLR 1233, 1240 (CA); *The Abidin Daver* [1984] 1 AC 398 (HL).

Finally, many solicitors in Hong Kong advise clients to establish corporations registered in British colonies or British dependent territories. These corporations are in no way affected by the resumption of sovereignty by China. It is clear that the *Matimak* decision seriously affects the commercial viability of these corporations and their desirability for investment purposes.

### The consequences of the decision on individuals resident in Hong Kong

The US legislation extends the courts' alienage jurisdiction to all cases between a state, or citizens thereof, and foreign states, citizens, or subjects. Clearly nationals of the People's Republic of China,<sup>24</sup> citizens of the United Kingdom,<sup>25</sup> and citizens of other independent countries doing business with US corporations in Hong Kong have a clearly established right to sue those US corporations in US federal courts. They are citizens of a foreign state. The court did however, obiter, express concern that the legislation might operate to the disadvantage of other groups in Hong Kong. The court made it clear that no 'citizen' of Hong Kong could sue in the US federal courts because Hong Kong is not a sovereign state. Since the Chinese Nationality Act has conferred Chinese nationality upon any person born in China (Hong Kong has always been for this purpose considered to be part of China) and all ethnic Chinese born in Hong Kong or born abroad whose parents are Chinese nationals or one of whose parents is a Chinese national, ethnic Chinese resident in Hong Kong will almost always have the right to sue in US federal courts. Any non-ethnic Chinese resident of Hong Kong, however, who holds a BDT or BNO passport,

<sup>24</sup> See Peter Wesley-Smith, *Constitutional and Administrative Law in Hong Kong* (Hong Kong: Longman, Asia 1993), pp 332–5. The Nationality Law of the People's Republic of China 1980 has been applied to the Hong Kong Special Administrative Region by Art 18 and Annex III of the Basic Law. Under that law Chinese nationality is conferred upon the following three classes of persons: (i) any person born in China whose parents are Chinese nationals or one of whose parents is a Chinese national; (ii) any person born abroad whose parents are Chinese nationals or any one of whose parents is a Chinese national (but a person whose parents are Chinese nationals and have settled abroad or one of whose parents is a Chinese national and has settled abroad and who has acquired a foreign nationality on birth does not have Chinese nationality); and (iii) any person born in China whose parents are stateless or of uncertain nationality but have settled in China. The Chinese Nationality Law does not recognise the concept of dual nationality. Further, nationality may be lost by the Chinese national settling abroad.

<sup>25</sup> The law relating to British citizenship is notoriously complex. See *ibid*, pp 328–31. Full British citizenship has been granted to many ethnic Chinese persons resident in Hong Kong (see, for example, the British Nationality (Hong Kong) Act 1990). Since these persons, unless they have lost their Chinese nationality by virtue of residence in the United Kingdom, are also classified as Chinese nationals under the Chinese Nationality Law, and since China does not recognise dual citizenship, their position in Hong Kong is unclear. What does seem to be clear, however, is that for the purpose of American alienage jurisdiction they will have the right to sue in federal courts (either as British citizens or Chinese nationals). Many ethnic Chinese living in Hong Kong have been granted British Dependent Territories Citizenship. This does not, however, give BDT passport holders a right to enter and remain in the United Kingdom. To this extent they would perhaps be unable to sue in US federal courts as British citizens. Since these people are also Chinese nationals under the Chinese Nationality Law, whatever difficulties they may face in the matter of consular protection in Hong Kong, it is suggested that they will encounter no difficulty suing in US federal courts as Chinese nationals.



may be regarded as stateless for the purposes of US alienage jurisdiction unless he has been granted full British citizenship or citizenship of another independent country.

### Does the decision still apply after reunification?

Perhaps the most important question requiring resolution is whether the reunification of Hong Kong with the People's Republic of China as from 1 July 1997 has altered and improved the status of Hong Kong registered corporations.<sup>26</sup> On a strict application of the law as expounded in *Matimak* there are no compelling reasons for concluding that the court would reach a different conclusion. In the post-reunification context the two significant tests to be applied are first whether Hong Kong is a foreign state for the purposes of the court's alienage jurisdiction and second whether a Hong Kong corporation is a citizen or subject of the People's Republic of China. Hong Kong was a colony of Great Britain. Great Britain was responsible for the colony's foreign policy. Hong Kong is now a Special Administrative Region of the People's Republic of China ('Hong Kong SAR'). China is responsible for its foreign policy. The test applied by the court was whether Hong Kong had been accorded formal or de facto recognition as an independent state by the US government. It would seem unlikely that the United States would now give such recognition to the Hong Kong SAR.

The second test is whether a Hong Kong corporation could be classified as a citizen or subject of the People's Republic of China. Again this seems unlikely since the Hong Kong SAR has been guaranteed its own legal regime under the Basic Law. Hong Kong registered companies have no obligations under the law of the People's Republic of China and they are not concurrently registered in China.

It would seem, therefore, that the unfortunate consequences of the *Matimak* decision will have carried over into the post-reunification era. Judge Altimari reaches this conclusion in his dissenting opinion, although his comments are obiter. The learned judge says:

[R]everision gives a Hong Kong corporation no advantage. Under the Basic Law laws previously in force in Hong Kong shall be maintained: see Article 8, Basic Law. Extending this same logic used to interpret citizenship under British law, a Hong Kong corporation will be governed by the Hong Kong Companies Ordinance of 1984 and not the Chinese Nationality Act which applied to natural persons. Therefore, a Hong Kong corporation will remain a citizen of Hong Kong after reversion and once again we sit on the horns

<sup>26</sup> Since the date of the judgment (27 June 1997) the judges have issued an amendment (30 August 1997) making it clear that the court expressed no view as to Hong Kong's current status.

of a dilemma. Unless we recognise Hong Kong as a limited purpose foreign state or as a political subdivision of China, alienage jurisdiction will be denied.

We however suggest that such a conclusion denies the legal reality of the situation. As from 1 July 1997, the Hong Kong SAR is now indeed a part of China as a matter of Chinese constitutional law and, therefore, Hong Kong-formed companies should be permitted to appear as parties in US federal courts, as the United States clearly recognises China as a sovereign state<sup>27</sup> and such companies are organised and established under the laws now existing in that particular part of China, in effect making such companies 'citizens' of China in the parlance of the United States Code 'alienage' provision.

The reasoning is as follows. Under Art 57 of the PRC Constitution<sup>28</sup> the National People's Congress ('NPC') is the 'highest organ of state power'. Pursuant to Art 62(5) of the PRC Constitution, the NPC has the power 'to decide on the establishment of special administrative regions and the systems to be instituted there.' Invoking such powers, on 4 April 1990 the NPC established the Hong Kong SAR with effect from 1 July 1997<sup>29</sup> and enacted the Basic Law of the Hong Kong SAR with effect from the same date.<sup>30</sup> Hence, Hong Kong became a Special Administrative Region of China and the Basic Law came into effect on 1 July 1997.

While the Basic Law provides in Arts 8 and 18 that the laws previously in force in Hong Kong before the change in sovereignty 'shall be maintained,'<sup>31</sup> this does not at all denigrate from the fact that, as of 1 July 1997, Hong Kong became part of China. Thus, even though the laws in Hong Kong may be based upon the English common law system, they are nevertheless the existing laws in a part of China. As the United States recognises China as a sovereign state, companies registered in Hong Kong (whether before or after 1 July 1997) should be considered as 'citizens' of China and therefore be permitted to appear as parties in US federal courts under the alienage provisions of the US Code.

<sup>27</sup> Pursuant to the Joint Communiqué of the United States of America and the People's Republic of China of 1 January 1979, released simultaneously in Washington and Beijing.

<sup>28</sup> Constitution of the People's Republic of China, adopted at the Fifth Session of the Fifth National People's Congress and Promulgated for Implementation by the Proclamation of the National People's Congress on 4 December 1982.

<sup>29</sup> Decision of the National People's Congress on the Establishment of the Hong Kong Special Administrative Region, adopted by the Seventh National People's Congress at its Third Session on 4 April 1990.

<sup>30</sup> Decision of the National People's Congress on the Basic Law of the Special Administrative Region of the People's Republic of China, adopted by the Seventh National People's Congress at its Third Session on 4 April 1990.

<sup>31</sup> These provisions, of course, mirror a similar provision contained in para 3(3) of the Joint Declaration of the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People's Republic of China on the Question of Hong Kong, executed in Beijing on 19 December 1984.

### Position of the Hong Kong SAR government on *Matimak*

In an amicus curiae brief filed on its behalf on 25 July 1997 in connection with a petition for rehearing the *Matimak* case en banc by the Second Circuit, the Hong Kong SAR government highlighted the foreign relations implications of the case for the United States. First, it was suggested that the Second Circuit decision undermines the provisions of the United States-Hong Kong Policy Act of 1992,<sup>32</sup> which provides for direct bilateral ties and agreements between the United States and Hong Kong. In the context of this Act, the brief noted that the United States and Hong Kong SAR governments were in the midst of negotiating an agreement for the promotion and protection of investments, one of whose terms should provide both national treatment and most favoured nation treatment by each party to investors (whether individual or corporate) from the other party. It was indicated in the brief that the *Matimak* decision's denial of access to federal courts in America by Hong Kong corporations would be 'directly inconsistent' with such a provision in an eventual Agreement for the Promotion and Protection of Investments between the US and the Hong Kong SAR. A trade official of the Hong Kong SAR confirmed in October 1997 that the investment protection agreement with the United States was still being negotiated and that, in the absence of a reversal of the Second Circuit decision by the US Supreme Court, the Hong Kong SAR government would seek 'other comfort' from the United States relating to the access to federal courts by Hong Kong corporations in the future. It is not entirely clear what this could mean short of legislation amending the relevant provision of the United States Code.

The second foreign relations issue featured in the Hong Kong SAR brief filed in *Matimak* concerned the so-called TRIPs Agreement<sup>33</sup> under the auspices of the World Trade Organisation ('WTO'), of which both the United States and the Hong Kong SAR are members, in the latter case as a 'separate customs territory.' As the TRIPs Agreement requires WTO members to accord most favoured nation treatment<sup>34</sup> as well as access to 'civil juridical procedures'<sup>35</sup> concerning the holding and enforcement of intellectual property rights to the nationals of other WTO members within their jurisdictions, the denial of access to federal courts under *Matimak* to Hong Kong SAR corporate holders of intellectual property rights for claims relating to such rights would amount to a violation of the TRIPs Agreement by the United States. Such a violation could eventually result in the Hong Kong SAR government invoking the

<sup>32</sup> 22 USC Secs 5701 et seq.

<sup>33</sup> Agreement on Trade-Related Aspects of Intellectual Property Rights, contained in GATT Secretariat, *The Results of the Uruguay Round of Multilateral Trade Negotiations: the Legal Texts* (Geneva: GATT Secretariat, 1994), p 366 et seq.

<sup>34</sup> *Ibid*, Art 4.

<sup>35</sup> *Ibid*, Art 42.

dispute settlement mechanism available under the auspices of the WTO, a result, it is believed, neither government would welcome.

In October 1997 it was reported in a Hong Kong newspaper that the Hong Kong SAR government had not decided whether it would file a further amicus brief if *Matimak* were appealed to the Supreme Court.<sup>36</sup> *Matimak* did, in fact, apply to the Supreme Court in December 1997, but the court refused to hear the appeal in January 1998. No amicus brief in support of the application was filed by the government of the Hong Kong SAR, although a supporting brief was submitted by the British government.<sup>37</sup> Apparently, the government of the Hong Kong SAR believed that its efforts and money would be more profitably utilised by way of supporting a case filed in a US federal court after the reunification of Hong Kong with China than on an appeal in *Matimak*.<sup>38</sup>

### The progeny of *Matimak*

There can be no doubt that there will be further litigation in the US federal courts on the issues raised in *Matimak*. An imponderable result of the *Matimak* decision is whether it will lead to a plethora of motions to vacate judgments previously obtained by Hong Kong corporations in federal courts throughout the United States of America. Conversely, it must be asked if Hong Kong corporations against whom judgments have been previously rendered in the US federal courts may now themselves move to have such judgments set aside in the wake of *Matimak*. A rash of such post-judgment motions in the federal courts could become an administrative nightmare. Of course, statutes of limitation relating to the cause of action previously sued upon would most likely have a significant bearing on the outcome of such proceedings, as would the doctrine of equitable estoppel. Nevertheless, although counsel for *Matimak* are aware of no such motions having been made at the present time, they hold the view that actions of this nature are feasible.

While *Matimak*'s influence on completed litigation remains to be seen, its impact has already been felt on pending litigation, again in the US District Court for the Southern District of New York, the court from which the decision in *Matimak* emerged. The Southern District case *Shamis v Ambassador Factors Corporation*<sup>39</sup> was decided on 15 August 1997, less than two months after the Second Circuit decision in *Matimak*. In *Shamis* the plaintiff, a citizen of Israel

<sup>36</sup> According to a report in the South China Morning Post of 26 October 1997 'Victim of legal limbo claims abandonment', the Hong Kong SAR Government was unwilling to provide funds to support an appeal to the US Supreme Court.

<sup>37</sup> According to the South China Morning Post, 8 February 1998, the brief from the British Government said 'This case raises important questions concerning whether the availability and protection of the US federal courts will be denied to the numerous corporations organised under the laws of the British Dependent Territories, which are territories under the sovereignty of the United Kingdom and whose laws are derived from United Kingdom legislation'.

<sup>38</sup> *Ibid.*

<sup>39</sup> 95 Civ 9818, 1997 US Dist, Lexis 12241.

and a British national, had been assigned claims against various New York defendants by the receivers of a Hong Kong corporation of which he had been a shareholder, officer, and director. The case primarily involved allegations of fraudulent factoring of accounts receivable and their diversion by the New York defendants from being paid over to the Hong Kong corporation as consideration for textile goods already shipped. It was also alleged that goods shipped to New York by the Hong Kong corporation had been fraudulently transferred.

The written assignment of the claims to the plaintiff was executed on the same day the complaint had been filed, 20 November 1995. In reply to a motion to dismiss the non-federal claims on the part of some of the defendants, US District Judge Sweet held that, although the case was filed before the *Matimak* decision, 'it was at least permissible to infer that the desire to secure a federal forum motivated the assignment,' as 'at the time of the assignment there existed enough authority to suggest to any Hong Kong-based party that it might be unable to establish diversity jurisdiction.'<sup>40</sup> Having made that determination, the judge then examined the facts surrounding the assignment of claims to the plaintiff in the light of another provision of the US Code<sup>41</sup> which bars jurisdiction of federal courts in civil cases where an assignment of claims has been made 'improperly or collusively ... to invoke the jurisdiction of the court.' Owing to the close connections between the plaintiff and the Hong Kong corporation, the judge further held that the assignment of claims had been 'presumptively collusive' and dismissed the non-federal claims, with leave to the plaintiff to replead upon a showing that the Hong Kong corporation's liquidators (receivers) 'are citizens of a nation officially recognized by the US Department of State as a foreign state.'<sup>42</sup> Clearly the US District Court judge's decision in *Shamis* was heavily influenced by the Second Circuit Court's decision in *Matimak*.

## Conclusions

So long as the *Matimak* decision stands, Hong Kong corporations cannot sue (and perhaps cannot be sued) in US federal courts of the Second Circuit. Although other Circuit courts are not strictly bound by a decision of the Second Circuit, they will undoubtedly be strongly influenced by it. This is a very unfortunate situation bringing with it serious consequences of both a financial

<sup>40</sup> Ibid, p 7 (citing *Land Oberoesterreich v Gude*, 109 F 2d 635, 637 (2d Cir 1940), cert denied, 311 US 670, 85 L Ed 431, 61 S Ct 30 (1940) and *Iran Handicraft & Carpet Export Center v Marjan International Corp*, 655 F Supp 1275 (SDNY, 1987), aff'd 868 F 2d 1267 (2d Cir, 1988), both of which cases are discussed in the Second Circuit *Matimak* decision). See discussion in text at note 5 above.

<sup>41</sup> 28 USC S 1359.

<sup>42</sup> *Shamis* (note 39 above), p 9.

and a political nature. The decision also impacts upon trade with the United States of America and the protection by Hong Kong companies of intellectual property rights in the US. Since an argument can be made that the position has changed as a result of Hong Kong's reunification with the People's Republic of China, further litigation on this point must be pursued in the light of the change in Hong Kong's status.

It would appear, however, that the most fruitful course of action that can immediately be pursued is to apply political persuasion upon the US State Department to accord some form of recognition to the Hong Kong SAR for the purposes of its corporations litigating in US federal courts. It is to be hoped that the outcome of such persuasion will be that the US federal courts will distinguish the position of post-reunification Hong Kong corporations from those under its predecessor regime.

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### Do We Still Need 'Shall'?

The recent Reservation of Question of Law<sup>1</sup> heard by the Court of Appeal in *HKSAR v Ma Wai-kwan* covered a number of fundamental issues relating to the constitutional validity of the Provisional Legislative Council and the acts of the National People's Congress. All of these issues are of great importance to Hong Kong. However, almost concealed in the judgment is an issue that is of equally great importance to the domestic issues of Hong Kong. That issue is the continued use of 'shall' in local legislation. While the Court of Appeal dealt with the issue of 'shall' in a traditional legal context and dismissed the arguments, the judgment and linguistic implications of this contentious word are worthy of serious consideration.

The judgment covers the arguments in detail and I will come to these in the course of this article. At this stage it is only necessary to look to the essence of the argument that was run in the Court of Appeal. Essentially this argument was that 'shall' has a future meaning. From this it flows that when Art 160 of the Basic Law ('BL160') says that 'the laws previously in force in Hong Kong shall be adopted' (emphasis added), the authorities in Hong Kong must take a positive step before the pre-existing law becomes the law of Hong Kong.

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1 *HKSAR v David Ma Wai-kwan* [1997] 2 HKC 315.