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Current Legal Developments in Hong Kong and China

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I. Introduction

In the following newsletter, we would like to inform you about the latest legal developments in Hong Kong and Mainland China. The main focus of this newsletter is on recent decisions regarding Arbitration, Labour Law as well as the implementation of "Rights of Third Parties" in Hong Kong.

II. Arbitration

In Hong Kong and Mainland China, legal disputes, particularly in international business transactions with large amounts in dispute (over USD 200,000), are regularly resolved through arbitration. The use of state courts is normally not a suitable alternative, as this procedure often leads to higher costs and time requirements. Another advantage of arbitration is the exclusion of the public as well as the confidentiality of proceedings and judgment. As a result, company secrets can be protected more efficiently. The growing importance of arbitration is reflected in the latest court rulings.

1. Arbitration Clause

a) Background

In "*Judger vs. Kroman*" *(Az. HCCT 6/ 2015)* ,the parties (a Hong Kong ship owner and a Turkish company) agreed by contract to resolve any legal disputes through an *arbitration court in Hong Kong.* Nonetheless, the Turkish company then asserted a claim due to alleged damage of the cargo and commenced litigation in a *Turkish court* against the ship owner. After that, the ship owner applied to the Court of First Instance ("**CFI**") for an injunction to restrain further conduct of the Turkish litigation against him.

b) Decision

At first, the CFI had to clarify the question of its own jurisdiction to grant the requested injunction. Because an arbitration-clause was the matter in dispute, the CFI pointed to two possible sources of authority, *Arbitration Ordinance* (*Section 45(2)) (Cap. 609)* as well as general procedural law*, High Court Ordinance (Section 21 L) (Cap. 4).*

In its judgement, the CFI ordered an injunction to restrain the Turkish company from further conduct of the Turkish litigation, as this procedure clearly was a breach of the contractually agreed arbitration clause. Nevertheless, because this judgement did not have any exterritorial effect, the Turkish company was free to continue court proceedings in Turkey. This may lead to the result of two different awards, the Turkish judgement as well as a Hong Kong arbitration award.

2. Enforcement of mainland awards in Hong Kong

a) Background

The underlying dispute arose out of a contract for sale of a property in Guangzhou, PRC between Ms Ho (a Hong Kong resident) as the seller, and on the other side the buyer and a PRC incorporated real estate agent. The dispute resolution clause in the sales contract provided for arbitration administered by the Guangzhou Arbitration Commission. The buyer and real estate agent subsequently initiated arbitration proceedings against Ms Ho after she had sold the property in question to a third party. The Chinese Arbitration Commission ruled in favour of the applicants and granted two so-called **Mainland awards**. After that, the ap-

plicants sought to enforce these awards in Hong Kong.

The proceeding of enforcing Mainland awards is explicitly regulated in *Section 92 ff. Arbitration Ordinance*. According to these rules, the applicant at first has to apply for an **enforcement order** at the Hong Kong Court.

In the present case, such an order was issued by the CFI. Subsequently, Ms Ho applied to the *Chinese* Intermediate People's Court of Guangzhou to set aside *the two arbitral awards*. She argued that she was not given proper notice (wrong address) of the arbitral hearing.

Her application was rejected on the grounds that Ms Ho had *actual knowledge* of the hearing. And according to *Chinese Arbitration Law* this leads to the cure of a defect in service.

Ms. Ho then contested the *Hong Kong Court's enforcement order* at the CFI.

b) Decision

The CFI granted the application and set aside the enforcement order. It based its arguments on the *Hong Kong Arbitrations Ordinance*. Under *Section 95(2)(c) Arbitration Ordinance,* enforcement of a Mainland award may be refused if the person against whom it is invoked proves that she

- was not given proper notice of the appointment of the arbitrator or of the arbitral proceedings; <u>or</u>
- was otherwise unable to present her case.

In this case, the CFI was of the opinion that these requirements were met and consequently judged contrary to the Chinese courts.

As a result, the applicants were not allowed to enforce the Mainland awards, at least in Hong Kong.

c) Comment

Parties to arbitral proceedings should beware of service requirements in respect of any documents involved. This must not only be in accordance with the applicable set of rules for arbitration agreed on by the parties, but also the law of the jurisdiction where enforcement is sought. The present case shows that the same situation can be judged differently by Chinese and Hong Kong authorities.

3. Enforcing a maritime arbitration award by arresting a ship

a) Background

The claimant chartered a motor tanker to the defendant charterers for five years under a charter contract which contained a London arbitration clause. The defendant failed to pay hire on time in full and the dispute between the parties was referred to arbitration. The claimant obtained a final award in his favour.

Subsequently, the claimant applied to the CFI to arrest the defendant's vessels anchored in Hong Kong as security for his claims. He highlighted to the court that the claim was put as one falling under *section 12 A(2)(h) High Court Ordinance*, being a claim *"arising out of any agreement relating to...the use or hire of a ship"* (i.e. a **maritime claim**). Therefore, the claimant asserted the court's competence to take such measures (i.e. **Admiralty jurisdiction**).

The defendant applied to the court to strike out the arrest of the vessel on the grounds that the proceedings and the arrest were in the nature of an application to *enforce the award*, and therefore an abuse of process. He submitted that the procedure of arrest was not available once the maritime claim had merged into a judgment or arbitration award**,** so that the claimant no longer had a maritime claim pursuant to *section 12*

A(2) HCO after the final award had been issued.

b) Decision

The court rejected the defendant`s submission and held that the maritime claim continues to exist as long as the award remains unsatisfied. For that reason, the claimant was entitled to arrest the vessel because the claim as pleaded was still a claim under *section 12A(2)(h) HCO.*

c) Comment

A claimant in arbitration proceedings who obtains a maritime award in its favour should be aware of the option of arresting a ship in Hong Kong. Such arrest will impose enormous pressure on the owner because he cannot use the ship and substantial costs arise.

The reason why previous cases have failed is because they sought to arrest on the basis of the **arbitration award**. What should have been done was the opposite, i.e. arrest on the basis of the **maritime claim**. Great care needs to be taken when preparing the arrest papers and this ought to be done by lawyers experienced in the arrest of ships.

III. Rights of Third Parties

The legal idea of *the contract to the benefit of a third party,* under German law regulated in §§ 328 f. BGB, will be implemented in Hong Kong, too. The *Contracts (Rights of Third Parties) Ordinance No.17(Cap. 623)* was passed in December 2014, and is expected to come into force in 2015.

1. Present legal status

Until now, as a principle of common law, in Hong Kong a person can only enforce a contract if he is a party to it ("**privity of contract**" rule).

This means traditionally lawyers have had to come up with alternative devices for conferring contractual benefits on third parties such as

- a deed poll – a type of deed made by and expressing the intentions of one party only, such as a power of attorney or a loan note instrument;
- agency arrangements – where a party enters into a contract as agent for its disclosed or undisclosed principal;
- collateral contracts/warranties – a contract between two parties may also be accompanied by a collateral contract or warranties between one of them and a third party in relation to the same subject-matter. Collateral warranties are extremely common in the construction industry.

2. New legal situation

The new rules provide a mechanism for parties to a contract expressly to agree in that contract that persons who are not parties to it will have rights under it.

a) Requirements

Therefore giving benefits to a third party is possible if:

- The contract expressly states so; or
- The contract **purports** to confer the benefit of that term on such person; and
- Such person is **expressly identified** in the contract by name or as a member of a group, such as all the employees of a business, all occupants of a building, all members of a group of companies, or all users of licensed software.

b) Legal consequence

In consequence, the third party is treated *as if they were actually a party* to the contract itself. This means the third party will be entitled to

claim damages and seek injunctions and specific performance. The availability of remedies will be subject to the usual rules governing their application under general law. However, the third party cannot enforce a term of a contract otherwise than in accordance with the other terms of that contract. For example, if there is a term which requires contractual disputes to be dealt with in a particular way (e.g., by reference to an expert, mediator, arbitrator), the third party will be bound to follow that route.

c) Revoking the benefits

To prevent contracting parties from undermining the rights granted to a third party, revoking or varying the terms of a contract requires the *third party`s consent* under the following circumstances:

- the third party has *assented* to the term and
- the promisor has *received notice* of the assent (whether in writing or orally).

In practice, the safest course for third parties will be to send a clear and unambiguous written notice to the promisor as soon as the contract is signed and the third party is aware of the benefit.

d) No burdens

The new rules do not provide to impose any burdens. Therefore, a third party cannot be bound by a contract or have obligations imposed on it against its will.

e) Exclusion

The following categories of contract are expressly excluded from the ambit of the new rules:

- a bill of exchange, promissory note or any other negotiable instrument;
- a deed of mutual covenant;
- a covenant relating to land;
- a contract of carriage by sea or by air under the Bills of Lading and Analogous Shipping Documents Ordinance (Cap. 440) and the Carriage by Air Ordinance (Cap. 500);
- a letter of credit.

3. Consequences for practice

With the implementation of *the contract to the benefit of a third party* the scope of contractual arrangements will be extended.

Examples:

- A supplier of goods may purport in its supply contract to exclude liability for the negligent acts not only of itself, but of its employees, agents and subcontractors.

- If a person enters into a contract with a tour company for a holiday package for its parents, and the tour company fails to honour the contract, then the new rules could enable the parents to sue the tour company directly for breach of contract.

- Health insurances of employers in favour of its employees often also cover the employee`s relatives. Because of the new rules, relatives will be able to assert their claims against the insurer on their own behalf.

If the contracting parties do not intend to benefit third parties, they should, for safety, include in their contract a blanket exclusion of the new rules.

IV. Labour Law

1. Implied Terms in law on employment contracts

a) Background

In the case of „*Tadjudin Sunny vs. Bank of America*" (*Az. HCA 507*), the plaintiff worked for several years for the defendant, a

bank in Hong Kong. The contract provided that the plaintiff was eligible to be considered for a bonus under the defendant's performance incentive programme. In Hong Kong's finance sector, bonus payments are an essential part of the total remuneration. Nonetheless, the *Employment Ordinance* (*Cap. 57)* does not provide any rules to that. On 28 August 2007, the defendant terminated the plaintiff's employment without paying her any bonus or pro-rata bonus for 2007. Thereupon, the plaintiff claimed against the defendant damages for wrongful termination of employment with the intention of depriving her of the performance bonus and thereby breaching the **implied term of anti-avoidance**.

According to the principles of common law, terms can become an integral part of a contract without explicit agreement, so called **implied terms**. The law on employment contracts e.g. recognises the **implied term of mutual trust and confidence**.

A term may only be implied into a contract if:

- it is reasonable and equitable;
- it is necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it;
- it is so obvious that "it goes without saying";
- it is capable of clear expression; and
- it does not contradict any express term of the contract.

b) Decision

After four years of proceedings, the court ruled in favour of the plaintiff. First, it held that the above requirements were fulfilled and therefore, the *implied term of anti-avoidance* became part of the employment contract.

The judge argued that the plaintiff could reasonably expect a bonus payment based on her performance in 2007 and that no talent would stay if he was under the constant fear that his employer would deprive him of the fruits of his effort by terminating him before the date of payment of the bonus. Without the assurance given by the implied term, the purpose of the bonus programme would be defeated. The defendant would be unable to retain talent and profit would suffer.

For that reason, the implied term of anti-avoidance did not contradict the expressly agreed term, which provided a short-period termination of the employment without the need of giving grounds for dismissal.

The plaintiff then proved that the defendant violated the implied term of anti-avoidance. It became apparent that the defendant had no other rational reason for termination than to avoid the upcoming bonus payment in December 2007 in the amount of USD 500,000.

2. Liability for occupational accidents

a) Background

The employee was employed by a Hong Kong company as a labourer on a construction site. As part of his responsibilities, the employee was required to unpack goods from crates and move them to the required location. During the performance of this work, the employee suffered several physical problems. He was admitted to hospital where he was diagnosed with spinal cord infarct with paraplegia. He subsequently asked his employer to pay HKD 1.6 million in compensation.

According to *Section 5 (1) Employees Compensation Ordinance (Cap. 282)*, an employer has an obligation to compensate an employee, if:

- the injury is suffered through an *accident* (i.e. unexpected and not deliberate),
- the accident arose *out of or in the course of* his employment and
- the accident was the *cause* of the injury.

b) Decision

The judge was of the view that these requirements were given and ruled in favour of the employee. The decision contained some notable points:

- Regarding the issue of *causation,* medical evidence was submitted by doctors for both parties. Neither was able to conclude with medical certainty the exact cause of the employee's injury. Nonetheless, the court considered that it is sufficient that the injury was *probably* caused by work activities.
- The employer has to compensate employees for personal injuries arising from workplace accidents even where the accident occurs through *no fault of the employer* or in circumstances in which the *employee acted contrary to his employer's orders.*

V. Miscellaneous

1. Trademark registration in China – Nicol(e) Kidman

a) Background

In 2006, a Chinese filed an application for registration of the trademark NICOL KIDMAN with the China Trademark Office. In 2009, the Trademark Office approved the registration of the trademark for umbrellas, purses etc.

The actress Nicole Kidman then filed an application for invalidation of the trademark with the Trademark Review and Adjudication Board ("**TRAB"**), claiming that the registration infringed her prior personal name rights and that the only intention in registering the mark was to take advantage of her reputation. This violated the good-faith principle and constituted an act of unfair competition.

b) Decision

In 2014, the TRAB ruled in favour of Ms Kidman and declared that the disputed trademark was invalid. The registration violated *Article 32 PRC Trademark Law: „No trademark application shall infringe upon another party's existing prior rights. …".*

Generally, an infringement of name rights requires that the name is identical to the trademark. However, in 2014 the Beijing High People's Court issued its Guide Concerning the Trial of Administration Cases of Trademark Authorisation and Confirmation, which clarifies that "*an identifying sign that is capable of being used in a corresponding relationship with a specific natural person may be considered as that person's name. … Fame may be a factor to assume such a corresponding relationship.*"

Therefore, small deviations (in this case the missing "e") shall be disregarded as long as there is a risk of confusion due to the circumstances.

Ms Kidman proved through various evidences such as movies, award ceremonies, magazine advertisements etc. that her name had a high reputation in China before the filing date of the disputed trademark.

2. New tax treaty between Hong Kong and Mainland China

On 1 April 2015, Hong Kong and Mainland China signed the Fourth Protocol to the comprehensive double taxation agreement. It will take effect in the course of this year and provides some tax benefits for Hong Kong companies/investment funds which operate in Mainland China:

- Tax exemption in China on gains derived from disposal of shares listed on a Chinese stock exchange.
- reducing the withholding tax rate for rentals from aircraft leasing and ship chartering from 7 percent to 5 percent.

We hope that the information provided in this newsletter was helpful for you.
If you have any further questions please do not hesitate to contact us.

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