Current Legal Developments in Hong Kong

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I. Setting aside arbitration awards

In August 2016, the Hong Kong Court of Appeal heard two cases on the issue of the court's ability to set aside international arbitration awards. In the first case, the court set aside the arbitration award because there was sufficient evidence that the applying party was unable to present its case to the arbitration tribunal properly. In the second case, the same court refused to set aside the arbitration award, as the court did not find sufficient evidence to do so.

1. Court of Appeal sets aside arbitration award

a) Facts

China Property Development (**CPD**) acquired a company (**BPP**) from Mandelcy (**Seller**). A dispute regarding the acquisition arose, and CPD and BPP together commenced arbitration proceedings against the Seller. Regarding one specific issue, the Seller argued only against BPP, and not against CPD, the other claimant. Thus, CPD was not able to present its case regarding the said issue. However, the Tribunal ruled on this issue against CPD.

CPD, therefore, applied to the court to set aside the arbitration award under Section 81 (2) (a) ii of the Arbitration Ordinance (**AO**), as it were unable to present its case to address those matters upon which the Tribunal might have based its decision.

b) Decision

The Court of First Instance (**CFI**) and Court of Appeal (**CA**) ruled that the Tribunal had denied CPD the opportunity to present its case. The CA also found that there was a breach

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of Section 81 (2) (a) iii AO, as the award dealt with a dispute beyond the scope of the arbitration.

2. Court of Appeal refuses to set aside arbitration award

a) Facts

A dispute arose with regards to four agreements between Tronic International (Claimant - **C**) and Topco Scientific (Defendant 1 - **D1**) and two other defendants (**D2** and **D3**). C submitted the case to arbitration, claiming damages against all Defendants for breach of contract. The Defendants submitted a counterclaim for damages for wrongful termination. The Tribunal awarded D1 and D2 damages and cost of arbitration.

C applied to the CFI to set aside the award on the grounds of Section 81 (2) (a) ii AO. C argued that it was unable to present its case and Section 81 (2) (a) iii AO, as the Tribunal considered issues which were not raised during the proceedings.

b) Decision

The CA ruled that C was given sufficient opportunity to make submissions prior to the tribunal's ruling. Article 19 of the ICC rules permits parties to raise new issues if authorised by the tribunal. The tribunal may at its discretion permit to argue newly arising issues as long as both parties receive the opportunity to present their case regarding the issue, including whether or not the issue should be canvassed. Here, the court ruled, C was given such an opportunity.

3. Comment

Both cases applied to the courts on the same grounds to set aside the respective arbitration award. CPD was successful in their claim due to the extraordinary circumstances and the tribunal's grave due process error.

Tronic's application to the court, on the other hand, rather appealed to the outcome of the arbitration, concerning the substantive merits of the dispute and the correctness of the award.

However, a motion to set aside an award has to show that a party's fundamental procedural rights have been violated (*Art. V of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards*). State courts will – in general – not assess the material findings and conclusions made by the tribunal. Regarding Tronic's arbitration process, there was no substantial breach of process.

Both cases show the Hong Kong Courts' positive approach to arbitration, with a firm ground not to interfere in arbitration awards and decisions unless there is a substantial breach of law.

II. No enforcement of arbitration awards which was already set aside at its seat

[Dana Shipping and Trading SA v Sino Channel Asia Ltd (HCCT47/2015)]

The CFI recently decided not to enforce an arbitration award based on an English court's decision to set aside said arbitration award.

a) Facts

A tribunal in London rendered an award in favour of the applicant (**A**), and A applied to the CFI for an enforcement order, which was granted.

The respondent (**B**) applied to the CFI to set aside the enforcement order. During the process in Hong Kong, B applied to the English courts to set aside the arbitration award, which was granted. Relying on the English judgement, B applied to the CFI to set aside the enforcement order.

b) Decision

The CFI found that the English award was in accordance with the same principles as Hong Kong law. The court also found that B did not abuse the process as B had reasonable grounds to rely on the English judgement when making his applications. Since the arbitration award was set aside in England, there was no basis for the CFI to enforce the (already set aside) English arbitration award.

This decision is not surprising since there is no ground to enforce an arbitration award that was already set aside at its seat.

III. Court refers matter to arbitration

[Chee Cheung Hing & Co Ltd v Zhong Rong International (Group) Ltd [2016] HKEC 656]

In this case, the CFI stayed court proceedings under Section 20 AO, which provides for referrals to arbitration where "*[…] an action is brought in a matter which is the subject of an arbitration agreement […].*" The CFI considered the arbitration agreement to be valid *prima facie* and binding despite the Plaintiff's contention that the underlying contract was not validly formed.

a) Facts

Chee Cheung Hing (**CCH**) commenced court proceedings seeking a declaration that the parties had not entered into a binding contract (for construction works) and was therefore entitled to compensation.

CCH sought the declaration on the basis that a letter of intent issued by Zhong Rong International (**ZRI**) did not constitute acceptance of the tender it had submitted for the works, and there was, therefore, no binding contract between the parties.

ZRI argued that the parties' signing of the letter of intent constituted acceptance of the tender, and the Plaintiff's execution of the works as well as the parties' subsequent conduct affirmed and evidenced the existence of a binding contract.

The conditions of the tender referred to the terms of the "Agreement and Schedule of Conditions of Building Contract" which included an arbitration clause. ZRI applied to the CFI under Section 20 AO on the basis that the contract (and arbitration agreement) between the parties were valid and binding, and therefore, CCH should start arbitration proceedings instead of submitting the matter to the ordinary courts.

b) Decision

The Court held that it should not attempt to resolve the issue and the matter should be referred to arbitration. The court found that the terms of both the tender and the letter of intent expressly provided that arbitration should resolve disputes.

This reasoning is a positive endorsement of the doctrine of separability of arbitration agreements in situations where the existence of the underlying contract is in dispute. The doctrine says that the dispute settlement clause has to be considered separate from the underlying contract. Thus, if the underlying contract is unenforceable, the dispute settlement agreement remains enforceable, and the dispute needs to be submitted to arbitration.

IV. Indemnity costs in Hong Kong Arbitration awards

[Peter Cheung & Co v Perfect Direct Limited & Yu Guolin (HCMP 2493/2012) and New Haven Investments Limited & Rondo Development Limited v Yu Guolin (HCA 115/2013)

In the above cases, the CFI has extended the principle of indemnity costs to cases where a party attempts to delay the enforcement of an arbitration award. While the action in the present judgment was not a direct challenge to an arbitral award, the CFI found that the purpose of the action was "*clearly an attempt to delay the enforcement of an arbitral award*". Therefore, indemnity costs (100% of the legal costs of the dispute) should be awarded to deter such behaviour, instead of only awarding costs on a party to party basis, based on which only 60% to 70% of the legal costs can be obtained from the losing party.

a) Facts

Yu Goblin (**Yu**) invested in a third company. Perfect Direct Limited (**PDL**) guaranteed to Yu the market value of shares of that company would remain stable (for ten months). However, the market value dropped and Yu, therefore, requested the guaranteed security. When PDL refused, Yu commenced court proceedings in Hong Kong.

Shortly after that the action was stayed with the consent of both parties and referred to arbitration in accordance with the arbitration clause of the guarantee agreement. An arbitral tribunal in Shanghai issued an award in favor of Yu, who then sought and obtained an Enforcement Order in Hong Kong.

PDL still refused to release the security and instead suggested to solve the matter by Hong Kong courts. Accordingly, Yu restored his claim in the court action.

Five working days before the hearing in the court, PDL applied to consolidate the action with another action ("Consolidation Summons"), which involved Yu and shared some overlapping facts. However, PDL did not file any evidence in support of the consolidation. Furthermore, PDL only belatedly filed evidence with regards to the initial court action.

The CFI had to decide whether costs regarding the consolidation and the court action should be ordered against PDL on an indemnity basis.

b) Decision

The CFI ruled that PDL had to pay costs on an indemnity basis. The CFI based its decision on PDL's overall behaviour (*including belated filing of evidence, attempt to re-litigate the same case in court and the failure to seek setting aside the arbitration award*), which justified the indemnity costs.

The extension of the indemnity costs principle, beyond challenges to arbitral agreements and awards to actions attempting delay, reinforces the pro-arbitration approach of the Hong Kong courts and its efforts to deter so-called tactics employed by unsuccessful parties to frustrate arbitral awards.

V. Summary

This summary of recent arbitration matters in Hong Kong shows that Hong Kong courts obtain a positive approach to arbitration and the basic rule remains that arbitration awards are quite difficult to be set aside by Hong Kong courts. This can be a double-edged sword because arbitration can be a way to settle a legal dispute outside of court quicker than submitting it to the ordinary Hong Kong courts, where proceedings usually take 18 to 24 months to obtain a first judgment. Furthermore, the arbitration award does usually end the dispute, because arbitration awards cannot be appealed and the courts will only in very limited cases set aside the award.

On the other side, it must be considered that there might be arbitration cases in which the award is plainly wrong, maybe because the arbitrator decided it wrongly or because the merits of the case were considered judged inconsistently. In such case, it is almost impossible for the losing party to set aside the award because the Hong Kong courts will only

consider whether fundamental rights have been violated and will not re-open the case again.

Before signing a contract with an arbitration agreement, it should carefully be considered whether arbitration is the appropriate matter for settling disputes, considering the above-mentioned pros and cons, but also considering that costs of arbitration do even for small cases easily exceed HKD 1 million.

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