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Hong Kong courts: pro-arbitration in principle and practice: U v A [HCCT 34/2016]

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It is well recognised that the pro-arbitration and pro-enforcement approach of Hong Kong courts is the key attribute that underpins Hong Kong's position as an attractive venue for commercial dispute resolution.

Due to the rapid economic growth in the markets and a surge in cross-border transactions, arbitration users across the globe are demanding a robust regulatory framework and a judicial climate that is pro-arbitration. Hong Kong has been successful in recognising these demands both in principle as well as in practice.

This article considers:

- The pro-enforcement approach of courts in Hong Kong in the context of the recent judgment in *U v A [HCCT 34/2016]*.
- Other important developments in the arbitration regime in Hong Kong.

U V A HCCT 34/2016 DECIDED ON 23 FEBRUARY 2017 BY THE HONOURABLE MADAM JUSTICE MIMMIE CHAN

In this case, the application of the respondents to set aside an order granting leave to U (the applicant) to enforce an ICC arbitral award rendered in Hong Kong was dismissed by the Hong Kong Court of First Instance.

Background

The underlying dispute arose under a preliminary assignment contract (PAC) dated 28 August 2007, under which U agreed to purchase from the first respondent 51% of the shareholding in a joint venture company (JV) in the People's Republic of China (PRC). The PAC also provided for transfer of various assets from the second respondent to the JV and change in the composition of the JV's board to reflect the new shareholding structure.

On 18 January 2008, a share transfer agreement (STA) was executed by the parties to finalise the arrangement, and was later submitted to the relevant PRC authorities for approval, as required under the PRC law. The provisions in the PAC regarding composition and control of the board were not contained in the STA approved by the authorities.

Disputes arose between the parties as to the composition of the JV's board and the transfer of assets as contemplated under the PAC.

The proceedings

On 30 September 2014, U commenced arbitration proceedings in Hong Kong against the respondents alleging various breaches on their part under the PAC. The arbitrator ultimately ruled in U's favour awarding him specific performance, damages and costs.

On 27 September 2016, the court granted leave to U to enforce the arbitral award in Hong Kong (the Order).

On 24 October 2016, the respondents made an application to set aside the Order on the grounds that:

- The respondents were unable to present their case.
- The award dealt with a difference not contemplated by or not falling within the terms of the submission to arbitration, or contained decisions on matters beyond the scope of the submission.
- It would be contrary to public policy to enforce the award and just to refuse the enforcement.

Issues and ruling

Ground one. The respondents had claimed in the arbitration proceedings that they were not bound by the terms and conditions of the PAC as it was invalid and ineffective under the PRC law. According to them, the PAC was a contract for the transfer of shares of a foreign-invested enterprise requiring approval of the relevant Chinese authorities to be legally valid and effective. They placed heavy reliance on a judgment dated 21 August 2015 handed down by a PRC court in a different set of proceedings between the second respondent and the JV, wherein it was ruled that the PAC was ineffective in circumstances where it did not have the requisite approval of the Mainland authorities.

However, the arbitrator held that the PAC was a framework contract, and not a share transfer contract requiring approval under the PRC law. The PRC judgment was not admitted in evidence. The arbitrator found that it was irrelevant to the determination of the dispute, since the nature of the proceedings and the parties involved in the PRC proceedings were different from those in the arbitration, and also that it was brought to her attention belatedly.

Challenging the enforcement of the award, the respondents contended that they were unable to present their case in the arbitration proceedings because the arbitrator had refused their application to adduce the PRC judgment as evidence on the issue of the validity of the PAC.

Justice Chan dismissed the respondents' submissions on this ground holding that no prejudice had been caused to the respondents by the arbitrator's decision. Citing the Hong Kong Court of Appeal case of Grand Pacific Holdings Ltd v Pacific China Holdings Ltd [2012] 4 HKLRD 1 (CA), where it was observed that the conduct complained of must be serious, even egregious, before a court could find that a party was unable to present his case, Justice Chan ruled that the respondents' complaint fell "short of such a standard". Her Ladyship further pointed out that depsite the arbitrator's decision to reject the PRC judgment as evidence, the respondents were given a full and fair opportunity to present expert evidence to the arbitrator, and to make submissions on PRC law governing the registration and approval requirements for foreign-invested enterprises, and the effect of PRC law on the PAC.

Ground two. The respondents submitted that the decision in the award relating to U's entitlement to appoint the Chairman of the JV's board was beyond the scope of the submissions, as the relief was not explicitly sought in the request for arbitration but only later included in the statement of claim.

On careful examination of the authorities, Justice Chan emphasised that the phrases "decisions on matters beyond the scope of the submission to arbitration" (as used in Article 34(2)(iii) of the Model Law for setting aside an award, and applied by section 81(1)(2)(iii) of the Arbitration Ordinance) and "a difference not contemplated by or not falling within the terms of the submission to arbitration" should be narrowly construed. They should only include decisions which are clearly unrelated to or not reasonably required for the determination of the arbitration, as "...to do otherwise would just as likely impede arbitration proceedings and increase costs, encouraging parties to segregate satellite or ancillary issues from an arbitration for separate court determination, and encourage unwarranted, microscopic and truncated challenges to an arbitral award, all of which is contrary to the objectives of the [Arbitration] Ordinance, to facilitate the fair and speedy resolution of disputes by arbitration without unnecessary expense".

Justice Chan further clarified that the scope of the parties' submission and reference to arbitration should be determined by the arbitration agreement, the request for arbitration and the pleadings served by the parties, however informal they may be.

Applying the principles to the present case, Her Ladyship held that the language of the contract, the ICC Arbitration Rules or the Arbitration Ordinance did not limit the relief sought in the arbitration to the claims made in the request. As the matter of appointment of the board chairman was "clearly related to and reasonably required" for the determination of the issues submitted by the parties to the arbitrator, these were considered within the terms of the submission to the arbitration.

Ground three. The respondents argued that it would be contrary to the public policy of Hong Kong to enforce the award as the PAC was invalid and ineffective under the PRC law for lack of registration. They also claimed that refusal of enforcement of the award would be just, since it would be contrary to PRC law and against the public policy of the PRC to enforce the award which requires performance of the respondents' obligations under the PAC on the Mainland.

Justice Chan relied on various Hong Kong decisions such as Hebei Import & Export Corp v Polytech Engineering Co Ltd [1999] 2 HKCFAR 111 and A v R (Arbitration: Enforcement) [2009] 3 HKLRD 389 to emphasise the restrictive scope of the term "contrary to public policy" and also made it clear that the ground should not be used as a "catchall provision whenever convenient".

Her Ladyship explained that an error of fact or law made by the tribunal is not a ground to resist enforcement and held that "It is not against the public policy of Hong Kong to enforce the Award whereby the Arbitrator ruled (rightly or wrongly) that the PAC is not one which by its nature requires registration and approval by the Mainland authorities...".

Her Ladyship took the final view that it remains for a party in whose favour an arbitral award is given to take steps to seek enforcement of the award in the appropriate jurisdiction. Her Ladyship ruled that "...So far as Hong Kong is concerned as the court of enforcement of the Award in Hong Kong, the impossibility of performance of the PAC and Addendum C on the Mainland by virtue of any alleged non-compliance with PRC law is not a ground to resist enforcement in Hong Kong. Considering the public policy interests in favor of enforcing arbitration agreements and arbitral awards in Hong Kong, and the fact that resisting enforcement of the Award on the Mainland is an option open to the Respondents, I cannot agree that it would be just to refuse enforcement of the Award in Hong Kong, on the Respondents' assertion that enforcement of the Award on the Mainland would be against the public policy on the Mainland or against PRC law - expressly contrary to the findings made by the Arbitrator applying PRC law".

Conclusion

The above decision is a recent example of the progressive approach of the Hong Kong judiciary towards arbitration. It demonstrates the pro-enforcement bias of the courts and assures commercial parties that an arbitral award will generally not be set aside unless there are very strong grounds.

Hong Kong courts continue to maintain a policy of minimal intervention and routinely support the arbitral regime by upholding its independence and finality. There is no doubt that Justice Chan's decision inspires confidence in parties considering arbitration as a forum for dispute resolution in Hong Kong.

The case also serves as a warning to parties that indemnity costs will follow in the event of an unmeritorious attempt to resist enforcement in Hong Kong.

OTHER SIGNIFICANT INITIATIVES AND DEVELOPMENTS IN THE ARBITRATION REGIME

Some of the most noteworthy developments in the arbitration regime in Hong Kong this year include the following.

Arbitration of disputes involving IPR

On 2 December 2016, the Arbitration (Amendment) Bill 2016 was gazetted by Hong Kong with the objective of clarifying that disputes over intellectual property rights (IPR) can be resolved by arbitration, and it will not be contrary to the public policy of Hong Kong to enforce awards involving IPR.

The effect is that enforcement of an award will not be refused in Hong Kong under either the arbitrability ground or the public policy ground merely because the award involves IPR. These changes are expected to come into effect on 1 January 2018.

First CIETAC HK award enforced in mainland China

On 13 December 2016, the Nanjing Intermediate People's Court of Jiangsu Province enforced an arbitral award made by the China International Economic and Trade Arbitration Commission Hong Kong Arbitration Center (CIETAC HK), making it the first CIETAC HK award to be enforced in mainland China. The underlying arbitration proceedings in Hong Kong were commenced by Ennead Architects International LLP (Ennead), an American architecture firm, against Fuli Nanjing Dichan Kaifa Youxian Gongsi (Fuli Nanjing), a Chinese property developer, for unpaid design fees.

The award was issued in favour of Ennead and required Fuli Nanjing to pay all of Ennead's outstanding fees and interest, as well as the arbitration costs. Ennead brought the enforcement proceedings in Nanjing to enforce the interest portion of the award, part of which had already been complied with by Fuli Nanjing. Relying on the 1999 Arrangement Concerning Mutual Enforcement of Arbitral Awards between Mainland China and Hong Kong, and further noting that the enforcement of the award would not contradict the public interests of mainland China, the Nanjing Court ruled to enforce the outstanding interest portion of the award.

Although Fuli Nanjing did not object to the enforcement of the award, this is a significant precedent confirming that Chinese courts are prepared to recognise and enforce the awards made by CIETAC HK. The ruling will also enhance Hong Kong's position as one of the most preferred and comforting forums for resolution of China-related disputes with a nexus to Hong Kong, and is a welcome move for parties entering into cross-border transactions in general or seeking to enforce CIETAC HK awards in mainland China.

CIETAC HK, which was established in 2012 as the first overseas sub-commission of the Chinese arbitral institution, only began to accept and administer cases since 1 January 2015 in accordance with the updated China International Economic and Trade Arbitration Commission Arbitration Rules 2015.

Lapse of automatic opt-in provisions

The automatic opt-in provisions applicable to the domestic regime under the Arbitration Ordinance expired on 1 June 2017, after the six-year transitional period came to an end. When the Hong Kong Arbitration Ordinance came into effect on 1 June 2011, it sought to create a unitary regime for arbitration in Hong Kong by eliminating

the distinction between domestic and international arbitration regimes. However, as various industries expressed a preference towards domestic arbitration, a provision was made to opt into the domestic regime by simply referring to "domestic arbitration" in their arbitration agreements.

Parties entering into agreement on or after 1 July 2017 and wishing to use the domestic regime will be required to expressly opt in to the provisions under Schedule 2 of the Ordinance, which contains provisions for:

- Having the dispute submitted to a sole arbitrator (paragraph 1).
- Consolidation of arbitrations (paragraph 2).
- Determination of preliminary points of law by the court (paragraph 3).
- Challenging arbitral awards on grounds of serious irregularity (paragraph 4).
- Appeal against the arbitral awards on questions of law (paragraphs 5, 6 and 7).
- Parties will remain free to adopt Schedule 2 in whole or in part.

Third party funding of arbitration and mediation proceedings

On 14 June 2017, Hong Kong passed the Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Bill 2016 legalising third party funding of arbitration and mediation proceedings in Hong Kong and abolishing the offences of champerty and maintenance in this context.

The Ordinance represents a significant and essential development for Hong Kong as an international dispute resolution centre, brining it in line with most other jurisdictions such as England and Wales, Australia, France, Germany, The Netherlands, Switzerland, Korea, the PRC, the EU and the US.

In summary, a third-party funder is now permitted to provide funding to a party pursuant to a funding arrangement (which must be in writing and made after the amended law takes effect), in return for a financial benefit if the arbitration/mediation is successful within the meaning of the funding agreement.

The law also contains disclosure requirements regarding informing the other parties and the relevant court or tribunal about the:

- Fact of a funding agreement.
- Name of the funder.
- Termination of the funding agreement (other than because the arbitration/mediation has ended).

It is proposed that a code of practice will be issued for monitoring the activities in connection with third party funding, including provisions for capital requirements, disclosure, privilege and conflicts of interest. The changes are expected to come into effect later this year.

CONCLUSION

Forward-looking reforms, the unobtrusive support of the judiciary and the positive trend of enforcement of awards continue to reinforce Hong Kong's position as one of the most preferred and comforting forums for international commercial dispute resolution.

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Experience

- Acting for publicly listed companies, senior employees, the Hong Kong Government, the US Government, major international banks and corporations throughout the world.
- Multi-jurisdictional fraud and international asset tracing litigation. Often requiring cross-border applications, freezing/gagging applications, urgent injunctive relief, the examination of senior executives/bank officers and recovery and enforcement proceedings generally.
- Extensive experience in forcing banks and financial institutions to provide information to assist in tracing and recovery of funds and fending off vulture funds in respect of international sovereign debt recoveries.
- Investigations and charges arising out of the Independent Commission Against Corruption and other regulatory bodies in Hong Kong.

Professional associations/memberships

- Consistently ranked as a top tier lawyer in the major legal guides. Recognised as a Leading Individual in the dispute resolution category in both Legal 500 Asia Pacific and Chambers Asia Pacific guides since 2011. Consistently ranked in Asialaw Leading Lawyer, the ALB Hong Kong Law Awards and Who's Who Legal Asset Recovery.
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Experience

- Disputes involving breach of contract, as well as tort and negligence claims, joint venture and shareholders' disputes, asset tracing and Mareva injunctions, SFC and ICAC investigations, enforcement of Hong Kong and foreign judgments.
- Matters relating to default of payment and commercial fraud, assisting liquidators and creditors in insolvency and bankruptcy matters.