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What's inside?

Adjudicator's claim for fees after resignation upheld

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In *Steve Ward Services (UK) Ltd v Davies & Davies Associates Ltd [2022] EWCA Civ 153*, England's Court of Appeal unanimously upheld the decision of the court below which had granted summary judgment to an adjudicator to enforce payment of his fees arising from an adjudication in which the adjudicator resigned prior to issuing a decision. The principal issue raised in the appeal concerned an adjudicator's entitlement to his or her fees, in circumstances where they have resigned from the referral because they did not consider that they had the necessary jurisdiction to decide the dispute. As the Court of Appeal pointed out, there is very limited authority on this point, and it had been eight years since the Court of Appeal last considered an adjudicator's entitlement to fees in circumstances where the referral did not go as anticipated. The decision is therefore of some importance.

Background

The Defendant (Steve Ward Services (UK) Ltd) carried out construction operations at a restaurant called "Funky Brownz", owned and operated by a company, BIL as "Funky Brownz". Ms Vaishali Patel was a director and the majority shareholder in BIL. A set of contract documents were drawn up but not signed, in which the client was described as "Vaishali Patel Funky Brownz". Invoices for the works as they progressed were addressed to and paid by BIL. As at completion of the works, the Defendant claimed an unpaid balance of £35,974.29 and the parties then fell into dispute on the unpaid balance and defects.

Subsequently, the Defendant commenced adjudication proceedings and appointed Mr Davies of Davies & Davies Associates Ltd as the adjudicator. However, before making a decision, the adjudicator resigned on the basis that BIL was not a party to the adjudication for which he had been appointed and that the relevant contract was in fact between the Defendant and Ms Vaishali Patel.

The adjudicator's contract of appointment, was made up of i) his letter to the parties; ii) his own terms of appointment; iii) the CIC Low Value Dispute Model Adjudication Procedure (1st Edition)(MAP); and iv) the Scheme for Construction Contracts (England and Wales) Regulations 1998 (SI 1998 649), as amended (Scheme).

The adjudicator issued an invoice for payment of his fees, which the Defendant refused to pay, on the basis that the adjudicator had committed a repudiatory breach of his contract of appointment. The Defendant was said to have accepted the adjudicator's repudiation, so that his terms and conditions of appointment had ceased to have effect.

The adjudicator's terms and conditions of appointment provided that *"In the event of the Adjudication ceasing for any reason whatsoever prior to a Decision being reached, a Fee Invoice will be raised immediately and is due for payment 7 days after the date of the Invoice*". They also provided that "*The Parties agree jointly and severally to pay the Adjudicator's fees and expenses as set out in this Schedule. Save for any act of bad faith by the Adjudicator, the Adjudicator shall also be entitled to payment of his fees and expenses in the event that the Decision is not delivered and/or proves unenforceable.…*" (Clause 1).

Decision of the High Court (Technology and Construction Court (TCC))

The TCC held that:

- It would have been wiser for the adjudicator not only to inquire as to the parties' position as to who were the contracting parties, but also to inquire whether both parties accepted that he had jurisdiction. However he did not do that.
- The effect of what the adjudicator did was to deprive the parties of an answer to their differences as to what sum was payable (either by Ms Patel or by BIL) in respect of the project.
- The route which the adjudicator took was outside the ambit of paragraph 13 of the Scheme: that paragraph entitles the adjudicator to investigate matters "necessary to determine the dispute", which necessarily involves the question, what is the dispute? At the time when the adjudicator resigned, there was no dispute either as to the identity of the contracting parties or as to his jurisdiction.
- Accordingly, the adjudicator's reasoning in deciding to resign on the basis that he had no jurisdiction when that was not an issue which the parties had referred to him, was erroneous.
- However, that was not the end of the matter, as it was necessary to consider whether the adjudicator was nevertheless entitled to the fees claimed.
- The adjudicator acted in accordance with what he regarded as being his duty. Far from there being a "deliberate and impermissible refusal to provide a Decision", the adjudicator resigned on the basis that it was not open to him to reach a Decision in a dispute between the Defendant and BIL of the rights and obligations of a contract between the Defendant and Ms Patel.
- Further, resignation by an adjudicator is not of itself a breach of the terms of the adjudicator's engagement since paragraph 9(1) of the Scheme permits the adjudicator to resign at any time on giving notice to the parties: the question here was whether upon resigning, the adjudicator was still entitled to his fees and the answer to that question turned upon the true construction of the adjudicator's terms and conditions.
- A situation such as this, where an adjudicator acting with diligence and honesty comes to the conclusion that the proper course is for him to exercise his right under Paragraph 9(1) of the Scheme to resign, is not a situation within the expression "bad faith".
- Accordingly, on the true construction of his terms and conditions of appointment, the adjudicator was entitled to be paid for the work done by him, subject to the application of the Unfair Contract Terms Act 1977 (UCTA).
- The clause in the adjudicator's terms of appointment regarding bad faith (referred to above) did not fall foul of the UCTA.

The Appeal

The Defendant appealed against the TCC decision and the adjudicator cross-appealed to challenge the one finding made against him, namely that his reasons for resignation were "erroneous" and that, in so acting, he went beyond his powers.

Issues on appeal

Was there a jurisdictional issue in the adjudication?

The Court of Appeal held that there was.

Was the adjudicator entitled to decline jurisdiction and resign in consequence?

The Court of Appeal held that the adjudicator was entitled to decline jurisdiction and resign because:

- The adjudicator was entitled to resign in any event pursuant to the terms of the Scheme, which did not require resignation to be for a good cause;

- Since there was an unqualified entitlement on the adjudicator's part to resign, it was impossible to say that he could not do just that. However, both the Scheme and MAP were silent about any entitlement to fees, and such an entitlement following resignation may well turn on two matters, namely why the adjudicator resigned and the terms of their contract of appointment.

- As to why the adjudicator resigned, there was no doubt that, in the circumstances of this case, the adjudicator was entitled to decline jurisdiction and resign - he had good cause to do what he did.

- Under the Scheme, the adjudicator has to investigate the matters "necessary to determine the dispute". If an adjudicator considers that it is necessary to work out if he or she has the jurisdiction to determine the dispute in the first place, then they are duty bound to consider and determine that issue. That in turn means that they should raise that issue with the parties before coming to their own conclusion. The Scheme gave the adjudicator the express power to do just that: to consider and raise with the parties a point which they had not raised but which he thought was important.

- It would strike at the heart of an efficient system of adjudication and adjudication enforcement if adjudicators were encouraged to believe that they must stay silent when they spot a potential jurisdictional problem, and wait for the parties to raise it before considering it themselves. It would be when an adjudicator took this 'ostrich' option, and the jurisdictional challenge was subsequently successful such that enforcement was refused, that an unsuccessful claimant would have a better argument that the adjudicator should not recover his or her fees, because they should have pointed out the jurisdictional problem when they first spotted it.

Subject to bad faith, was the adjudicator entitled to be paid for the work done prior to his resignation?

The TCC judge had construed the adjudicator's terms and conditions to mean that he was entitled to be paid fees for the work he had done, unless there had been an act of bad faith on his part. The Court of Appeal held that, subject to the question of bad faith, the judge's construction of Clause 1 was correct.

The Court of Appeal noted that there was no binding authority on an adjudicator's entitlement to fees when he or she resigns and that the leading case on an adjudicator's entitlement to fees when the adjudication does not go as expected is PC Harrington Contractors Ltd v Systech International Ltd [2012] EWCA Civ 1371.

Drawing the various strands together, the Court of Appeal summarised the applicable principles as follows:

(a) Under the provisions of the Scheme, an adjudicator is entitled to resign. No reason is required.

(b) Whether or not the adjudicator is entitled to fees following any such resignation, will depend on i) the precise terms of his or her appointment, and ii) the conduct of the adjudicator.

(c) The court's consideration of conduct may involve asking why the adjudicator resigned, so it may matter whether the adjudicator was right or wrong to resign.

(d) A finding that the resignation involved or was the result of default/misconduct or bad faith, depending on the terms of appointment, will - in accordance with the general approach in PC Harrington - usually be sufficient to disentitle the adjudicator from recovering fees. Conversely, absent such a finding, there will usually be an entitlement to the fees incurred prior to resignation.

Was the adjudicator guilty of bad faith?

The Court of Appeal said that it was made plain in a recent Supreme Court decision that, depending on the circumstances of the case, an act of bad faith will usually require some measure of dishonesty or unconscionability.

The Court of Appeal said that as a matter of principle there was plainly a difference between default or misconduct (an expression used in the Scheme), on the one hand, and bad faith (as per Clause 1 in the adjudicator's terms) on the other. For the purposes of Clause 1, a finding of bad faith must involve some form of unconscionable or deliberately unacceptable conduct on the adjudicator's part, which is more serious than simple default. An adjudicator may be guilty of default or misconduct because, as in PC Harrington, he conducts the adjudication in such a way that the parties end up with an unenforceable decision. But that default or misconduct may have been wholly inadvertent on his part.

The Court of Appeal added that the qualitative difference between the two is also reflected in the Scheme. There, liability for the adjudicator's acts or omissions is excluded, unless there is also bad faith. That makes it plain that bad faith is more serious than simple default or misconduct, and therefore there is a higher threshold before it can be established.

The Court of Appeal held that the adjudicator was not guilty of default/misconduct, much less bad faith. He had raised a real issue as to jurisdiction; he had not received what he quite reasonably considered proper answers; and in the circumstances, in the judge's words, he had acted with 'diligence and honesty' in coming to the conclusion that the proper course was for him to resign.

The only criticism of the adjudicator's conduct which the Court of Appeal accepted was his failure to give the parties a final warning prior to resigning. However, given the circumstances of this case, that conduct did not fall outside the commercial norms to be expected of an adjudicator. There was nothing unconscionable about what the adjudicator did. He had done his best to get answers to his questions and had failed. Although he should have given the parties one final warning prior to resigning, his failure to do so could not, the Court of Appeal said, by any stretch of the imagination, be described as "bad faith".

Was Clause 1 contrary to UCTA?

The Court of Appeal held that UCTA had no application in this case.

Adjudicator's cross appeal

The Court of Appeal allowed the adjudicator's cross appeal, holding that he did not go outside the ambit of the Scheme and his reasons for resigning were not erroneous.

Discussion

Whilst and to a significant extent, the Court of Appeal's decision turned on the terms of the Scheme and the adjudicator's terms of appointment, the key take-aways from this case are (1) whilst adjudication is a fast moving procedure, the parties should nevertheless go through the adjudicator's terms of appointment carefully before accepting the terms and appointing the adjudicator, and (2) like arbitrations, it is not uncommon in adjudications for there to be questions as to which are the relevant contracting parties. As this case illustrates, the adjudicator should take the initiative and invite the parties to address this issue even if the parties have not raised this as a relevant dispute. If the matter cannot be resolved and the adjudicator has in mind resigning (and depending on the terms of his appointment), he should give a final warning to the parties prior resigning.

When can the court consolidate arbitrations?

KK Cheung

In the recent case of Employer v Consultant HCCT 39/2021, a construction dispute, the Employer sought consolidation of the arbitration between the Employer and Consultant (1st arbitration) with two other arbitrations that had already been consolidated by consent (namely an arbitration between the Employer and Contractors (2nd arbitration) and an arbitration between the Contractors and Subcontractor (3rd Arbitration). The application for consolidation was made under s.2 of Schedule 2 of the Arbitration Ordinance (Cap 609) (Ordinance). The main issue to be determined was whether s.2 of Schedule 2 applied to the relevant Agreement between the Employer and Consultant. The court held that it did, meaning that the court had the power to order the consolidation sought.

The parties

The Plaintiff was the Employer, the 1st Defendant was the Consultant, the 2nd - 5th Defendants were the Contractors and the 6th Defendant was the Subcontractor on a project for construction of a bridge.

The dispute

After the bridge was substantially completed, defects were discovered. An external pre-stressing tendon of the Bridge was found to have ruptured (T3 Tendon). Emergency replacement and disruptions followed. Further investigations revealed widespread voids, corrosion and defects in other tendons of the bridge, as a result of which extensive protective, preservative and remedial works had to be carried out, including the replacement of over 70 tendons.

The arbitrations

The disputes concerning the defects were submitted to arbitration pursuant to the arbitration clauses contained respectively in the Agreement between the Employer and Consultant, the Contract between the Employer and Contractors, and Subcontract between the Contractors and Subcontractor. A sole arbitrator was appointed in the three arbitrations. The arbitration between the Employer and Contractors under the Contract (2nd Arbitration) was by consent consolidated with the arbitration between the Contractors and Subcontractor (3rd Arbitration) (Consolidated Arbitration).

Employer's application for consolidation

The Employer sought consolidation of the arbitration between the Employer and Consultant under the Agreement (1st Arbitration) with the Consolidated Arbitration, under s.2 (1) of Schedule 2 of the Ordinance, on the ground that there were common questions of law and fact in the arbitrations, that the rights to relief claimed were in respect of or arose out of the same transaction or series of transactions, and that it was desirable to make an order for consolidation. The Contractors and Subcontractor agreed to the consolidation, but the Consultant did not.

The issue in dispute was whether s.2 (1) of Schedule 2 of the Ordinance applied to the Agreement because, if it did not, then there was no basis for the application to consolidate.

Schedule 2 of the Arbitration Ordinance (Cap 609)

As the court explained, the Ordinance, which came into effect in 2011, introduced a unitary regime for arbitration agreements and arbitrations in Hong Kong, and removed the distinction between domestic and international arbitration agreements made in the previous Arbitration Ordinance, Cap 341. However, parties were given the option under the Ordinance to opt into provisions governing domestic arbitrations under Cap 341. These opt in provisions are contained in Schedule 2 of the Ordinance and include a provision for consolidation of arbitrations.

Schedule 2 automatically applies in cases provided for in s.100 of the Ordinance. S.100 provides that "*All the provisions in Schedule 2 apply, subject to section 102, to- (a) an arbitration agreement entered into before the commencement of this Ordinance which has provided that arbitration under the agreement is a domestic arbitration; or (b) an arbitration agreement entered into at any time within a period of 6 years after the commencement of this Ordinance which provides that arbitration under the agreement is a domestic arbitration*."

The purpose of s.100 was to address concerns raised by the construction industry, that the term "domestic arbitration" was a common feature of standard forms of construction contracts used in Hong Kong, and that such users may continue to employ the term "domestic arbitration" in contracts before and for some time after commencement of the Ordinance. Accordingly, a six-year transitional period was provided for in s.100, to allow time to the construction industry to make the necessary preparations for the unified arbitration regime. After the transitional period, parties who wished to utilise the domestic arbitration regime were required to expressly opt in pursuant to s.99 of the Ordinance, and to adopt Schedule 2 in whole or in part.

The arbitration clause in the Agreement between Employer and Consultant

The key issue to be determined was whether the arbitration clause (Clause 44) in the Agreement (made in 2002) provided that the 1st Arbitration under the Agreement was a domestic arbitration.

Clause 44 provided for arbitration of any dispute or difference of any kind arising between the Employer and Consultant in connection with or arising out of the Agreement, to be in accordance with the Arbitration Ordinance or any statutory modification thereof for the time being in force, and stated that the HKIAC Domestic Arbitration Rules shall apply to any arbitration instituted in accordance with the clause, unless the parties agreed to the contrary.

The parties agreed that (i) the 1st Arbitration and Consolidated Arbitration were now governed by the Ordinance; (ii) s.2 of Schedule 2 applied to the Consolidated Arbitration; and (iii) at the time when the Agreement was made in 2002, the applicable arbitration rules referred to in Clause 44 were the 1993 HKIAC Domestic Arbitration Rules (1993 Rules).

The court noted that whereas s.100 (and the wholesale application of the Schedule) refers to the requirement of an arbitration agreement which "has provided" or "provides" that the arbitration under the agreement is a domestic arbitration, s.99 employs the words "provide expressly", and s.100 is silent as to whether the provision has to be "express". S.99 of the Ordinance states: "*An arbitration agreement may provide expressly that any or all of the provisions (of the Schedule) are to apply…*"

The Consultant's position was that s.100 should not be interpreted to include "implication", as that went against the natural and ordinary meaning of the words in the section and the legislative intent behind s.100. The court disagreed. It said that by omitting use of the word "expressly", s.100 did not exclude an implied provision in the arbitration agreement, and the effect of such implied provision.

The court said that if the legislative intent was to permit the construction industry to retain the use and any benefit of the domestic arbitration regime, when they had agreed to use a common standard form of contract which refers to "domestic arbitrations", with the intention to follow and adopt the domestic arbitration regime that brings about, then it was not against such legislative intent to construe s.100 to extend and apply to an agreement which makes implied provision for domestic arbitrations.

Accordingly, the court concluded that the "provision" in s.100 may be one implied into an agreement.

Did domestic arbitration apply expressly or by implication to the Agreement between Employer and Consultant?

The next issue for determination was whether Clause 44 provided for arbitration to be a domestic arbitration, expressly, or by implication. The court said it was clear that Clause 44 did not *expressly* provide for domestic arbitration.

The court accepted the Employer's submissions that when one considered the Agreement at the time when it was made in 2002, there could be no dispute that Clause 44 was intended to be a domestic arbitration agreement under Cap 341 in force at the time. The adoption of the 1993 Rules reflected that intention – albeit the 1993 Rules themselves did not provide expressly for such.

The court said that at the time when the Agreement was made (which was the relevant time for objectively construing the parties' intention as reflected in the Agreement), s.100 of the Ordinance was *not* in existence. At that point in time, when both parties to the Agreement were Hong Kong parties, their arbitration agreement was domestic by operation of the law, without the need for them to make any specification or provision for their agreement and arbitration to be domestic. It went without saying, in those circumstances and in the context of the Agreement, the court said, that their agreement provided for domestic arbitration, and there was no specification otherwise. Once made, the Agreement and Clause 44 became binding on the parties from 2002, and would not change in its substance, nature and meaning by the subsequent commencement of the Ordinance in 2011.

What s.100 requires, the court said, is that there must be an established intention of the parties in the arbitration agreement that they intended to have a domestic arbitration, which had been demonstrated in this case. By referring to and incorporating the 1993 Rules in their arbitration agreement under Clause 44, the agreement between the Employer and Consultant had by implication provided for domestic arbitration. This was not a case of the Employer merely relying on the arbitration agreement being domestic by operation of the law at the time of the Agreement, under Cap 341, to claim that the parties had "provided" for a domestic arbitration.

Order for consolidation

Having held that s.2 of Schedule 2 applied to the Agreement and 1st Arbitration, the Court had power to order the consolidation sought. The court found that there were clearly common questions of law and fact in the 1st Arbitration and Consolidated Arbitration. The rights to relief claimed undoubtedly arose out of the same transaction or series of transactions in the project, concerned the construction of the bridge, and whether the Consultant, Contractors and/or the Subcontractor should be liable in contract or in negligence for the defects discovered. There would be substantial savings in time and costs, the court said, if all relevant parties were included in the consolidated arbitrations, so that discovery and evidence could be exchanged for all parties, witnesses could be called at the same hearing, and the risks of inconsistent findings could be avoided.

The court noted that the entire dispute was complex, multilayered but intertwined, and it was necessary for the arbitrator to be able to manage the claims and the dispute under one ceiling or reference, in a consolidated arbitration. If there should indeed be parts of the case that, in the Consultant's opinion, did not concern its liability, no doubt it would be open to the Consultant to inform the arbitrator of its stance, and the hearing could be managed for parts of the evidence to be

taken without the attendance of the Consultant and its advisers, if the Consultant preferred this, in the interests of saving time and costs.

Accordingly, the court made an order for consolidation of the 1st Arbitration and the already Consolidated Arbitration.

Comments

Unlike litigation, the court has no power to consolidate different arbitrations in multi-party disputes, unless Schedule 2 of the Arbitration Ordinance is applicable, even though it may save costs and avoid inconsistent decisions on similar issues. S.100 of the Ordinance is only applicable where an arbitration agreement was entered into before 1 June 2011 or within a period of 6 years from 1 June 2011 which provided that arbitration under the agreement is a domestic arbitration. As time goes by, s.100 will fall into disuse.

Many arbitration rules, for example, the 2018 HKIAC Administered Arbitration Rules, now provide for the power of the HKIAC to order consolidation of arbitrations. However, it still has to satisfy one of the following requirements:-

(a) the parties agree to consolidate; or
(b) all of the claims in the arbitrations are made under the same arbitration agreement; or
(c) the claims are made under more than one arbitration agreement, a common question of law or fact arises in all of the arbitrations, the rights to relief claimed are in respect of, or arise out of, the same transaction or a series of related transactions and the arbitration agreements are compatible.

It should be noted that many Hong Kong standard forms of building contract, including those used in the private and public sectors, adopt the HKIAC Domestic Arbitration Rules, which ironically do not provide for consolidation of arbitrations.

When will enforcement of an adjudication decision be stayed?

Stanley Lo

In Quadro Services Ltd v FP Mc Cann [2021] EWHC 1490, England's Technology and Construction Court held that the Claimant was entitled to summary judgment to enforce an adjudicator's decision, whereby it had been awarded over £1 million. The court refused the Defendant's application for a stay of execution of the judgment pending its application to reverse the adjudicator's decision. The court held that the high threshold for establishing special circumstances that would justify a stay had not been met. Despite the COVID-19 pandemic and loss of the contract with the Defendant, the Defendant had not shown that it was probable that the Claimant would be unable to repay the judgment sum if it was ordered to do so in future.

Background

The Defendant was contracted to construct new accommodation buildings for a university and entered into a subcontract with the Claimant in respect of some of the works. A dispute arose between the parties and the Claimant referred the matter for adjudication. The adjudicator decided that the Defendant should pay the Claimant over £1 million.

The Claimant applied for summary judgment to enforce the adjudication decision and the Defendant applied for a stay of execution, although it accepted that judgment should be entered for the Claimant. The Defendant sought a stay of execution, pending its Part 7 Proceedings i.e. its proceedings seeking to reverse the adjudicator's decision. The question before the court was whether there should be a stay of execution of the judgment on terms that the sum due under it be paid into an escrow account or into court pending the outcome of the Defendant's application to challenge the adjudicator's decision.

Principles applicable to stay application

The court said that the relevant considerations for the purposes of granting a stay in the context of the enforcement of an adjudication decision remained those set out by Coulson J (as he then was) in Wimbledon Construction Company 2000 Ltd v Vago [2005] BLR 374. It was absolutely clear from the authorities, the court said, that the starting point is the presumption that the successful party, the likely claimant in any enforcement proceedings, should not be kept out of its money.

The court referred to the guidance set out by Coulson J in the Wimbledon case:

(a) Adjudication (whether pursuant to the 1996 Act or the consequential amendments to the standard forms of building and engineering contracts) is designed to be a quick and inexpensive method of arriving at a temporary result in a construction dispute.

(b) In consequence, adjudicators' decisions are intended to be enforced summarily and the claimant (being the successful party in the adjudication) should not generally be kept out of its money.

(c) In an application to stay the execution of summary judgment arising out of an Adjudicator's decision, the Court must exercise its discretion with considerations (a) and (b) above firmly in mind.

(d) The probable inability of the claimant to repay the judgment sum (awarded by the Adjudicator and enforced by way of summary judgment) at the end of the substantive trial, or arbitration hearing, may constitute special circumstances rendering it appropriate to grant a stay.

(e) If the claimant is in insolvent liquidation, or there is no dispute on the evidence that the claimant is insolvent, then a stay of execution will usually be granted

(f) Even if the evidence of the claimant's present financial position suggested that it was probable that it would be unable to repay the judgment sum when it fell due, that would not usually justify the grant of a stay if:

    (i) the claimant's financial position is the same or similar to its financial position at the time that the relevant contract was made; or
    (ii) the claimant's financial position is due, either wholly, or in significant part, to the defendant's failure to pay those sums which were awarded by the adjudicator."

The court said that it was clear from the authorities that the threshold for obtaining a stay is a high one. It said that, as far as it was aware, there was no authority to support a general proposition that the merits of the underlying claim are a relevant factor when deciding whether or not to grant a stay in the context of adjudication enforcement. Further, it went against the long line of authorities to the effect that unless there is a breach of natural justice or other permanent jurisdictional issue, even a manifest error of law is not a valid ground for not enforcing an adjudicator's decision. It was therefore clear, the court said, that it should not take into account the underlying merits, but should focus on the factors set out in the Wimbledon case and the cases that had followed it.

The court said that if the Claimant's financial position was due wholly or in significant part to the Defendant's failure to pay the sum awarded to the Claimant by the adjudicator, that would militate against the grant of a stay regardless of whether the evidence of the Claimant's current financial position suggested that it was probable that it would not be able to repay the judgment. The question therefore was: does the evidence of the Claimant's present financial position suggest that it was probable that it would be unable to repay the judgment sum once judgment was given in the Part 7 proceedings?

The court said that notably, despite the pandemic and despite losing the very contract that was the subject of these proceedings, the Claimant's management accounts evidenced a going concern with a substantial turnover and assets (despite what must have been very difficult trading conditions over the relevant period) and significant sums in its Claimant's bank accounts.

The court noted that the Claimant had consistently shown that it was in profit and that it was continuing to trade, and that there was no suggestion that it could not pay its debts. There was too much speculation on the Defendant’s part to support its case that the Claimant could not repay the debt. The court found that there was insufficient evidence to demonstrate that on the basis of the financial information made available that the Claimant would not be able to repay the judgment sum a year or eighteen months from now, still less if the Part 7 claim was suitable for the shorter trial scheme. Accordingly, the threshold for establishing special circumstances such as would justify a stay had not been met.

Comments

Whilst the security of payment legislation in Hong Kong is still yet to be passed, the security of payment provisions (SOPP) applicable to public works contracts have been in place since January 2022. Pursuant to the SOPP, the Hong Kong Government as the employer may exercise its discretion to make direct payment to the sub-contractor who has obtained a favourable decision in adjudication, unless the main contractor certifies and submits documentary proof to the employer that any sub-contractor at higher tiers will be unable to recover the amount of direct payment by way of deduction from its payments due or which may become due to its sub-contracting parties at next lower tier.

It is not clear from the SOPP and the relevant Works Bureau Technical Circular how the employer will exercise its discretion in making direct payment if the main contractor provides the above-mentioned certification and documentary proof to it.

Although the UK judgment may not necessarily be followed by the employer, it may provide guidance as to the factors to be considered by the employer in exercising its discretion in making direct payment. When the security of payment legislation is in operation in future, the Hong Kong Court may also follow the UK judgment when dealing with any application for stay of execution of an adjudicator's decision.

Court sets out relevant principles when considering question of interest payable on judgment sum

Justin Yuen

The recent judgment in *China Agri-Products Exchange Ltd v Wang Xiu Qun & Anor*, HCA 1807/2011, usefully sets out the relevant principles considered by the court when considering the question of interest payable on a judgment sum, in particular, whether it should be reduced due to a claimant's delay in commencing or prosecuting proceedings. The court also considered simple versus compound interest.

Background

The court had handed down judgment in the Plaintiff's favour for RMB510 million for an Overpayment Claim, HK$54 million for a Profit Guarantee Claim and HK$1 for a Land Indemnity Claim and the court had to determine the question of interest in respect of those awards. The issues were:

(i) When should the pre-judgment interest payable by the Defendants start to run in respect of the Overpayment Claim, Profit Guarantee Claim and Land Indemnity Claim (Issue 1);
(ii) Whether there should be a 50% discount to the pre-judgment interest payable by the Defendants by reason of alleged delay on the Plaintiff's part in bringing the matter to trial (Issue 2); and
(iii) Whether the interest payable under certain Instruments was simple or compound interest (Issue 3).

Issues 1 & 2: Starting time for the computation of pre-judgment interest and question of delay

The Court set out the relevant principles as follows:

- S.48(1)(b) of the High Court Ordinance (Cap 4) (HCO) provides that the court may award simple interest on any claims for damages for all or part of the period between the date when the cause of action arose and date of judgment.

- An award of interest is to compensate the claimant for being deprived of the money during the relevant period. In commercial cases, such compensation is reflected in interest at a rate at which a person in a similar position as the claimant generally would have had to pay to borrow money. For such cases, prime plus 1% should be the starting point and interest would be awarded at such rate, unless there was evidence to persuade the court that time had come to move away from such rate.

- Delay may be a factor taken into account by the court in considering the question of interest. The principles for the exercise of jurisdiction under s.48 of the HCO, are:

    - the court may take into account delay on the claimant's part and reduce the award of interest accordingly;
    - a broad-brush approach to questions of delay is appropriate. That requires being realistic, and considering the character of the delay, making due allowance for the circumstances. Essentially, the court is concerned to see whether the claimant has neglected or declined to pursue or prosecute their claim for a significant period. If so, the logic of disallowing or reducing an award of interest for that period comes into play.

- In commercial disputes, the following principles are also relevant:

    - where a claimant has delayed unreasonably in commencing or prosecuting proceedings, the court may exercise its discretion either to disallow interest for a period or to reduce the rate of interest;

- in exercising that discretion the court must take a realistic view of delay. In the case of business disputes, litigation is for all parties an unwelcome distraction from their proper business. It is not reasonable to expect any party to take every litigious step at the first possible moment, or to concentrate on litigation to the exclusion of all else. Delay should only be characterised as unreasonable for such purposes when, after making due allowance for the circumstances, it can be seen that the claimant has neglected or declined to pursue their claim for a significant period;
- when determining what disallowance or reduction of interest should be made to mark a period of unreasonable delay, the court should bear in mind that the defendant has had the use of the money during that period of delay (though it may not always excuse the fault of the claimant.

Parties' positions

The Plaintiff's position was that pre-judgment interest should run from the date of the accrual of the causes of action of the respective claims. The Defendants' position was that it should only run from the date the claims were "*properly introduced and particularised*" by the Plaintiff, namely either the date of the writ, or alternatively, of the Re-Re-Amended Statement of Claim (SOC). The Defendants also alleged that there was "*substantial unjustifiable delay*" on the Plaintiff's part.

Court's decision on pre-judgment interest

The Court held that:

- There was no unreasonable delay on the Plaintiff's part in prosecuting its claim before the date of the writ. If anything, the lapse of time was caused by the Defendants' own wrongful conduct. There was simply no justification to deny the Plaintiff's request for pre-judgment interest for the period from the dates of accrual of the respective causes of action of the claims to the date of issue of the writ.

- Regarding Issue 2 and the Defendants contention that there should be at least 50% discount on the interest payable by the Defendants to the Plaintiff, relying on a number of matters relating to the Plaintiff's alleged "*delay in prosecuting the present action*", there was again no substance in the Defendants' criticisms.

- Regarding the Defendants complaint that it took the Plaintiff some 8.5 years to bring the present action to trial, there was nothing to suggest that the Plaintiff had been dragging its feet or had been acting unreasonably. Further, the progress of this case had to be judged realistically given (i) its complexity; (ii) need to adduce expert evidence from multiple disciplines; (iii) existence of parallel Mainland proceedings; and (iv) the Defendants' own conduct of the litigation.

- It was completely unrealistic to expect the Plaintiff to be in a position to plead all particulars and exact figures of the respective claims at the earlier rounds of pleadings. There was also no justification to deny interest to the Plaintiff by reason of the subsequent amendments.

- The time span of this litigation had to be considered against the overall complexity of the case and vast amount of factual and expert evidence adduced at the trial, which was reflected in the length of trial (23 days) and length of judgment (212 pages). In a case of this magnitude, the length of time taken from the commencement of the action to conclusion of the trial could not be said to be extraordinary, and the Plaintiff should not be held accountable or penalised for the same.

- The interest for the award under the Overpayment Claim and Profit Guarantee Claims should start to run from the respective dates of the accrual of the respective causes of action to the date of judgment at the rate of prime plus 1%. The interest for the award of the Land Indemnity Claim should start to run from the date of issue of the writ to the date of judgment at the rate of prime plus 1%.

Issue 3: Interest payable under the Instruments

The Plaintiff still owed amounts due under two respective Instruments, plus any interest stipulated in them, to the Defendants. There was a dispute as to whether such interest should be simple interest or compound interest. Clause 2 of the Instruments provided an undertaking to pay "*適用于每天結餘的年利率為 5%的利息(利息以一年 365 天為基準)*".

The Defendants argued that the definition of compound interest as commonly understood, is that interest is to be calculated on the principal amount and also on the accumulated interest of previous periods (be it on daily, monthly or quarterly intervals), thus being regarded as "interest on interest already accrued", whereas the definition of simple interest is that interest is merely to be calculated upon the principal (i.e. the original amount of the loan) and that it then followed from the words "*每天結餘*" in Clause 2 that interest was to be accrued at an annual interest rate of 5% compounded on a daily interval. In the case of ambiguity in the meaning of Clause 2, the Defendant argued that the *contra proferentem*

rule applied, so that the clause should be construed against the interest of the Plaintiff as it was the party who drafted the terms of the Instruments.

The Court rejected the Defendants' above arguments, holding that the interest payable under the Instruments was only simple interest, for the following reasons:

- An express contract for payment of interest will normally specify the interest rate, and it may further specify the method of computing interest and whether interest is to be compounded. Computing of interest must be distinguished from compounding. The latter is the capitalisation of interest so that interest itself yields interest.

- The courts have emphasised that a construction for charging compound interest should be supported by the wording of the relevant clause. The party claiming compound interest has the burden to prove the contractual terms for charging compound interest and the rate. The fact that interest was stated in the relevant clause to accrue from day to day is "*neutral*". If it were the parties' intention that the interest accruing daily be capitalised, it would be surprising that there was no reference to compound interest or capitalisation of interest in the relevant clause.

- In the present context, had it been the parties' intention that the interest under the Instruments was to be compounded daily, they could have easily provided for it by stipulating, e.g. the payment of "複利息" or "複利率" (i.e. the Chinese term for compound interest). Yet there were no such words in Clause 2.

- Therefore the combined effect of the words "*每天結餘*" and subsequent phrase "*利息以一年 365 天為基準*" was that the annual interest rate of 5% would be divided by 365 to produce a daily interest factor, which could then be multiplied by the number of days for which the loan was outstanding. The words "*每天結餘*" themselves are neutral as to whether the interest charged is simple or compounded in nature. They do not, without more, support a construction that interest was to be compounded or capitalised daily.

- There was no room for the application of the *contra proferentem* rule because:

    - the meaning of Clause 2 was clear; and
    - the modern view is to recognise that commercial parties are entitled to make their own bargains and that the court's task is to interpret fairly the words they have used. In relation to commercial contracts negotiated between parties of equal bargaining power (as was the case here), the *contra proferentem* rule has a very limited role.

Comment

Given the long duration of litigation in Hong Kong, interest is an important component of the winning party's claim. This judgment provides clear guidance as to the period and rate generally adopted by the court in awarding interest.

Court rules on construction of "null and void clause" in surety bond

Leo Wong

In the recent case of *Hoyden Holdings Ltd v CMB Wing Lung Insurance Company Ltd*, DCCJ 1729/2021, the court had to determine a question of construction in relation to a Surety Bond. Deacons acted for the Defendant, the Surety. The Court found in the Defendant's favour, holding that the Surety Bond had become null and void, by reason of the issuance of the Certificate of Practical Completion by the Architect of the Main Contractor.

Background

According to the Decision of the Court, the dispute arose from a construction project in relation to which the Employer had engaged a Sub-Contractor, for among other things, the design, supply and installation of curtain walls.

By virtue of a Warranty the Sub-Contractor warranted to the Employer that it would "*carry out complete and maintain the Sub-Contract Works*" and would exercise reasonable skill and care in the design and selection of materials. The Sub-

Contractor also provided the Employer with a Surety Bond (for the value up to HK$2,993,000), which was executed by the Defendant as the Surety.

The Main Contractor served a Notice of Default on the Sub-Contractor and terminated the Sub-Contractor's employment, by virtue of a Notice of Determination. The Sub-contractor subsequently went into voluntary liquidation.

The Certificate of Practical Completion was issued by the Architect to the Main Contract (i.e. the contract between the Employer and Main Contractor). The Employer, through its solicitors, demanded payment from the Defendant pursuant to the Surety Bond.

The Employer subsequently commenced this action and claimed against the Defendant for $2,993,000, on the basis that the Employer had to pay the Main Contractor more than $8 million as the costs of curtain wall remedial works.

The Surety Bond

The question before court was whether the Surety Bond remained valid, despite the issuance of the Certificate of Practical Completion by the Architect to the Main Contract, which hinged on the interpretation of the following provisions in the Surety Bond:

"*NOW THE CONDITION of the above written Bond is such that **if** the Nominated Sub-Contractor shall duly perform and observe all the terms, provisions, conditions and stipulations of the Sub-Contract and the Warranty on the Nominated Sub-Contractor's part to be performed and observed according to the true purport intent and meaning thereof or **if** on default by the Nominated Sub-Contractor the Surety shall satisfy and discharge the damages sustained by the Employer thereby up to the amount of the above written Bond then this obligation shall be null and void but otherwise shall be and remain in full force and effect but no alterations in terms of the Sub-Contract or the Warranty or in the extent or nature of works to be executed and completed thereunder and no allowance of time by the Architect to the Contract under the Sub-Contract nor any forbearance or forgiveness in or in respect of any matter or thing concerning the Sub-Contract on the part of the Employer or the said Architect shall in any way release the Surety from any liability under the above written Bond.*

This Bond shall remain valid for receipt of claims as aforesaid until the date of issue of the Certificate of Practical Completion by the Architect to the Contract (as evidenced to the Surety by presentation to him by the Nominated Sub-Contractor of a copy of the Certificate of Practical Completion bearing the signed statement of the issuing party that he is the Architect to the Contract) after which date the Bond shall become null and void and must be returned to the Surety for cancellation."

In Court, the second paragraph of the Surety Bond was referred to as the "*Null and Void Clause*".

The court said that in considering the effect of the Null and Void Clause in the Surety Bond it had to start from the basic principles on the construction of contracts. It decided that the Null and Void Clause should be interpreted in the way suggested by the Defendant and held that:

- There was no ambiguity. The "Certificate for Practical Completion" referred to in the Null and Void Clause was the certificate issued by the Architect to the Main Contractor in the project, and that was indeed issued. The plain effect of the Null and Void Clause was that once the Certificate was issued, that would be the cut-off time for the Employer to lodge any claim pursuant to the Surety Bond.

- Agreements such as Surety Bonds must be strictly construed.

- Although the court should bear in mind the commercial purpose of the Surety Bond when interpreting its terms, at the same time, it should not undervalue the importance of the language of the Null and Void Clause. Hence, the Plaintiff's argument that the words "Certificate for Practical Completion" in the Null and Void Clause could only reasonably be read as referring to a certificate to which the Sub-Contractor would have been entitled or received had it completed the works which it undertook, was rejected.

- The words "Certificate for Practical Completion" in the Null and Void Clause were simply not qualified as such. To accept the Plaintiff's interpretation, would involve reading words into the Surety Bond which were not there in the first place. Furthermore, the "Certificate of Practical Completion" in the Null and Void Clause meant a Certificate issued by the Architect to the Main Contractor. The court's attention had not been drawn to any contractual provision in the Sub-Contract which provided that the Sub-Contractor would have been entitled to receive any Certificate.

- While the Court accepted that the "Certificate of Practical Completion" was issued after the Sub-Contractor's employment had been terminated, there is nothing in the Surety Bond which stipulates that the Null and Void Clause would not come into effect in such circumstances.

- The Court should not "bend backwards" so as to assist the Plaintiff in achieving its purpose of requiring the Surety to pay, but should adopt a "balanced view" and give effect to the contractual bargain which the parties had struck.

Court sets aside arbitral award for arbitrator's accounting mistake

KK Cheung

England's High Court, in *Ducat Maritime Ltd v Lavendar Shipmanagment Inc* [2022] EWHC 766 (Comm), recently set aside an arbitral award under section 68(2) of the Arbitration Act 1996 (essentially equivalent to s.4 of Schedule 2 of Hong Kong's Arbitration Ordinance, Cap 609 (Arbitration Ordinance)) on the basis of serious irregularity, in that the arbitrator had made an obvious accounting mistake, causing substantial injustice, thereby breaching the arbitral tribunal's duty to act fairly and impartially between the parties under s.33 of the Arbitration Act 1996 (which is similar to s.46 of the Arbitration Ordinance).

Background

The arbitral award in question arose from a dispute between the Owners and Charterers, under a charterparty in respect of a vessel. The charterparty contained an arbitration clause, requiring the parties to submit any disputes to arbitration under the LMAA Small Claims Procedure 2017.

The Owners were the claimants in the arbitration, and sought US$37,831.83 by way of unpaid hire. The Charterers sought to deduct US$15,070 for the vessel's underperformance, by way of set-off and counterclaim, and consequently counterclaimed for overpaid hire, which was said to amount to US$6,258.35.

Based on the arbitrator's findings in respect of liability, the owners should have been awarded US$28,277.91. However, due to a calculation error, the arbitrator mistakenly valued the owners' claim at US$53,692.66, which was more than the US$37,831.83 that the Owners had in fact claimed. The arbitrator determined that they could not award the owners a sum which exceeded the amount actually claimed and awarded them US$37,831.83.

The Charterers applied twice to the arbitrator under s.57(3) of the Arbitration Act 1996 (similar to s.69 (1) (a) of the Arbitration Ordinance), seeking a correction of the award on the basis that there had been a clerical mistake or error arising from an accidental slip or omission, but the arbitrator declined the applications, stating that there was "no error or mistake in the calculations".

The Charterers then applied to the High Court to set aside part of the award under s. 68(2)(a) of the Arbitration Act 1996.

Sections 68 and 33 of the Arbitration Act 1996

The relevant part of s.68 provides:

"(1) A party to arbitral proceedings may (upon notice to the other parties and to the tribunal) apply to the court challenging an award in the proceedings on the grounds of serious irregularity affecting the tribunal, the proceedings, or the award…
(2) Serious irregularity means an irregularity of one or more of the following kinds which the court considers has caused or will cause substantial injustice to the applicant–
(a) failure by the tribunal to comply with section 33 (general duty of tribunal);…"

Section 33 of the Arbitration Act provides:

"(1) The tribunal shall-
a) act fairly and impartially as between the parties, giving each party a reasonable opportunity of putting his case and dealing with that of his opponent, and
b) adopt procedures suitable to the circumstances of the particular case, avoiding unnecessary delay or expense, so as to provide a fair means for the resolution of the matters falling to be determined.
(2) The tribunal shall comply with that general duty in conducting the arbitral proceedings, in its decisions on matters of procedure and evidence in the exercise of all other powers conferred on it."

The court referred to the fact that for a s.68 challenge to succeed, the Charterers had to show an irregularity that fell within the exhaustive list of categories set out in s.68(2) of the Arbitration Act, and that the irregularity had caused or would cause substantial injustice to the applicant. The court also noted that an applicant, under s.68 has to surmount a "high hurdle" or high threshold and bears a heavy burden and that the section was "*really designed as a long stop, only available in extreme cases, where the tribunal has gone so wrong in its conduct of the arbitration that justice calls out for it to be corrected*".

Charterers' case on irregularity

The Charterers' argued that the arbitrator had gone so wrong that justice called out for it to be corrected and that there was an irregularity falling within s.68(2)(a) on two bases:

(i) The arbitrator had failed to comply with s.33 of the Arbitration Act because he reached a conclusion that was contrary to the common position of the parties, and for which neither party contended, without providing an opportunity for the parties to address him on the issue.

(ii) He had made an obvious accounting mistake.

The Charterers contended that this irregularity had caused them substantial injustice.

Court’s decision on irregularity

The Court held that there was an irregularity, constituted by the arbitrator's failing to adhere to the common ground between the parties, in deciding how much was owed on a basis which had not been argued by either party, without giving them the opportunity to comment on it. This represented a failure to comply with the s.33 duty. The common ground was that the Owners' total claims added up to US$37,831.83, and that the underperformance claim was the Charterers' counterclaim, not the Owners' claim. The arbitrator had departed from that common ground and had failed to give the Charterers an opportunity of addressing him on two key aspects of his decision, namely: (i) that the Owners' claims, in fact, added up to US$53,692.66; and (ii) that the underperformance claim was a part of the Owners' claim.

The court said that the position was that the parties had been in agreement that the Charterers' counterclaim did not form part of the Owners' claim. They had not made submissions on that point because there was no need to. That issue was not in the arena.

Furthermore, while he did not realise that he had made a mistake, the arbitrator did realise that there seemed to be a problem. In the award, he recognised that the total of the amounts which he was treating as being due to the Owners was greater than the amount they had claimed. Without asking for an explanation, the solution he imposed was, as he saw it, to confine the Owners to their claim, and award them the amount of US$37,831.84.

The court said that when the arbitrator realised that the amount he thought was due to the Owners was more than the amount they had claimed, and that this was unexplained, he should not have proceeded to resolve the problem as he did, without giving the parties the opportunity of commenting on it. Had he done so, the error would have come to light. That, the court said, was a sufficient basis to conclude that there was an irregularity within s.68(2)(a).

In respect of the arbitrator having made an accounting error, the court said that the focus of the s.68 enquiry is whether there has been a failure of due process, and not whether the tribunal has got the answer right, to be unquestionably correct. Illogicality or irrationality on the part of the tribunal does not, itself, bring the case within one of the heads of s.68(2). However, the court said that a gross and obvious accounting mistake, or an arithmetical mistake of the 2 + 2 = 5 variety made in the award, may well represent a failure to conduct the proceedings fairly, not because it represents an extreme illogicality but because it constitutes a departure from the cases put by both sides, without the parties having had an opportunity of addressing it. In such a case, neither party's case is likely to have included the mistake as a basis for the result arrived at, and, in making the error, the tribunal is likely to have departed from common ground between the parties as to how arithmetical processes work, or whether items in an account are credits or debits, and to have done so without giving the parties an opportunity of addressing the justifiability of the departure. If a "glaringly obvious error" in the award can be said to arise in this way, s.68 can probably be regarded as applicable, without subverting its focus on process.

Charterers' case on substantial injustice

The remaining question was whether the Charterers could show that the irregularity found by the court to have occurred, caused them substantial injustice. The court held that there was substantial injustice. It had no doubt that if the Charterers been given the opportunity before the award was made, to comment on the way in which the arbitrator was proposing to deal with its failed counterclaim and whether the Owners' total claim should have been regarded as US$53,692.66, the

arbitrator might well have reached a different view, and that the result might have been significantly different. The court regarded it as substantially unjust that a party should, by reason of an error such as that made by the arbitrator here, be ordered to pay about 33% more than was due by way of principal, and be ordered to pay interest on its own unsuccessful counterclaim. This, the court said, went well beyond what could reasonably be expected as an ordinary incident of arbitration, even small claims procedure arbitration.

Conclusion

Having found a serious irregularity which affected the award, the court considered it inappropriate to remit the award to the arbitrator, given that there had already been two unsuccessful applications to him to correct the award, and also given that it would involve unnecessary costs. The court therefore set aside part of the award, namely the sum of US$9,553.92.

Comment

The wording of sections 68 and 33 of the Arbitration Act 1996 is similar to section 4 of Schedule 2 (applicable if opted in by the parties) and section 46 of the Arbitration Ordinance in Hong Kong respectively. Whilst the Arbitration Act and Arbitration Ordinance have provision for correction of any errors in computation, any clerical or typographical errors or any errors of a similar nature, they do not provide for the Court to correct such errors if the tribunal refuses to do so. The aggrieved party has to resort to section 68 of the Arbitration Act or section 4 of Schedule 2 of the Arbitration Ordinance, as the case may be, for the correction. That is probably why the English Court has to stress that illogicality or irrationality on the part of the tribunal does not, itself, bring the case within one of the heads of s.68(2) but it may amount to a failure to give the parties an opportunity of addressing the tribunal's departure from the common grounds of the parties in breach of section 33(1)(a) of the Arbitration Act 1996.

Court considers measure of damages for breach of contract for services

Joseph Chung

In the recent case of Jekco Elevators Ltd v Million Hotel Management Ltd, CAMP 101/2022, the District Court awarded the Plaintiff damages of HK$135,300 for the Defendant's wrongful termination of a lift maintenance service agreement and dismissed the Defendant's counterclaim for damages occasioned by the engagement of another service provider to carry out remedial works. The Court of Appeal dismissed the Defendant's renewed application for leave to appeal.

Background

The Plaintiff agreed with the Defendant to provide service and maintenance to two elevators at a hotel, for two years from 1 June 2015, at a monthly service fee of HK$6,000 (1st Agreement) and for two years from 1 June 2017, at a monthly fee of HK$6,600 (2nd Agreement).

The Defendant gave notice to terminate the 2nd Agreement on the ground that the Plaintiff's service was unsatisfactory and that the Plaintiff had persistently breached the express terms of the 2nd Agreement in: (i) failing to provide competent technicians to carry out maintenance and repair service of the lifts; (ii) failing to inform and/or explain to the Defendant's employees the repair works required and progress of such; (iii) failing to ensure that the two lifts and their associated equipment and machinery were kept in a proper state of repair and safe working order; and (iv) failing to provide technicians to the Defendant's premises as soon as possible in cases of emergency. It was also the Defendant's pleaded case that, by reason of the above "Four Failures", the Plaintiff was in breach of the implied terms of both Agreements in failing to carry out the lift maintenance service with reasonable care and skill and within a reasonable time, pursuant to sections 5 and 6 of the Supply of Services (Implied Terms) Ordinance, Cap.457.

The Plaintiff commenced proceedings against the Defendant for HK$135,300 damages for repudiatory breach, being the monthly fee for the rest of the contractual term of the 2nd Agreement. The Defendant counterclaimed for HK$213,300 damages for breach of the 2nd Agreement, that being the costs of engaging another service provider (Sigma) to carry out inspection and repair works to remedy the defects in the lifts.

District Court Judgment

Liability

The District Court judge (Judge) held that breaches committed during the contractual period of the 1st Agreement could not be taken into account in deciding whether termination of the 2nd Agreement was justified.

After assessing the four failures referred to above, the Judge found that the Defendant had no valid ground for terminating the 2nd Agreement prematurely. Accordingly, the Defendant's early termination of the 2nd Agreement amounted to a repudiatory breach, which was accepted by the Plaintiff.

Quantum

The Judge rejected the Defendant's argument that the Plaintiff could only claim damages but not the balance of the contract sum (i.e. monthly fees for the remainder of the contractual term) because:

- While the Plaintiff was indeed suing for $135,300, which was equivalent to the contractual sum for the remaining period of the 2nd Agreement, it was clear from the Statement of Claim that the Plaintiff was suing for this sum as damages rather than as a debt.

- The term of the 2nd Agreement was undisputed. On the evidence, the Defendant had stopped paying the monthly service fee after it terminated the 2nd Agreement on 15 September 2017.

- The Defendant had not pleaded any positive case in its Defence and Counterclaim for challenging the amount of damages claimed by the Plaintiff and the particulars of facts relied upon.

The Judge expressed agreement with the proposition in *Ryoden Lift Services Limited v The Incorporated Owners of Rialto Mansion* (unreported) DCCJ 36/2005 that "*the prima facie measure of damages for wrongful termination of a contract for professional service is the contract price*."

The counterclaim

The Judge dismissed the Defendant's counterclaim, which was premised on the quotation given by Sigma (Quotation) setting out the repair works proposed to be done to remedy the defects.

The Judge said that if the undisputed fact was that the lifts operated without any problem even without any replacement of the alleged defective parts, the Defendant had failed to prove that the Plaintiff had breached the Agreements in failing to replace those parts for the Defendant. This objective fact coincided with the Plaintiff's expert opinion, which the Judge preferred over the Defendant's expert opinion.

Defendant's application to Court of Appeal for leave to appeal

The Defendant's intended grounds of appeal were:

The Judge erred in:

- not making a determination on whether the Plaintiff was in repudiatory breach of the 2nd Agreement by reason of the incident when lift no. 1 uncontrollably descended from 27/F to G/F, that being a serious incident based upon which the Judge ought to have concluded that the Plaintiff was in repudiatory breach. Further or alternatively, the Judge should have taken into account nine incidents of uncontrolled ascending and descending during the 1st Agreement, and held that this together with the other uncontrolled descending incident were sufficiently serious to warrant the termination of the 2nd Agreement (Ground 1).

- not making a determination on whether the Plaintiff was in breach of the 1st Agreement, when the determination was relevant to (i) whether the Defendant was entitled to damages on its counterclaim, and (ii) whether the Plaintiff's breach of the 2nd Agreement was sufficiently serious to justify the termination of the 2nd Agreement (Ground 2).

- relying on the proposition that the *prima facie* measure of damages for wrongful termination of a contract for professional service is the contract sum: *Royden Lift Services Limited*, *supra*, which is incorrect as a matter of law; and awarding the balance of the contract sum of the 2nd Agreement as damages when the Plaintiff had failed to plead and prove any loss of net profits as a result of the Defendant's termination of the 2nd Agreement (Ground 3).

Refusal of leave to appeal

The Court of Appeal held that the intended grounds of appeal were not reasonably arguable and the intended appeal

had no reasonable prospect of success. Nor was there any matter which, in the interests of justice, required the appeal to be heard. It held as follows:

Ground 1

The Judge had not erred in his dealing with the uncontrolled descending incident and this ground was not reasonably arguable.

Ground 2

The Defendant bore the burden of proving that the parts mentioned in the Quotation were defective and that the Plaintiff had failed to replace them pursuant to the Agreements, as a result of which costs were incurred to engage Sigma to carry out remedial works. Given that the Judge had, after considering the Defendant's complaints and relevant provisions in the Agreements, concluded that the Defendant failed to prove that the Plaintiff was in breach of *both* Agreements by failing to replace the parts mentioned in the Quotation, this would be the end of the counterclaim.

The Defendant's argument in this application that the Judge made the finding without first making a finding on whether the Plaintiff was in breach of the 1st Agreement was both circular and untenable. In relation to loss other than the Quotation, there was no room for arguing it on appeal, since there was no plea of general damages or other special damages in the Defence and Counterclaim, and the claim of "Further and/or other relief" in the Prayer could not change the position.

Ground 3

The Defendant's primary contention was that the damages should be based on loss of net profits and not loss of gross revenue, and the Judge erred in awarding damages based on the monthly service fee for the remainder of the term of the 2nd Agreement. It was also argued that the proposition in *Ryoden Lift Services* that "the *prima facie* measure of damages for wrongful termination of a contract for professional service is the contract price" was incorrect as a matter of law, and the Judge erred in accepting and relying on it.

As regards the issue of the measure of damages, the Judge had correctly, held that:

(i) the Plaintiff had pleaded that the unpaid balance of the contract sum was its loss and damage occasioned by the Defendant's repudiation of the 2nd Agreement;
(ii) on the undisputed evidence, the Defendant had not paid any monthly service fee to the Plaintiff after the termination of the 2nd Agreement; and
(iii) the Plaintiff was accordingly deprived of the monthly service fee as a result of the termination of the 2nd Agreement, which was the loss and damage it has suffered.

If the Defendant wished to challenge the measure of damages that the Plaintiff could claim or argue that the Plaintiff was only entitled to loss of net profits and the balance of the contract sum was not its loss of net profits, it was obliged to properly raise it in the pleading. Fairness required that the Plaintiff be given due notice of what case it was called upon to meet so that it could prepare its case accordingly. It was thus incumbent upon the Defendant to state the grounds on which it sought to contest the amount of damages claimed by the Plaintiff and to give particulars of all the facts relied upon to support any positive case it sought to advance on the amount of the damages claimed. The Defendant, not having properly pleaded its case on the measure of damages that the Plaintiff was entitled to, could not now seek to raise this ground as a ground of appeal.

As to the proposition in the *Ryoden Lift Services Limited* case, both in *Ryoden Lift Services Limited* and the present case, the contract involved was not an employment contract, but a contract for service. The following passage on the measure of damages for breach of contracts for professional and other services by the party engaging the services (in *McGregor on Damages* (21st edition) at §34-002) represents the law to be applied in a case like the present, namely where a contract for service is repudiated by the party engaging the service:

"*A person whose services have been improperly dispensed with has a number of alternative remedies open to them, similar to those whose available to the employee and also to the agent acting on behalf of a principal. They may sue on the contract for such remuneration of fees as have been agreed and, if suit on the contract is not available, they may sue on a quantum meruit for the value of the services already rendered. With these actions at their command, an action for damages may not prove necessary. When it is brought into play, the measure of damages is likely to be the amount that they would have earned from the services had they not been prevented from continuing to act; consequential losses are somewhat difficult to envisage. As with the employee, they will be required to mitigate their damage by seeking alternative remunerative occupation. However, since they have a freer hand in performing the services and may not*

have to devote their time exclusively to the contract, other services upon which they embark will not be truly alternative if they could have performed both concurrently, and will therefore not go in mitigation of damage."

In the present case, the monthly service fees for the remaining contractual period of the 2nd Agreement were what the Plaintiff would have earned had it not been prevented from continuing with the 2nd Agreement by the Defendant's wrongful termination. The Defendant had not raised the issue of mitigation of loss in its pleading. Nor was it shown at trial that the Plaintiff could have mitigated its loss through alternative engagement. In the circumstances, the award of the service fees for the remainder of the term of the 2nd Agreement as the measure of damages for the Defendant's wrongful repudiation could not be faulted.

Accordingly, while the reference to the proposition in *Ryoden Lift Services Limited* was not entirely apposite, the Judge had not erred in his award of damages on the Plaintiff's claim.

Comments

Ground 3 of the appeal might seem to be attractive at first glance. The measure of Damages for wrongful repudiation of a contract for building works is usually loss of net profit since the cost of earning the profit is saved after the repudiation of contract. The Court of Appeal in this case makes it clear that the approach in employment contracts and contracts solely for services is different. Proof of loss of net profit may not be necessary, as explained in *McGregor on Damages* (21st edition) at §34-002.

Stanley Lo admitted to HKIAC List of Arbitrators

Stanley Lo, Consultant of our Construction practice group has been admitted to the List of Arbitrators of the Hong Kong International Arbitration Centre (HKIAC) for three and a half years from 20 June 2022. Stanley is also on the Joint List of Arbitrators of the Hong Kong Institute of Architects and Hong Kong Institute of Surveyors.

The HKIAC was established in 1985 by a group of leading professionals to meet the growing need for dispute resolution services in Asia and the HKIAC List of Arbitrators comprises members who have demonstrated significant experience in arbitration.

Our Construction Practice partners **K.K. Cheung** and **Joseph Chung** are also on the list / panels of arbitrators of various other arbitration commissions in the region including:

- The Hong Kong International Arbitration Centre
- China International Economic and Trade Arbitration Commission
- The Shanghai Arbitration Commission
- The Shenzhen Court of International Arbitration
- Qingdao Arbitration Commission
- Asian International Arbitration Centre in Malaysia
- The Arbitration Centre Across the Straits

Adjudication Updates

Following the trend with the Government's rolling out of the security of payment provisions in its public works contracts and the gradual increase in the use of adjudication in Hong Kong's construction dispute resolution process, our construction newsletters will also include case updates on adjudication.

At Deacons, we are able to provide support in the adjudication process including preparing adjudication related documents, strategic advice, and attending any oral hearings during the adjudication process. We also have team members who are qualified adjudicators. Our partner, Joseph Chung, a fellow member of the Hong Kong Institute of Construction Adjudicators (HKICAdj) is on the Panel of Adjudicators of the HKICAdj. Our consultant, Stanley Lo is on the Panel of Adjudicators of the Hong Kong International Arbitration Centre.

Want to know more?

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