DEACONS
的近律師行

Newsletter

International Arbitration

May 2023

What's inside?

Court refuses to enforce arbitral award

Joseph Chung

In Canudilo International Company Limited v 胡志强 (Wu Chi Keung) & Ors [2023] HKCFI 700, the court set aside an Enforcement Order, whereby the Applicant had been granted leave to enforce an arbitral award made in its favour. It found that Arbitrator 2 (appointed after resignation of Arbitrator 1) had considered himself bound by the earlier award made by Arbitrator 1, and in doing so had failed to give the Respondents a reasonable opportunity to present their case.

The Dispute

The arbitration had been commenced by the Applicant (CIC) under sales contracts made between CIC as seller, and a Company as buyer. The Respondents were the Company's guarantors (Guarantors). CIC claimed that the Company had defaulted in payment under the contracts and the Guarantors were liable for payment of the sums due. The Company did not take part in the arbitration. Two of the Guarantors were shareholders of the Company and according to them, due to disagreements amongst the shareholders and controllers of the Company, it was not possible to engage legal representatives to represent the Company independently in the arbitration or to file a defence on the Company's behalf.

Interim Final Award of Arbitrator 1

After commencement of the arbitration, Arbitrator 1 was appointed. No step was taken by the Company in the arbitration and it did not file any defence or evidence or make any submissions. The Guarantors raised various issues and disputes in their Defence.

Having acceded to CIC's application to bifurcate the arbitration into the determination of (i) CIC's claims as to the Company's liability for payment, and (ii) CIC's claims against the Guarantors in respect of their liability, Arbitrator 1 then declared that the arbitration proceedings between CIC and the Company were closed. In a notice issued to the parties, he directed that an interim final award would be issued by him within 4 weeks and stated: "*For avoidance of doubt, it is hereby declared that the Arbitration proceedings between CIC and the other Respondents should continue to proceed*." Throughout this time, the Company had no legal representation and no documents were filed for the Company in the arbitration.

Subsequently, Arbitrator 1 issued an Interim Final Award (2020 Award), in which he pointed out that the Company had failed to respond to the direction as to the service of written submissions and other documents and that the 2020 Award only involved the dispute between CIC and the Company and that the dispute between CIC and the other Respondents in the arbitration would continue, and that having considered the submissions and materials of CIC, Arbitrator 1 did not

consider that the disputed matters between CIC and the other Respondents in the Arbitration had to be determined in the 2020 Award.

Arbitrator 1 concluded in the 2020 Award that as between CIC and the Company, the Company should pay to CIC the sums due under the Contracts and arbitration costs.

Subsequently, Arbitrator 1 issued a procedural order, notifying all parties that he had received a letter from solicitors acting for the Company, seeking an extension of time for making written submissions on the Company's behalf, notwithstanding that Arbitrator 1 had already declared the proceedings between CIC and the Company closed. Arbitrator 1 then resigned on the grounds that he was of the view that to continue to act in the arbitration after the issue of the 2020 Award would give rise to reasonable suspicion or doubt as to his impartiality as arbitrator.

Final Award of Arbitrator 2

The HKIAC appointed a new arbitrator (Arbitrator 2). Arbitrator 2 notified the parties, including solicitors appointed by then for the Company, that the 2020 Award had already been issued, and that the entire arbitral proceedings between CIC and the Company had concluded. He pointed out that the Company had indicated to the HKIAC that the 2020 Award should be set aside, and it would be making the necessary application to the new tribunal. He also stated that he would only be dealing with the arbitration proceedings between CIC and the Guarantors.

Following a hearing, Arbitrator 2 issued a Final Award, in which he found the Guarantors liable under the contracts and ordered them to pay CIC certain amounts, with costs. Arbitrator 2 made it clear in the Final Award that he was bound to follow the 2020 Award, which was binding not only on the Company, but also on the Guarantors. Although Arbitrator 2 appeared to deal with the Guarantors' defences, it was only on a peripheral basis, with the starting point that he was bound to follow the findings made by Arbitrator 1 in the 2020 Award.

Application to set aside Enforcement Order

The court granted leave for CIC to enforce the Final Award against the Guarantors as a judgment of the court and in terms of the Final Award. The Guarantors applied (out of time) to set aside that Enforcement Order on the grounds that the Tribunal had exceeded its mandate and jurisdiction by failing to determine the issues in dispute, that the arbitration was not conducted in accordance with the arbitration agreement and/or the agreed arbitration procedures, that the Guarantors did not have a reasonable opportunity to present their case, and that enforcement of the Award would be contrary to the public policy of Hong Kong. It was argued that Arbitrator 2 had failed to decide the key issue of the Guarantors' Defence, that they as guarantors were not liable when there was no valid primary debt due from the Company, and that Arbitrator 2 had failed to apply an independent mind, and without being influenced by the 2020 Award made against the Company, when he made the Final Award.

Setting aside of Enforcement Order

The court granted the Guarantors' application for an extension of time to make the setting aside application and set aside the Enforcement Order, holding that:

- Arbitrator 2 had considered that he was bound by and had to follow the 2020 Award. In relation to the Guarantors' defences, Arbitrator 2 stated that Arbitrator 1 had already made a decision on such and that the factual disputes that he was deciding were the same facts decided by Arbitrator 1 in the same arbitration and that since none of the parties had disputed the award, he had to abide by it.

- Reading the Final Award as a whole, Arbitrator 2 had decided the essential issue of whether there was a primary debt established to be due from the Company, on the basis that this had already been decided in the 2020 Award, which he had to follow.

- On an objective reading of the Final Award, the court had grave concerns that Arbitrator 2 had not applied his own independent mind pursuant to the mandate given to him under the arbitration agreement to decide the dispute between the parties.

- The Guarantors were entitled in law to test and challenge the evidence on the contracts, and on the alleged primary debt. It was not reasonably clear from the Final Award and the dismissive approach adopted by Arbitrator 2 to the Defence, that he had independently considered the issues raised in the Defence and the evidence adduced in the second part of the arbitration heard by him, when deciding the liability of the Guarantors under the contracts.

- It had to be borne in mind that even if Arbitrator 1 had not resigned after hearing the first part of the bifurcated arbitration, the arbitrator would still have to determine the issues raised, the defences pleaded and evidence adduced by the Guarantors in the second part of the arbitration.

- It was grossly unfair and unjust that Arbitrator 2 considered that the Guarantors had already been given the opportunity to present their evidence and make their submissions before Arbitrator 1, had failed to do so, and should be bound.

- Although there was one arbitration, there were two parts of the hearing against different parties: CIC against the Company in the first part, and CIC against the Guarantors in the second part. Contrary to what was stated in the Final Award, the Guarantors did not have the "equal opportunity" to appear and to present and argue their case in the first part of the hearing against the Company. The first part involved CIC proving its case of the Company's liability, in circumstances when the Company had not filed a defence or put in any submissions or evidence, and in circumstances when Arbitrator 1 had made it clear that he would not deal with the issues and disputes raised by the other Respondents as guarantors in the first part of the arbitration. The Guarantors were not seeking to have a second bite of the cherry, as Arbitrator 2 had stated. They never had the first bite.

- What was more disturbing, was not whether Arbitrator 2 had erred in law and on facts as to the matters put before and decided by Arbitrator 1, but that the Guarantors had not been given notice nor the reasonable opportunity to meet the case made against them in the hearing of the arbitration on their liability.

- The primary liability of the Company for the debt under the contracts, and the Guarantors' liability for such primary debt if established, were indeed the very issues for determination by Arbitrator 2. Whether there was a primary debt due from the Company to CIC was the case the Guarantors had to meet and had been prepared to meet in the arbitration. However, in deciding this issue, Arbitrator 2 considered himself to be bound by the 2020 Award and had entirely changed the landscape of the arbitration by taking such a stance. As a result, the case against the Guarantors was that there was already a binding 2020 Award made against them, they were bound by the findings as to the validity and enforceability of the contracts and the lack of vitiating factors, and that they were therefore liable as Guarantors.

- The arbitration had not been conducted in accordance with the arbitration agreement and/or the agreed arbitration procedures. It would be contrary to basic notions of justice and requirements for a fair hearing to enforce the Final Award, when Arbitrator 2 had failed independently to determine the issues in dispute between CIC and the Guarantors, and had unfairly and unjustly deprived the Guarantors of the reasonable opportunity to present their case as to whether they were bound by the 2020 Award and the findings made in that Award.

- The conduct of the arbitration by Arbitrator 2 was seriously flawed or egregious, such that due process was denied. The Guarantors had been surprised by the case they had to meet - that there was already a binding 2020 Award on their liability.

- It was obvious that Arbitrator 2 had failed to properly understand the facts and procedures which had taken place in the arbitration, and had failed to carry out the very task he was appointed to carry after resignation of Arbitrator 1, who had done so in order to avoid the appearance of bias after making the 2020 Award, and to ensure that there would be someone who could objectively and impartially render an award on the liability of the Guarantors.

- The violation of the Guarantors' rights in the arbitration was sufficiently serious and egregious, for the Final Award to be set aside. It could not be said that it was beyond doubt that the Final Award would have been the same if all the evidence had been properly and seriously considered, and the Guarantors had been given the reasonable opportunity to properly present their case. The rationale must be that even if the Guarantors' Defences were considered to be unmeritorious, they were nevertheless entitled to the reasonable and fair opportunity to present their case to the fact finding tribunal and to have their Defence properly and fairly determined. This was fundamental to the process of fair trial, and the absence of such pre-requisites of due process cannot be condoned by the court, by recognizing and permitting enforcement of an award which had given rise to substantial injustice.

CIC's application for leave to appeal this decision was recently refused.

Comments

Whilst the facts based on which the court set aside the Enforcement Order are quite unique, it illustrates the basic principle that if a party is deprived of the reasonable opportunity to properly present its case in the arbitration, any award rendered against it will not be enforceable. One should note that if the 2020 Award had been unfavourable to CIC, it may not have had the second bite of the cherry by continuing with the arbitration against the Guarantors.

Court finds arbitral award manifestly valid and orders immediate enforcement

Justin Yuen

In Q v F [2023] HKCFI 647, the court dismissed the Respondent's application to set aside an Enforcement Order, whereby the Applicants had been given leave to enforce an arbitral award (Award) against him. The court held that, contrary to his assertions, the Respondent had been given notice of the arbitration and the opportunity to defend himself before the Award was made. The court, having found the Setting Aside Application unmeritorious and the Award manifestly valid, made an order for immediate enforcement of the Award, that being consistent with the court's policy of enforcement of arbitration agreements and awards without unnecessary expense and delay.

Arbitration Award and Enforcement Order

The Applicants, who were the Claimants in the arbitration, were granted leave to enforce the Award against three Respondents (Enforcement Order). The Award stated that R1 and R2 were in breach of a Framework Agreement and R1-R3 were in breach of a Subscription Agreement. R3 (Y) was ordered pay to the 2nd Claimant US$13,302,493.15 and the costs of the arbitration.

Y's application to set aside Enforcement Order

Y applied to the court to set aside the Enforcement Order (Setting Aside Application) on the grounds that there had been material non-disclosure in the application for the Enforcement Order, in that the Applicants had not informed the court that he had made an appeal to the HKIAC concerning the Award and that he had not been given notice of the arbitration or a chance to defend himself in the arbitration before the Award was made. He also claimed that he did not receive notice of the arbitration, as he was not in Hong Kong at the relevant time, due to travel restrictions and quarantine requirements during the Covid pandemic.

The Applicants applied for security from Y, and in default of security, for the Setting Aside Application to be dismissed.

No setting aside for material non-disclosure

The court held that there was no basis to set aside the Enforcement Order on the grounds of material non-disclosure. Y's "appeal" to the HKIAC in fact consisted of his solicitor's letter to the HKIAC (Letter), in which they referred to the Award and the fact that Y had not been in Hong Kong and had not received notice relating to any arbitration and did not have a reasonable opportunity to attend the arbitration. However, the Applicants' affirmation in support of the application for the Enforcement Order, had exhibited a copy of the Letter. Accordingly, the court found that it was clear that there had been no withholding of the fact that Y had raised objections to the HKIAC on the basis that he had not received notice of the arbitration, was not given the opportunity to attend the arbitration, and that he had been absent from Hong Kong.

Y had been given notice of the arbitration

The court referred to the Subscription Agreement, to which Y was a party. It contained an arbitration clause (16.1) providing for written notice of disputes arising out of or relating to the Subscription Agreement to be given, and clause 16.2 provided that any document in an action may be served on a party to the Subscription Agreement by being delivered to that party's address in the "Details" of the Subscription Agreement. The court noted that Notice of Arbitration had been sent to Y's email address as recorded in the Details and that such service was in accordance with clause 16.2 and was also deemed received under the notice provision in clause 14.1 of the Subscription Agreement. On the Applicants' evidence, which Y had not disputed, the Applicants' lawyers had received notice of the successful delivery of the email. Although Y claimed in his evidence that the email address had been suspended and that he had no access to the company computer at the relevant time, on the evidence, the emails had been successfully sent to Y and had not bounced back. Further, on the Applicants' evidence, Y himself had informed them in their discussions that he was aware of the arbitration.

The court held that having been served with the Notice of Arbitration and given notice of the commencement of the arbitration, the empaneling of the arbitral Tribunal, and timetable for the service of the necessary documents for the arbitration, Y had notice of all these matters, but chose not to take any steps, nor to communicate with the Tribunal in relation to the claims made against him, and any defence he may have. He could have, but chose not to, inform the Tribunal that he would not be able to attend or to appear in the arbitration in Hong Kong on any date, and that the hearing should be postponed for any reasons he relied on. Even on Y's own evidence, he had been in Hong Kong when the

Notice of Arbitration was served on him, by email. It was open to him, the court said, to deal with the Notice and to correspond with the Tribunal, if he had intended to do so.

The Tribunal had given a reasonable opportunity to Y, and the other parties to the arbitration, to present their cases, the court said. It had specified the time within which the statement of Defence and other evidence should be filed, and fixed the dates of the hearings. The Tribunal was entitled to proceed with the hearing in the absence of any defence, documents, or any response being submitted or made by Y pursuant to the Tribunal's directions and orders. This was a case, the court said, not of Y having been deprived of the opportunity, but of his failing to utilize the opportunity afforded to him, to present his defence in the arbitration, and it was a matter of his own conscious decision. Whether he had made attempts to settle the matter with the Applicants, and whether he had a good defence to the claims made, were irrelevant, when it was his own decision not to appear in the arbitration to present his case.

Further, the arbitration hearing was partly by remote or virtual attendance. Therefore, even if Y was not in Hong Kong, he could have applied to attend by video conferencing facilities, but chose not to do so.

Dismissal of Setting Aside Application

Accordingly, the court concluded that there was no merit at all in Y's Setting Aside Application. Bearing in mind the unmeritorious Setting Aside Application and manifest validity of the Award, the court held that there should be an order for immediate enforcement, and for the Setting Aside Application to be dismissed, instead of adjourning the matter until after the substantive hearing of the Setting Aside Application set for 28 April 2023. This, the court said, was consistent with the court's policy of enforcement of arbitration agreements and awards without unnecessary expense and delay. It would not be in the interests of either the Applicants or Y himself, for further legal costs to be incurred.

Applicants' Security Application

The court did not have to consider the Applicants' application for security, since it made an order for immediate enforcement of the Award. However, it said that having considered the lack of merits in Y's Setting Aside Application, absence of frank disclosure of his assets and falsity of factual assertions made by him in putting forward the grounds for the Setting Aside Application, notwithstanding the short delay until the scheduled substantial hearing on 28 April 2023, it would have ordered Y to furnish security within 21 days for the full amount of the Award, as a condition for the further conduct of the Setting Aside Application.

Court holds that tortious disputes did not fall with ambit of arbitration clause

KK Cheung

In Li Wenjun v Chen Chunhui [2023] HKCFI 405, the 1st Defendant applied to court to stay the proceedings in favour of arbitration, pursuant to section 20 of the Arbitration Ordinance, Cap 609 (Ordinance) or the court's inherent jurisdiction. The court dismissed the application, holding that the Plaintiff's action was tortious in nature and did not fall within the ambit of the relevant arbitration clause. The court also found that the 1st Defendant had waived his right to arbitrate.

Background

The Plaintiff's action had been commenced by specially endorsed Writ, stating a case of deceit and conspiracy against the 1st and 2nd Defendants. The Plaintiff alleged that she had been induced into transferring her shares by the 1st Defendant's false representations. Subsequently, the Plaintiff was able to obtain a copy of the Share Transfer Agreement (Agreement) and by an Amended Statement of Claim, the Agreement was introduced under particulars of fraud.

Arbitration clause (Clause)

The Agreement contained an arbitration clause (Clause) providing: "因履行本协议所发生的争议，各方应友好协商解决：协商解决不能的，任一方均有权向香港国际仲裁中心按照其在本协议签署时现行有效的仲裁规则提起仲裁解决。"

Section 20 Arbitration Ordinance

Section 20 of the Ordinance, provides that if the matter in the action is the subject of an arbitration agreement, the court shall, if a party so requests not later than when submitting his first statement on the substance of the dispute, refer the

parties to arbitration, unless it finds that the agreement is null and void, inoperative or incapable of being performed. If these requirements are satisfied, the stay is mandatory.

The court has to consider four questions in determining a stay application, namely (i) is the clause in question an arbitration agreement? (Question 1); (ii) is the arbitration agreement null and void, inoperative or incapable of being performed? (Question (2); (iii) is there in reality a dispute or difference between the parties? (Question 3); (iv) is the dispute or difference between the parties within the ambit of the arbitration agreement? (Question (4).

The court said that in this application, there were in truth only two issues, namely whether Questions (2) and (4) could be answered in D1's favour. The court dealt with Question(4) first, since the answer, it said, was reasonably clear and determinative of the application, as if the this issue was determined against D1, there was no question of invoking the court's inherent jurisdiction.

Question (4): Is the dispute or difference between the parties within the ambit of the arbitration agreement?

It was common ground that the construction of the Clause was governed by PRC law and the issue turned upon whether, on a proper construction, the Plaintiff's causes of action in the proceedings fell within the scope of disputes embraced by the Clause.

The court noted that the threshold requirement which had to be met by D1, who bore the burden of proof in this application, was that he had to show that there is a *prima facie* or plainly arguable case that the parties are bound by the Clause, and unless the point is clear, the court should not resolve the issue, and the matter should be stayed in favour of arbitration for the arbitral tribunal to determine its own jurisdiction.

Expert evidence

The Plaintiff and D1 each adduced PRC expert evidence. The court noted that when approaching expert evidence on foreign law, the court must look at the basis of legal reasoning to determine what weight, if any, should be attached to the opinion and that if neither opinion renders useful assistance, the court is left with a "linguistic and common sense interpretation".

The court said that, on the face of it, the threshold of *prima facie* or plainly arguable case is not a high one, but on the other hand, even if the court only has PRC legal expert evidence from the applicant, it does not follow that the court would accept the evidence without evaluation of the legal reasoning.

In this case, the evidence of D1's legal expert (Pan) was contradicted by that adduced by the Plaintiff's expert (Ye). The court said that such evidence had to be assessed and it had to come to a view as to whether the Plaintiff's case was properly grounded. It said that once the PRC law evidence is contested, the court has to come to a view whether the *prima facie* or plainly arguable case is properly supported.

The court said that the critical part of the Clause is the first sentence: "因履行本协议所发生的争议". It was common ground between Pan and Ye that the disputes in this action were tortious in nature (侵权之诉). The question over which they differed was whether the tortious disputes fell within the scope of the Clause. Ye answered this question in the negative, stating that "因履行本协议所发生的争议" should be construed to mean disputes arising from a party's failure to perform his obligations under the Agreement or to comply with its terms. Ye's opinion was supported by a judgment of the Supreme People's Court (SPC), which held that a practically identical arbitration clause did not cover a tortious dispute.

The court found that Ye's opinion was consistent with the clear wording of the Clause and supported by the highest authority in the Mainland.

D1's expert, Pan, gave a contrary opinion, adopting a wide construction of the Clause. His opinion was that the Clause was capable of covering the tortious disputes between the parties. However, the court found that on a close reading of Pan's opinion, his reasoning was not really supported by the legal authorities he cited. Apart from the lack of adequate underpinning for his opinion, the court was also unable to see how, in the face of a clear authority from the SPC, Pan's view could be supported.

Determination of Question (4)

In view of the above, Question (4) was resolved against D1.

Question (2): Is the arbitration agreement null and void, inoperative or incapable of being performed?

The court noted that an arbitration agreement is inoperative if a party has waived his right to arbitrate. There would be such a waiver if (i) a party has a right under a contract or by operation of law; (ii) he knows of the existence of the right or the facts giving rise to such right; and; (iii) he has by conduct, clearly and unequivocally abandoned his right, or indicated that he is not exercising his right.

The court said it should take a holistic view in examining D1's conduct generally in this action, and evaluate the particular action or non-action relied upon by the Plaintiff to contend that D1 had abandoned the right to arbitration in light of his conduct.

The court said it was quite clear from the original Statement of Claim (SOC) that the Plaintiff was alleging a case of fraud against D1. She alleged that by virtue of his fraud, her shares in the company in question were transferred to another company for no consideration. It was the Plaintiff's case from day one, the court said, that in reliance upon D1's representations she had signed various documents given to her.

The court said that despite his knowledge of and involvement in the Agreement, D1 had chosen to defend this action on the basis that he had nothing to do with the disposal of the Plaintiff's shares and such defence was inconsistent with the Agreement. First, D1 had chosen not to rely upon the Agreement and contend that the disposal was a genuine sale. Second, this was an opportunistic application.

Contrary to D1's contention, the court found that the Plaintiff had not changed her case. The Agreement was added by way of amendment to the particulars of fraud after she had obtained a copy of it and she was relying upon it as an instrument used to cheat her out of the shares.

The court held that D1 had not in any way indicated that he would be applying for a stay in light of the proposed amendment to the Statement of Claim, after having received the Plaintiff's application to amend the Statement of Claim. Instead, he took no objection to the amendment at the hearing. The court said that where an amendment of a pleading will introduce issues which the defendant says he is entitled to have resolved by arbitration, the defendant should object to the amendment on this ground at the time the amendment application is made

Further, D1 had agreed to pay the Plaintiff security for costs, which was plainly inconsistent, the court said, with this application by which he sought a stay pending arbitration.

Determination of Question (2)

Question (2) was also resolved against D1: he had waived his right to arbitration.

Comments

Generally, given the "pro-arbitration" approach of the Hong Kong Courts, one would have expected the court to adopt a broad interpretation of the arbitration clause to hold that the tortious claim should also be referred to arbitration. However, this decision of the court turns on the particular wording of the arbitration clause and the expert evidence on Mainland Chinese law.

Under Hong Kong law, the test for determining whether a tortious claim is within the ambit of an arbitration clause is the two-limb close connection test:-

(1) the resolution of a contractual issue is necessary for a decision on the tortious claim; or
(2) the contractual and tortious disputes are so closely knitted together on the facts, that an agreement to arbitrate on one can properly be construed as covering the other.

The above test has been applied in various cases. For further details, please see our previous article.

In this case, the plaintiff did not dispute that the construction of the arbitration clause was governed by PRC law. It is not clear from the judgment whether the arbitration clause was expressly governed by PRC law. In the absence of an express provision, even if the governing law of the agreement is PRC law, it may be possible to argue that the governing law of the arbitration clause is the law of the seat of the arbitration, which is in Hong Kong. Please see our previous article for more details on this subject.

Hong Kong Mediation Council Seminar on 30 May 2023 - Deploying Mediation Skills in the NEC Contract Administration

Hong Kong Mediation Council Ltd (HKMC) is holding a seminar on 30 May 2023, on “Deploying Mediation Skills in the NEC Contract Administration”, which may be of interest to some of our readers. The seminar will take place at 6:30pm at HKIAC, 38/F, Exchange Square, 8 Connaught Place, Central. The HKMC was established almost 30 years ago and is part of the Hong Kong International Arbitration Centre. Its mission is to offer an international mediation centre in Hong Kong and cultivate a culture of mediation and other forms of Alternative Dispute Resolution (ADR), so that ADR is widely accessible. Our Consultant, Stanley Lo, is the Vice-person of HKMC and our Senior Associate, Genevieve Lam, is a committee member of the Construction Mediation Division of HKMC.

Want to know more?

KK Cheung
k.k.cheung@deacons.com
+852 2825 9427

Joseph Chung
joseph.chung@deacons.com
+852 2825 9647

Richard Hudson
richard.hudson@deacons.com
+852 2825 9680

Peter So
peter.so@deacons.com
+852 2825 9247

Carmen Ng
carmen.ng@deacons.com
+852 2825 9502

Justin Yuen
justin.yuen@deacons.com
+852 2825 9734

Stanley Lo
stanley.lo@deacons.com
+852 2826 5395