HCCT 40/2014

IN THE HIGH COURT OF THE

HONG KONG SPECIAL ADMINISTRATIVE REGION

COURT OF FIRST INSTANCE

CONSTRUCTION AND ARBITRATION PROCEEDINGS

NO 40 OF 2014

IN THE MATTER OF SCHEDULE 5, ARBITRATION ORDINANCE, (CAP 341) AND ARTICLE 34, UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL ARBITRATION

and

IN THE MATTER OF HKIAC/ A11022

BETWEEN

A — Plaintiff

and

B — Defendant

Before : Hon Mimmie Chan J in Chambers
Date of Hearing : 20 May 2015
Date of Decision : 15 June 2015

D E C I S I O N

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1. This is an application made by A ("**A**") to set aside an arbitral award issued by the arbitrator in June 2014 ("**Award**"), in an arbitration commenced on 18 February 2011 ("**Arbitration**") by B ("**B**") as claimant.

2. B is a company organized under the laws of Grand Cayman, and A is a company organized under the laws of the Republic of China. The parties entered into a Development and Sales Agreement dated 13 May 2008 ("**Agreement**"), for the joint development, manufacture, distribution and marketing of security and integrated circuit solution for designated goods ("**Products**"). Disputes arose under the Agreement in relation to the Products and A's performance, and the Arbitration was commenced with B complaining that A was in breach of the Agreement. In the Arbitration, B sought a declaration that the Agreement had been rescinded, damages representing repayment of the development fees paid to A under the Agreement, the price of the Products paid by B in respect of the deliveries made under the Agreement, loss of profits, and a declaration that A is liable to indemnify B under its contracts with its sub-

purchasers. On its part, A counterclaimed for the balance of the development fees and the outstanding price of the Products claimed to be payable under the Agreement.

3. In June 2014, the Arbitrator issued the Award, whereby B's claims against A were allowed, and A's counterclaim was dismissed. The Arbitrator found that A had failed to deliver the Products with the contractual features in compliance with the relevant standards stipulated under the Agreement.

4. In September 2014, A applied to set aside the Award, on the basis that it would be contrary to public policy to enforce the Award. The grounds relied upon by A are that the Arbitrator had failed to deal with a defence relied upon by A in the Arbitration, that the claims made by B were time-barred under the express provisions of the Agreement ("**Limitation Defence**"), and had failed to give any reasons for its rejection of the Limitation Defence.

Matters not in dispute

5. It is not disputed that the old Arbitration Ordinance, Cap 341 ("**Cap 341**") applies to the Arbitration, since it was commenced before the operative date of the new Arbitration Ordinance, Cap 609 ("**Cap 609**"). The parties do not take issue that the relevant clause relied upon in the Limitation Defence (paragraph 7.5 of the standard terms and conditions of sale ("**Paragraph 7.5**")) was incorporated into and formed part of the Agreement. Nor is it disputed that the Limitation Defence was

pleaded in the Statement of Defence in the Arbitration, put in issue by B, and argued by the parties before the Arbitrator. It was referred to in the Award as one of the issues framed by B.

6. At the hearing before me, counsel for B also confirmed his acceptance that the Arbitrator had not expressly dealt with the Limitation Defence in the Award. B only contends that the Limitation Defence had been implicitly dealt with, and that the reasons for its dismissal can be inferred or understood from the Award when it is read in its context, and as a whole.

The applicable legal principles

7. The applicable legal principles are clear from the authorities. Article 34 of the Model Law (which applies to the Arbitration as an international arbitration under Cap 341) sets out the exclusive recourse against an arbitral award, and under Article 34 (2) (b), an arbitral award may be set aside by the court if the award is "in conflict with the public policy" of the forum of the court. "Contrary to public policy" has been held by the Court of Final Appeal in *Hebei Import & Export Corp v Polytek Engineering Co Ltd* (1999) 2 HKCFAR 111, 139 to mean "contrary to the fundamental conceptions of morality and justice" of the forum. Before a Convention jurisdiction can refuse enforcement of a Convention award on public policy grounds, "the award must be so fundamentally offensive to that jurisdiction's notions of justice that, despite its being a party to the convention, it cannot reasonably be expected to overlook the objection" (p 123H-I of the judgment in *Hebei*).

8. The public policy ground is to be narrowly construed, and "must not be seen as a catch-all provision to be used wherever convenient". It is "limited in scope and is to be sparingly applied" (*Qinhuangdao Tongda Enterprise Development* [1993] 1 HKLRD 173, 178). In *A v R (Arbitration : Enforcement)* [2009] 3 HKLRD 389, the court held that if the public policy ground is to be raised, there must be "a substantial injustice arising out of an award which is so shocking to the court's conscience as to render enforcement repugnant".

9. In considering whether or not to refuse enforcement of an award, it is clear that the court does not look into the merits of the case, nor at the underlying transaction. Error of law is not a ground for the setting aside of an award under Article 34. The court's role is confined to determining whether or not grounds exist for refusing to enforce the award because it would be contrary to public policy (*Xiamen v Eton Properties Limited & Anr* [2009] HKLRD 353). Enforcement should be "as mechanistic as possible" (*Xiamen Xinjingdi Group Ltd v Eton Properties Limited & Anr* [2009] 4 HKLRD 353(CA); *Re PetroChina International (Hong Kong) Corp Ltd* [2011] 4 HKLRD 604).

10. In *Grand Pacific Holdings Ltd v Pacific China Holdings Limited (in liq) (No1)* [2012] 4 HKLRD 1, the Court of Appeal made it clear that in an application for setting aside an arbitral award under Article 34 of the Model Law, the court is only concerned with the structural integrity of the arbitration proceedings, since the remedy of setting aside is not an appeal as to the substantive merits of the dispute or the correctness or otherwise of the award.

11. It is also clear that even if the grounds for setting aside are sufficiently made out, the court may nonetheless enforce the award as a matter of discretion. The grounds set out in Article 34 are only grounds on which an award "may" be set aside (*Hebei Import & Export Corp v Polytek Engineering Co Ltd* in the context of refusal of enforcement of an award). In *Grand Pacific Holdings Ltd v Pacific China Holdings Ltd (in liq) (No1)* [2012] 4 HKLRD 1, in the context of an application to set aside an award on the ground of a party's inability to present his case, the Court of Appeal emphasized that:

> "An error would only be sufficiently serious if it has undermined due process... Even so, the Court may refuse to set aside the award if the court is satisfied that the arbitral tribunal could not have reached a different conclusion. How a court may exercise its discretion in any particular case will depend on the view it takes of the seriousness of the breach. Some breaches may be so egregious that an award would be set aside although the result could not be different."

12. It is also to be borne in mind, that it is in the interests of public policy to uphold an agreement made between parties to submit their dispute to arbitration, and as a matter of comity, to enforce an arbitral award which is binding on the parties and enforceable under and in accordance with the international Convention (as recognized by the Court in *A v R (Arbitration : Enforcement)* [2009] 3 HKLRD 389).

The Limitation Defence

13. In this case, it cannot be disputed that the issues identified by the parties and in the pleadings used in the Arbitration include a defence

relied upon by A, that the claims made by B are time-barred under and by operation of Paragraph 7.5. This provides:

> "Any action by (B) hereunder must be commenced within one (1) year of the date of delivery of the Product giving rise to the claim or the date the cause of action arose, whichever is earlier."

14. On its face, there are 2 elements to Paragraph 7.5 which affect the relevant time limitation of one year. The first is the date of delivery of the Product giving rise to the claim. The second is the date the cause of action arose. Paragraph 7.5 provides that the earlier of these 2 dates is the relevant date for computation of the time limitation.

15. According to B, A were in breach of the Agreement in failing to develop and deliver Products which complied with the technical standards specified under the Agreement, and that the Products were not compatible with other software and components for integration into the applications of the required goods. It is further claimed that A failed to provide the requisite maintenance and support services it contracted to provide under the Agreement.

16. Apart from the Limitation Defence, A's denial of breach under the Agreement turns (in gist) on the meaning of the Products to be provided by A under the Agreement, the applicable and relevant standards with which the Products should comply, and the extent of B's obligations of maintenance and support under the Agreement. It is, however, correct to say that however strong the merits of B's claims are

against A for breach of the Agreement, such claims inevitably fail and stand to be dismissed if the Limitation Defence succeeds.

17. Counsel for B accepts that the Arbitrator did not expressly deal with the Limitation Defence in the Award and the reasons given for his finding in favor of B. It was argued that from the way in which the Arbitrator dealt with the claims made by B for A's breach, and his acceptance that the Agreement was for a term of 10 years, the Arbitrator had implicitly found that the claims are not barred under Paragraph 7.5.

18. In the case of *R v F* [2012] 5 HKLRD 278, the court held that an arbitral award must be read and understood in its proper context, in particular against the context as to how the relevant issues have been argued before the tribunal. This is because arbitration is private and confidential, and an award is intended to be read by the parties who would be familiar with the background and how the issues have been argued. So long as the readers of the award (namely the parties themselves) can understand how and why the tribunal reached its conclusion on a particular issue, the reasons in the award do not have to be elaborate or lengthy, so long as it can be understood in its proper context. The court emphasized that the reasons to be given in an award for a particular issue should be proportional to the complexities of how that issue is contended before the tribunal.

19. In the Award, the Arbitrator dealt with the parties' arguments concerning the Products to be developed and supplied by A, finding that the Products mean "the security and integrated circuit solutions for the

goods", with the features set forth in Schedule 1 of the Agreement, that the Products had to comply with the "**Relevant Standards**", and that A had failed to provide such Products, so as to be in breach of its obligations under the Agreement. The Arbitrator found that the Agreement is "fundamentally a contract to develop and deliver" the Products, that A had wholly failed to deliver and develop the Products, and had accordingly failed to earn the fees under the Agreement. The consideration for the payments B had made were found to have totally failed.

20. According to the evidence, there were a series of deliveries, or purported deliveries, of the Products to B under the Agreement. The first of such deliveries took place in December 2008, and the last of the deliveries took place in September 2009. It was A's case (according to its opening submissions and its closing submissions filed in the Arbitration) that even taking the last date of delivery in September 2009, by the time B commenced the Arbitration in February 2011, the claims were already barred under Paragraph 7.5.

21. On behalf of B, counsel emphasized the findings made by the Arbitrator in the Award, that A had "failed to deliver" Products which comply with the Relevant Standards and which contained the contractual features, to be in fundamental breach of the Agreement. It was argued that this constituted the Arbitrator's rejection of the Limitation Defence, in that the date of delivery of the Products never arose, meaning that the one year from that date never commenced to run under Paragraph 7.5.

22. I do not agree that these findings of the Arbitrator are sufficient to deal with the Limitation Defence.

23. First, when the Arbitrator referred (in paragraphs 285, 286 and 288 (2) of the Award) to A's failure to deliver the Products, it was in the context of his findings on whether A was in breach of its obligations notwithstanding its purported delivery of what A claimed to be the Products under the Agreement. The Arbitrator went on in paragraph 289 of the Award to find that A was in fundamental breach of the Agreement, as the basis for his finding that B was entitled to treat the Agreement at an end, and to seek a declaration that the Agreement is rescinded. In the remaining paragraphs 294 and 298 of the Award, when the Arbitrator again referred to the Agreement being one to develop the Products and to A's failure to develop and deliver, it was in the context of his finding that the value of B's payments of fees had failed, and further, that the Products had not been accepted by B.

24. Secondly, even if the Arbitrator's references to A's "failure" to deliver can be interpreted to mean that the 1st limb of Paragraph 7.5 does not apply, the Arbitrator did not proceed to deal with the 2nd limb of Paragraph 7.5, as to whether the one year period commencing from "the date the cause of action arose" had expired. If this date is the earlier of the date of delivery of the Products giving rise to the claim, it will be the relevant period for deciding whether B's claims were time-barred under Paragraph 7.5.

25. I agree with counsel for A, that on construction of Paragraph 7.5, "one year of the date of delivery of the Product giving rise to the claim" can mean the date of delivery of items purported to be the Products, which are in fact defective and which give rise to claims under the Agreement. Any implicit finding that there was no delivery of the Products in compliance with the Agreement may not by itself be sufficient for the dismissal of the Limitation Defence.

26. The Arbitrator included in his findings that the Relevant Standards are the standards which the parties had to comply with for the 10 year duration of the Agreement. The arguments made by Counsel for B, on the effect of a continuing agreement and A's continuing obligations, suggest that this finding of the Arbitrator can be taken to mean that the Arbitrator had rejected the claim that B's claims were time-barred, as there would be continuing obligations and hence continuing breaches during the 10 year Agreement to develop and deliver the Products. However, if there had been an earlier delivery or purported delivery of defective Products, for the computation of the one year limitation under Paragraph 7.5, the Limitation Defence may still be applicable, and I do not agree that the Arbitrator's reason for rejecting the time bar claim can be so readily and easily inferred from his findings.

27. It has to be borne in mind that Paragraph 7.5 provides for "any action" by B under the Agreement to be barred after the expiration of the time stipulated, and under the arbitration clause in the Agreement, "any dispute, controversy or claim arising out of or relating to (the Agreement), or the breach, termination or invalidity thereof" has to be

settled by arbitration. The time bar therefore covers all claims falling within the wide ambit of the arbitration clause, including B's claims for damages, recovery of the price of the Products and the fees paid under the Agreement, and not just the claims for rescission, and indemnity (which the Arbitrator dealt with in paragraph 297 of the Award, when he mentioned that the effect of the limitation clause can be dealt with in any proceedings which may be commenced in respect of the sub-sales).

28. On the whole, I do not agree that reading the Award in its entirety, and in the context of how the issues were argued before the Tribunal, the reasons expressed in the Award are sufficient to enable A to understand how, and why, the Limitation Defence is rejected. This is particularly so bearing in mind the need for proportionality, as the Court emphasized in *R v F* [2012] 5 HKLRD 278. The Arbitrator dealt with the other issues raised and arguments made by both parties in meticulous detail, in a 126 page "Reasons for Final Award", containing 307 paragraphs (excluding the acknowledgment of thanks). The Limitation Defence was listed as B's issues, but the Arbitrator did not deal with Paragraph 7.5 and the issues raised therein at all.

Whether contrary to public policy

29. At first blush, it may appear that A can only establish that the Arbitrator has made an error of law or on the facts, in failing to find that deliveries of the Products giving rise to the claim had been made at the latest by September 2009, such that the claims made by B were time-

barred under Paragraph 7.5, and that this is not a recognized ground for setting aside an arbitral award under Article 34.

30. Counsel for A referred to authorities in which the English courts have set aside awards, where the arbitral tribunal failed to address or deal with a central issue raised in the arbitral proceedings (such as a defence of waiver or estoppel) : *Ascot Commodities NV v Olam International Ltd* [2002] CLC 277, *Van der Giessen-de Noord Shipbuilding Division BV v Imtech Marine and Offshore BV* [2009] 1 Lloyd's Rep 273 and *Soeximex SAS Agrocorp International Pte Ltd* [2012] 1 Lloyd's Rep 52. In such cases, the English court held that in failing to address a central issue raised in the arbitration, there was serious procedural irregularity to justify setting aside the arbitral award.

31. As counsel for B pointed out, these cases were decided under s 68 (2) (d) of the English Arbitration Act, which deals with challenging arbitral awards on the ground of "serious irregularity", which has no equivalent under Cap 341 (or Cap 609, absent the parties' prior agreement), and has no application to Hong Kong. It is pertinent to note that under s 68 (2) of the Act, "serious irregularity" is defined, and includes (under s 68 (2) (d)) failure by the tribunal to deal with all the issues that were put to it, and which the court considers has caused or will court substantial injustice.

32. Nevertheless, I bear in mind the observations made by the Hong Kong courts that where the conduct of the arbitrator complained of, or the error in the arbitral process, are such that it is sufficiently serious to

have undermined due process, or be egregious, and that a real risk of prejudice has been shown as a result, the award may be set aside (*Grand Pacific Holdings Ltd v Pacific China Holdings Ltd (in liq) (No1)* [2012] 4 HKLRD 1).

33. It is fundamental to concepts of fairness, due process and justice, as recognized in Hong Kong, that key and material issues raised for determination, either by a court or the arbitral tribunal, should be considered and dealt with fairly. An award should be reasoned, to the extent of being reasonably sufficient and understandable by the parties (ie within the confines set out in *R v F* [2012] 5 HKLRD 278). Under Article 33(2) of the Model Law, the award should state the reasons upon which it is based. Having carefully considered the Award, I have to agree that the parties are entitled to query whether the Limitation Defence had been considered at all by the Arbitrator, and if rejected by the Arbitrator after due consideration, why it was rejected. The process of arbitration is intended as a way of determining disputes and points at issue, and I agree with the sentiments expressed by the court in *Ascot Commodities NV v Olam International Ltd* [2002] CLC 277 and in *Van der Giessen-de Noord Shipbuilding Division BV v Imtech Marine and Offshore BV* [2009] 1 Lloyd's Rep 273 that it is a serious irregularity and a denial of due process which causes substantial injustice and unfairness to the parties, if an important issue, which the parties are entitled to expect to be addressed, is not in fact addressed.

34. Even if the Arbitrator finds in favor of B on all its claims of A's inability and failure to deliver the Products in compliance with the

Relevant Standards and conforming to the contractual specifications, and A's failure to develop the Products pursuant to its contractual obligations, B's action against A and its claims for remedies in the Arbitration will fail, if the Limitation Defence succeeds. The Limitation Defence is a material point and issue which could have rendered the Award materially different, and the failure to consider it, or to explain the dismissal of the Limitation Defence, results in unfairness to A, as well as a real risk of injustice and prejudice to its case. Based on what was set out in the Reasons for the Award and the materials before the Tribunal, it cannot be said that it is plain and obvious, or beyond any doubt, that the Award would have been the same, if the Limitation Defence had been considered (*Brunswick Bowling & Billiards Corp v Shanghai Zhonglu Industrial Co Ltd* [2011] 1 HKLRD 707; *Paklito Investment Ltd v Kolckner East Asia Ltd* [1993] 2 HKLR 49). This is not a case in which different defences are raised, any one of which would have defeated the claims made, such that the failure to deal with any one of the other defences would not have made any difference to the award.

35. For the above reasons, I consider that there is sufficient injustice arising out of the Award, in its current form, which cannot be overlooked by the Court's conscience, and that enforcement of the Award would offend our notions of justice.

Setting aside or remission?

36. Under Article 34 (4) of the Model Law, when the court is asked to set aside an award, it may, where appropriate and so requested

by a party, suspend the setting aside proceedings to give the arbitral tribunal an opportunity to resume the proceedings, or to take such other action as in the arbitral tribunal's opinion will eliminate the grounds for setting aside.

37. B seeks an order suspending the setting aside proceedings, if the Award is found to be in conflict with public policy.

38. On A's part, it was argued that remission is inappropriate, since there is loss of confidence in "the Tribunal's ability to grapple with the key issues", and further, that the Arbitrator cannot reasonably be expected to have a clear or reliable recollection of the arguments, since the arbitration hearing took place in August and October 2013. It is also claimed that the Arbitrator had already made up his mind on all the matters before the Tribunal, such that it would be difficult if not impossible for the Arbitrator to change his mind, thus giving rise to an appearance of pre-judgment or bias. Counsel referred to the factors relevant to the Court's determination of whether remittance is appropriate, as outlined in *Sinclair Roche & Temperley v Heard* [2004] 1 IRLR 763.

39. Although the hearing before the Arbitrator took place in August and October 2013, the date of the Award and the Reasons for the Award is June 2014. The Reasons total 126 pages, and set out in detail the background, the issues raised, the complaints made by B, the evidence adduced by the witnesses and the experts, the Arbitrator's findings and his reasons for the findings. I do not consider that it would be difficult for the Arbitrator to recall the facts of the dispute, and the arguments

made by the parties, which are set out in the detailed closing submissions. I would envisage it to be a simple matter for the Arbitrator to include in the Award his findings on the Limitation Defence, on the basis of the factual findings he already made.

40. As mentioned in the earlier part of this decision, the Limitation Defence can be said to be a separate and independent consideration in the sense that irrespective of what the Arbitrator regards to be the merits of B's claims as to A's breach, a finding on the Limitation Defence and the construction of Paragraph 7.5 can lead to a different outcome for B's action, and a dismissal of its claims. No suggestion of misconduct or bias has been made against the Arbitrator, who is an experienced professional, nor is there any claim of the hearing being flawed or mishandled by the Arbitrator in any way. In view of the nature of the Limitation Defence which has been omitted, I do not consider that there is any real risk of an appearance of pre-judgment or bias, if the matter is now remitted to the Arbitrator.

41. I will accordingly make an order for remission of the Award to the Arbitrator, for him to consider the Award and to take such action as he thinks appropriate under Article 34(4), and further order these proceedings to be stayed for 90 days for this purpose, with liberty to the parties to apply to this Court thereafter, if necessary.

42. Since A has been successful in the challenge of the Award on the basis of the Arbitrator's failure to deal with the Limitation Defence, with the Award being remitted under Article 34 (4), I will make an order

nisi that the costs of the application be paid by B to A, with certificate for Counsel.

(Mimmie Chan)
Judge of the Court of First Instance
High Court

Mr Liu Man Kin and Ms Eleanor Yeung, instructed by F Zimmern & Co, for the plaintiff

Mr Andrew Mak and Ms Carol LW Wong, instructed by SH Leung & Co, for the defendant