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Hong Kong Court Sets Aside Arbitral Awards Under Exceptional Circumstances

Two recent decisions illustrate what constitutes exceptional circumstances justifying the rare intervention of Hong Kong courts in arbitration matters.

Hong Kong is internationally renowned as a pro-arbitration jurisdiction where the courts' approach is to permit enforcement of arbitral awards save in exceptional circumstances. Two recent decisions of the Hong Kong Court of First Instance, both with "unusual" facts, illustrate the extent to which Hong Kong courts are prepared to set aside an arbitral award or refuse to enforce if the requisite high thresholds are established. Specifically, the Court of First Instance concluded that the award in the first case was made beyond the arbitrator's jurisdiction, and that the arbitrator's error in the second case was so serious that it amounted to a denial of due process.

Case I: Arbitrator's jurisdiction wrongfully exercised in the absence of any dispute between the immediate parties to the arbitration agreement

In *CMB v. Fund, Cattle and Management* [2023] HKCFI 760, the subject award was made pursuant to an arbitration agreement in an investment agreement (Agreement) between the plaintiff (CMB), the first defendant (Fund), and the second defendant (Cattle) whereby CMB agreed to acquire a minority equity stake of a company (HC). The arbitration agreement provides for all disputes between the parties arising out of or related to the Agreement to be settled by arbitration.

CMB commenced court proceedings in Hong Kong (HCA) against L (who represented Fund when dealing with CMB), X (who represented Cattle when dealing with CMB), C (director of the HC), and Management (advisor of Fund). CMB claimed in the HCA that these parties had made fraudulent misrepresentations to CMB which induced CMB to enter into the Agreement with Fund and Cattle, and had conspired by unlawful means to defraud CMB. Notably, L, X, C, and Management were not parties to the Agreement; nor were claims made against Fund and Cattle in the HCA.

Shortly after commencement of the HCA, Fund, Cattle, Management, L, and X commenced arbitration proceedings against CMB (Arbitration) seeking permanent and interim anti-suit injunctions against CMB. They also sought certain declarations, including that the HCA was an abuse of process, and the following declaration (Declaration), which became the subject of challenge by CMB, namely, "(Fund and Cattle) have no liability to (CMB) with respect to the allegations arising out of the (Agreement) that are the subject matter of the (HCA), and that all such allegations in so far as they are made against (Fund and Cattle) are false".

In the Award, the arbitrator found that L, X, and Management were not parties to the Agreement and therefore he had no jurisdiction to grant the anti-suit injunction at their request to restrain the HCA. Further, the HCA was not a breach by CMB of the Agreement, and no damages for breach should be awarded.

However, the arbitrator found that he did have jurisdiction over Fund and Cattle "in so far as they seek declarations of non-liability as regards their own position". He accordingly made the Declaration. He further made some observations "to provide some assistance in the (HCA)… although it is not necessary [for him] to decide these points", including that "[t]he allegations made in the (HCA) are on their face improbable" and the arbitrator's own views on the evidence given by CMB and L concerning the allegations made in the HCA.

The court, having reviewed the Award as a whole and in this context, held that the arbitrator did not have jurisdiction to make the Award including the Declaration:

1. To begin with, no dispute existed between CMB on the one hand, and Fund and Cattle on the other. The HCA was commenced by CMB against L, X, C, and Management which were not parties to the Agreement.

2. The Arbitrator already ruled that L, X, and Management were not parties to the Agreement as affiliates, and had no jurisdiction to decide the claims of those parties in the Arbitration.

3. The claims made in the Arbitration concerned solely and essentially claims of fraudulent misrepresentation and conspiracy inducing and regarding the Agreement, which CMB made in the HCA only against L, X, and Management. Therefore, those claims should be the very matters to be decided by the court.

4. A legitimate interest for Fund and Cattle to seek the Declaration cannot by itself invoke the jurisdiction of the Arbitrator when no dispute exists between CMB, Fund, and Cattle and no claims made against Fund and Cattle in the HCA.

5. In response to the argument that the Agreement was broad in scope as to all disputes arising out of or related to the Agreement, the court held that no matter how wide the arbitration clause, it can only cover disputes and claims between the parties to the Agreement, namely claims and disputes between CMB and Fund and Cattle in the present case.

Case II: Arbitrator's error amounted to denial of due process

In another recent decision of Mimmie Chan J in *Canudilo International Company Limited v. Wu Chi Keung and Others* [2023] HKCFI 700, the court granted an application, made out-of-time, to set aside an ex parte enforcement order of an arbitral award based on different grounds. Despite the general position that the court will not intervene in cases in which the arbitrators had merely erred on facts or law, the court held that the case "calls for consideration of whether errors made by the arbitrator on facts and law can be so egregious and cause an outcome which is so unfair and unjust, that the court cannot ignore the errors as enforcement of the award made would be repugnant".

Canudilo International Company Limited (CIC) commenced an arbitration in Hong Kong under two sale contracts against a principal debtor (Company) and five individual guarantors (Guarantors), two of whom were named Wu (Wu). CIC claimed that the Company had defaulted in the payment of the purchase price for the goods sold under the contracts, and, accordingly, the Guarantors were liable for the payment of

the sums. The Company did not present any defence, evidence, or submissions in the arbitration. Wu, on their part, raised a number of defences, including misrepresentation and economic duress.

Upon CIC's application, the arbitrator (Arbitrator 1) decided to bifurcate the arbitration such that he would first determine the Company's liability owed to CIC on paper, and the remaining proceedings between CIC and the Guarantors would continue with an oral hearing.

Having considered CIC's and the Company's submissions, Arbitrator 1 issued an interim award (2020 Award) in favour of CIC regarding the dispute between the Company and CIC. Arbitrator 1 had expressly stated that he need not deal with and decide on the disputed issues between the Guarantors and CIC, including the dispute on whether a valid debt was due under the relevant contract.

After the 2020 Award, Arbitrator 1 resigned to avoid any suspicion or doubt as to his impartiality as arbitrator in the second part of the proceedings between CIC and the Guarantors. A new arbitrator (Arbitrator 2) was then appointed, who considered himself (and the Guarantors) to be bound by the 2020 Award, and issued a final award (Final Award) holding the Guarantors liable to pay CIC under the contracts.

CIC obtained leave from the Hong Kong Court to enforce the Final Award in Hong Kong against the Guarantors. Wu then applied to set aside the order out-of-time on the ground that Arbitrator 2 had failed to decide the key issue of their defence and failed to apply an independent mind, without being influenced by the 2020 Award. Wu argued that the arbitration was not conducted in accordance with the arbitration agreement and/or the agreed arbitration procedures, that Wu did not have a reasonable opportunity to present their case, and that enforcement of the Final Award would be contrary to public policy of Hong Kong.

Mimmie Chan J granted Wu's application and refused to enforce the Final Award:

1. Arbitrator 2 found himself and all the Guarantors including Wu bound by the 2020 Award on the essential issue of whether a primary debt was due from the Company. This finding gave rise to grave concerns on the court's part, where, in particular, Arbitrator 1 had expressly stated that it was *not* necessary for him to address the liability of the Guarantors in the 2020 Award.

2. Contrary to Arbitrator 2's finding that the Guarantors were seeking to have a "second bite of the cherry" by disputing the primary debt owed by the Company, the court found that the Guarantors "never had the first bite" as the 2020 Award was made without consideration of the Guarantors' defences.

3. Of greater concern was the fact that Wu had not been given notice or a reasonable opportunity to defend the case against them regarding their liability, i.e., whether the 2020 Award was binding on the Guarantors and whether Arbitrator 2 was bound to follow it.

4. Therefore, the arbitration had not been conducted in accordance with the arbitration agreement and/or the agreed arbitration procedures. Arbitrator 2 had failed to consider and decide Wu's defence in an impartial and independent manner, unfairly and unjustly depriving Wu of the reasonable opportunity to present their case, which would be contrary to the basic notions of justice and requirements for a fair hearing to enforce the Final Award.

5. The court also rejected CIC's argument that irrespective of any errors made by Arbitrator 2, the Final Award would likely not have been different since Wu had failed to establish any good defence on the merits to the claims. The court held that it was not beyond doubt that the Final Award would have been the same if all the evidence had been properly and seriously considered, and that the violation of Wu's rights in the arbitration was sufficiently serious and egregious for the Final Award to be set

aside. The entitlement to a reasonable and fair opportunity to present one's case to the fact finding tribunal and to have its defence properly and fairly determined is fundamental.

6. Whilst the application was made out-of-time, the court granted an extension given the merits of the belated application and the seriousness of the errors undermining the structural integrity of the Final Award.

Commentary

Notwithstanding Hong Kong's pro-arbitration judicial climate, these two decisions demonstrate the exceptional circumstances in which the Hong Kong courts will intervene in an arbitral tribunal's decisions and help highlight some key considerations in determining an application for setting aside or enforcing arbitral awards in Hong Kong. These exceptional grounds include that the award contains decisions on matters beyond the scope of the submission to arbitration and that the arbitral procedure was not in accordance with the agreement of the parties.

In *CMB*, the claimants were effectively attempting to use arbitration as a tool to stop or pre-determine a related High Court action between non-parties to the arbitration agreement. As illustrated by the decision in *CMB*, if the arbitral tribunal has exceeded the scope of its jurisdiction as established by the parties' agreement, the Hong Kong courts will be prepared to interfere.

Notably, the court in *Giorgio Armani SpA v. Elan Clothes Co Ltd* [2019] HKCFI 2983 granted an anti-suit injunction to restrain a party from pursuing PRC court proceedings against certain entities who were only affiliates of a party to the arbitration agreement. However, the facts in that case were different from *CMB*, as the arbitration agreement there was expressed to be made "by and between" the plaintiff "together with its branch offices and Affiliates". In contrast, such language was absent in *CMB*, and the arbitrator already found that L, X, C, and Management were not parties to the Agreement, even as affiliates. This point serves a reminder to commercial parties that arbitration is a consensual process, which normally will not extend to non-parties to the arbitration agreement. To avoid any unnecessary dispute, commercial parties should state clearly which parties are intended to be subject to the arbitration agreement at the outset. Commercial parties should also consider this issue in more complex commercial arrangements that might involve multiple related contracts between different parties, and determine whether they all agree to be bound by the arbitration agreement.

If the jurisdiction of the arbitral tribunal is established, the court would move on to consider any allegations of serious irregularity, violation of due process, and conflicts with public policy, and closely examine the relevant facts and circumstances. As Mimmie Chan J emphasised in *Canudilo*, the Hong Kong court would not intervene in cases in which the arbitrators had merely erred on facts or law. However, if the applicant was indeed deprived of a reasonable opportunity to present its case, or if the procedure adopted by the tribunal was so "seriously flawed" and "egregious" that due process was denied (as in the case in *Canudilo*), the court would find it justified to set aside the arbitral award on the ground that the arbitration was not conducted in accordance with the arbitration agreement.

While these recent decisions constitute successful efforts to set aside arbitral awards in Hong Kong, they are still rare instances based on unusual facts and circumstances. The courts in Hong Kong are generally reluctant to interfere with a tribunal's decisions to prevent losing parties from relitigating their cases to circumvent the consequences of an unfavourable award.

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