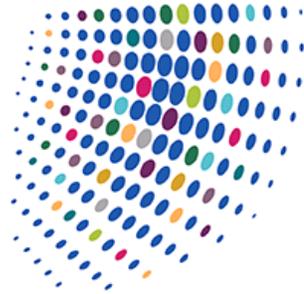


# Alerts & Publications



## Hong Kong Law Update: Using the Common Law to Enforce an Arbitral Award

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### KEY CONTACTS

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### Summary

A successful party in an arbitration made efforts to enforce an arbitral award in its favour in Hong Kong by means of the statutory process to enforce an arbitral award as if it were a judgment of the Hong Kong Court, only to find that the award, which required “continued performance” of a contract between the parties to the arbitration, was no longer capable of performance. The successful party also applied to the Hong Kong Court for a common law action on the award, claiming damages as an alternative. On appeal, the Hong Kong Court of Appeal determined that, on principle, such a remedy was available to a plaintiff, as a common law action on an award arose out of a breach by the losing party of the implied mutual promise between the parties to an arbitration to honour the resulting award, i.e. the losing party had not complied with the award. A successful party must, however, elect between remedies, as the losing party cannot be under two inconsistent liabilities concurrently, although a party should not be required to make such election until he is able to make an informed choice.

### Background

1. The Hong Kong Court of Appeal (the “**HKCA**”) recently reached a decision in the Eton Properties<sup>[1]</sup> case (CACV 158/2012). Proceedings in this matter have been on foot since CIETAC arbitration proceedings were commenced by the Plaintiff against the 1st and 2nd Defendants (“**D1 and D2**”) in 2005 following D1 and D2’s failure to comply with a land development agreement (the “**Agreement**”). Under the Agreement, the Plaintiff agreed to pay D1 and D2 a sum of RMB120m for the right to develop a plot of land (the “**Plot**”) and the consequent profits on such development. D1 and D2, each holding 50% of the shareholding in the Hong Kong company (“**Hong Kong Legend**”) which itself held 100% of the PRC company (“**Xiamen Legend**”) which owned the Plot, agreed to transfer their shares in Hong Kong Legend to the Plaintiff. The Plaintiff claimed damages in the sum of RMB1,275,000 for the late delivery of the land, and continued performance of the agreement. The governing law was PRC law, and continued performance is a PRC law concept, not to be confused with the common law concept of specific performance, as well as fees and costs.

2. Shortly after the arbitration was commenced, a restructuring process began, whereby D1 and D2's holdings were, initially, very substantially diluted. Ultimately, D1 transferred its holding to another entity, and D2 made a declaration of trust that it held its holding on trust for that same other entity (later to become the 3rd Defendant in the Court proceedings). Unaware of the restructuring process, and unaware that any prospect of a share transfer pursuant to the Agreement had become unworkable, the Plaintiff proceeded with its claim for continued performance. The Defendants proceeded to develop the Plot.

3. In October 2006, the arbitral tribunal issued an award (the "**Award**") against D1 and D2 which included the following:

- D1 and D2 to pay damages of RMB1,275,000 (in respect of late delivery of the land); and
- D1 and D2 shall continue to perform the Agreement (i.e. including the share transfer).

4. The Plaintiff applied to the Xiamen courts to execute the Agreement, but the Xiamen Municipal Intermediate Court dismissed the application on the grounds that the owner of the plot, Xiamen Legend, was an entity which "shall not directly bear the civil responsibility" of D1 and D2, and that D1 and D2 were Hong Kong companies whose assets were outside of the court's jurisdiction.

5. The Plaintiff sought to enforce the Award in Hong Kong.

## Enforcement history in Hong Kong

### (a) Statutory Process

6. The Plaintiff first brought proceedings under the Statutory Process pursuant to section 2GG and section 40B of the Arbitration Ordinance in force at the time (Cap. 341), under which a PRC award is enforceable in Hong Kong in the same manner as a Hong Kong Court of First Instance judgment that has the same effect. The Hong Kong Court's jurisdiction in enforcing the Award was not disputed and the Plaintiff successfully obtained a formal judgment enforcing the Award demanding continued performance of the Agreement (i.e. the Defendant's obligation to transfer the shares of Hong Kong company to the Plaintiff).

7. However, as D1 and D2's holdings in the Hong Kong company had been substantively diluted, the performance of the original obligations was rendered impossible.

### (b) Common Law Action on the Award

8. The Plaintiff initiated a common law action on the award ("**Common Law Action**"), claiming - in the alternative to an order enabling it to become the sole shareholder of Hong Kong Legend (on the basis that the proceeds of sale of the development were held directly or indirectly by Hong Kong Legend) - damages.

The High Court judge dismissed the Plaintiff's application, and the Plaintiff appealed to the HKCA.

## Nature of the action and Plaintiff's burden of proof

9. The HKCA held that the Common Law Action was an alternative method of enforcement of an arbitration award, as opposed to the statutory process, which the HKCA described as a "short cut" for enforcement. A Common Law Action was an independent cause of action, to be distinguished from the breach of the Agreement which led to the arbitration.

10. The HKCA considered a number of authorities, and reached the conclusion that there was an implied mutual promise made by the parties to an arbitration that the arbitral award would be honoured. A failure by the losing party to honour the award would constitute a breach of the implied promise, which would normally lead to the successful party suffering loss. This created a new and separate cause of action, the available remedies for which could include damages for breach of the implied promise. A claim for damages under this new cause of action was therefore different to a claim for damages under the Agreement.

11. To avail himself of such a cause of action, the Plaintiff had to prove, as a matter of fact, a valid submission of a dispute to arbitration, an award in favour of it and that the Defendants had failed to honour it. Time started to run from the time that the losing party breached the implied promise, i.e. when it failed to comply with the Award. Neither did the Plaintiff have to show that there was an implied promise under PRC law. While PRC law governed the Agreement, the Common Law Action was for the enforcement of the implied promise and was therefore concerned with the law of remedies, and governed by the law of procedure of the *lex fori*, i.e. Hong Kong law.

12. The Plaintiff did not expressly plead that D1 and D2 had not honoured the Award, but it was common ground that they had not done so. Further, the HKCA held that the Plaintiff did not have to plead or prove the implied promise, because it was an implication of law, and not a fact.

## Available Remedies - Could the Court order the Defendants to pay the Plaintiff damages for the loss suffered as a result of the Defendants' failure to comply with the non-monetary Mainland Award?

13. The HKCA considered this point, and the cases of *Dalmia Cement v National Bank of Pakistan*, *Selby v Whitbread & Co* [1917] 1 KB 736, and *Birtley and District Co-op Society v Windy Nook and District Industrial Co-op. Society (No. 2)* in detail. In a Common Law Action, in contrast to enforcement under the statutory process, the Court could grant remedies, including damages, whether or not the arbitral tribunal had awarded damages or not. The Court considered that, as a

matter of principle, a plaintiff in a Common Law Action should be able to take advantage of the flexibility of the Court to grant an order from a range of remedies. Hon Yuen JA, giving the judgment of the HKCA, stated *“a court enforcing an award by way of a Common Law action on the award is not hamstrung by the precise terms of the award in the same way that it would be if enforcing it by way of the Statutory Process.”* She went on to say that where there was a breach of promise, *“there was no reason why an innocent party could not obtain damages for that breach just because, had the promise been honoured, the other party would have done an act rather than have paid a sum of money.”*

14. On the facts, continued performance of the Agreement was incapable of performance because the Plot had already been developed by Xiamen Legend according to a different plan, and D1 and D2, as the parties to the Agreement and as unsuccessful parties in the arbitration, no longer effectively held any substantial legal interest, and no beneficial interest at all, in Hong Kong Legend.

15. In these circumstances, the Hong Kong court had the jurisdiction to grant damages reflecting the loss suffered by the Plaintiff by the D1 and D2's failure to comply with the Award.

## The Plaintiff must elect between continued performance and damages

16. The Court also held that the judgment entered “in terms of the award” under the statutory process, i.e. for continued performance, could not co-exist with a judgment for damages in the Common Law Action, as D1 and D2 could not be subject to two inconsistent liabilities at the same time. The Plaintiff had to elect between these two remedies.

17. Asking itself whether the Plaintiff had already elected by applying for judgment to be entered under the statutory process, the HKCA held that the Plaintiff had not done so. At the time that the Plaintiff had made that application, it was ignorant of the fact that D1 and D2 no longer held any of the beneficial interest and a substantially diluted legal interest in Hong Kong Legend. This was partly because the nature of the statutory process by which judgment is entered does not require pleadings or discovery, which would have revealed the restructuring. The Plaintiff only became aware of the dilution of D1 and D2's shares in the Hong Kong company after judgment was entered under the statutory process.

18. The HKCA held that the Plaintiff could not elect a remedy unless and until it was able to make an informed choice, provided that the election was not unreasonably delayed to the prejudice of the Defendants.

19. Consequently, the Plaintiff was entitled to make an informed choice between maintaining the judgment for “continued performance” under the statutory process and a judgment for damages under the common law action on the award. Should the Plaintiff choose damages, the judgment for performance under the Statutory

Process should be set aside. The Court therefore did not make any order in respect of damages, but directed the parties to consult with each other to agree the procedure to be adopted for the Plaintiff's election.

## Other ways to enforce a Mainland Arbitral Award in Hong Kong

20. The statutory process referred to in the Eton Properties case was that set out in the old Arbitration Ordinance (Cap 341) ("**Old Ordinance**"). In the new Arbitration Ordinance (Cap. 609) ("**New Ordinance**"), the position remained largely the same. Section 84 of the New Ordinance provides that an arbitration award is enforceable in the same manner as a judgment of the Court that has the same effect, but only with the leave of the Court. Thus, if the Court grants leave, the Court may enter judgment in terms of the award. Section 92 provides that a Mainland award is enforceable in Hong Kong either in the manner set out in section 84, or by action in the Court.

### ***Quasi-debt claim***

21. An action in the Court can take the form of a claim for damages as was the case in the Eton Properties case, or, in an appropriate case, a debt claim, i.e. Court action for the enforcement of the award as a debt, as was the case in *Shantou Zheng Ping Xu Yueli Shu Kuaot Trading Co Ltd v Wesco Polymers Ltd* <sup>[2]</sup>. In that case, after issuing proceedings for the enforcement of the award as a debt, the plaintiff applied for summary judgment under RHC Order 14. The defendant unsuccessfully argued that the triable issues, which included a conflict between experts on matters of PRC law, had to be resolved at trial. The plaintiff argued that, if the Court was able to exercise its discretion to enforce the award under section 40E of the Old Ordinance (section 95 of the New Ordinance), there was no need to resolve the conflict between the experts, which argument the Court accepted, stating that the plaintiff should not face an extra burden to make his task more difficult than it would otherwise have been. Having considered the issues, Burrell J found that, although there was a conflict in expert opinions on PRC law, there were irresistible grounds for exercising the Court's discretion in the plaintiff's favour.

22. While this claim was presented as a debt claim, it appears as though the Court treated it as a claim under the statutory machinery, or, at least, that the Court's discretion to enforce trumped the potential Order 14 arguments. It would appear, therefore, that while this route presents a further variation, it may be simpler to follow the statutory machinery under section 84.

## Conclusion

23. Successful parties in arbitration should consider carefully whether to proceed to enforcement by the statutory process, which is an expedited procedure, not requiring pleadings or discovery, and may be appropriate when enforcing the strict terms of an award, or by Common Law Action for damages based on the

losing party's breach of the implied promise to honour the arbitral award, or by a Court action for the enforcement of a debt.

24. Assuming the Hong Kong Court has the jurisdiction to enforce the foreign award, under the Common Law Action, and following the HKCA's judgment, it also has the jurisdiction to grant a full range of remedies as appropriate, which may differ from the original terms of the foreign award. If the enforcement of the original award becomes incapable of performance, proceeding by Common Law Action may provide a more practical and flexible approach. It will be interesting to see how future courts treat this question.

*O'Melveny was involved in providing legal advice to the Plaintiff on the merits of appealing the judgment of the Hong Kong Court of First Instance.*

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<sup>[1]</sup> *厦门新景地集团有限公司(formerly known as 厦门市鑫新景地房地产有限公司) v Eton Properties Limited and others*

<sup>[2]</sup> [2002] HKEC 76

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