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HCCT 54/2008

IN THE HIGH COURT OF THE

HONG KONG SPECIAL ADMINISTRATIVE REGION

COURT OF FIRST INSTANCE

CONSTRUCTION & ARBITRATION PROCEEDINGS

NO. 54 OF 2008

IN THE MATTER of an application for the enforcement of an arbitral award

and

IN THE MATTER of the Arbitration Ordinance, Cap. 341

BETWEEN

A — Applicant (Claimant in Arbitration)

and

R — Respondent (Respondent in Arbitration)

Before: Hon Reyes J in Chambers (not open to public)

Date of Hearing: 30 April 2009

Date of Judgment: 30 April 2009

JUDGMENT

I. INTRODUCTION

1. This case concerns a New York Convention award. The award was made following arbitration proceedings in Denmark before a Sole Arbitrator (a Danish Commercial Court judge). The Applicant wishes to enforce the award as an Order of this Court. The Respondent says that the enforcement of the award would be contrary to public policy.

II. BACKGROUND

2. The Applicant (a Danish company) and the Respondent (a Hong Kong company) entered into an Agreement in 2004.

3. By Clause 3 of the Agreement, the Respondent undertook to pay 12% commission on total sales by the Respondent to a Customer. The commission was to be paid in consideration of the Applicant referring the Customer (a Danish company) to the Respondent.

4. Clause 2 of the Agreement required the Respondent to provide the Applicant with copies of relevant sale contracts between the Respondent and Customer. The Agreement stipulated in Clause 7 that the Respondent should not contact the Customer "to circumvent the conditions set forth in this agreement". By Clause 16, the Respondent was not to disclose the terms of the Agreement to the Customer.

5. Clause 12 of the Agreement gave the Respondent the option of terminating the arrangement:-

> "after a period of four (4) years upon paying [the Applicant] an amount equivalent to 12% of the 4 (four) years estimated sales to [the Customer]. Such estimated sales shall be based on previous sales and expected sale."

6. Clause 18 of the Agreement provided:-

> "In each and every event that [the Respondent] commits a substantial breach of the terms of this Agreement, [the Applicant] shall be entitled to receive the sum of US$1,000,000 as liquidated damages. Liquidated damages shall be in addition to any other remedies [the Applicant] may have."

7. Clause 20 made Danish law applicable to the Agreement. Clause 21 stipulated ICC arbitration in Copenhagen if any dispute between the parties could not be settled by negotiation.

8. The Applicant referred the Customer to the Respondent. The Respondent or its affiliates entered into sales contracts with the Customer. But the Respondent failed to pay any commission to the Applicant. The Respondent also refused to provide the Applicant with copies of relevant sales contracts with the Customer.

9. The Applicant consequently commenced arbitration proceedings in Denmark. Just before the substantive hearing of the dispute, the Respondent's Danish lawyers informed the Arbitrator that they were no longer acting for the Respondent.

10. On 3 June 2008 the Arbitrator heard the matter substantively in the absence of the Respondent. He considered witness statements and a transcript of live evidence from representatives of the Customer. That live

evidence was taken before the So,/nderborg City Court for use in the arbitration.

11. On 12 September 2008 the Arbitrator published the award. The award ordered the Respondent to pay US$3 million (together with interest and costs) to the Respondent.

12. The Arbitrator found 3 breaches by the Respondent. Those were the non-provision of relevant sale contracts contrary to Clause 2, the non-payment of commission contrary to Clause 3, and the circumvention of the Agreement contrary to Clause 7. In relation to the latter, the Arbitrator found that the Respondent had circumvented the Agreement by secretly contracting with the Customer through a related company.

13. The Arbitrator then applied Clause 18 to the 3 breaches. Given "the Respondent's total neglect of its contractual obligations," the Arbitrator concluded that liquidated damages "should not be fixed to a sum below [the Applicant's] claim of US$3 million".

III. DISCUSSION

A. Court's approach

14. Under Arbitration Ordinance (Cap. 341) (AO) s. 44 enforcement of a Convention award "shall not be refused except in the cases mentioned in this section". The grounds on which the Court can refuse to enforce a Convention award are therefore circumscribed by AO s. 44. If none of the grounds listed in AO s. 44 apply, the Court must enforce the Convention award.

15. The only ground for non-enforcement that might conceivably be relevant here is found in AO s. 44(3). That provides that enforcement "may ... be refused ... if it would be contrary to public policy to enforce the award".

16. That is a narrow ground. According to *Hebei Import & Export Corp. v. Polytek Engineering Co. Ltd.* (1999) 2 HKCFAR 111, the public policy objection only applies where the consequence of enforcing an award would be to "violate the most basic notions of morality and justice" of the Hong Kong Court (Litton PJ at 118D-E).

17. This stance is consonant with case law elsewhere.

18. In *Profilati Italia SrL v. PaineWebber Inc. and another* [2001] 1 Lloyds Rep 715 Moore-Bick J was considering whether an award might be set aside under s. 68 of the English Arbitration Act 1996 because it was "procured ... contrary to public policy".

19. He stated (at §17):-

> "..... I think that where the successful party is said to have procured the award in a way which is contrary to public policy it will normally be necessary to satisfy the Court that some form of reprehensible or unconscionable conduct on his part has contributed in a substantial way to obtaining an award in his favour. Moreover, I do not think that the Court should be quick to interfere under this section. In those cases in which s. 68 has so far been considered the Court has emphasized that it is intended to operate only in extreme cases. Lord Goldsmith, QC on behalf of PaineWebber drew my attention to the now familiar passage in par.280 of the Report of the Departmental Advisory Committee on Arbitration Law on what was then the Arbitration Bill where the Committee said in relation to cl. (now s.) 68:-
>
> > 'Having chosen arbitration, the parties cannot validly complain of substantial injustice unless what has occurred simply cannot on any view be defended as

> an acceptable consequence of that choice. In short, clause 68 is 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.'
>
> This passage has since been adopted and applied in a number of cases to which I was referred... None of these decisions concerned an application under s. 68(2)(g), but each in its own way emphasizes the fact that the expressions 'serious irregularity' and 'substantial injustice' are intended to be reserved for only the most serious cases."

20. In *Soh Beng Tee & Company Pte Ltd. v. Fairmount Development Pte Ltd.* [2007] SGCA 28, V. K. Rajah JA (delivering the decision of the Court) observed:-

> "59. These cases [challenging the enforcement of arbitration awards] must be read in the context of the current judicial climate which dictates that courts should not without good reason interfere with the arbitral process, whether domestic or international. It is incontrovertible that international practice has now radically shifted in favour of respecting and preserving the autonomy of the arbitral process in contrast to the earlier practice of enthusiastic curial intervention:....
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> ....
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> 62. .... Aggressive judicial intervention can only result in the prolonging of the arbitral process and encourage myriad unmeritorious challenges to arbitral awards by dissatisfied parties. Left unchecked, an interventionist approach can lead to *indeterminate challenges*, cause *indeterminate costs* to be incurred and lead to *indeterminate* delays...."

21. In similar vein, in *Asuransi Jasa Indonesia (Persero) v. Dexia Bank* [2006] SGCA 41, Chan Sek Keong CJ stated (at §59) that the public policy ground only militates against enforcement:-

> "where the upholding of an arbitral award would 'shock the conscience' ... or is 'clearly injurious to the public good or ... wholly offensive to the ordinary reasonable and fully informed member of the public' ... or where it violates the forum's most basic notion of morality and justice..."

22. All this is unsurprising. Public policy itself leans towards the enforcement of foreign arbitral awards as a matter of comity. The parties agreed to resolve their disputes by arbitration, rather than through the Court. They should be held to what they have agreed and be obliged to comply with an arbitration award.

23. By choosing arbitration, the parties must be deemed to have undertaken the risk that an arbitrator might get matters wrong in his decision. An error (whether of law or fact does not matter here) by an arbitrator in an award cannot by itself counterbalance the public policy bias towards enforcement. If the public policy ground is to be raised, there must be something more, that is, a substantial injustice arising out of an award which is so shocking to the Court's conscience as to render enforcement repugnant.

24. Public policy is often invoked by a losing party in an attempt to manipulate an enforcing Court into re-opening matters which have been (or ought to have been) determined in an arbitration. The public policy ground is thereby raised to frustrate or delay the winning party from enjoying the fruits of a victory.

25. The Court must be vigilant that the public policy objection is not abused in order to obtain for the losing party a second chance at arguing a case. To allow that to happen would be to undermine the efficacy of the parties' agreement to pursue arbitration. That by itself would not be conducive to the public good.

26. There is a further point to bear in mind.

27. As I pointed out in *Xiamen Xingjingdi Group Ltd. v. Eton Properties Ltd.* [2008] 4 HKLRD 972 (at §§61-63), an agreement that parties are to settle disputes through arbitration in some place X, is equivalent in law to an exclusive jurisdiction clause. The agreement gives exclusive jurisdiction to the Courts of X as far as supervising the conduct of the relevant arbitration is concerned. See also *A v. B* [2007] 1 Lloyds Rep 237 (Colman J) at §111 and *C v. D* [2008] 1 Lloyds Rep 239 (CA) at §17.

28. This means that, if a party alleges that there is something invalid about an award made in X, then it is for that party to apply to the Court of X (as the supervising jurisdiction) for relief against the award.

29. Recourse should not be to the enforcing Court. It is not for the enforcing Court, in the guise of applying public policy, to usurp the jurisdiction of the supervising Court and in effect itself supervise the supervising Court. All the Hong Kong Court as the enforcing Court does (and can do) when it considers the public policy objection is to assess whether there is something so repugnant about an award such that, as matter of discretion, it should not be enforced here.

B. Respondent's arguments

30. Mr. Victor Dawes (appearing for the Respondent) submits that Clause 18 is void as a penalty clause.

31. This (Mr. Dawes says) is because Clause 18 cannot be a genuine pre-estimate of the loss that might be suffered by the Applicant in the event of breach. The invalidity of Clause 18 (Mr. Dawes notes) would be the result whether one applies Danish or Hong Kong law.

32. The US$3 million in damages which the Arbitrator awarded to the Applicant was based on the liquidated damages figure stipulated in Clause 18. Accordingly, Mr. Dawes suggests that, as matter of public policy, this Court should not enforce the Award. To enforce the award would be oppressive (Mr. Dawes concludes) as it would require the Respondent to pay an amount which is likely to be substantially in excess of actual loss.

33. I am unable to accept Mr. Dawes' argument. I do not think that the Respondent's complaint can by any stretch of the imagination qualify as a matter which "shocks the conscience". I do not think that the test for the public policy ground just explained above is met here. On the contrary, it seems to me that the Respondent finds itself in its present predicament as a result of its own decisions as to the conduct of its defence in the arbitration.

34. First, in its pleadings in the arbitration, the Respondent did not actually complain about the US$3 million which the Applicant claimed pursuant to Clause 18. The award states on this that:-

> "On the Respondent's side there has in fact only been one argument, which from the beginning of the dispute until the time the Respondent's advocate resigned as attorney representing the Respondent has been that [the Applicant] the has provided no evidence at all for a breach of the Referral Agreement."

35. The Respondent might conceivably have raised the matter orally in the substantive hearing before the Arbitrator. But it did not do so. Instead, it chose to discharge its Danish lawyers and not to appear at all in the arbitration.

36. Thus, the Arbitrator did not explore the question whether the US$3 million claimed was or was not a genuine pre-estimate of damages. He was constrained from doing so by the Danish legal principle of *forhandlingsmaksimen* (adversarial procedure) whereby an arbitrator "may only rule on the basis of the allegations and submissions put forward by the parties".

37. Thus, if the Respondent's present point about Clause 18 being a penalty was never considered by the Arbitrator, the Respondent has only itself to blame for that.

38. In this connection, as a matter of Hong Kong law, if one does not object to a liquidated damages clause as a penalty in the course of a trial (whether before a Court or arbitrator), one is taken to have accepted the liquidated damages clause as reasonable. One cannot belatedly plead a penalty clause after one has lost a substantive hearing.

39. Second, consider the nature of the Respondent's proposition that Clause 18 is a penalty clause.

40. Both Danish and Hong Kong laws strike down penalty clauses. But under both laws whether or not a clause is a penalty clause is a fact-sensitive question.

41. To answer the question a tribunal needs to look into whether an amount A is or is not a genuine pre-estimate of damages. Without such an investigation of fact, it is not possible to say whether A constitutes a penalty.

42. Since the Respondent did not bother to raise the matter of penalty clause in the arbitration, the Arbitrator did not investigate whether the US$1 million per breach stipulated by Clause 18 was a genuine pre-estimate of damages. There is no means by which this or any other Court can readily evaluate in the abstract whether Clause 18 is or is not a penalty. Thus, the Respondent is unable to discharge the burden of showing that it has even an arguable case that Clause 18 is a penalty.

43. Third, the Respondent attempts to make good this deficiency by referring to the Applicant's pleading in the arbitration. That (according to the Respondent) referred to loss in the amount of DKK 2,174,806.44 (about US$386,820).

44. Further, the Respondent argues that breaches of Clause 2 (duty to provide copies of sale contracts) and Clause 7 (duty not to circumvent the Agreement) could not cause pecuniary loss to the Applicant.

45. It follows (the Respondent suggests) that, even on the Applicant's own case, the most that it was entitled to was US$386,820, a tenth of the damages actually awarded.

46. This (the Respondent contends) is conclusive proof that the award of US$3 million is excessive and oppressive.

47. I do not accept the Respondent's analysis.

48. To begin with, assume that actual losses under the Agreement turn out to be Amount A and A is less than US$3 million. It does not logically follow from this that the US$1 million stipulated in Clause 18 is

necessarily a penalty. One cannot use the benefit of hindsight to argue that the US$1 million did not constitute a genuine pre-estimate of damages. The actual loss A may be some evidence that Clause 18 was not a genuine pre-estimate. But it can only be indicative and hardly conclusive evidence.

49. In any event, the Arbitrator accepted the Applicant's submission that the Respondent had attempted to circumvent the Agreement by dealing with the Customer through an affiliated company. Taking account of the sales between the Respondent and its affiliated company to the Customer up to 17 August 2007, the Applicant's pleading estimated the commission payable to be DKK 2,174,806.44.

50. But that estimate was only of commission due up to August 2007. There is no reason to believe that the Respondent has since then ceased to do business with the Customer. There was no evidence before the Arbitrator suggesting that the Respondent was no longer doing business with the Customer. What evidence there was suggested the opposite. Presumably then, commission would continue to accrue.

51. It was the Applicant's case in the arbitration (as the Arbitrator observes in the award) that the Applicant would at least have earned commission for 10 years. The Arbitrator seems to have accepted that submission since the Arbitrator went out of his way in the award to state his view that liquidated damages "should not be fixed to a sum below [the Applicant's] claim" of US$3 million.

52. I am thus unable to see anything to fault in the Arbitrator's reasoning.

53. Fourth, Mr. Dawes draws my attention to Clause 12 of the Agreement. Mr. Dawes suggests that, since under that provision the Respondent had an option to withdraw from the Agreement after 4 years, the Applicant should at most only be entitled to liquidated damages for 4 (not 10) years.

54. That argument was of course not raised by the Respondent during the arbitration. Again the Respondent has only itself to blame for that.

55. Even if the Respondent had raised the argument, would it have been obviously sound? I do not think so.

56. Clause 12 is ambiguous. The Respondent appears to have a right to terminate after 4 years, but only after paying commission "equivalent to 12% of the 4 (four) years estimated sales to [the Customer]". The estimate "shall be based on previous sales and expected sales".

57. On one reading of Clause 12, the price for exercising the option appears to be the payment of commission that would have been earned in the 4 years following the exercise of the option to terminate. Otherwise, why would one need to estimate the commission payable upon termination? There would be no need to estimate. One would already know the actual sales between the Respondent and Customer in the 4 years prior to the exercise of the option. There would be nothing to estimate if all that the Applicant was entitled to receive was 12% of that historically determined amount.

58. Therefore, the reference to "estimate" possibly posits that, upon exercise of the option, the Applicant would be entitled to commission for sales over an initial 4 years plus estimated sales in the succeeding 4 years. That would make at least 8 years of commission payable. It is perfectly plausible for the amount of US$3 million to represent a genuine pre-estimate of the total commission payable over that period of 8 years.

59. Had Clause 12 been raised during the arbitration, its proper construction could have been explored by the Arbitrator. It was not so explored due to the Respondent's deliberate default. It cannot be contrary to public policy to enforce the award where it was the Respondent's own decision not to raise Clause 12 in the arbitration.

60. In summary, there is no injustice here which cries out for redress. There is no basis for refusing enforcement as a matter of public policy.

61. Instead, it seems to me that what the Respondent is trying to do is to re-open the dispute to enable it to argue points which ought to have been raised in the arbitration. That is an abuse of process.

62. Finally, Mr. Dawes refers me to a dictum of Sir Anthony Mason NPJ in Hebei (at 136J-137C). The dictum states:-

> "It follows also that a failure to raise the public policy ground in proceedings to set aside an award cannot operate to preclude a party from resisting on that ground the enforcement of the award in the enforcing court in another jurisdiction. That is because each jurisdiction has its own public policy."

63. The Respondent (Mr. Dawes submits) should not be precluded from now raising the penalty clause argument, merely because it did not raise the same in the arbitration.

64. I reject that submission. Sir Anthony Mason's dictum continues:-

> "What I have said does not exclude the possibility that a party may be precluded by his failure to raise a point before the court of supervisory jurisdiction from raising that point before the court of enforcement. Failure to raise such a point may amount to an estoppel or a want of *bona fides* such as to ... justify the court of enforcement in enforcing an award (see *Chrome Resources SA v. Léopold Lazarus* (Yearbook Commercial Arbitration XI (1986) 538). Obviously an injustice may arise if an award remains on foot but cannot be enforced on a ground which, if taken, would have resulted in the award being set aside."

65. The penalty clause argument has neither been raised in the arbitration nor before the Danish Court. Either would have been a proper forum in which to take the penalty clause point if it was thought that there was any validity to it. Given that the argument has not been so raised, this Court should regard the Respondent as now estopped from taking the point.

IV. CONCLUSION

66. There is no merit to the Respondent's application. It is dismissed. My previous Order Nisi making the award enforceable as a judgment of this Court should now become absolute. I shall hear the parties on costs and consequential orders.

[After hearing further submissions]

67. Parties should comply with arbitration awards. A person who obtains an award in his favour pursuant to an arbitration agreement should be entitled to expect that the Court will enforce the award as a matter of course.

68. Applications by a party to appeal against or set aside an award or for an Order refusing enforcement should be exceptional events. Where a party unsuccessfully makes such application, he should in principle expect to have to pay costs on a higher basis. This is because a party seeking to enforce an award should not have had to contend with such type of challenge.

69. Further, given the recent introduction of Civil Justice Reform (CJR), the Court ought not normally to be troubled by such type of application. A party unmeritoriously seeking to challenge an award would not be complying with its obligation to the Court under Order 1A Rule 3 to further the underlying objectives of CJR, in particular the duty to assist the Court in the just, cost-effective and efficient resolution of a dispute.

70. If the losing party is only made to pay costs on a conventional party-and-party basis, the winning party would in effect be subsidising the losing party's abortive attempt to frustrate enforcement of a valid award. The winning party would only be able to recover about two-thirds of its costs of the challenge and would be out of pocket as to one-third. This is despite the winning party already having successfully gone through an arbitration and obtained an award in its favour. The losing party, in contrast, would not be bearing the full consequences of its abortive application.

71. Such a state of affairs would only encourage the bringing of unmeritorious challenges to an award. It would turn what should be an exceptional and high-risk strategy into something which was potentially "worth a go". That cannot be conducive to CJR and its underlying objectives.

72. Accordingly, in the absence of special circumstances, when an award is unsuccessfully challenged, the Court will henceforth normally consider awarding costs against a losing party on an indemnity basis. The Respondent will here pay the Applicant's costs on an indemnity basis.

(A. T. Reyes)
Judge of the Court of First Instance
High Court

Mr. Jenkin Suen, instructed by Messrs. Stephenson Harwood & Lo, for the Applicant

Mr. Victor Dawes, instructed by Messrs. Richards Butler, for the Respondent