Dispute Resolution

July 2014

Welcome to the July edition of our Dispute Resolution Bulletin.

London Partner Brian Perrott wrote an article in the March edition of our Dispute Resolution Bulletin, looking at conflicting decisions of the English High Court as to the effect of the wording of the standard form of freezing order. The release of the Court of Appeal's decision in one of those cases has brought some much needed clarity. Brian analyses the impact of this latest decision in our opening article.

In our second article, Singapore Partner Paul Aston reflects on the launch of two new dispute resolution centres (SICC and SIMC) in Singapore. Next, London Associate Eleanor Midwinter examines a recent decision as to whether it is possible under English law to enforce clauses where parties are required to resolve disputes by "friendly discussion".

Our final piece comes from our Hong Kong office. Associate Fergus Saurin considers how far it is possible for parties arbitrating in the People's Republic of China to gain the benefits of an ad hoc arbitration.

Should you require any further information or assistance on any of the issues dealt with here, please do not hesitate to contact any of the contributors to this Bulletin, or your usual contact at HFW.

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Crystal clear? The Court of Appeal on freezing orders

In the March issue of this Bulletin, we examined the conflicting decisions in *Group Seven Ltd v Allied Investment Corporation Ltd & Ors (Group Seven)* and *Lakatamia Shipping Company v Nobu Su & Ors (Lakatamia)* as to whether assets held by companies wholly owned and controlled by a defendant are subject to the standard form of freezing order. The release of the *Lakatamia* appeal judgment on 14 May 2014 has provided much-needed clarification.

Background

Paragraph 6 of the standard form of freezing order (Paragraph 6) provides:

"[The restriction on dealing] applies to all the Respondent's assets whether or not they are in his own name and whether they are solely or jointly owned. For the purpose of this order the Respondent's assets include any asset which he has the power, directly or indirectly, to dispose of or deal with as if it were his own. The Respondent is to be regarded as having such power if a third party holds or controls the asset in accordance with his direct or indirect instructions."

In *Group Seven*, the defendant was subject to a standard form freezing order and listed as one of his assets a debt owed to a company of which he was sole shareholder and sole director. The company eventually settled with the debtor for a much reduced sum. The claimant argued the defendant had breached the order by procuring the disposal of one of his "assets" within the meaning of Paragraph 6.

Hildyard J held that when the defendant as sole director signed the agreement settling the debt, he was merely the means by which the company acted. Paragraph 6 was not engaged and the freezing order was not breached.

In *Lakatamia*, the defendant was also subject to a standard form freezing order. He sought a declaration that assets held by companies owned and controlled by him were not subject to the restrictions in the order. Burton J rejected the request, concluding that Paragraph 6 did apply to assets held by companies under the defendant's control because, among other matters, the owner of a company could by resolution or otherwise *"access and direct the fate of"* the company's assets. The defendant appealed.

Lakatamia appeal

The Court of Appeal endorsed Burton J's decision, but criticised his reasoning. It held that:

1. The effect of Paragraph 6 was that assets beneficially owned by the defendant would be subject to a freezing order, whether held legally by him or another. However, assets held legally by the defendant for the benefit of another would not.
2. There was no basis to say that Paragraph 6 was intended to or did have the effect of bringing within the definition of the defendant's assets the assets of a company which he controls.
3. However, a standard form freezing order will prevent an individual from diminishing the value of his shareholding in a company he owns or controls. That will not usually prevent the company from dealing with its assets in the ordinary course of business since that will not usually diminish the value of the defendant's shareholding.

The judgment does present challenges for those on the attack.

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Analysis

For many practitioners and their clients, the judgment brings a refreshing clarity to the scope of the standard form of freezing order. The purpose of freezing orders is to restrain the defendant from dealings with assets which will be available to satisfy any judgment obtained. Assets targeted by a standard form freezing order are therefore those that belong beneficially to the defendant.

A defendant faced with a freezing order will not be permitted to diminish the assets of his companies (and thereby his own assets in the form of his shareholdings) unless he can show that such disposals lie within the exception for dealings in the ordinary course of business. Where, for example, a company is a special purpose vehicle, disposal of its primary asset would likely fall foul of Paragraph 6.

The Court of Appeal emphasised that a defendant's ability to control the assets of his company does not mean that they are his assets within the meaning of Paragraph 6. This reflects the courts' return to a stricter view of separate corporate personality in the recent cases of *Prest v Petrodel* and *VTB v Nutritek* and probably represents the last nail in the coffin of the idea of 'control as ownership'.

In order directly to freeze assets of a non-defendant company, a claimant must either make a sufficient case that the company is *"just the money-box of the defendant"* and holds its assets for his benefit, or it must make the company itself a defendant under the Chabra jurisdiction (outlined in our March article).

The judgment does present challenges for those on the attack. For claimants previously stung by duplicitous defendants, the idea that their opponent is 'indirectly' prevented from dealing with corporate assets for fear of reducing the value of his shareholding may be of little comfort.

It may be that, for more 'respectable' defendants, the prospect of a rigorous disclosure regime put in place to police the value of their shareholding is itself an effective threat. The Court's attitude seemed to be that in cases of fraud, misappropriation of funds or some other dishonesty, claimants should be able to seek a wider order than the standard form, either directly to freeze corporate assets and/or to make the relevant companies defendants themselves. It will be interesting to see how the courts respond if and when an application for an order on these wider terms is made.

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hfw Singapore builds its dispute resolution capabilities

Recent developments in Singapore demonstrate its intention to position itself as a leading dispute resolution centre in Asia.

Singapore is already widely recognised as a centre for arbitration. It is the third most popular arbitral seat internationally and SIAC is the fourth most popular arbitral institution. Singapore is a signatory to the New York Convention and SIAC awards have been enforced by courts in Australia, China, Hong Kong, India, Indonesia, the UK, USA and Vietnam amongst other countries. SIAC also established its first overseas office – in Mumbai – last year.

The Singapore courts have contributed to SIAC's success by being supportive of arbitration, upholding the finality of awards and keeping intervention to a minimum.

Now Singapore is turning its attention to other forms of dispute resolution.

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PAUL ASTON, PARTNER

The Singapore government has announced the creation of two new dispute resolution centres, the Singapore International Commercial Court (SICC) and Singapore International Mediation Centre (SIMC). The aim is to meet what it sees as a growing demand for dispute resolution in the region.

In his keynote address to the SIAC Congress in June, the Singapore Minister for Law, K. Shanmugam, explained the government's thinking in more detail.

The combined Association of Southeast Asian Nations (ASEAN) economies achieved annual growth of 5% last year, compared to global economic growth estimated at less than 3%. ASEAN is working towards establishing the Asian Economic Community, AEC, which would provide a single market for goods, services and labour in the region. It is also negotiating the Trans Pacific Partnership, a multilateral trade agreement which involves 12 countries including Singapore, the US, Australia and Japan.

As Asia's economy continues to grow, there will be a commensurate demand for neutral venues in which to launch complex, cross-border transactional disputes which are conducted transparently, efficiently and fairly. Singapore is positioning itself to meet that demand by offering arbitration, mediation (which is more popular in the region than in other parts of the world) and litigation in one location.

Shanmugam commented, *"The SICC would appeal to those who, for example, have non-arbitrable disputes and who would like the availability of an appeal. The SIMC will provide international commercial mediation services as an important complement to arbitration and litigation. Successful mediation can allow parties to mutually arrive at a mix of legal and non-legal solutions suited to their different interests."*

The intention is to provide what Shanmugan described as a *"complete suite of dispute resolution offerings"*.

The hope is that the opening of the Singapore International Mediation Centre (SIMC) later this year and the forthcoming Singapore International Commercial Court (SICC) will attract greater levels of international legal work to Singapore and bring benefits to its legal system, legal practitioners and the wider community.

A committee has been set up to develop the SICC as a division of Singapore's High Court, with its judgments enforced as those of the High Court. This will require amendments to Singapore's constitution. The SICC will handle cases involving any substantive law, and foreign counsel can be registered with the court and appear depending on the law of the dispute. The bench will be staffed with "borrowed" judges from different jurisdictions again sitting depending on the law of the substantive dispute. It is meant to be an international commercial court situated in Singapore and separate from the existing Singapore High Court.

The Singapore Ministry for Law is working with the Singapore Business Federation, Singapore Academy of Law and SIAC to establish the SIMC, which it is planned to open later this year.

It will be interesting to see whether establishing the SIMC and the SICC will extend Singapore's success in arbitration into commercial mediation and court-based commercial litigation for international cases.

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hfw Is it possible to enforce a clause requiring parties to resolve a dispute by "friendly discussion"?

We are regularly asked about the enforceability of agreements to negotiate or take other steps prior to commencing formal dispute resolution procedures, often in the context of long-term contracts. Clauses frequently take the form of a requirement to 'negotiate in good faith' or 'make efforts to settle' before commencing arbitration or court proceedings. Whilst it is always desirable to resolve a dispute in this way where possible, parties should bear in mind that the inclusion of additional steps of this sort can lead to increased time and costs, before resolving the substantive dispute has even begun.

The recent English High Court decision in *Emirates Trading Agency LLC* (ETA) *v Prime Mineral Exports Private Limited* (PMEP) (1 July 2014) will therefore be of interest to parties who have existing contracts including clauses of this type, or who are negotiating them.

ETA and PMEP were parties to a long term contract for the supply of iron ore. PMEP failed to lift the contractual quantities and ETA terminated the contract, stating that they would commence arbitration within 14 days if payment was not received. ETA did not actually refer the dispute to arbitration until around six months later. In the meantime, several meetings between the parties took place.

The contract contained a dispute resolution clause, as follows:

"11.1 In case of any dispute or claim arising out of or in connection with or under this LTC….the Parties shall first seek to resolve the dispute or claim by friendly discussion. Any Party may notify the other Party of its desire to enter into consultation to resolve a dispute or claim. If no solution can be arrived at between the Parties for a continuous period of 4 (four) weeks then the non-defaulting party can invoke the arbitration clause and refer the disputes to arbitration.

11.2 All disputes arising out of or in connection with this LTC shall be finally resolved by arbitration in accordance with the Rules of Arbitration of the International Chamber of Commerce ("ICC"). The place of arbitration shall be in London ("UK"). The arbitration shall be conducted in the English language…"

PMEP claimed that the clause had not been complied with and disputed the Tribunal's jurisdiction. The Tribunal decided that the clause did not contain an enforceable obligation to engage in friendly discussions, but if it did, it had been complied with. PMEP then applied to the English High Court under s.67 of the Arbitration Act 1996, challenging the Tribunal's jurisdiction.

PMEP's application was rejected. The Court decided that the clause was both enforceable and had been complied with. In doing so, it took into account the following factors:

- Both English public policy and decisions of courts in other jurisdictions supported a move towards enforcing alternative dispute resolution provisions where possible. Recent Singapore[1] and New South Wales[2] decisions in particular had given clear and helpful guidance on giving effect to parties' agreements to act in 'good faith', and to mediate or negotiate. In circumstances where they had

It does not seek to depart from the generally understood position that clear words are required to make a clause enforceable.

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voluntarily restricted their rights in a manner consistent with public policy, commercial parties could reasonably expect such terms to be enforced. They had *"obvious commercial sense"*.

- The role of the court was not to make parties' contracts for them but equally, the court should not refuse to enforce terms on the basis that they might be difficult to evidence. This clause was not open-ended, incomplete or unclear. There was no requirement for further agreement in order for matters to proceed if the negotiation was unsuccessful.
- There was no reason in principle that the court could not decide whether the parties had acted in accordance with the clause. There would be some occasions when it would be very easy to say that a party had not acted in the spirit of the clause, for example by refusing to negotiate at all, and others where it might be more difficult.

In the circumstances, ETA was able to demonstrate that it had entered into *"friendly discussions"* for the requisite period before commencing arbitration.

- Higher authorities which might otherwise bind the court could be distinguished. As compared with *Walford v Miles*[3], this was not an "agreement to agree". This was an agreed clause contained within a no doubt heavily negotiated contract between commercial parties. There was a time limit for the negotiation period and it was intended to be compulsory. As compared with *Sulamerica v Enesa*[4], there was no failure properly to specify the terms of a tiered dispute resolution clause. In *Sulamerica*, the relevant clause required mediation to take place prior to arbitration but required further detail in order to operate, such as a method for selecting the mediator and a defined mediation process.
- The term *"friendly discussions"* necessarily implied an obligation of *"good faith"*, as confirmed by the decision in *Yam Seng v International Trade Corp*[5].

This case has attracted attention. It does not seek to depart from the generally understood position that clear words are required to make a clause enforceable. Certainty remains the key. However, it does mark a shift in the approach of the English courts to this kind of clause. Perhaps the most striking element is that a clause couched in the relaxed language of *"friendly discussions"* was interpreted as importing an enforceable obligation of good faith. This may be a result of the Court's willingness to consider decisions from Australia and Singapore, where greater store is set on resolving disputes by consensus, in reaching its conclusion.

For now, this first instance decision stands and ETA have been refused permission to appeal. Parties should keep in mind that the English courts are now more likely to enforce a time-limited requirement to seek to resolve a dispute by good faith negotiations as a condition precedent to arbitration. They should also be aware that tiered dispute resolution clauses can sometimes add to the length and cost of resolving a dispute.

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1 *International Research Corp PLC v Lufthansa Systems Asia Pacific Pte Ltd* [2013] SGCA 55. (See Adam Richardson's article on this decision in the March 2013 edition of IAQ.)

2 *United Group Rail Services v Rail Corporation New South Wales* (2009) 127 Con LR 202

3 [1992] 2 AC 128

4 See our Latin America Bulletin, September 2013 and our Shipping Bulletin, December 2012.

5 [2013] EWHC 111 (QB) (See our Dispute Resolution Bulletin, February 2013.)

PRC arbitration and hybrid arbitration clauses – an opportunity for flexibility

Ad hoc arbitration agreements offer contracting parties considerable latitude in deciding the appropriate dispute resolution procedure themselves and avoid the difficulties of the one-size fits all model sometimes associated with institutional arbitration. They also dispense with the sometimes considerable administrative and other costs levied by arbitral institutions.

One of the distinguishing features of arbitrations with their seat in the People's Republic of China (PRC) is that they must be conducted under the auspices of a PRC-recognised arbitral institution. There are in excess of 200 such institutions in the PRC, with perhaps the most well known outside the PRC being the China International and Trade Arbitration Commission, better known as CIETAC.

This means that where an arbitration is seated in the PRC, it cannot be on an ad hoc basis. The obvious downside of this is that parties cannot benefit from the two key advantages traditionally associated with ad hoc arbitration, namely flexibility in terms of procedure and overall cost-effectiveness.

A recent decision of the Ningbo Intermediate Court is therefore to be welcomed since it does appear to confirm that hybrid arbitration clauses are permitted under PRC law, allowing for some element of flexibility in PRC arbitrations.

Although there are no official figures, anecdotal evidence indicates that CIETAC has administered (and continues to administer) arbitrations in accordance with hybrid arbitration clauses.

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The case concerned a jurisdictional challenge by a Chinese petrochemical company, Zhejiang Yisheng, in a dispute with a Luxembourg company, Invista, over the licensing of certain proprietary technology.

Invista had previously commenced arbitration proceedings against Zhejiang Yisheng pursuant to the terms of a licensing agreement which it is understood provided for arbitration under the auspices of CIETAC, but in accordance with the UNCITRAL arbitration rules. Clauses of this type are often referred to as hybrid arbitration clauses.

Under both the 2005 and 2012 CIETAC arbitration rules, where the parties have agreed to refer their disputes to CIETAC arbitration, but have also agreed on the application of other arbitration rules, the parties' agreement prevails unless their agreement is incapable of being performed or is in conflict with a mandatory provision of PRC law. The 2012 rules also clarify that where the parties have agreed on the application of other arbitration rules, CIETAC will perform the relevant administrative duties.

Notwithstanding these provisions, Zhejiang Yisheng are understood to have argued, in effect, that the arbitration agreement amounted to an ad hoc arbitration agreement and was thus invalid. Initially, the Ningbo Court is understood to have upheld the challenge and concluded that the arbitration agreement was invalid. However, the decision was referred up to the Zhejiang Court and thereafter to the PRC Supreme Court under the PRC report and review system.

Following its review, the Supreme Court required the Ningbo Court to rule in Invista's favour, albeit without making any wider decision on the validity of hybrid arbitration clauses generally.

Although there are no official figures, anecdotal evidence indicates that CIETAC has administered (and continues to administer) arbitrations in accordance with hybrid arbitration clauses.

In light of the decision of the PRC Supreme Court and the practice of CIETAC, it does seem that parties arbitrating in the PRC do have the option of choosing a hybrid arbitration clause so as to gain some flexibility – to choose under which rules to

arbitrate their disputes – with CIETAC performing administrative duties.

However, whilst this allows for an element of flexibility, it does not assist in relation to the issue of the costs associated with institutional arbitration. In order to take advantage of the potential benefits of ad hoc arbitration in terms of costs, the best option remains to subject disputes to arbitration in a jurisdiction where ad hoc arbitration is permissible.

When contracting with PRC counterparties, a good compromise can be to subject disputes to arbitration in Hong Kong, which permits ad hoc arbitration and benefits from the advantages of the Arrangement Concerning Mutual Enforcement of Arbitral Awards between the mainland and the Hong Kong Special Administrative Region, thus facilitating the enforcement of Hong Kong arbitration awards in the PRC.

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hfw Conferences and events

HFW International Arbitration Seminar
Hong Kong
23 October 2014

HFW International Arbitration Seminar
London
19 November 2014

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