

HIGHEST COURT IN HONG KONG CLARIFIES THE LIMITS OF JUDICIAL INTERVENTION IN THE ARBITRAL PROCESS

(C v D [2023] HKCFA 16)

The Court of Final Appeal (CFA) decided that the court did not have power to set aside an arbitral tribunal's decision on whether pre-arbitration conditions in an arbitration agreement were fulfilled. It concluded that upon the proper construction of the Agreement, both the main contractual dispute and the dispute as to the fulfilment of the pre-arbitration conditions under the Agreement fell within the parties' contemplation and intended submission to arbitration, such that the Appellant could not rely on Article 34(2)(a)(iii) of the Model Law to bring proceedings in the court to set aside the arbitral award.

Background

A contractual dispute arose between the Appellant (**C**) and the Respondent (**D**) in relation to the operation of a jointly-owned broadcasting satellite. The clause in question was an escalation clause, also known as a multi-tiered dispute resolution (**MDR**) clause, which provided for pre-arbitration conditions requiring the parties to conduct good faith negotiations for a period of 60 business days before referring the dispute to arbitration in Hong Kong. The clause also provides that "*either Party may, by written notice to the other, have such dispute referred to the Chief Executive Officers of the Parties for resolution.*"

Invoking the escalation clause, D referred the dispute to arbitration at the Hong Kong International Arbitration Centre. C challenged the jurisdiction of the tribunal on the grounds that the pre-arbitration procedures had not been complied with, namely D's written notice for negotiations was not addressed to C's CEO but to its board of directors. The Tribunal rejected the challenge and a partial award was rendered against C for breach of contract.

C brought proceedings in the Court of First Instance (**CFI**) and relied on Article 34(2)(a)(iii) of the Model Law (which is incorporated in Section 81(2)(a)(iii) of the Arbitration Ordinance (Cap. 609)) to set aside the partial award, contending the arbitrators were wrong to decide that the pre-arbitration requirements had been complied with. Section 34(2)(a)(iii) of the Model Law provides that an arbitral award may be set aside by the court if the party making the application can prove that "*the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or contains decisions on matters beyond the scope of submission to arbitration.*"

Decisions of the lower courts

The CFI dismissed the application finding that non-compliance with a pre-condition to arbitration is a question of admissibility, not jurisdiction. It considered that C's objection was not that the Tribunal lacked jurisdiction to hear the claim, but simply that the claim itself was not yet ripe for determination as pre-arbitration requirements had not been met. The issue in question did not trigger Article 34 of the Model Law and so there was no basis for the court to set aside the Tribunal's decision. C then appealed to the Court of Appeal (**CA**).

The CA dismissed the appeal and upheld the CFI's decision. Both courts held that C's objection went to the admissibility of the claim and not the jurisdiction of the tribunal. The CA regarded the dispute falls "*within the terms of the submission to arbitration*" and therefore it did not provide a basis for judicial intervention to set aside the partial award under Article 34(2)(a)(ii) of the Model Law. C then appealed to the CFA.

Decision of the CFA

The CFA unanimously dismissed the appeal. It concluded that, upon the proper construction of the Agreement, both the main contractual dispute and the dispute as to the fulfilment of the pre-arbitration conditions under the agreement fell within the parties' contemplation and intended submission to arbitration and therefore did not give rise to grounds for the court to set aside the partial award under Article 34(2)(a)(iii) of the Model Law.

A majority of the CFA held that the distinction between "admissibility" and "jurisdiction" should be adopted as a helpful aid for determining whether judicial intervention in an arbitral process was permissible. It took note that the conceptual distinction was widely adopted by academic writers and in recent case law in Singapore, English and New South Wales which are, like Hong Kong, leading centres for arbitration. Further, the majority adopted a presumption that, in the absence of unequivocal language to the contrary, pre-arbitration conditions should be regarded as matters of admissibility and therefore would not be subject to judicial intervention.

In terms of defining "jurisdiction", the Court took the view that the jurisdiction of an arbitral tribunal is essentially agreement-based. Given the freedom of contract, in the context of arbitration, the "jurisdiction" of a tribunal has no fixed definition but is ultimately dependant on the parties' agreement, reflecting their consent to arbitration.

Mr. Justice Gummow NPJ agreed to the dismissal of the appeal but differed on the reasoning. The judge regarded the admissibility/jurisdiction distinction as an unnecessary distraction and held that the question is simply to consider whether C's objection falls within the scope of Article 34(2)(a)(iii), commenting that many decisions of courts in Model Law jurisdiction applied the Article without any attention to such a distinction.

Comments and practical implications

This is a key decision that clarifies the limits of judicial intervention in the arbitral process and gives certainty to parties in dispute who seek to invoke or rely on an escalation clause in their arbitration agreements. More importantly, the decision has practical implications to commercial parties in general who have mutually consent to refer their dispute to arbitration. Here are some relevant considerations:

- **Pre-contract considerations:** At the time of contracting, it is important to consider carefully in the event a dispute arises, whether the parties would like to go through mandatory steps to resolve the dispute before commencing arbitration proceedings under an escalation clause. Such a clause is particularly useful in preventing small disputes from snowballing, helping parties to preserve their commercial relationships and saving the parties' time and costs. However, the inclusion of an escalation clause in a contract would also mean that parties cannot have the flexibility to commence proceedings on their own timeline until they have proven to the Tribunal that all pre-arbitration conditions have been met. This poses challenges and risks to parties particularly in circumstances where the limitation period of a claim is close to its expiration.
- **Drafting of escalation clauses:** The decision lays down the presumption that pre-arbitration conditions should be regarded as matters of admissibility and therefore would not be subject to judicial intervention. However, this does not mean that parties are unable to make compliance with pre-arbitral steps a jurisdictional issue. As Chief Justice Cheung has pointed out in his judgment, the "jurisdiction" of a tribunal has no fixed definition but is ultimately dependent on the parties' agreement, reflecting their consent to arbitration. Therefore, if the parties wish to do so, they can rebut the presumption by clear language, agreeing that certain matters which would otherwise be classified as going to admissibility only under the distinction are matters going to "jurisdiction" affecting fundamentally their consent to arbitrate, such that the "jurisdiction" of the tribunal is circumscribed accordingly. In addition, words chosen should not be opened to much room for speculation and the parties should state specifically which part of the escalation mechanism is mandatory and which part is only optional to prevent future disputes on the compliance of the escalation clause.
- **Compliance with escalation clauses:** If there is an escalation clause in the arbitration agreement, parties will need to comply with the pre-arbitration conditions fully before formal proceedings are commenced. If the tribunal considers that the conditions are not fulfilled, it may stay the arbitration proceedings to allow time for compliance with the escalation clause or impose costs sanctions against the non-compliant party for failing to comply with the escalation clause, or even dismiss the claim as inadmissible. In the absence of unequivocal language to the contrary, any decisions to be made by the Tribunal in relation to matters going to admissibility are likely to be final and conclusive and is not subject to judicial intervention.
- **Proper identification of the nature of a dispute:** It is crucial for the parties to identify whether an issue is in fact jurisdictional or presumptively non-jurisdictional before asking the court to decide whether jurisdiction was correctly assumed. This could avoid giving rise to a lengthy and expensive dispute and an unfruitful outcome for the reason that the issue is not subject to judicial intervention.
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