

HONG KONG: STAY OF AWARD ENFORCEMENT, CROSSCLAIMS AND "NO SET-OFF" CLAUSES

In *CF v SHK and S Listco* the Hong Kong Court held that a "no set-off" clause precluded the award debtor from seeking to set-off a connected crossclaim against the award debt, and examined the required threshold that the debtor requires to meet in order to justify staying execution of an enforcement order.

Introduction

In *CF v SHK and S Listco*¹, the parties entered into a **Settlement Agreement** in respect of a corporate dispute concerning sums due under a Shareholders Agreement (the **SHA**). The Settlement Agreement included a "no set-off" clause, which obliged SHK to make payment "without any withholding, set-off, counterclaim, retention or deduction" (the **No Set-off Clause**).

Parties include a "no set-off" clause in contracts with the aim of ensuring that the receiving party will be paid the amount due under the contract, in full, without any sums being deducted by the paying party on the basis that those sums are due to be paid, or are owed, to the paying party.

Background

CF and SHK entered into a Share Purchase Agreement (the **SPA**), under which SHK acquired 80% of CF's shares in a company incorporated in the Chinese Mainland (**CF China**). Pursuant to the SHA, which included a put option, CF and SHK further agreed that CF could require SHK to purchase CF's remaining shares in CF China at an **Initial Put Price**. S Listco entered into a guarantee in favour of CF which, in short, guaranteed payment of the Initial Put Price (**IPP Guarantee**).

CF exercised the put option and called upon SHK to buy the remaining shares in CF China for of RMB 1.2 billion. Payment was not made by SHK in compliance with the SHA, nor by S ListCo under the IPP Guarantee.

Subsequently, CF and SHK entered into the Settlement Agreement, which included the No Set-off Clause, as noted above. SHK was to pay the Initial Put Price to CF in nine instalments. Again, SHK's obligations under the Settlement Agreement were guaranteed by S Listco (the **Supplemental Guarantee**).

SHK failed to pay the fifth instalment to CF, in breach of the Settlement Agreement.

The Arbitrations

CF commenced arbitration against SHK and S Listco pursuant to the Settlement Agreement and the Supplemental Guarantee (the **First Arbitration**). The tribunal issued an Award in favour of CF which ordered SHK and S Listco to pay to CF the remaining Initial Put Price of RMB 1 billion (approximately US\$140 million) plus interest and costs, without any withholding, set-off, counterclaim, retention or deduction (the **Award**).

The arbitral tribunal dismissed SHK and S Listco's counterclaim for damages, which alleged that prior to entering into the SPA, CF had made certain misrepresentations about the value of CF China and the solvency of its subsidiaries (the **Crossclaim**).

CF obtained leave from the Hong Kong Court of First Instance (the **Court**) to enforce the Award (the **Enforcement Order**). SHK did not seek to set aside the Award or the Enforcement Order.

Shortly thereafter, SHK commenced separate arbitration proceedings in Hong Kong against CF and its parent company, seeking damages in excess of RMB 1 billion in relation to the Crossclaim (the **Second Arbitration**).

¹ [2024] HKCFI 1493.

The Stay Application

In addition, SHK and Listco applied to the Court seeking orders staying the execution and / or enforcement of the Enforcement Order, pending the determination of the Second Arbitration. They argued that;

- the Court ought to take "*a holistic view*" of the various agreements made between the parties and look at the their dealings as a whole; and
- On that basis, analyse whether it would be fair and just to stay enforcement of the Award, taking into account:
 - the "*reasonably arguable*" claims of misrepresentation made by SHK and S Listco in the Second Arbitration which enables them to assert an equitable set-off against the sum awarded to CF in the Award; and
 - the "*close connection*" between CF's claim and the Crossclaim and whether it would be just to allow CF to enforce payment of the sum awarded without taking the Crossclaim into account.

The Court considered the nature and effect of the No Set-off Clause when deciding whether to stay enforcement of the Award pending the determination of the Second Arbitration and observed that:

- Following English decisions such as *Tubeworkers Ltd v Tilbury*² and *Society of Lloyd's v Leigh*³, and the Singapore Court of Appeal decision in *Koh Lin Yee v Terrestrial*⁴, the Court agreed with CF's submission that a "no set-off" clause, which unequivocally excludes all crossclaims, has the effect of excluding any form of legal or equitable set-off.
- The terms agreed by the parties were clear: "*[t]he expressed intention of the parties is obvious, and the consensus at the time when the Settlement Agreement was made must be that any right of set-off or counterclaim, and any form of deduction, would be excluded*".
- Primacy of party autonomy: the terms of the parties' agreement "*must be paramount*" and takes precedence over the Court's discretionary power to grant a stay.

The Court revisited the principles governing the exercise of its discretion when asked to stay the enforcement of a judgment enforcing an arbitral award, in circumstances where the award debtor asserts equitable set-off, relying on claims in a separate arbitration, explaining that:

- Generally, a judgment creditor should not be deprived of the benefits of a judgment, and shall be entitled to enforce a judgment secured against a judgment debtor⁵.
- A judgment creditor should only be deprived of the benefits of their judgment when there is abuse or manifest injustice, and there must be "*very special*" or "*exceptional*" circumstances to justify a stay of enforcement⁶.
- When deciding whether there are special circumstances, the Court will consider:
 - a. the nature of the claims;
 - b. the extent of the overlap between the claim in the judgment and the unresolved crossclaim;
 - c. the strength and size of the crossclaim;
 - d. the likely delay before the crossclaim will be adjudicated;; and
 - e. the extent of prejudice that may be suffered by the judgment creditor and the judgment debtor respectively.

Significant delay militates against a stay⁷.

Decision

The Court held that:

- the tribunal had upheld the validity of the No Set-off Clause in the Settlement Agreement, which clearly and plainly provided for payment of the Initial Put Price without any form of set-off. SHK was bound by the terms of the Settlement Agreement, including the No Set-off Clause.
- The Award had not been challenged and the correctness of the arbitrator's findings on facts or on law was not relevant to the application now before the Court.

² [1985] 4 Con LR 13.

³ [1997] CLC 1398.

⁴ [2015] 2 SLR 497.

⁵ Following the decision of the Court of First Instance in *S v G* [2021] 3 HKC 262, which was confirmed by the Court of Appeal in *S v G* [2022] HKCA 383 (**S v G**).

⁶ *S v G* and *Credit Lyonnais v SK Global Hong Kong Ltd* [2003] 4 HKC 104.

⁷ *Israel Sorin Shohat v Balram Chainraj* [2017] 6 HKC 174.

- The balance of injustice was in favour of refusing the application and allowing CF to enforce the Award.

In reaching its decision, the Court took the following factors into account:

- SHK's claim in the Second Arbitration is, at most, "arguable" and SHK had not sought to argue before the Court that the merits of the Crossclaim were so strong as to justify stay of enforcement.
- the Second Arbitration was at an early stage. It would take years (not months) for the Second Arbitration to be determined. As such, "it would be unjust for CF, which has a final and binding judgment for a substantial amount, to have to wait for the resolution of the [Second] Arbitration".
- SHK and Listco would not suffer any injustice if the stay was refused: the parties had agreed to arbitrate any disputes arising in relation to the Settlement Agreement in Hong Kong. SHK and Listco (who were sophisticated parties and legally represented during the negotiation of the contracts) entered into that agreement in the knowledge that CF, a foreign entity, might not have any assets in Hong Kong. Given the circumstances in which the Settlement Agreement was negotiated, the Court rejected the proposition that it would be prejudicial to SHK and S Listco if, many months after CF was permitted to enforce the Order, they secured an award against CF in the Second Arbitration and had to enforce that award outside Hong Kong. Put simply, that was (or should have been) obvious to all parties involved and was part and parcel of the bargain struck by the parties.

Conclusion and Comments

The decision in *CF v SHK and S Listco* is welcome because it confirms:

- the high threshold which must be met in order to secure an order from the Hong Kong court staying enforcement of an arbitral award; and
- the binding nature of "No Set-off" Clauses, which are regularly included in all manner of commercial contracts.

Parties routinely include "No Set-off" clauses in standard term contracts because of the protection it affords them in the event of a dispute. It is important to ensure that such clauses are reasonable, and satisfy the requirements of Section 4 of the Misrepresentation Ordinance (Cap. 284) and Section 3 of the Control of Exemption Clauses Ordinance (Cap. 71). If that is achieved, a "No Set-off" clause effectively removes the risk of a spurious crossclaim being used by the debtor party in order to delay payment to the creditor party which, in complex disputes involving multiple contracts and parties, can result in significant delay and additional legal costs being incurred.

It is therefore important that such clauses are drafted with due care and attention and considered in the context of the transaction as a whole, including the terms of any associated or connected contracts, guarantees or other agreements.

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