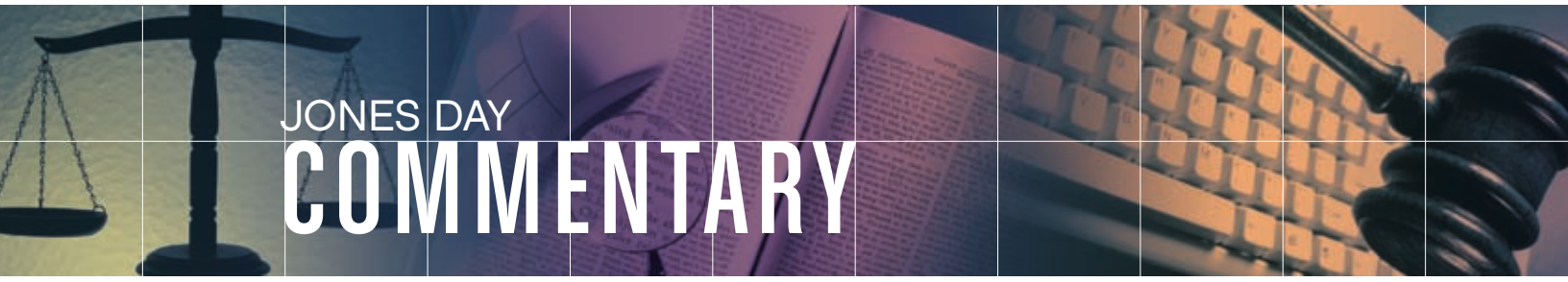
JULY 2007



POORLY DRAFTED DISPUTE RESOLUTION CLAUSES: HONG KONG COURT OF APPEAL ATTEMPTS TO UNRAVEL THE MESS

There is an unfortunate irony when parties end up in litigation over the meaning and effect of dispute resolution clauses. After all, the primary objective of these clauses should be the timely and cost-effective resolution of disputes—not the source of disputes. The Hong Kong Court of Appeal recently handed down its judgment dealing with just such a dispute in the case of *PCCW Global Ltd (formerly Beyond the Network, Limited) v Interactive Communications Service Ltd (formerly Vectone Limited).*

The cause of the dispute between Beyond and Vectone was simply the result of poor contract drafting. The following summary of the dispute resolution and jurisdiction provisions illustrates the problems confronted by the parties:

Clause 4: Differences over billing charges were to be resolved amicably between the parties. Failure to reach an amicable resolution within a reasonable period of time (not to exceed 14 days) meant that the parties would submit their differences to the Hong Kong courts for resolution.

Clause 5: The agreement would be subject to the laws of Hong Kong and the parties submitted to the exclusive jurisdiction of the courts of Hong Kong.

Clause 11.2: The agreement would be interpreted in accordance with the laws of the State of New York, and any disputes "*shall be submitted to the courts in the State of New York.*"

Clause 11.3: Either party may require any dispute arising under the agreement to be "*settled by binding arbitration in accordance with the commercial arbitration rules of the American Arbitration Association. . . . The arbitration shall take place in New York, NY, USA.*"

THE FACTS

The case involved a dispute over alleged billing discrepancies in invoices issued by Beyond to Vectone for the provision of international telephone services. The sum in dispute was US$718,999.26. This led to Beyond commencing proceedings against Vectone in the Hong Kong High Court in December 2004 to recover the disputed sum. After obtaining several extensions of time for the filing of its defense, Vectone applied to stay the proceedings to arbitration on the basis that clause 11.3 gave rise to a binding arbitration agreement. (By way of explanation, under the laws of Hong Kong, as in many other jurisdictions, court proceedings can in certain circumstances be stayed if the parties had previously agreed that they should resolve their disputes through arbitration rather than litigation.)

DECISION AT FIRST INSTANCE

The judge at first instance held that clause 11.3, which stipulated arbitration in New York, was not a binding arbitration agreement. That being the case, the judge refused to stay the court proceedings. What, then, was the effect of clause 11.3? The judge dealt with clause 11.3 in the following two ways (neither being helpful to Vectone):

- Clause 11.3 was permissive only and the parties could refer their disputes to arbitration if they agreed. In such an event, the agreement of the parties would become an arbitration agreement and override clause 5. However, because Beyond did not agree to arbitration, clause 5 remained in effect.
- Alternatively, the judge was of the view that pursuant to clause 4.3, an attempt by the parties to "resolve the dispute amicably within a reasonable period of time" included referring the dispute to arbitration under clause 11.3. Whatever a reasonable period of time for invoking arbitration may be (14 days as argued by Beyond or something else), Vectone did not give notice of its intention to refer the differences over billings to arbitration until five months after the invoices were first disputed. This was, according to the judge, an unreasonable amount of time "by any objective yardstick." Consequently, the court held that Vectone waived any right under clause 11.3 to arbitrate.

The judge was also required to deal with what appeared to be contradictions between clause 5 (exclusive jurisdiction of Hong Kong) and clause 11.2 (submission of disputes to the courts of the State of New York). The judge unraveled the apparent contradiction by concluding that there was no contradiction because the word "shall" in clause 11.2 was intended to be permissive and not mandatory. In the words of the judge: "[T]o read 'shall' in clause 11.2 in some other way, as (say) incorporating some mandatory flavor, would be inconsistent with the plain and obvious meaning of the expression 'exclusive jurisdiction' in clause 5."

In other words, the judge effectively found that the word "shall" in clause 11.2 meant "may." This may seem like a surprising if not remarkable construction of clause 11.2. However, the alternative would have been for the judge to conclude, as argued by Vectone, that these two clauses gave rise to an insurmountable contradiction and that they should therefore be ignored, thereby leaving the arbitration provision in clause 11.3 as the only clear basis for resolving disputes. However, due to the overriding requirement that the court should "make sense of the contract as a whole," the judge could not simply ignore the express words of the parties, and he had to give them some meaning that worked within the overall contract. Although the Court of Appeal did not have to resolve this particular issue, the judges in that case said in passing that "it may be that the judge's view that 'shall' in clause 11.2 cannot be mandatory, may provide the only satisfactory answer."

THE APPEAL

Vectone appealed the decision at first instance to the Court of Appeal. Vectone's appeal appeared to be based on the following three limbs. First, clause 11.3 was a valid arbitration agreement. Second, differences over billing charges could be dealt with by the Hong Kong courts under clause 4 or, in the alternative, by way of arbitration under clause 11.3, *i.e.*, in the event that one of the parties decided to give notice of arbitration. Third, on the basis that clause 11.3 was a valid arbitration agreement that covered billing charges, Vectone argued that the judge at first instance did not have the power to decide the issue of whether or not there was a valid arbitration agreement.

Instead, the judge should have referred the issue to the arbitrator (who at that stage had not even been appointed by the parties), who would have then decided the issue.

The Court of Appeal accepted that if an election was made by one of the parties to refer disputes to arbitration under clause 11.3, there would be a binding agreement to arbitrate and the court would be obliged to stay the litigation in favor of the arbitration. The key issue then was whether the differences over billing charges that Vectone purported to refer to arbitration were in fact covered by clause 11.3 or whether clause 4 provided an exclusive regime to resolve such disputes via the courts of Hong Kong.

The Court of Appeal answered this question by construing clause 4 and clause 11.3 in the light of the factual matrix surrounding the drafting and negotiation of these provisions. The evidence before the Court of Appeal proved that the agreement was initially based on Beyond's standard form of contract. The agreement was, however, the result of substantial negotiations leading to a number of drafts being prepared and discussed by the parties.

It was of significance to the Court of Appeal in construing clause 4 that it found that the unamended standard form stated in relation to differences over billing charges that "*in the event the parties are unable to resolve the dispute amicably, it shall be resolved by* arbitration in accordance with section 11.3" (emphasis added). Those words were replaced during negotiations with the requirement that the differences over billing charges should be dealt with by the courts of Hong Kong. The Court of Appeal found that the omission from clause 4 of the reference to arbitration under clause 11.3 was part of the factual matrix or background to the contract and could be used as an aid to interpret the intention behind clauses 4 and 11.3.

Before the Court of Appeal decided whether clause 11.3 covered differences over billing charges, it analyzed the law surrounding the extent of the courts' powers to decide the question of whether there was a valid arbitration agreement. Vectone argued that the court could determine whether there was a valid arbitration agreement only on a prima facie basis and that the courts should not usurp the function of the arbitral tribunal to decide the disputes referred to it. The principle was succinctly put in the earlier Hong Kong case of *Pacific Crown Engineering Ltd v Hyundai Engineering and Construction Co. Ltd [2003]*: "The proper test is therefore is there a prima facie or plainly arguable case that the parties were bound by an arbitration clause. The onus being on the defendant to demonstrate that there is."

The judge at first instance decided this point by highlighting the significant delay that had already been suffered by the parties since the issue of the writ in December 2004 and stated as follows:

> 43. While I accept that is a possible course, it does not strike me as appropriate here. A decision by an arbitrator on his jurisdiction would still be open to challenge before this Court. The matter would simply return to me. Where (as here) a question of construction is involved and little (if any) extrinsic evidence is sought to be adduced in aid of construction, it would be conducive to saving time and cost to determine the question of jurisdiction now.
> 44. The writ was issued in December 2004. It is presently December 2005 and a Defence has yet to be filed. Given my views on clauses 4.3, 5, 11.2 and 11.3, it would be wrong to refrain from deciding the jurisdictional issue now. To remit the question to an arbitrator would only lead to unjustifiable delay and expense.

The Court of Appeal took a different route and dealt with the point by looking at the issue of whether or not there was clear evidence that clause 11.3 gave rise to an arbitration agreement that covered the differences over billing charges. As mentioned earlier, the Court of Appeal did find that clause 11.3 was a permissive but enforceable arbitration agreement. However, it concluded that clause 4.3 was a "self-contained provision on how any dispute or contest over billing should be determined." It provided a formal notification of disputes and a tight timetable for amicable settlement "not to exceed 14 days" and "then the parties will submit the difference to the Hong Kong Courts." That being the case, the Court of Appeal concluded that the arbitration agreement in clause 11.3 did not cover disputes over billing charges under clause 4. The Court of Appeal effectively agreed with the judge at first instance and did not stay the litigation, albeit based on different reasoning.

CONCLUSION

This case is a good illustration of what can go wrong for parties to commercial agreements if dispute resolution and jurisdiction clauses are poorly drafted. Whilst parties are not always mindful of the risk of disputes when negotiating and drafting their contracts, the failure to think ahead and deal with these possibilities with precise clauses could expose the parties to complex procedural arguments when disputes subsequently arise. Parties should avoid ending up in the ironic situation of wasting time and money arguing over the true meaning of these clauses instead of resolving the primary disputes that have arisen between them. (The writ in this case was issued in December 2004, and two years later the parties had still not begun to resolve the dispute over the US$718,999.26!) Such an outcome can be easily avoided if the time is taken to get these clauses right in the first place. They are, after all, important parts of a contract that can assist greatly in the efficient and cost-effective resolution of disputes. Such a clause should not become the cause of dispute.

This Commentary *was originally published in the May 2007* Asian-Counsel. *Reprinted with permission.*

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