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STAYING LITIGATION IN FAVOR OF ARBITRATION—ARE HONG KONG COURTS TOO ARBITRATION-FRIENDLY?

A common procedural argument that arises in relation to arbitration is the staying of litigation proceedings commenced by a plaintiff in breach of a valid arbitration agreement. For what would appear to be obvious reasons, there had never been a case in Hong Kong—or any other common-law arbitration-friendly jurisdiction—where a plaintiff sought to stay litigation that it actually started contrary to an enforceable arbitration agreement.

But that was precisely what happened in a recent Hong Kong case, *Chok Yick Interior Design & Engineering Co Ltd v Fortune World Enterprises Ltd [2010] HKEC 146*, where the plaintiff succeeded in unprecedented fashion and obtained a stay of court proceedings that had been ongoing for more than 18 months. Essentially, by relying on the court's inherent jurisdiction and its newly acquired case management powers, the plaintiff was able to sidestep traditional procedural hurdles that would have normally prevented an application for stay from succeeding.

FACTUAL BACKGROUND

Chok Yick entered into a contract with Fortune World to carry out interior fitting works in respect of a construction project. To receive payment, architects on behalf of Fortune World would issue certificates indicating their satisfaction with the completed works. However, when the architects issued interim certificates for payment, Fortune World did not pay Chok Yick, and Chok Yick commenced court proceedings in the High Court of Hong Kong.

The dispute concerned two separate proceedings commenced by the plaintiff, which were consolidated. Despite the existence of an arbitration agreement in the contract to refer all disputes to arbitration, the plaintiff breached the arbitration clause by commencing court proceedings. The defendant did not dispute the jurisdiction of the court in either proceeding and responded by defending all claims and making counterclaims against the plaintiff. Similarly, the plaintiff also defended and replied to those counterclaims.

However, before the proceedings were consolidated, the plaintiff served arbitration notices in respect of each proceeding. In the first proceeding, the notice was served nine months after pleadings already closed, and in the second proceeding, the notice was served one month before close of pleadings. Both notices were rejected by the defendant on the basis that the parties were already litigating their disputes. In all, starting from the initial writ of the first proceeding to the final reply in the second proceeding, 18 months had passed. It was at that point when the plaintiff applied to stay the proceedings in favor of arbitration. At the hearing, the judge consolidated the two proceedings, held in favor of the plaintiff by staying the consolidated proceedings, and awarded the plaintiff its costs of the stay application.

OUT-OF-THE-ORDINARY STAY APPLICATION

The stay application made by the plaintiff in this case was so unusual that it led even the judge to comment on its peculiarity. The usual situation in Hong Kong involves a defendant making the application to stay under section 6 of the Arbitration Ordinance, which refers to Article 8 of the UNCITRAL Model Law found at Schedule 5 of the Arbitration Ordinance. However, an application to stay will usually fail if the defendant has taken any step in the proceedings, such as filing and serving its defense. Likewise, it would be expected that a plaintiff seeking to stay proceedings that it had actually commenced would also be barred from relying on these provisions, given that it has clearly taken steps in the proceedings by initiating the litigation.

INHERENT JURISDICTION

Despite the plaintiff not having a procedural basis to stay the proceedings under section 6 of the Arbitration Ordinance, the court does have an inherent jurisdiction to stay any proceeding under section 16(3) of the High Court Ordinance. However, this inherent jurisdiction is usually exercised with reference to a defendant's application to stay, not an application by the plaintiff. Even so, the judge in this case opined that an inherent jurisdiction to stay exists, either of its own volition or on the application of any person. The judge reasoned that section 6 of the Arbitration Ordinance (including Article 8 of the UNCITRAL Model Law) did not reduce the court's inherent jurisdiction to grant a stay.

The judge relied on the case of *Louis Dreyfus Trading v Bonarich International (Group) [1997] 3 HKC 597*, where the Hong Kong Supreme Court held that there is no justification for restricting the court's power to stay proceedings if it was exercisable where the "court thinks fit." Additionally, in the House of Lords decision of *Channel Tunnel Group Ltd & Anor v Balfour Beatty Construction [1993] AC 334*, the court recognized its discretionary right to stay proceedings in appropriate cases. Similarly, on whether a stay of proceedings could still be obtained by a party after it took a step in proceedings, the judge accepted the plaintiff's supporting case of *Marshall-Karson Construction and Engineers v Kowloon Canton Railway Corporation, unreported, Con. List No. 38 of 1994*, where the defendant filed its defense and applied for a stay of proceedings on the same day.

The above three cases all draw common authority from an old English case, *Racecourse Betting Control Board v Secretary for Air [1944] Ch.114*. In that case, the court restrained the plaintiff from bringing litigation proceedings that would breach the underlying arbitration agreement. In particular, Mackinnon L.J. lamented in that case that it was "unfortunate that the power and duty of the court to stay the action was said to be under…the Arbitration Act of 1889. In truth, that power and duty arose under a wider general principle, namely, that the court makes people abide by their contracts."

ACTIVE CASE MANAGEMENT

As an alternative argument, the judge also cited the court's new powers of case management that were implemented by Hong Kong's Civil Justice Reform, which took effect last year. He cited Order 1B rule 1(e) of the Rules of the High Court, which gives the court power to stay the whole or part of any proceedings, if it furthers the underlying objectives of the reforms—one of which is to encourage and facilitate alternative dispute resolution.

In exercising his case management powers, the judge noted in particular that:

1) The parties' contract contained an arbitration clause, indicating they agreed to arbitrate.

2) The case dealt with technical construction issues and items for which an experienced building arbitrator would be more appropriate.
3) Initiating proceedings does not necessarily waive an arbitration agreement.
4) The accumulated costs have not gone to waste, as the existing proceedings helped define the issues an arbitrator would have to decide.
5) Unnecessary dual proceedings could be avoided.

COMMENTARY

It was not known why the plaintiff suddenly wanted to arbitrate. In any event, the decision reiterates and demonstrates how far Hong Kong courts might go to uphold arbitration agreements.

One of the Civil Justice Reform's main purposes was to expedite dispute resolution and save costs. However, staying proceedings that had been ongoing for 18 months seems to presume that an arbitrator will be able to step in and pick up from where the case was stayed. This is rarely the case in practice. Additionally, it is unlikely that the Civil Justice Reforms intended to include arbitration as a mode of alternative dispute resolution that the court should promote or encourage parties to pursue because the reality of arbitrating in Hong Kong is that it can be every bit as costly and time consuming as litigation. The obvious form of alternative dispute resolution that the courts should be focusing on as part of its case management objectives is mediation.

It is worth noting that the defendant also argued that the stay should not be granted on the basis that the plaintiff had waived its rights to arbitrate because it had commenced the litigation and continued in the proceedings for 18 months. Unfortunately, the waiver issue was not discussed in greater detail by the judge, and the case *Aggressive Construction v Data-Form Engineering, unreported, HCA 2143/2008*, which was cited in support of the no-waiver argument, had a significantly different fact pattern. In that case, plaintiff brought a statutory claim under the Employment Ordinance that was outside the scope of the arbitration agreement that the defendant defended and counterclaimed (the counterclaim concerned claims that came within the ambit of the arbitration agreement). The disputed issue was whether the statutory claim constituted a step in the proceedings in relation to the arbitration agreement. If it did constitute a step in the proceedings, the plaintiff would have waived its right to arbitrate. However, the court held that it did not and pointed out that the plaintiff preserved its arbitration rights because it never filed a defense in respect of the defendant's counterclaim, hence it took no steps in those proceedings. Furthermore, both parties in that case would have sustained limited costs in respect of the counterclaim. In contrast, the plaintiff in the current case was actively involved in court proceedings for 18 months, and both parties would have incurred considerably greater costs.

Admittedly, *Fortune World* is a particularly unusual case, and it is unlikely a similar case would appear any time soon. However, this case nevertheless highlights the extent of the court's inherent jurisdiction and, more importantly, how a Hong Kong High Court judge might interpret the court's new case management powers. Based on the reasoning of this case, any court proceeding commenced in Hong Kong that breaches a valid arbitration agreement can be stayed, regardless of whether a defendant or a plaintiff makes the application, even if the parties have been embroiled in those proceedings for months, if not years.

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