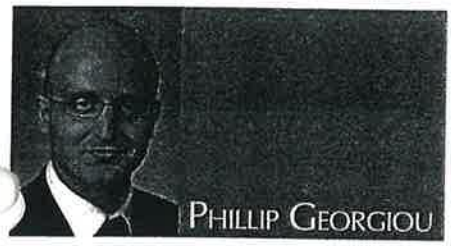
Staying Litigation in Favour of Arbitration – Are Hong Kong Courts too Arbitration-Friendly?



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Introduction

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

This is, however, precisely what happened in a recent Hong Kong case, *Chok Yick Interior Design and Engineering Co Ltd v Fortune World Enterprises Ltd*[1], where the plaintiff 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 normally have prevented a stay application from succeeding.

Factual background

Chok Yick (the plaintiff) entered into a contract with Fortune World (the defendant) to carry out interior fitting works in respect of a construction project. To receive payment, the project Architect would issue certificates indicating its satisfaction with the completed works. When, however, the Architect issued two interim certificates for payment, the defendant did not pay. The plaintiff brought court proceedings in the High Court.

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The dispute concerned two separate sets of proceedings commenced by the plaintiff which were consolidated. The proceedings were brought despite the existence of an arbitration agreement in the contract to refer all disputes to arbitration and were therefore in breach of the arbitration clause. 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 defended and replied to those counterclaims.

Before the proceedings were consolidated, however, the plaintiff served notices of arbitration in respect of each proceeding. In the first proceeding, notice was served nine months after pleadings already closed; in the second proceeding, 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, from issue of the writ in the first proceeding to the final reply in the second, 18 months had passed. It was at that point that the plaintiff applied to stay the proceedings in favour of arbitration. At the hearing, the judge consolidated the two sets of proceedings, held in favour of the plaintiff by staying those proceedings and awarded the plaintiff its costs of the stay application.

Out of the ordinary stay application

The plaintiff's stay application was so unusual that it even led the judge to comment on its peculiarity. It is usually the defendant who makes an application for a stay, under s 6(1) of the Arbitration Ordinance (Cap 341), which applies art 8 of the UNCITRAL Model Law ('the Model Law') (Fifth Schedule to the Ordinance) to domestic arbitrations. A stay application will usually fail if the defendant has taken any step in the proceedings, such as filing and serving its defence. Likewise, it would be expected that a plaintiff seeking to stay legal proceedings that it had itself 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

Whilst a plaintiff may not have a procedural basis to stay proceedings under s 6 of the Arbitration Ordinance, the court does have an inherent jurisdiction to stay any proceeding under s 16(3) of the High Court Ordinance (Cap 4). This inherent jurisdiction is, however, usually exercised with regard to a stay application by the defendant, not the plaintiff. Even so, the judge in *Chok Yick* opined that an inherent jurisdiction to stay exists, either of the court's own volition or on the application of any person. The judge reasoned that s 6 of the Arbitration Ordinance and art 8 of the Model Law did not limit the court's inherent jurisdiction to grant a stay.

The judge relied on *Louis Dreyfus Trading Ltd v Bonarich International (Group) Ltd*[2], where the High Court held that there was no justification for limiting the court's power to stay proceedings if it were exercisable where the "court thinks fit." Additionally, in *Channel Tunnel Group Ltd v Balfour Beatty Construction Ltd*[3], the House of Lords recognised a discretionary right to stay proceedings in appropriate cases. Similarly, as to whether a stay of proceedings could still be obtained by a party after it took a step in proceedings, the judge followed *Marshall-Karson Construction and Engineers Ltd v Kowloon Canton Railway Corporation*[4], where the defendant filed its defence and successfully applied for a stay of proceedings on the same day.

These three cases all draw common authority from an old English *case, Racecourse Betting Control Board v Secretary for Air*[5], where the court restrained the plaintiff from bringing litigation proceedings that would breach the underlying arbitration agreement. In particular, Mackinnon LJ 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."

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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 (CJR), which took effect on 2 April 2009. He cited Ord 1B r 2(e) of the Rules of the High Court (RHC), which gives the court power to stay the whole or part of any proceedings if it furthers the underlying objectives of the reforms[6] — one of which is to encourage and facilitate alternative dispute resolution[7].

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

(1) the parties' contract contained an arbitration clause, indicating that 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 had 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.

Waiver of rights to arbitrate

The defendant also argued against a stay on the ground that the plaintiff had waived its rights to arbitrate, having commenced litigation and continued the proceedings for 18 months. Unfortunately, the waiver issue was not discussed in greater detail by the judge. *Aggressive Construction Co Ltd v Data-Form Engineering Ltd*[8], which was cited in support of the no-waiver argument, had a significantly different fact pattern. In that case, the plaintiff brought a statutory claim under the Employment Ordinance (Cap 57) that was outside the scope of the arbitration agreement. The defendant served a defence and counterclaim; the latter concerned claims that fell 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, the plaintiff would have waived its right to arbitrate. The court held, however, that it did not, pointing out that the plaintiff had preserved its arbitration rights because it never filed a defence in respect of the defendant's counterclaim, and therefore took no steps in those proceedings. Furthermore, both parties in the *Aggressive Construction* case would have sustained limited costs in respect of the counterclaim. In the *Chok Yick* case, by contrast, the plaintiff had been actively involved in court proceedings for 18 months

and both parties would have incurred considerably greater costs.

Commentary

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

One of the main purposes of the CJR is to expedite dispute resolution and save costs. Staying proceedings that had been ongoing for 18 months seems, however, to presume that an arbitrator would 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 CJR intended to include arbitration as a mode of ADR 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 ADR that the courts should be focusing on as part of their case management objectives is mediation.

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Admittedly, *Chok Yick* is a particularly unusual case and it is unlikely that a similar case will appear any time soon. 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 proceedings 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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1 [2010] HKEC 146, 29 January 2010, unreported.
2 [1997] 3 HKC 597.
3 [1993] AC 334.
4 Con List 38/1994, 13 April 1995, unreported.
5 [1944] Ch 114 (Court of Appeal, England & Wales).
6 RHC Ord 1A, r 1.
7 *Ibid*, r 4(2)(e).
8 HCA 2143/2008, 4 August 2009, unreported.
9 The author wishes to thank Chester Hui for his assistance in preparing this commentary.