

Insights

SPLIT DISPUTE RESOLUTION CLAUSES: A RECENT EXAMPLE

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SUMMARY

In a recent judgment (*Construction Company v Guarantor* [2021] HKCFI 2558, judgment date: 17 August 2021), a Hong Kong court upheld a U.S. arbitral award made pursuant to a split dispute resolution clause. In dismissing the application to set aside the award, the court gave due weight to the decision by the supervisory court at the seat of the arbitration. The court also considered the limitative effects the clause has on the arbitrator's jurisdiction, and its interaction with issues of procedural fairness.

A split dispute resolution clause is a clause which provides different dispute resolution processes for different claims or species of dispute between the parties. It often takes the form of a carve-out clause, whereby the parties agree to carve out specific types of disputes from the main dispute resolution process and submit such disputes to a different dispute resolution process.

THE SPLIT DISPUTE RESOLUTION CLAUSE AND ITS BACKGROUND

The arbitral award concerned a parent company guarantee ("Guarantee") granted by the defendant guarantor ("Guarantor") in favour of the plaintiff construction company ("Company") in respect of a construction project located in the U.S. and carried out by the Company for a subsidiary of the Guarantor ("Subsidiary"). At the time the Guarantee was granted, the Subsidiary was in arrears on payments due to the Company, and the Company had given notice of its rights to terminate the construction contract for cause. It was against these background facts that the Guarantee was provided to induce the Company to agree to accept payment of the outstanding debts pursuant to an agreed "*Funding Schedule*". Under the Guarantee, the Guarantor had a primary obligation to pay the "*Funding Schedule Payments*" on their due dates, without set-off, counterclaim or defence of any nature.

The Guarantee contained a split dispute resolution clause. In essence:

- “*Claims and disputes related to non-payment of the Funding Schedule Payments*” are to be referred to mandatory expedited arbitration under the AAA Fast Track Rules and, in that scenario, the arbitrator’s jurisdiction is limited to deciding “*the sole issue ... [of] whether payment of the Funding Schedule Payments was made in accordance with the Guarantee*” (the “Sole Issue”).
- A separate dispute resolution procedure is available for “*all other claims and disputes*”.

THE DECISION ON JURISDICTION AND THE AWARD

After the Guarantor failed to make the Funding Schedule Payments, the Company commenced an arbitration against the Guarantor. The Guarantor denied liability on the basis that the Company’s claim was tainted by illegality. Specifically, the underlying construction contract was unlawful by reason of the Company failing to comply with various licensing requirements. In response, the Company contended that the arbitrator had no jurisdiction to decide the Guarantor’s illegality defence, and sought a ruling to that effect.

In the decision on jurisdiction, the arbitrator decided that his authority was limited by the dispute resolution clause to the determination of the Sole Issue. Subsequently, having satisfied himself that the Company discharged its burden of proof on each element of its claim, the arbitrator made an award in the Company’s favour. The arbitrator found that the Guarantee was independent of the construction contract and hence was valid, and in obiter that, prima facie, the Company had the necessary licenses in place.

The Guarantor challenged the award in an U.S. court, which dismissed the challenge and upheld the award. No appeal was made against the U.S. judgment.

THE HONG KONG JUDGMENT

After the Company obtained an order to enforce the award in Hong Kong, the Guarantor applied under *section 89 of the Arbitration Ordinance*¹ to set aside the enforcement order¹.

As explained by Mimmie Chan J in her judgment dismissing the Guarantor’s application, by adopting the laws of the State of California to govern the Guarantee and submitting their disputes to arbitration in accordance with the AAA Fast Track Rules, the parties had submitted to the supervisory jurisdiction of the U.S. court as the seat of the arbitration. Therefore, the Hong Kong courts would give due weight to the judgment by the U.S. court, acting as the supervisory court, on issues of the validity of the contract and on the procedure of the arbitration.

The court nonetheless dealt with the arguments raised by the Guarantor, summarised as follows:

- The court rejected the Guarantor’s complaint of its alleged inability to present its case. The court found that the arbitrator refused to hear evidence and submission on the licensing issue

because the scope of his jurisdiction was confined to the determination of the Sole Issue, and the licensing issue was not material to the Sole Issue. On the materiality of the licensing issue, the court endorsed the U.S. court's comment that the Guarantor or the Subsidiary could resolve disputes concerning the licensing issue using the dispute resolution procedure provided in the Guarantee for "*all other claims and disputes*" or the dispute resolution procedure under the construction contract, and added that an opportunity to present evidence on the licensing issue would not have any impact on the outcome of the arbitration on the Sole Issue.

- The court dismissed (what in essence was the Guarantor's re-run of) its illegality defence. The court explained that, in the context of an application to set aside an enforcement order, the Guarantor is required to show that not only the underlying contract, but also specifically the severable arbitration agreement contained in that contract, is illegal and therefore invalid. There simply was no evidence to show that that was the case.
- Having agreed with the findings of the arbitrator and the U.S. court on the scope of the arbitrator's jurisdiction and the validity of the Guarantee, the court considered that there was nothing contrary to the Hong Kong court's conscience or its fundamental conceptions of morality or justice to justify refusing enforcement of the award on grounds of public policy.

KEY TAKEAWAYS

1. For a wide variety of reasons, parties occasionally may wish to carve out specific types of disputes from the main dispute resolution process and submit such disputes to a different dispute resolution process. However, serious and careful consideration should be given to such wishes, given that split dispute resolution clauses frequently give rise to disputes over jurisdiction. This case highlights the importance of stipulating clearly which disputes are to be covered by which dispute resolution process. It also may be advisable expressly to deal with the clause's intended effect on the tribunal's jurisdiction and the relationship between the different dispute resolution processes as contemplated by the clause.
2. This recent judgment is a further confirmation of the pro-arbitration and pro-enforcement approach of the Hong Kong courts. Specifically, when comparing the standards to be applied in enforcement proceedings under Hong Kong and U.S. law, the Hong Kong court considered there was a common theme in that the court does not act as an appellate court on questions of law and will not interfere in the arbitral process unless there are good justifications for it do so.
3. This case also demonstrates that, where an arbitral award has been considered by a supervisory court at the seat of the arbitration, a Hong Kong court will give due weight to the supervisory court's decision. Further, the court does not look favourably upon a party which unsuccessfully challenged an arbitral award in a supervisory court and who subsequently seeks to challenge the same award in an enforcement proceeding in Hong Kong.

Section 89 sets out the grounds for refusing enforcement of Convention awards. The equivalent provisions for Mainland awards, Macao awards and other arbitral awards (including Hong Kong awards) are in *sections 95, 98D and 86* respectively.

RELATED CAPABILITIES

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