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IMPORTANT JUDGMENT ON PRE-CONDITIONS IN ARBITRATION CLAUSES

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SUMMARY

Many modern commercial contracts contain dispute resolution clauses which submit disputes to arbitration. It is common for parties to agree to a set of pre-conditions or escalation mechanisms which have to be complied with before formal arbitration can commence.

Some commentators were of the view that failure to comply with the escalation clauses in a contract put the jurisdiction of an arbitral tribunal in question and left open the possibility for the arbitral award to be challenged.

A recent decision of the Hong Kong High Court (*C v D* [2021] HKCFI 1474) provides a welcome confirmation of the growing international recognition that non-compliance with escalation mechanism is a question of admissibility, not jurisdiction.

Background of the case

The contract in question contained a dispute resolution clause (clause 14.2) which provided that in the event of a dispute having arisen between the parties, "*the Parties shall attempt in good faith promptly to resolve such dispute by negotiation".* Clause 14.2 went on to say that *"[e]ither Party may, by written notice to the other, have such dispute referred to the Chief Executive Officers of the Parties for resolution*".

The arbitration clause (clause 14.3) then provided that "*[i]f any dispute cannot be resolved amicably within sixty (60) Business days of the date of a Party's request in writing for such negotiation … then such dispute shall be referred by either Party for settlement exclusively and finally by arbitration in Hong Kong …*".

Before the Defendant initiated the arbitration proceeding, the CEO of the Defendant issued a letter on 24 December 2018 to the Chairman of the Board of Directors of the Plaintiff "*in a final effort to*

resolve this issue and avoid further legal proceedings". The CEO of the Plaintiff received a copy of this letter not directly from the CEO of the Defendant, but from the Chairman.

Issues which arose

After the Defendant referred the dispute to arbitration, the Plaintiff objected to the jurisdiction of the arbitral tribunal on the basis that the Defendant had made no request for negotiations under clauses 14.2 and 14.3, and therefore the condition precedent for arbitration to commence had not been fulfilled.

The arbitral tribunal dealt with the jurisdictional challenge together with the issue of liability. The tribunal held that clause 14.2 mandated that good faith negotiation be attempted, and that the Defendant's letter of 24 December 2018 had fulfilled this condition. The second sentence of clause 14.2 (about escalation to the CEOs) was held by the tribunal to be optional. The tribunal accordingly rejected the Plaintiff's objection and proceeded to find against the Plaintiff on liability in its award.

The Plaintiff subsequently applied to the Court to have the award set aside based on Article 34(2)(a)(iii) and (iv) of the UNCITRAL Model Law (i.e. that the award did not fall within the terms of the submission to arbitration and that the arbitral procedure was not in accordance with the parties' agreement) as incorporated by section 81 of the Arbitration Ordinance.

The Plaintiff contended that a written reference to the CEOs for determination of the dispute in accordance with the second sentence of clause 14.2 was a condition precedent to any reference to arbitration.

The Defendant responded to the challenge with an overarching objection that the question of whether the pre-condition to arbitration had been fulfilled was a question of "admissibility" rather than jurisdiction, and that the court should not interfere with the arbitral tribunal's decision on that question. In any event, the Defendant's stance was that the condition precedent was satisfied by its written request to negotiate given on 24 December 2018.

Admissibility vs Jurisdiction: the Court's decision

The Court relied on a number of leading academic works and case authorities from the US and Singapore and English Courts in support of their respective arguments.

In general terms, the importance of the distinction between matters of jurisdiction and matters of admissibility is that the latter usually are considered not to provide a ground for challenging the authority of the parties' agreement to arbitrate. Questions of admissibility fall within the purview of the parties' agreement to arbitrate and therefore the arbitral tribunal's determination on such questions generally should be considered decisive and final.

The academic works and case authorities referred to in the judgment almost unanimously regarded compliance with pre-conditions to arbitrate or escalation mechanisms as a matter going to

admissibility, not jurisdiction, unless the parties expressly have agreed that non-compliance with pre-conditions would exclude the arbitral tribunal's jurisdiction.

The Plaintiff relied on *Emirates Trading Agency LLC v Prime Mineral Exports Pte Ltd* [2015] 1 WLR 1145 and *HZ Capital International Ltd v China Vocational Education Co Ltd* [2019] HKCFI 2705 in support of its argument that failure to comply with pre-conditions to arbitrate was to be regarded as a matter of jurisdiction. However, the Court distinguished *Emirates Trading* and *HZ Capital* on the basis that the distinction between jurisdiction and admissibility was not actually raised in those cases and that there was no adversarial argument on this specific distinction in either of the two cases.

The Plaintiff's further argument that its constitutional right of access to the court was unjustifiably curtailed also was rejected by the Court. The Court highlighted (among other things) that the reason why there only are a limited number of grounds upon which an arbitral award can be set aside (as set out in section 81 of the Arbitration Ordinance) is the underlying desirability to restrict the Court's interference in arbitrations.

The Court concluded that the Plaintiff's complaint against the arbitral award did not fall within either Article 34(2)(a)(iii) or (iv) as mentioned in the originating summons. The Defendant was awarded costs on the indemnity basis.

A welcome decision

The approach adopted by the Court in *C v D* [2021] HKCFI 1474 is consistent with Hong Kong's policy for disputes to be dealt with in a "one stop shop" through arbitration with speed and finality, especially when the parties' commitment to arbitrate is not in doubt.

This new judgment is a welcome addition to the body of international case law and academic authorities which already is in place to give effect to arbitration agreements. It reinforces the pro-arbitration and pro-enforcement stance taken by Hong Kong Courts and upholds the principle of certainty that parties to arbitration agreements very much treasure.

RELATED PRACTICE AREAS

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MEET THE TEAM

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