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INTERPRETATION OF ARBITRATION CLAUSES: DOES "MAY" ARBITRATE ACTUALLY MEAN YOU "MUST" ARBITRATE? ARE "NO ARBITRATION UNTIL COMPLETION/TERMINATION" CLAUSES VALID?

Sep 16, 2021

Where an arbitration clause provides that parties "may" submit their disputes to arbitration, does this mean that arbitration is mandatory or merely permissive? What is the effect of a proviso in an arbitration clause which provides that arbitration cannot be conducted until the construction works have been completed or contract has been terminated?

These two issues – which arise often – were dealt with by Mimmie Chan J of the Court of First Instance (the "**Court**") in *Kinli Civil Engineering Limited v Geotech Engineering Limited* [2021] HKCFI 2503 (Date of Decision: 26 August 2021).

Background

The plaintiff ("**K**") was the subcontractor of the defendant ("**G**") in a public housing development project. K commenced court proceedings against G to claim for alleged unpaid contract sums.

G then applied for the court proceedings to be stayed on the ground that the dispute should have been submitted to arbitration in accordance with the dispute resolution clause in the subcontract between the parties, the English translation of which was:

> *"If in the course of executing the Contract, any disputes or controversies arise between (G) and (K) on any question and the parties are unable to reach agreement, both parties **may** in accordance with the relevant arbitration laws of Hong Kong submit the dispute or controversy to the relevant arbitral institution for resolution, and the arbitral award resulting from arbitration in the HKSAR shall be final and binding on both parties, and unless otherwise agreed by both parties, **the aforesaid arbitration shall not be conducted before either the completion of the main contract or the determination of the subcontract.**"* (emphasis added)

Submissions by the plaintiff (applicant) K to oppose arbitration

Opposing to G's stay application, K made three main submissions:

1. As a matter of contractual interpretation, the use of "may", instead of "shall" or "must", meant merely that the parties had the option to elect arbitration, and did not take away the right of K to litigate the dispute in court. The parties could not have intended that arbitration was compulsory.

2. If there were disputes as to performance of the contract, or as to interim payments due, or regarding delay and liability for liquidated damages, a proviso in the dispute resolution clause that these disputes be arbitrated only after completion of the main contract and termination of the subcontract would create hardship on the parties, and render the subcontract "unworkable".

3. Under the dispute resolution clause, arbitration can be conducted **only** after the completion of the main contract or the determination/termination of the subcontract. That did not preclude litigating disputes arising in the course of the subcontract before its termination, and before the completion of the main contract.

The Court's decision

The Court rejected all three of K's submissions and ordered that the court proceedings be stayed in favour of arbitration.

1. On the interpretation of the dispute resolution clause, the Court adopted the modern approach to the construction of arbitration agreements, which involves the presumption in favour of arbitrability and the "one-stop" adjudication approach. This approach is based on the assumption that the parties, as rational businessmen, are likely to have intended any dispute arising out of the relationship into which they had entered or purported to enter to be decided by the same tribunal. The Court also stated that an arbitration clause will not be construed as giving a choice to the parties between arbitration and litigation, unless there was very clear language providing for such.

   The Court also considered the authorities where "may" was used in the dispute resolution clauses which purport to be arbitration clauses. The authorities generally supported the view that this type of clauses provide for permissive arbitration until one of the parties chooses to invoke the arbitration clause, in which case and at which time the arbitration becomes mandatory for both parties.

2. As regards the requirement that arbitration be commenced only after completion of works under a construction contract, or after determination of the contract for a contractor's works, the Court observed that this is a common requirement in standard form construction contracts in use in Hong Kong. This requirement serves the important purpose of ensuring that the contractor should continue to proceed with the works despite a dispute had arisen.

   The Court therefore disagreed with K's submission that such a requirement rendered the subcontract "*unworkable*".

The Court also stated that it was open for the parties to agree a carve out provision to provide certain disputes (e.g. EOT) to be dealt with by way of a dispute resolution procedure other than arbitration. Given that the parties did not do so in the present case, however, the Court refused to depart from the position as expressly stated in the dispute resolution clause, i.e. disputes should be arbitrated only upon completion of the main contract, or termination of the subcontract.

3. As to K's submission that disputes could be litigated before the subcontract's termination and before the completion of the main contract, the Court found that, in the present case, the parties' relationship was one of "*contractor and subcontractor, confined to the execution of the Works on the Project*", and that it would be unusual for the parties with such a relationship to establish separate and distinct procedures for resolving the same dispute.

The Court also noted that the dispute resolution clause made no mention of litigation. Rebutting K's submissions, the Court stated that if the parties intended that disputes be resolved by litigation before the completion of the main contract and/or termination/determination of the subcontract, the parties could easily have spelt that out and made such clear in the subcontract. Yet, the parties did not do so.

In light of the above, the Court concluded that the effect of the use of "may" in the dispute resolution clause was that, if a dispute arose between the parties which could not be agreed, the parties were bound to arbitrate such disputes if either party elected arbitration.

The Court therefore held that G had discharged the onus to establish a *prima facie* case of the existence of an arbitration agreement, and allowed G's stay application.

In passing, the Court also reaffirmed its earlier decision in *C v D* [2021] HKCFI 1474[1], and stated that whether a party has complied with the procedure as to the exercise of the right to arbitrate in an arbitration agreement, was a question of admissibility of the claim for the arbitral tribunal to decide, and not a question for the court, as long as there was a *prima facie* case of the existence of an arbitration agreement. In other words, in the present proceedings, K would not have been able to oppose the stay application on the ground that the main contract works had not yet been completed, or that the subcontract had not been determined/ terminated.

Takeaway points

1. The use of "may" in an arbitration clause does not (in and of itself) mean that arbitration is permissive rather than mandatory.

2. If a dispute resolution clause gives parties the right to arbitrate only upon the fulfilment of certain conditions (e.g. after completion of the works), but is silent on whether the parties are at liberty to litigate their disputes before then, the position is most likely to be that there is a right to litigate,

before those conditions are fulfilled, only if there is clear wording in the clause giving the parties such right.

3. The requirement that arbitration be commenced only after completion of the works, or after determination/termination of the underlying contract, is a common requirement in construction contracts in Hong Kong. This is not an “unworkable” arrangement and leaves no room for a contracting party to argue that litigation can be commenced before (or after) these events.

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1. Date of Judgment: 24 May 2021. This also was a Court of First Instance decision, but by the Hon G Lam J. See BCLP’s earlier article on this decision: https://www.bclplaw.com/en-US/insights/important-judgment-on-pre-conditions-in-arbitration-clauses.html.

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