

Insights

RECENT CASE WHERE A HONG KONG COURT SET ASIDE AN ARBITRAL AWARD - 廣東順德展燁商貿有限公司 V SUN FUNG TIMBER COMPANY LIMITED [2021] HKCFI 2407

Feb 15, 2022

SUMMARY

In *廣東順德展燁商貿有限公司 v Sun Fung Timber Company Limited* [2021] HKCFI 2407, a Hong Kong court set aside an enforcement order in respect of an arbitral award, after finding that the shareholder-director of the respondent had colluded with or was assisted by the claimant to misuse the arbitral process and procure the award to further his own personal interest.

THE CONTRACT, THE ARBITRATION AND THE AWARD

The judgment concerns enforcement proceedings for an arbitral award dated 19 May 2017 (the Award) that related to a contract for the sale of marble (the Contract) by Sun Fung Timber Company Limited (the Respondent in the arbitration) to 廣東順德展燁商貿有限公司 (the Claimant in the arbitration).

The Respondent was a family-run timber retail business, and was owned by an individual “ST” and a corporate shareholder “NI” on a 50/50 basis. ST and another individual “DL” (the majority shareholder of NI) were the only directors of the Respondent. Daily operations of the Respondent were left to ST, and it was ST who had entered into the Contract purportedly on behalf of the Respondent.

The arbitration commenced on 15 May 2017 after the Respondent allegedly failed to deliver the marble in accordance with the Contract.

Four days later, on 19 May 2017, the Award was made by consent and without full trial of the merits. Under the Award, the Respondent was to pay the Claimant the sum of RMB 59 million and legal costs.

Twelve days later, on 31 May 2017, ST sold the Respondent’s shop (the Property) for HKD 50 million. ST did not update the Respondent’s registered address, which was recorded to be the

Property address, despite the sale of the Property. Separately, ST assigned the Respondent's rights under a contract valued at HKD 7.5 million to the Claimant.

In October 2017, the Claimant petitioned to wind-up the Respondent on the ground of the Respondent's non-payment of the debt owed under the Award. Upon receiving a notice from the Official Receiver, NI/DL became aware of the petition, the Contract and the Award for the first time. NI opposed the petition.

In December 2018, the High Court of Hong Kong dismissed the Claimant's petition on the basis that NI successfully had demonstrated a *bona fide* case that the Contract was a sham transaction to deprive the Respondent of valuable assets.^[1] The Claimant appealed unsuccessfully against the dismissal.^[2] (We discussed that Court of Appeal judgment in [our previous post](#)).

In June 2019, the Claimant obtained an enforcement order in respect of the Award (the Enforcement Order). By virtue of the Award and the Enforcement Order, the Claimant obtained HKD 32.9 million from the sale proceeds of the Property, and a charging order over another landed property of the Respondent.

The charging order brought the enforcement proceedings to the attention of NI/DL. After obtaining leave to intervene in the enforcement proceedings, NI applied to set aside the enforcement order.

THE JUDGMENT

The application was heard by the Honourable Mimmie Chan J, judge-in-charge of the Construction and Arbitration List.

SUSPICIOUS FEATURES OF THE TRANSACTION

The judge found that the terms of the Contract were extraordinary in the context of the Respondent's usual business and financial situation, casting serious doubt on the genuineness of the transaction. First, while the Respondent was in the timber retail business, the Contract was for the sale of a significant value of marble (62 times larger than the Respondent's entire sales revenue in 2015). Second, the Respondent had no existing stocks of marble and no financial resources to acquire the required quantity from any supplier. Despite the Respondent's supposed need for funds, the deposit purportedly paid by way of cheque by the Claimant was never deposited into the Respondent's accounts. Third, the Contract required delivery within a very short time (6 days) and imposed a delay penalty of 1% per day.

The judge also considered other circumstantial evidence. Most notably, the Contract was entered into when the Respondent's shareholders were discussing to wind down the operations and divide the assets of the business. Moreover, the Claimant had been incorporated just three months before the date of the Contract. In addition, although the Claimant's case was that Contract was negotiated for months, no contemporaneous records of the negotiations were produced. Furthermore, ST had

kept NI/DL completely in the dark by failing to inform them of the existence of the Contract or the Award, and by taking no steps to change the Respondent's registered address.

The judge also took into account events that took place after the Award was made. First, referring to the timing of the sale of the Property, the assignment of the Respondent's contractual entitlements, and the presentation of the winding-up proceedings, the judge found that steps were taken "*in orchestrated sync*" to enforce and execute the Award. Second, despite its duty to make full and frank disclosure in the *ex parte* application to commence the enforcement proceedings, the Claimant did not disclose that the Property had been sold, or the past and potential disputes by the Respondent of the service of documents at the Property. Similarly, although the Claimant expressly informed the court by affirmation that it would serve a copy of the Enforcement Order on NI, it did not in fact do so. By taking these steps, in the judge's view, the Claimant successfully achieved its objectives of avoiding NI/DL from becoming aware of the enforcement proceedings and from taking steps to resist enforcement of the Award. Lastly, after the Enforcement Order was made, the Claimant did not seek any charging order against ST, who was among the contributories of the Respondent.

EVIDENCE OFFERED BY THE CLAIMANT

In contrast, the Claimant offered "*extremely limited evidence*" to refute the allegation of fraud, and the judge found that the Claimant's evidence was unsatisfactory or unreliable in many aspects. In addition, the Claimant purported to rely on irrelevant board minutes as proof of ST's authority to enter into the Contract (those minutes in fact were for the approval of financial statements).

ST'S SCHEME

Although allegations of fraud must be proved by cogent evidence, the judge explained, direct evidence of fraud is relatively rare and fraudsters typically are skilled at hiding their tracks.

The judge concluded, on the entirety of the evidence, that it was more probable than not that the Claimant was a party to ST's scheme to orchestrate the Contract and the Award, to cause the Respondent to be liable for a debt to the Claimant, to misuse the winding-up and other recovery proceedings to receive valuable assets of the Respondent, and to deprive NI of its share of such assets. In doing so, ST acted entirely in furtherance of his own person interest, rather than in the interests of the Respondent.

SETTING ASIDE THE ENFORCEMENT ORDER

Accordingly, the judge set aside the Enforcement Order on the following grounds:

- ST had no actual, implied or apparent authority to enter into the Contract on behalf of the Respondent. In particular, the judge explained, because the Claimant did not act in good faith

in dealing with ST in relation to the Contract, the Claimant could not rely on the indoor management rule to bind the Company to ST's actions.

- The Respondent was never a party to the Contract or the arbitration agreement contained in the Contract.
- The Respondent had not been given proper notice of the arbitration: No evidence was provided to show that a notice of arbitration was ever served on the Respondent. In fact, neither the Award nor the affirmation provided by the Claimant's director referred to the fact, details or manner of any such service.
- The Respondent was unable to present its case in the arbitration: ST had no implied or usual authority to bind the Respondent by his conduct of the arbitration. In this regard, the judge held that ST was acting for his own person interest when he caused the Respondent to admit that it was in breach of the Contract, and to consent to the Award to be entered against the Respondent for a significant amount.
- Public policy ground: The judge found that ST colluded with the Claimant to misuse the arbitral process and procure the Award to further his own personal interest. Therefore, it would be "*shocking to the conscience of the Court*" to permit the Claimant to enforce the Award.
- Material non-disclosure: The Claimant's failure to disclose the sale of the Property and the past and potential disputes as to the service of documents at the Property was "*serious, deliberate, intentional and material*". Also, the judge held that the representation given by the Claimant as to the service of the Enforcement Order on NI amounted to misleading the court.

DISCUSSION

廣東順德展煒商貿有限公司 v Sun Fung Timber Company Limited is a case of highly unusual facts, where arbitral and judicial processes were (ab)used to perpetrate a fraud. It also demonstrates that, while Hong Kong is a pro-arbitration and pro-enforcement jurisdiction known for adopting a mechanistic approach towards enforcement of arbitral awards, Hong Kong courts will not hesitate to set aside an award where there are serious and material irregularities.

Also clear from this case is that an appropriate level of judicial review and scrutiny of arbitral awards is important as a safeguard to ensure the integrity of arbitral processes and to protect the public from harm. Such judicial review and scrutiny is an important part of the foundation of the public's confidence in arbitration as a fair and just dispute resolution mechanism.

As recognised by the judge, fraudsters typically are skilled at hiding their tracks. Considering the significant financial impact fraud may bring to a victim, party representatives and tribunal members should be alert to unusual or suspicious features or circumstances of a case or a transaction, even

where documents at first glance appear to be in good order, and make judicious use of the various procedural powers and tools conferred upon them to ensure the integrity of the arbitral process.

[\[1\]](#) [2021] HKCFI 2756.

[\[2\]](#) [2021] HKCA 1660.

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