

Shenanigans in Shangri-La? Hong Kong courts refuse to enforce mainland China arbitral award

Introduction

In a recent decision the Hong Kong Court of First Instance refused to enforce a mainland arbitral award on public policy grounds.

The court in *Gao Haiyan v. Keeneye Holdings Ltd* [2011] HKEC 514 was not entirely impressed by the inventive plans of would-be mediators to induce settlement. The court found that arbitrators-turned-mediators create an appearance of bias when they (i) wine and dine a friend of an arbitral party, and (ii) request that the friend "work on" getting the arbitral party to accept the would-be mediators' settlement proposal.

The case highlights the perils of Arbitration-Mediation (**Arb-Med**). Arb-Med – common in mainland China – involves arbitrators acting as mediators before deciding the merits of a case. The new Hong Kong Arbitration Ordinance, which enters into force later this year, also permits the practice subject to safeguards.

Background

In June 2010, a Xian Arbitration Commission (**XAC**) arbitral tribunal (**Tribunal**) determined that a share transfer agreement between Keeneye Holdings Ltd (**Keeneye** or the **Respondents**) and a Chinese couple – Gao Haiyin and Xie Heping – (the **Applicants**) was invalid because it resulted from duress and misrepresentation. The Tribunal issued an award (**Mainland Award** or **Award**) "recommending" that Keeneye pay the Applicants RMB 50 million. The Applicants then sought to enforce the Mainland Award in Hong Kong. Keeneye argued that enforcement of the Award would be contrary to public policy. Keeneye contended that the Tribunal's conduct during mediation was improper and that the Award was tainted by bias or apparent bias.

The arbitral proceedings were in two hearings. At the first hearing, the parties agreed to submit the dispute to mediation under Article 37 of XAC's Arbitration Rules (the **Rules**). The Rules permit an arbitral tribunal or the presiding arbitrator to conduct mediation. During the mediation period, the Tribunal decided it would suggest that Keeneye pay the Applicants RMB 250 million to settle the case. But the Tribunal had no apparent basis for the figure, nor did it seek the parties' input. Nonetheless, the Tribunal appointed Pan Junxin (XAC's Secretary General) and Zhou Jian (an arbitrator) to contact the parties with the proposal. Pan and Zhou's appointment did not strictly conform to Article 37 of the Rules. Pan and Zhou, however, took the "mediation initiative" of arranging dinner at the Xian Shangri-La hotel with Zeng Wei – a third-party "related to" (關係人) Keeneye. At the Shangri-La, Pan told Zeng of the Tribunal's RMB 250 million settlement proposal and asked Zeng "to work on" Keeneye. Ultimately, Keeneye was not so keen and refused the settlement proposal. The Applicants too rejected the proposal. Arbitration resumed with a second hearing and Keeneye lost the case.

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Judgment

Arbitrators-turned-mediators' conduct created appearance of bias

Hong Kong courts can refuse to enforce a mainland award "if it would be contrary to public policy to enforce the award." Section 40E(3) of the Arbitration Ordinance (Cap. 341). The test is whether the award was made in circumstances that would cause a fair-minded observer to apprehend a real possibility of bias on the part of the arbitral tribunal. *Deacons v. White & Case LLP* [2003] HKC 374; *Porter v. Magill* [2002] AC 357 (HL)).

In the instant case, the court held that a fair-minded observer would "apprehend a real risk of bias" and that "what happened at the Shangri-La would give the fair-minded observer a palpable sense of unease." The court based its conclusion on the following findings:

1. The Tribunal's procedures were "not strictly in accordance with Article 37" of XAC's Arbitration Rules, which the parties adopted. The parties, for example, never consented to Pan (XAC's Secretary General) acting as a mediator. Nor did Zhou or Pan obtain party consent before meeting Zeng.
2. The mediators made their proposal to an intermediary – Zeng – rather than to the Respondents or the Respondents' lawyers. As a result, "the impartial observer would fear that Zeng was chosen as an intermediary because he was perceived as a person wielding influence over the Respondents who could press the proposal of paying the Applicants RMB 250 million."
3. Asking Zeng "to work on" the Respondents to accept the settlement proposal suggested that the mediators were forwarding their own agenda rather than communicating a neutral plan.
4. The mediators RMB 250 million settlement proposal was made "without authorisation from the Applicants or inking as to whether the Applicants were prepared to accept the same." This suggested that the mediators were "acting on their own on an initiative which favoured the Applicants."
5. The RMB 250 million settlement proposal was inexplicably disproportionate compared with the final Award's recommendation that Keeneye pay the Applicants RMB 50 million.

For these reasons, the court refused to enforce the award. In addition, the court highlighted "the potential for an appearance of bias" inherent to the Arb-Med process. The court cautioned, "the mediator who may be sitting as arbitrator in the same case must be particularly careful not to convey to one party or the other the impression of bias."

Hong Kong courts are not constrained by foreign decisions on bias

Nor was the court persuaded by the Applicants' waiver and estoppel arguments. The arguments ran: (i) the Respondents waived their right to complain about bias because they proceeded with arbitration; and (ii) the court was estopped from considering the enforcement issue because the Xian Intermediate Court already denied the Respondents' bias allegations.

As to the first argument, the court accepted that raising an allegation of bias would have risked antagonising the Tribunal, and that a complaint to XAC would potentially have been decided by XAC's Secretary General – Pan Junxin – whose conduct was under scrutiny. No waiver.

The court also rejected the second argument. Hong Kong courts must consider the question of bias "from the viewpoint of Hong Kong public policy" which may differ from a foreign jurisdiction's public policy. Thus a foreign court's determination that an arbitral award did not violate public policy will not estop Hong Kong courts from finding a public policy violation and refusing enforcement of the award.

Conclusion

Keeneye Holdings underscores the difficulties involved with enforcement of arbitral awards that follow Arb-Med. An arbitrator's impartiality, rightly or wrongly, can be contested where he/she has served as a mediator in the same dispute that he/she decides. Given the litigation consequences, arbitral parties should therefore exercise caution in appointing arbitrators as mediators.

Since the new Hong Kong Arbitration Ordinance permits Arb-Med, the impartiality of would-be mediators is likely to be litigated again. Watch this space.

This Client briefing does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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