

HONG KONG COURT AWARDS INDEMNITY COSTS AGAINST PARTY INITIATING COURT ACTION IN BREACH OF ARBITRATION AGREEMENT

Hong Kong has previously adhered to the principle that parties who fail in an attempt to set aside or challenge enforcement of arbitral awards will be ordered to pay indemnity costs (i.e., full reimbursement of the winning party's reasonable legal expenses) to the other party. The Hong Kong courts took the view that in light of the parties' agreement to arbitrate, and the court's role in facilitating compliance with the arbitral process, applications to set aside an arbitral award or to resist enforcement should be deterred except in rare cases. In the recent case of *Chimbusco International Petroleum (Singapore) Pte Ltd v. Fully Best Trading Ltd* (HCA 2416/2014), the Hong Kong Court of First Instance extended this principle by holding that indemnity costs would also be imposed against a party that commences court litigation in breach of an arbitration agreement, unless special circumstances exist.

Background

The plaintiff, *Chimbusco International Petroleum (Singapore) Pte Ltd*, commenced litigation proceedings against the defendant, *Fully Best Trading Ltd*, for payment of sums due under an agreement for the supply of fuel oil.

Relying on the arbitration clause in the agreement, the defendant applied for a stay of the proceedings pending arbitration. The defendant's application was subsequently consented to by the plaintiff. The remaining issue, decided by the court, was whether the costs of the application should be paid for by the plaintiff on an indemnity basis, or whether the costs should be in the cause of the arbitration (i.e., costs of the litigation to be awarded in accord with the final outcome of the arbitration).

Decision

The Hong Kong Court of First Instance relied on the case of *A v. R (Arbitration: Enforcement)* [2009] 3 HKLRD 389, where it was held that a party that applies unsuccessfully to set aside an arbitral award or to resist its enforcement will be ordered to pay costs on an indemnity basis unless special circumstances can be shown. The *A v. R* court's holding rested on the premise that (i) courts and prevailing parties should not usually be presented with an application to challenge an arbitral award given the limited grounds available for set-aside and (ii) parties are obliged to assist the court in achieving just, cost-effective and efficient resolution of disputes. *A v. R* observed that parties should be discouraged from undermining these objectives. Thus, that court concluded that if a losing party were only required to pay costs on a conventional party-

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and-party costs basis, the winning party would only be able to recover approximately two-thirds of its costs of the challenge, effectively reducing the deterrent effect on unjustified challenges.

In *Chimbusco*, the plaintiff argued that there was a difference between a failed attempt to resist enforcement of an arbitral award, and a failed attempt to challenge an arbitration agreement. In the case of the latter, the plaintiff alleged that given that it had not yet had the opportunity to argue its case before the tribunal in the arbitration, the indemnity costs principle should not apply.

The court rejected this argument on the basis that the parties should comply with their obligation to proceed to arbitration under their arbitration agreement, which would be treated the same as their obligation not to challenge enforcement of an arbitration award made under their arbitration agreement without valid grounds. Further, the parties should be obligated to assist the court in the cost-effective and efficient resolution of disputes, which is undermined by an unsuccessful challenge of the arbitration agreement. Accordingly, the court concluded, there is no reason to differentiate between unsuccessful challenges to an arbitral award and unsuccessful challenges to an arbitration agreement.

The plaintiff also argued that the arbitration clause was null and void due to uncertainty, as it called for arbitration at the Singapore International Arbitration Centre in accordance with the Singapore Bunker Claims Procedure. Without expressing any specific conclusions on the choice of those rules (which apply in contracts for the sale and/or supply of bunkers), the court rejected plaintiff's argument, explaining that the parties had expressed a clear intent to arbitrate in Singapore and such agreement was capable of being performed in Singapore, even if any deficiency in the clause might oblige the parties to apply to the Singapore court to appoint the arbitrators. The judge found that the tribunal should rule on its own jurisdiction and on the rules to be applied.

Conclusion

This case extends the existing jurisprudence in Hong Kong favoring arbitration and using the power of imposing indemnity costs as a disincentive to engage the courts in matters subject to final and binding resolution through arbitration. The decision is further confirmation of the practice of courts in pro-arbitration jurisdictions, such as Hong Kong and Singapore, to uphold arbitration agreements and ensure efficient and effective dispute resolution proceedings. By ordering costs on an indemnity basis against a party who commences litigation proceedings in the context of an arbitration agreement that might even have had some defects necessitating judicial support at the seat, a clear message has been sent that non-compliance with arbitration agreements will face the same criticisms as unsuccessful attempts to set aside awards or challenge enforcement proceedings.