



# Fruit of collusion: Hong Kong Court set aside an enforcement order for a Mainland award

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On a rare occasion, the Court of First Instance has set aside an enforcement order for a Mainland award (made under the auspices of the Zhanjiang Arbitration Commission) on the basis that the underlying contract was a sham, the arbitration agreement was not valid, and thus it would be contrary to public policy to enforce the award.

[廣東順德展煒商貿有限公司 v Sun Fung Timber Company Limited \[2021\] HKCFI 3823](#)

## Background

The Respondent (**Company**) was 50% owned by ST and 50% owned by a company, NI, of which DL was the majority shareholder. ST and DL were both directors of the Company.

In late 2016, a dispute arose between the two shareholders and directors. As a result, the Company started to wind down its operations, with talks between ST and DL about selling the assets of the Company.

On 14 April 2017, ST purportedly entered into a contract on behalf of the Company with the Applicant (**GD**) for the sale of marble (**Contract**). The Contract contained many peculiar features. The Company's usual business involved only timber retailing, as opposed to marble stones. The Contract, nonetheless, was for the sale of a substantial amount of marble to GD for the significant sum of RMB 220 million. The consideration

was some 62 times of the Company's annual sales revenue, and GD was incorporated only 3 months before the date of the Contract. Pursuant to the Contract, the delivery of the marble was to be made within 6 days, failing which the Company had to pay RMB 2.2 million per day as penalty. The Company failed to deliver the marble.

On 15 May 2017, pursuant to the arbitration agreement in the Contract (**Arbitration Agreement**), GD commenced arbitral proceedings before the Zhanjiang Arbitration Commission against the Company for breach of the Contract (Arbitration). ST conducted the entire Arbitration on behalf of the Company, and caused the Company to admit liability and confirm that the Company should pay damages in the sum of RMB 59 million. Within 4 days, GD obtained an award against the Company in the agreed amount (**Award**).

GD sought to wind up the Company based on the Award. NI and DL only became aware of the Award during the course of the winding-up proceedings, which were subsequently dismissed by the Hong Kong court on the basis of a bona fide dispute over the debt.

GD then applied *ex parte* for and obtained an order granting leave to enforce the Award in Hong Kong (**Enforcement Order**). NI obtained leave to intervene in these proceedings and sought to set aside the Enforcement Order on the grounds that ST lacked authority to enter into the Contract, that the Contract (including the Arbitration Agreement therein) was

void, that the Company had not been given proper notice of the Arbitration, and that the enforcement of the Award would be contrary to public policy. In particular, NI argued that the Contract was in reality a sham orchestrated by ST and GD to enable ST to receive valuable assets of the Company without the need to share such assets with NI, should the Company be dissolved in the usual way.

## Decision

The Hong Kong court noted that the claims of fraud must be substantiated by cogent evidence, but remarked that direct evidence of fraud was generally rare due to deliberate concealment by the fraudsters. In this circumstance, the Court drew inferences of dishonesty from the highly unusual facts of the case. In addition to the extraordinary commercial terms of the Contract, the Company's apparent lack of financial capabilities to source the massive quantity of marble under the Contract cast serious doubt on the genuine nature of the dealing between ST and GD. Further, the Contract and the Award came into existence only when the shareholders were contemplating a wind down of the business of the Company. NI and DL were kept in the dark in relation to the Contract and the Award (both of which were substantial) until GD sought to wind up the Company. The court also took note of GD's abnormal behaviour in the winding up proceedings – despite seeking multiple charging and garnishee orders against the Company's assets, GD did not pursue any proceedings to seek recovery from ST who owed a substantial debt to the Company.

In light of all the circumstantial evidence, the court was satisfied that it was more probable that the Contract and the Award were designed to enable ST and GD to receive valuable assets of the Company. Since ST was not acting in good faith and was not authorised by the Company's board to act on behalf of the Company in the Arbitration, his conduct of the Arbitration did not bind the Company.

Moreover, the Arbitration Agreement in the Contract was not valid. ST was not authorised to enter into the Contract on behalf of the Company. There was also no implied or apparent authority as GD did not have any prior dealings with ST and the Company did not give any clear representation of authority.

The Court further held that the Company had not been given proper notice of the Arbitration and was unable to present its case. No one in

the Company was notified of the Arbitration apart from ST.

Based on the above, the Court concluded that it would be contrary to the public policy of Hong Kong to permit enforcement of the Award. The Enforcement Order was set aside as a consequence.

## Comment

This case demonstrates a rare instance where the Hong Kong Court set aside an award on the ground of public policy due to fraud and collusion. Fraud is often hard to establish – anything less than cogent evidence does not suffice. Nevertheless, in this case, the court was able to draw inferences of dishonesty from the highly suspicious circumstances surrounding the Contract in particular, and set aside the Enforcement Order on that basis.

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