

## COURT OF FINAL APPEAL RULES ON JURISDICTION OF COURT IN A COMMON LAW ACTION TO ENFORCE AN ARBITRAL AWARD

ETON PROPERTIES LIMITED AND ANOTHER v. 厦门新景地集团有限公司 formerly known as 厦门市鑫新景地房地产有限公司 [2020] HKCFA 32

In the final chapter of a long running dispute spanning 15 years concerning an agreement for the delivery and development of a piece of land and subsequent share sale, the Court of Final Appeal (CFA) dismissed the parties' cross appeals and decided that in a common law action to enforce an arbitral award, the Court has jurisdiction to order remedies beyond the content of the award. The CFA also usefully clarified certain principles in relation to the tort of inducing a breach of contract and constructive trust, which highlights the complexity of these claims in a cross-jurisdictional transactional context.

This briefing addresses the differences between the two methods of enforcing a Mainland award: (i) a common law action to enforce the award and (ii) through the "mechanistic" statutory procedure under the Arbitration Ordinance (Ordinance) for converting the award into a judgment of the court. It also discusses the principles addressed by the CFA in relation to the tort of inducing a breach of contract and constructive trust.

### Background

The dispute arose from a complex agreement for the delivery of a piece of land in Xiamen (Land), development of the Land, and sale and purchase of shares in a Hong Kong company (Target) indirectly owning the right to develop the Land (Agreement). The 1<sup>st</sup> and 2<sup>nd</sup> Defendants each held one share of the Target, comprising the Target's entire share capital. Under the Agreement, the Plaintiff were to first pay a deposit on signing, with the remaining transfer price payable by instalments. The Land was to be transferred to the Plaintiff within six months of the Agreement. The Plaintiff would then develop the Land

subject to supervision by the 1<sup>st</sup> and 2<sup>nd</sup> Defendants. After full payment of the transfer price, the 1<sup>st</sup> and 2<sup>nd</sup> Defendants were to transfer their shares in the Target to the Plaintiff's nominee. The Agreement was governed by PRC law and any disputes arising from it are to be submitted to the China International Economic and Trade Arbitration Commission for arbitration (Arbitration Agreement).

The Plaintiff paid the deposit as per the terms of the Agreement, but, shortly after concluding the Agreement, the 1<sup>st</sup> and 2<sup>nd</sup> Defendants decided to terminate the Agreement. The Plaintiff refused to accept the termination and pressed for performance. Pursuant to the Arbitration Agreement, the Plaintiff commenced arbitration. The Plaintiff obtained a favourable award in 2006 (1<sup>st</sup> Award) whereby the 1<sup>st</sup> and 2<sup>nd</sup> Defendants were ordered to continue performance of the Agreement. Unbeknownst to the Plaintiff, whilst the arbitration was ongoing (indeed, before the first hearing in the arbitration), the Defendants began a restructuring by transferring their shares in the Target and allotting a large number of shares to the 3<sup>rd</sup> Defendant (Restructuring).

At this juncture, it is useful to summarise the two routes to enforce a Mainland arbitral award under the Ordinance:

- Through a common law action to enforce the award (Common Law Action);
- Through a statutory procedure under section 2GG of the Ordinance<sup>1</sup> to convert the award into a judgment of the court. Under this procedure, if

<sup>1</sup> Repealed and replaced by sections 84 and 92 of the Arbitration Ordinance (Cap. 609) which have the same effect as section 2GG of the repealed Arbitration Ordinance (Cap. 341).

leave is given, the court may enter judgment in terms of the award (**Statutory Action**).

When the 1<sup>st</sup> Award was not complied with,<sup>2</sup> the Plaintiff brought a Statutory Action to enforce the 1<sup>st</sup> Award in the High Court of Hong Kong. The Court granted leave to enforce the award and entered judgment in its term by ordering the 1<sup>st</sup> and 2<sup>nd</sup> Defendants to continue to perform the Agreement (**Order**). The 1<sup>st</sup> and 2<sup>nd</sup> Defendants applied to set aside the Order and, in support of the application, revealed that through the Restructuring they had divested themselves of their shareholding in the Target and the 3<sup>rd</sup> Defendant had become the sole beneficial owner of the Target. They argued that continued performance of the Agreement was rendered impossible. The Court of First Instance (CFI) however, rejected the impossibility argument and refused to set aside the Order.

Being made aware of the Restructuring, the Plaintiff started a Common Law Action in 2008 to enforce the 1<sup>st</sup> Award (**Action**). In the Action, the Plaintiff sought declarations that shares in the Target were held on constructive trust in favour of it and brought tortious claims for inducing breach of contract and conspiracy against entities associated with the 1<sup>st</sup> and 2<sup>nd</sup> Defendants (**Non-contractual Claims**). The Plaintiff subsequently added a claim for damages or equitable compensation (**Damages Claim**) in the event the primary relief of continued performance of the Agreement (which would include, for example, transfer of shares in the Target) proved unachievable. These claims clearly went beyond the scope of the 1<sup>st</sup> Award. Before the CFI, the Judge dismissed the Action in its entirety.

The Court of Appeal (CA) allowed the Plaintiff's appeal against the dismissal of the Common Law Action to enforce the 1<sup>st</sup> Award, thus allowing the Damages Claim should the Plaintiff so elect. The CFI's dismissal of the Non-Contractual Claims was nevertheless upheld. The CA asked the Plaintiff to choose between (i) continued performance of the Agreement and (ii) damages or equitable compensation as the two remedies are contradictory.

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<sup>2</sup> The Plaintiff's application to the Xiamen Municipal Intermediate Court to enforce the 1<sup>st</sup> Award failed because the 1<sup>st</sup> and 2<sup>nd</sup> Defendants being Hong Kong companies were out of its jurisdiction.

<sup>3</sup> The elements required to be proved are that there was a submission to arbitration, the arbitration was conducted in

The Plaintiff eventually opted for damages against the 1<sup>st</sup> and 2<sup>nd</sup> Defendants. This resulted in the cross-appeals before the CFA, with the 1<sup>st</sup> and 2<sup>nd</sup> Defendants seeking to overturn the CA's decision on the Common Law Action, and the Plaintiff seeking to overturn CA's decision on the Non-Contractual Claims.

### First appeal - Common Law Action

For the first appeal on the Common Law Action to enforce an arbitral award, the crux is whether the remedy which may be granted under such action is prescribed by the terms of the arbitral award. In other words, whether, as is the case with the Statutory Action, in a Common Law Action, the Court may only make an order in terms of the award. If the Court is so restricted, then the CA was wrong to award the Plaintiff damages, as the 1<sup>st</sup> Award ordered the continued performance of the Agreement but not damages.

The CFA held that in a Common Law Action, a Court can grant relief which goes beyond the terms of the arbitral award, and accordingly the CA did not act beyond its jurisdiction in awarding damages. In so holding, the CFA rejected the Appellants' (1<sup>st</sup> and 2<sup>nd</sup> Defendants) arguments that:

- A court may only enforce an award "mechanistically" by making an order which mirrors the award. In rejecting this argument, the CFA referred to the procedural differences between the Statutory Action and the Common Law Action - the former is essentially a summary procedure involving only an *ex-parte* application by the party seeking to enforce the award, while the latter requires the party to sue on the award and prove his case.<sup>3</sup> Therefore there is no reason why the Common Law Action should be subject to the same restrictions as the Statutory Action.
- The Action, in particular the Damages Claim, is an action based on and arising out of the Agreement and so is caught by the Arbitration Agreement. Accordingly, to award damages to the Plaintiff would be to outflank the arbitral regime agreed by

pursuance of the submission, that the award is a valid award, made pursuant to the provisions of the submission, and valid according to the *lex fori* i.e. the law of the place where the arbitration was carried out and where the award was made.

the parties. The CFA rejected this argument and held that Hong Kong law implies a mutual promise on the parties to an arbitration to honour the arbitral award. Failure to do so constitutes a fresh cause of action separate and independent from the underlying dispute. The Damages Claim is not a claim based on and arising out of the Agreement and accordingly is not subject to the Arbitration Agreement.

- The award of damages (which is premised upon the Agreement having been terminated) is fundamentally inconsistent with, and barred by, the 1<sup>st</sup> Award (which is premised upon the Agreement subsisting and not terminated). The CFA rejected that the two are inconsistent. It distinguished between the arbitral proceeding stage where parties' mutual rights and liabilities are determined, and the enforcement stage, where the court enforces the award. There is no requirement for consistency between the content of an arbitral award (a matter in the arbitral proceedings stage) and the relief granted in a common law action to enforce the award (a matter in the enforcement stage).

## Second appeal - Non-contractual Claims

As mentioned above, the Plaintiff had brought Non-Contractual Claims in the Action to bolster its chance of obtaining redress for the wrongs committed against it. The conspiracy claim having fallen away, there were two claims which remained in issue before the CFA - the tort of inducing breach of contract, and constructive trust over the shares in the Target.

### Element of "inducement" in a tortious claim of inducing breach of contract

The Plaintiff claimed that the persons who participated in the Restructuring (including the 3<sup>rd</sup> Defendant) (**Relevant Defendants**) caused the 1<sup>st</sup> and 2<sup>nd</sup> Defendants to lose indirect control over the Target thus induced a breach of the Agreement by them. One of the elements for the tort is that the inducer "intended" to bring about the breach of contract.<sup>4</sup> The CFA upheld the CA's finding that the requisite intent was lacking. The sequence of events was that the 1<sup>st</sup> and 2<sup>nd</sup> Defendants decided to terminate the Agreement, then carried out the Restructuring, in the

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<sup>4</sup> The elements of the tort of inducing a breach of contract are (i) a contract, (ii) known to a third party who (iii) does something which induces or persuades a contracting party to

belief that the renunciation would bring the Agreement to an end and would at most result in damages payable to the Plaintiff. Accordingly, believing the Agreement had come to an end, the Restructuring was not carried out with the intent of frustrating the contractual obligation to procure the transfer of shares in the Target, and as such the tort of inducing a breach of contract was not made out.

### Constructive trust - when proprietary interest arises in the transfer of Hong Kong company shares

The Plaintiff claimed that it held the beneficial interest in the shares of the Target, a Hong Kong company, on the basis of the well-established principle that when there is a valid contract for sale of property (including shares) which is capable of being specifically enforced, the vendor becomes in equity a trustee for the purchaser. The CA rejected the Plaintiff's claim on the basis that the concept of trust does not exist under PRC law (the governing law of the Agreement).

The CFA rejected the CA's simplistic approach. Instead, the CFA adopted the following two stage approach in concluding that no proprietary interest arose from the Agreement: first, it determined whether equitable proprietary interest in the shares is legally capable of existing under the *lex situs* (the law of the place where the property is situated). Here, the law of Hong Kong, as the *situs* of the shares, determines that an equitable interest in shares of a Hong Kong company is capable of subsisting, if the Agreement is specifically enforceable. Second, it determined whether the characteristics of the Agreement which the governing law (i.e. PRC law) treats it as having are such as to make it capable of being specifically enforced under Hong Kong law. The fact that PRC law did not recognise the concept of trust was not the end of the matter.

Here, the CFA determined that the Agreement was incapable of being specifically enforceable under Hong Kong law. The Agreement was not a straightforward contract for the transfer of shares in the Target and was in fact subject to a number of conditions to be satisfied and the satisfaction of those conditions was beyond the Plaintiff's sole control. The Agreement with these features was not one which a

break it, (iv) intending to bring about the breach and (v) thereby causing loss.

Hong Kong court applying its own law would specifically enforce. In particular, the fact that the continued performance of the Agreement would require the Court's supervision constitutes a bar to specific performance.

### Conclusion

The decision clarifies that the difference between the two routes to enforce a Mainland arbitral award in Hong Kong - the statutory "mechanistic" enforcement route and the common law enforcement route, lies not only in procedure, but also potentially in the available remedies. Whereas the statutory enforcement route only allows mechanistic enforcement of the arbitral award by entering judgment in terms of the award, the remedies available in the common law action to enforce the award are potentially wider, and are not circumscribed by the terms of the award. This is a welcoming decision for parties who have obtained a favourable arbitral award but faced with the situation where the losing party commits acts which render the award more difficult / impossible to perform. Rather than having to accept that the award has been rendered nugatory, or having to return to the tribunal

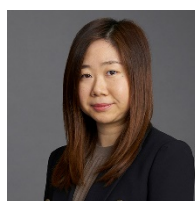
to obtain alternative remedies, the winning party may seek remedies outside of the award by commencing a common law action to enforce the award.

The difficulty in mounting a tortious claim of inducing breach of contract is also highlighted. In particular, the inducer must know that he is inducing a breach of contract. It is not enough that he knows that he is procuring an act which at law constitutes a breach of contract. What matters is the mental state of the inducer. If a person commits an act which constitutes a breach of contract at law but under a mistaken belief that the underlying contract had already come to an end, the requisite "intent" is still lacking.

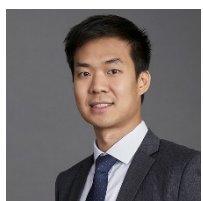
The CFA's decision on the issue of constructive trust demonstrates the intricacy of the relationship between the *lex situs* and the proper law of contract in the context of an international commercial arbitration. The crucial question is not whether the foreign law recognises the concept of trust. Instead, one has to look at both the *lex situs* and the governing law of the agreement to determine whether equitable proprietary interest arises from the particular facts of the transaction.



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