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HK COURT CONSIDERED THE PROPER SCOPE OF THE COURT'S INTERVENTION AGAINST AN ARBITRAL TRIBUNAL'S RULING REGARDING PUBLIC POLICY

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SUMMARY

In *G v N* [2023] HKCFI 3366 (judgment date: 29 December 2023), a Hong Kong court considered the question of whether and to what extent it is open for the court to review an arbitrator's ruling on matters of public policy. The court stayed the enforcement of the award and remitted the award to the arbitrator.

Later, in [2024] HKCFI 655 (judgment date: 9 February 2024), the same judge considered the case to have raised an "*important and novel*" question as to what is the proper scope of judicial intervention in arbitral awards on grounds of public policy, and granted leave to appeal to the Court of Appeal.

BACKGROUND

Under the Arbitration Ordinance (**AO**), an award is not subject to review on the ground of an alleged error of law (unless Schedule 2 of the AO applies). However, under Article 34(2)(b)(ii) of the Model Law as adopted by Section 81(1) of the AO, the court may set aside an award on the ground that the award is in conflict with public policy.

What makes the present case special is that the law regarding illegality had changed after the award was rendered, and the arbitrator acknowledged in the award not only that the defence of illegality is one of policy, but also that the strict application of the old test on illegality "*would inevitably lead to injustice and the unjust enrichment of N*" and "*was defensible on the basis that it is not a principle of justice but a principle of policy*". It was argued before the court the setting-aside application was made not on the ground that there was an error of law, but purely on the public policy ground.

The unusual circumstances of this case put firmly in the spotlight the questions of whether it is open for the court to review the tribunal's ruling on matters of public policy and, if so, whether the

arbitrator's ruling is to be characterised as a ruling on matters of public policy which is subject to review by the court or as a ruling on an issue of law which is not subject to review.

THE ARBITRATION AND THE AWARD

N was a company incorporated in the British Virgin Islands (**BVI**). In October 2020, G and N entered into a share purchase agreement (**SPA**), pursuant to which N allotted shares to G in return for the price of about US $146 million (**Consideration Monies**).

In March 2021, in the proceedings commenced by another shareholder of N, the BVI courts set aside the placement of shares after finding that the placement was not in the interest of the company, and that N's directors approved the placement for the improper purposes of supporting the *de facto* control in N by K (G was K's wholly-owned indirect subsidiary) and defeating the shareholders' requests to call a shareholders meeting.

Following the BVI judgment, G commenced arbitration in Hong Kong pursuant to the arbitration clause in the SPA. G sought the recovery of the Consideration Monies.

In the first partial award, the arbitrator dismissed G's personal restitution claim on the ground of illegality and dismissed G's proprietary claim on the equitable doctrine of unclean hands. In the second partial award, the arbitrator awarded N about US$ 13 million in damages for the losses suffered by G as a result of G's unlawful acts.

THE CHANGE IN THE LAW

After the first partial award was rendered and before the second partial award was rendered, there was a change in the law regarding illegality.

In March 2023, the Hong Kong Court of Appeal (**CA**) handed down its judgment in *Monat Investment Ltd v. All Person(s) in Occupation of Part of The Remaining Portion of Lot No. 591 in Mui Wo D.D. 4 No.16 Ma Po Tsuen, Mui Wo, Lantau Island & Anor* [2023] HKCA 479. In *Monat*, the CA departed from the traditional "reliance approach" that was established in 1993 by the House of Lords of the UK in *Tinsley v Milligan* [1994] 1 AC 340, in favour of the "proportionality approach" that was established in 2016 by the Supreme Court of the UK in *Patel v Mirza* [2017] AC 467.

In brief terms, the *Patel* approach is less strict than the *Tinsley* approach and directs the court to determine "*whether it would be harmful to the integrity of the legal system to allow a claim involving an illegal act*" by considering a "*trio of necessary considerations*", namely (a) the underlying purpose of the prohibition; (b) whether the denial of the claim may render other public policies ineffective or less effective, and (c) proportionality.

Although the arbitrator considered the cases on illegality, including both *Tinsley* and *Patel*, the arbitrator decided not to follow *Patel* on the basis that (at that time) *Patel* had not yet been

considered by the Hong Kong Court of Final Appeal to apply as part of Hong Kong law.

G'S SETTING ASIDE APPLICATION

G applied to set aside the awards, or alternatively for the setting-aside proceedings to be stayed and the matter be remitted to the arbitrator.

One of the (two) grounds relied on by G was that the awards were in conflict with public policy. G was clear in stating that it did not seek to challenge the arbitrator's findings on the facts or on the law, but only the arbitrator's denial of the relief on policy grounds.

THE JUDGE'S DECISION

Counsel for N made submissions regarding the finality of arbitral awards. According to N, G's complaints at most amounted to complaints regarding errors of law which did not entitle G to challenge the awards, and that there was no manifest injustice and nothing shocking to the conscience of the court to justify not to enforce the awards.

Notwithstanding the above submissions which the court considered to be sound, the court concluded that it was entitled to review the tribunal's ruling on public policy. The court's reasoning can be summarised as follows:

- The court accepted the submissions by counsel for G that, while it would not be open for the court to review the arbitrator's findings of facts and application of the law to the facts to determine whether there was any illegality, the court has jurisdiction to review and determine the arbitrator's ruling on the consequences of the illegality ground.
- The court considered the Privy Council's decision of *Betamax v State Trading Corp* [2021] UKPC 14, which is a highly persuasive authority for Hong Kong courts. In *Betamax*, the Privy Council construed a provision in Mauritius' International Arbitration Act that was the equivalent of Article 34(2)(b)(ii) of the Model Law. In the view of the Privy Council, the court is entitled to determine the nature and extent of public policy, whether an award conflicts with such policy, and - in the context of illegality - the consequence and effect of the illegality found.
- The court added that, in an application to set aside or resist enforcement of an arbitral award, it is open for the applicant to show and the court to consider any contentions that the award conflicts with public policy, and it would not be against New York Convention spirits or principles to do so.
- The court concluded that it is bound to consider, when the court is asked to do so, whether an arbitral award or the enforcement of the award would be contrary to the public policy of Hong Kong as recognised by the Hong Kong courts at the current date.

On G's case, under the new *Patel* test, the arbitrator should not deny relief simply because the placement was illegal, but instead would be required to consider multiple factors. G also submitted that the denial of relief would not have achieved the purpose of the policy (which G contended was to prevent the illegal act in question, namely the improper exercise of the power conferred upon N's directors), would render ineffective the public policy behind the rule against unjust enrichment, would be disproportionate, and would be inconsistent with the fact that the relevant BVI legislation did not impose any penalty for the breach in question.

The court held that it would be manifestly unjust and would be against the public policy of Hong Kong to enforce the award, and the court ordered the matter be remitted to the arbitrator.

THE LEAVE TO APPEAL

N applied for leave to appeal against the court's decision to remit the awards (**Decision**). N's leave application was heard by the same judge.

In the view of the court, the Decision raised the question as to the proper scope of judicial intervention over arbitral awards on the ground of public policy, which the court described as an "*important and novel*" issue. The case highlighted the interplay between the policy for the denial of remedy on ground of illegality and the policy to support the enforcement of arbitral award with minimum curial intervention.

However, the court emphasised that parties should not be encouraged to use public policy as a ground to seek a substantive review of an award, such as on any alleged misapplication of the *Patel* test or alleged failures to consider a particular factor.

The court also considered that there was a reasonable prospect of success in N's argument that the change from the *Tinsley* test to the *Patel* test at most would constitute a change in legal framework, rather than a change in public policy or its scope, and so G's complaints should be characterised as a question of law for which no review is permissible.

The Court of Appeal's guidance on the extent of permissible review on the ground of public policy, in the view of the court, would benefit the development of arbitration law in both Hong Kong and other Model Law jurisdictions.

For the above reasons, the court granted leave for N to appeal against the Decision.

KEY TAKEAWAYS AND CONCLUDING REMARKS

This is a rare case where a Hong Kong court refused to enforce an arbitral award on the public policy ground. However, in line with the Hong Kong courts' usual pro-arbitration stance, the court remitted the matter to the arbitrator for the arbitrator to remedy the issues that gave rise to the ground for setting aside.

It waits to be seen what view the CA will take regarding whether the Hong Kong courts have the power to review and to set aside or refuse to enforce an arbitral award on public policy ground.

However, it can be seen from the discussions above that the permissible scope of review of an arbitrator's ruling on public policy appears – in the eyes of the first instance court – to be quite limited. First, the court held and emphasised that the court's review is limited to the consequence and effect of the illegality found. Secondly, the court signalled its reluctance to interfere with any alleged non-application or misapplication of the factors in the new *Patel* test in determining the consequence and effect of the illegality found. Thirdly, in the submissions by counsel for N which the judge considered to have a reasonable prospect of succeeding, a change in the law or – by extension – application of the wrong test for the denial of relief on ground of illegality should not justify the court to review and interfere with the arbitrator's ruling on the consequence and effect of the illegality found.

The above also serves to illustrate the challenge in being able to draw a clear line as to when the arbitrator's ruling ceases to be a ruling on public policy and is to be considered an error of law. It will be instructive to see what the CA will add to the discussions, if the appeal is to proceed (notwithstanding the fact that the arbitration has resumed following the Decision).

It is not difficult to foresee that *G v N* will be a case significant to the development of arbitration law in Hong Kong, especially in respect of the permissible scope of review of an arbitrator's ruling on public policy.

However, as the court repeatedly has emphasised, *G v N* is a case in which the challenge explicitly was advanced on public policy ground alone rather than one that premised upon there being any error of law. It may be that *G v N* might be regarded as applying to a somewhat narrow compass of circumstances.

It is and remains the position that an error of law in an arbitral award will not be subject to review by the court. As was demonstrated in the Decision itself, a party who seeks to set aside or resist enforcement of an award by inviting the court to review the arbitrator's ruling on public policy might find itself facing an uphill battle trying to argue and convince the court that it is not seeking to challenge the arbitrator's ruling on an issue of law.

If on the contrary parties wish to allow the court to review an arbitrator's ruling on an issue of law, they may wish to consider in their arbitration agreement to opt-in to the relevant provisions in Schedule 2 of the AO.

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