Court of Appeal of Hong Kong

CACV 31/2011

IN THE HIGH COURT OF THE

HONG KONG SPECIAL ADMINISTRATIVE REGION

COURT OF APPEAL

CIVIL APPEAL NO. 31 OF 2011

(ON APPEAL FROM HCCT NO. 45 OF 2009)

IN THE MATTER OF ENFORCEMENT OF ARBITRATION AWARD

BETWEEN

SHANDONG HONGRI ACRON CHEMICAL JOINT STOCK COMPANY LIMITED	Applicant/ Creditor
and	
PETROCHINA INTERNATIONAL (HONG KONG) CORPORATION LIMITED	Respondent/ Debtor

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Before: Hon Kwan JA in Chambers

Date of Hearing: 8 June 2011

Date of Handing Down of Decision: 13 June 2011

DECISION

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1. This is an application for security for costs in an appeal. A point of some importance was raised in opposition by the appellant, which put in a written submission by Miss Teresa Cheng, SC and Mr Adrian Lai. Put shortly, they contended that the Court of Appeal should not exercise its discretion to order security in the context of enforcement of a foreign arbitration award against an award creditor, even if it has jurisdiction to do so.

2. The order made by Saunders J on 25 January 2011 being the subject of this appeal was made in somewhat unusual circumstances. The background matters relevant to this application, taking from two rulings given by the Judge on 6 August 2010 and 25 January 2011, may be stated as follows.

The background

3. On 21 September 2009, the China International Economic and Trade Arbitration Commission ("CIETAC") issued an award in an arbitration between the parties to these proceedings, Shandong Hongri Acron Chemical Joint Stock Co. Ltd. ("Hongri") and **Petrochina** International (Hong Kong) Corporation Ltd. ("Petrochina"). Hongri is a company incorporated in the PRC carrying on business as a manufacturer of fertilisers. The relevant parts of the award read as follows:

"1. [Hongri] shall return 3,810.578 tonnes of sulphur to [**Petrochina**].

2. [**Petrochina**] shall return to [Hongri] the sum of US$2,953,198, being the payment received for the goods.

3. [**Petrochina**] shall indemnify [Hongri] the sum of US$1,624.26 … , being the insurance premium incurred.

4. [**Petrochina**] shall indemnify [Hongri] the sum of RMB 350,002.58, being 14 items of fees … incurred in relation to the goods under the Sale and Purchase Contract at the destination port…

5. [**Petrochina**] shall indemnify [Hongri] the sum of RMB65,400, being the authentication fee.

6. … [**Petrochina] is responsible for 70% of the arbitration fee… [Petrochina**] shall pay to [Hongri] the sum of RMB 243,160.40.

The sums mentioned in (2), (3), (4), (5) and (6) above, which are payable to [Hongri], shall be paid by [**Petrochina**] to [Hongri] within 30 days from the date of this award. Should payment be made after the deadline, interest shall be added in accordance with the law."

4. On 17 November 2009, Hongri made an ex parte application under sections 2GG and 40B of the Arbitration Ordinance, Cap. 341 for leave to enforce paragraphs 2 to 6 of the award, but excluding paragraph 1. Saunders J made an order in terms on 18 November ("the Ex Parte Order").

5. On 4 December 2009, **Petrochina applied to set aside the Ex Parte Order contending that by reason of what it described as a supplemental award of CIETAC by two letters dated 18 and 20 November 2009, the return of the goods in the same status as and when they were originally received was a condition precedent to its obligation to pay the amount ordered under the award. Petrochina** alleged Hongri had refused to discharge its obligation to return the goods.

6. On 16 December 2009, Saunders J ordered that the sum of US$2,953,198 be paid into court pending a joint inspection of the goods by each party's expert. He further ordered upon satisfactory inspection that the goods are the original goods and upon the return of them to **Petrochina, the said sum be paid out of court to Hongri. Petrochina** paid into court the said sum on 23 December. Notwithstanding the payment, no successful arrangement was made to enable the return of the goods, so the funds have remained in court.

7. On 16 March 2010, Hongri applied by summons under Order 14A for trial of preliminary issues. The issues included the following: whether as a matter of law (1) the obligation of Hongri in paragraph 1 of the award and the obligation of **Petrochina** in paragraph 2 of the award are concurrent obligations; and (2) whether the two letters of CIETAC dated 18 and 20 November 2009 are binding on the parties as a supplementary award.

8. On 17 May 2010, Saunders J gave leave to **Petrochina** to amend its summons of 4 December 2009, to add seeking leave to enforce the whole of the award including paragraph 1.

9. On 6 August 2010, Saunders J made an order to vary the Ex Parte Order by granting leave to **Petrochina to enforce paragraph 1 of the award against Hongri and ordered Hongri do forthwith return to Petrochina** 3,810.578 tonnes of sulphur. He stayed execution of the judgment pending further order of the court and gave directions for a case management conference in respect of Hongri's summons under Order 14A dated 16 March.

10. On 21 January 2011, the Judge heard Hongri's Order 14A summons and Petrochina's amended summons of 18 May 2010. On 25 January, he gave his ruling on the three issues argued before him as follows:

(1) On the issue whether the obligation of Hongri in paragraph 1 of the award and the obligation of **Petrochina in paragraph 2 of the award are concurrent obligations, or whether the return of the sulphur is a condition precedent to payment, the Judge held that the obligation of Petrochina** to make payment of the sums awarded is not concurrent with Hongri's obligation to return the sulphur, but is subsequent to, and conditional upon the due performance of that obligation.

(2) On the issue whether the two letters of CIETAC dated 18 and 20 November 2009 are binding on the parties as a supplementary award, the Judge held that these letters and a third letter of CIETAC dated 30 March 2010 do not form part of the arbitral award.

(3) On the issue whether the Ex Parte Order should be set aside for material nondisclosure by Hongri, the Judge was satisfied there was no material nondisclosure.

11. The order made by Judge as a result of the above rulings, which is the subject of Hongri's appeal, is in these terms:

"1. Leave be granted to [**Petrochina**] to enforce paragraph 1 of the Arbitral Award … against [Hongri] in the same manner as a judgment of the High Court of the Hong Kong Special Administrative Region to same effect.

2. [Hongri] do forthwith return to[**Petrochina**] the original 3,810.578 tonnes of sulphur delivered under the contract … in the same status and quality as and when the same were received by [Hongri] ("the Delivery Obligation").

3. Leave be granted to [Hongri] to enforce paragraphs 2 to 6 of the Arbitral Award… against [**Petrochina**] in the same manner as a judgment of the High Court of the Hong Kong Special Administrative Region to same effect.

4. Judgment be entered that, upon due performance of [Hongri's] Delivery Obligation, [**Petrochina**] do pay to [Hongri] (a) the sum of US$2,953,198; (b) the sum of RMB 11,126.18; (c) the sum of RMB 350,002.58; (d) the sum of RMB 65,400; (e) the sum of RMB 243,160.40; (f) interest on the sum of US$2,953,198 at judgment rate from 22 October 2009 to the date of payment; and (g) interest on the sum of RMB 669,689.16 at judgment rate from 22 October 2009 to the date of payment.

5. There be a hearing on costs if agreement cannot be reached between [Hongri] and [**Petrochina**].

And it is ordered that the Order for stay of execution made by the Honourable Mr Justice Saunders dated 6 August 2010 be lifted."

12. Hongri filed a Notice of Appeal on 22 February 2011 against the above order, seeking to set aside paragraphs 2 and 4 thereof, and contending that the obligation of Hongri in paragraph 1 of the award and the obligation of **Petrochina** in paragraph 2 of the award are concurrent obligations and are to be performed independently of each

other. Further, Hongri seeks a declaration there is no requirement that it shall return the sulphur in the same status and quality as and when the same were received by it.

13. **Petrochina** filed a Respondent's Notice on 15 March 2011 seeking to vary paragraph 1 of the order to read "to enforce paragraph 1 of the Arbitral Award … as supplemented by the two letter of CIETAC … dated 18 and 20 November 2009", on the ground that the Judge had erred in holding that the said letters were not supplement to and did not form part of the Award.

14. As matters now stand, the disputes between the parties as to the quality of the goods in Hongri's possession waiting to be returned and whether they were the original goods delivered remain unresolved. Notwithstanding the stay of execution in August 2010 was lifted by the order made on 25 January 2011, no order has been made to enable execution of the judgment that has been entered as a result of the ruling of Saunders J in January 2011.

15. On 17 March 2011, Petrochina's solicitors wrote to Hongri's solicitors requesting security for costs of the appeal in the region of HK$713,050, on the basis Hongri is ordinarily resident out of Hong Kong and the appeal has no merits. Hongri's solicitors replied on 24 March 2011 declining to provide security and stating, among other reasons, no security for costs should be made as the court is dealing with enforcement procedures arising out of Order 73 of the Rules of the High Court. Petrochina's solicitors replied to this on 3 May 2011 and issued the present summons seeking security on 6 May.

16. In the hearing before me, Mr Lai appeared on his own to present oral submissions for Hongri. **Petrochina** appeared by its solicitor Mr Simon Wong.

The grounds of opposition

17. Hongri raised a number of grounds in opposition. Other than the first ground, which I have mentioned at the outset, the other three were:

(1) Hongri has reasonably strong merits in the appeal;

(2) Hongri has sufficient assets within the jurisdiction, being the sums paid into court by **Petrochina** in the total amount of US$3,025,198 (being the totality of the sums under paragraphs 2 to 6 of the award); and

(3) **Petrochina** has delayed in taking out this application.

18. Hongri's counsel also submitted that the amount of security sought in the sum of HK$713,050 is excessive. Firstly, the estimated costs should be reduced as a substantial part relates to the Respondent's Notice. Secondly, the estimated costs are grossly inflated.

19. I propose to deal with the other grounds of opposition first before I turn to the main ground. The question of quantum will be dealt with last.

Merits in the appeal

20. I do not propose to set out the arguments raised in the Notice of Appeal and Hongri's submissions why paragraphs 2 and 4 of the order should be set aside. Suffice it to say on a preliminary assessment I regard the grounds of appeal as reasonably arguable, but I do not think the higher threshold of strong grounds of appeal is met.

21. **Petrochina** has contended the appeal has no merits to support its argument that the court should exercise discretion to order security for costs in these circumstances. For the same reason as above, I do not think this is made out.

22. My preliminary assessment is that the merits in this appeal do not go strongly one way or other. Hence, I will not take into account the strong merits as contended by Hongri in deciding whether to refuse security, nor will I take into account the lack of merits as contended by **Petrochina** in considering whether to award security.

Assets within jurisdiction

23. Hongri contended that the total sums paid into court by **Petrochina of US$3,025,198 are an asset of Hongri, as it has always been in the position to return the goods and the non-fulfilment of the Delivery Obligation is solely attributed to Petrochina's unreasonable behaviour and unfounded allegation. Hence, the sums paid into court can be used to set off any potential claim of Petrochina** in costs. Other than these sums, there is no evidence Hongri has any assets in Hong Kong.

24. Hongri's counsel further submitted that paragraph 1 of the award amounts to an order for specific performance against Hongri to deliver the goods to **Petrochina. In the event the order for specific performance has become impossible to be enforced, the court may substitute damages. So even if there had been deterioration of the goods which renders it impossible to return the goods in the same status and quality as and when the same were received by Hongri, the court may provide for remedies such as compensation or abatement to achieve practical restitution and justice. On the evidence adduced by Hongri, and assuming the goods have now become worthless, the maximum amount of damages Petrochina could recover would be US$1,084,716, not taking into account that the goods had been defective when first received by Hongri. After deducting US$1,084,716 from the sums paid into court, the remaining sum of US$1.9 million odd is more than sufficient to meet any claim of costs by Petrochina**.

25. Mr Wong submitted for **Petrochina the effect of the order under appeal is that if Hongri fails to return the goods in the same status and quality as and when the same were received by it, Hongri does not have the right to demand the sums paid into court. As the order under appeal is valid and subsisting, Hongri does not have any**

right or interest in those funds. He contended that the effect of paragraphs 1 and 2 of the award is to put the parties into the same situation as if the contract had been nullified and for this to happen, the remedy is possible only if restoration to the status quo ante is feasible. As Hongri has not yet performed the Delivery Obligation, it has no right to enforce payment for the goods, and no right to apply the sums paid into court to meet any claim of costs by Petrochina.

26. As to the remedies in equity where it has become impossible to enforce specific performance, Mr Wong submitted the parties are bound by the terms of the award. If Hongri cannot comply with the Delivery Obligation and requests for an order for payment, then it would need to apply to the arbitral tribunal or the PRC Court for appropriate relief.

27. Security for costs of the appeal is to cater for the situation where Hongri is liable for Petrochina's costs. This situation will arise where the above contentions along the lines developed above by Mr Wong are upheld. So for this reason, I do not think it appropriate for present purpose to regard the sums paid into court as the assets of Hongri readily available to meet its costs liability to **Petrochina** in the appeal.

Delay in application

28. I propose to deal with this shortly. There is a gap between 24 March 2011 (the date of the letter of Hongri's solicitors refusing to provide security) and 3 May 2011 (the date of the letter of reply of Petrochina's solicitors). The present summons was issued on 6 May and the appeal is to be heard on 13 July 2011. Petrochina's solicitors explained that the period of inaction was due to the intervening Easter holidays and Labour Day holiday and the absence on leave of the handling solicitor. I do not think the delay is such that I should exercise my discretion to refuse security.

Security for costs on appeal in enforcement of foreign arbitral award

29. I come to the principal ground of opposition.

30. It is pertinent to bear in mind these matters which are not controversial.

31. Order 59 rule 10(5) provides that the Court of Appeal "may, in special circumstances, order that such security shall be given for the costs of an appeal as may be just." The overriding consideration that the rule requires is whether "special", not exceptional, circumstances exist making it just to order security (*Chung Kau v. Hong Kong Housing Authority & Ors.* [2004] 2 HKLRD 650 at 656H, para. 14(4)).

32. As stated in the *Hong Kong Civil Procedure 2011*, Vol. 1, para. 59/10/28, the principles governing the award of security for costs at the stage of the Court of Appeal are wider and stricter than those applicable to the award of security for costs in the court below. The categories of "special circumstances" for this purpose are not closed. In deciding whether to award security for the costs of an appeal to the Court of Appeal, the

court takes into account the fact that the appellant has already had the issue concerned determined in the court below, and it is prima facie an injustice to the respondent to allow an appeal to the Court of Appeal to proceed without security for costs being furnished in circumstances where the respondent will be unable to enforce against the appellant any order for costs made by the Court of Appeal.

33. The rationale for the practice of ordering security where the appellant is resident abroad is undue delay or expense in enforcing the costs order abroad. This is not based on any intention to discriminate against foreign appellants. The presumption that it is difficult to enforce the costs order abroad may be disproved by the appellant, in which case security will not be ordered (*Hong Kong Civil Procedure 2011*, para. 59/10/31).

34. Where special circumstances exist, as where the appellant is resident abroad, the court still has a residual discretion not to order security if the appellant could demonstrate counterveiling factors which would militate against such an order being made (*Chung Kau v. Hong Kong Housing Authority & Ors.*, at 656D, para. 14(2)).

35. A common counterveiling factor is the merits of the appeal. I have found against Hongri on this, holding that it has not met the higher threshold of strong grounds of appeal.

36. Hongri submitted that another counterveiling factor I should take into account is that security is sought against an award creditor in the context of the enforcement of an international arbitration award.

37. As I understand the submissions of Hongri's counsel, founded largely on the decision of the English Court of Appeal in *Gater Assets Ltd. v. NAK Naftogaz Ukrainiy* [2007] 2 Lloyd's Rep 588, they did not argue strongly there is no jurisdiction for the Court of Appeal to order security for costs in an appeal. Their primary submission is that security should not be ordered in this situation as a matter of discretion.

38. They drew my attention to the judgment of Moser LJ in *Gater Assets*, paras. 92 and 93, in which the judge concluded the court did not have jurisdiction to order security for costs against an award creditor in proceedings to set aside an order to enforce a foreign arbitral award. Rix LJ assumed but did not decide there is technical jurisdiction to order security for costs against an award creditor and decided the appeal on the basis of discretion (paras. 75 and 88). Buxton LJ, who was in the minority, was of the view that the English court did possess jurisdiction to order security for costs and should exercise its discretion to order security in the enforcement proceedings.

39. I am inclined to think there is jurisdiction for the Court of Appeal to order security for costs in this appeal. My reasons are as follows.

40. Firstly, there is no statutory provision to remove the power conferred by Order 59 rule 10(5) in this situation. Nor is there any express provision that security for costs of an appeal may not be ordered in this context on the ground of foreign residence, similar to

section 56(2) or Schedule 2, section 7(2) in the new Arbitration Ordinance, Cap. 609, which came into operation on 1 June 2011.

41. Secondly, the cases of *T K Bulkhandling GmbH v. Meridian Success International Ltd.*, HCMP No. 4765 of 1998, Findlay J, 30 November 1998 and *FG Hemisphere Associates LLC v. Democratic Republic of the Congo & Ors*, HCMP No. 928 of 2008, Dep J Mayo, 22 October 2008 are distinguishable. In both these cases, the award debtor applied for security for costs against the award creditor in respect of an application by the debtor to set aside leave granted to enforce a foreign award. Findlay J referred to Order 73 rule 10A, which makes special provision for ordering security *against* a debtor seeking to set aside the ex parte order giving leave to enforce the award, and made the point that if it were envisaged that a debtor involved in the Order 73 procedure should be permitted to apply for security for costs against the award creditor, that would have been provided in rule 10A. The judge did not think this omission was accidental and was satisfied that Order 23 did not apply to the enforcement procedures in Order 73. In the second case, Dep J Mayo agreed with Findlay J and also followed the majority decision in *Gater Assets*. He too held Order 73 must take precedence over Order 23.

42. *Gater Assets* was not concerned with the jurisdiction of the Court of Appeal to order security for costs in an appeal. The present appeal is plainly not governed by the procedures in Order 73. As submitted by Mr Wong, procedural matters in this appeal are governed by Order 59 and are outside the regime of Order 73. The argument which found favour with Findlay J that Order 73 provides for a self-contained statutory regime governing procedural matters relating to the enforcement of arbitration awards does not apply to the stage of an appeal so as to exclude the jurisdiction to order security for costs in an appeal.

43. I turn to consider the matters relevant to the exercise of discretion urged upon me. As Dep J Mayo had remarked in *FG Hemisphere Associates LLC v. Democratic Republic of the Congo* at para. 15, the issues of jurisdiction and the relevant exercise of the discretion are to an extent inter-related.

44. Hongri's counsel pointed out that where an award creditor seeks to enforce an arbitration award under the New York Convention, the court must have regard to Article III of the Convention, which provides that each contracting state shall recognise arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon, under the conditions laid down in Articles IV to VI, and there shall not be imposed substantially more onerous conditions or higher fees or charges on the recognition or enforcement of arbitral awards to which the Convention applies than are imposed on the recognition or enforcement of domestic arbitral awards. They submitted that the jurisprudence applicable to Convention awards should apply equally to Mainland awards, as prior to the reunification on 1 July 1997, Mainland awards were Convention awards and the Convention only ceased to apply to Mainland awards after reunification because the PRC and Hong Kong are no longer separate members to the Convention vis-à-vis each other.

45. These matters are not controversial, and Mr Wong has not argued to the contrary.

46. Relying on *Gater Assets*, Hongri's counsel made the point that in the case of the enforcement of a domestic award, an award debtor would not in principle be entitled to security for costs, so that to impose security for costs against an award creditor who seeks enforcement of a Convention award would be to impose substantially more onerous conditions than were imposed in the case of domestic awards and is in breach of Article III of the Convention. Further, under the Convention, an award creditor is entitled as of right to enforce his award subject only to the narrow exceptions allowed, as this is part of an international agreement to make international arbitration attractive and efficient. To require an award creditor to provide security for costs before he can enforce his award would seem to run counter to the essential basis of the Convention, and derogates from the requirement in Article III that enforcement be accorded under the conditions laid down in Articles IV to VI (paras. 72, 80 and 81, per Rix LJ).

47. Hongri's counsel submitted that the same reasoning and policy consideration should apply to the Mainland award here, and should militate against the exercise of discretion in ordering security for costs in this appeal. As in Convention awards, an award creditor of a Mainland award is entitled as of right to enforce his award subject only to the same narrow exceptions allowed. They submitted further that the "rules of procedure of the territory" in Article III should include the appeal procedures. So to order security for the costs of an appeal against an international award creditor on the ground of foreign residence is to place such a creditor in a worse position than in the case of enforcement of domestic awards. This lacks justification and is against the spirit of promoting international arbitration.

48. Petrochina's answer to the above is that this opposition is entirely irrelevant, as when this appeal is heard by the Court of Appeal, one has gone past the stage at which the award is registered and becomes enforceable as a local judgment. Hongri is appealing against the determination of preliminary issues made by the court below in granting leave to enforce the whole of the award. The Court of Appeal is not concerned with the enforcement of the award. There is no reason why the general considerations mentioned earlier governing the exercise of discretion in requiring security for costs on appeal should not apply in the case of this foreign appellant.

49. I do not find this an easy decision. In the end, I am persuaded by the submissions of Hongri. The award may now be entered as a judgment with the leave granted by the court but judgment has not been executed. I do not think it is correct to say that the Court of Appeal is not concerned with the enforcement of the award, as the preliminary issues decided against Hongri being the subject of the appeal would have a bearing on the execution of the judgment and the execution stage in the enforcement of the award has not been carried out. I am inclined to think that the same considerations militating against the ordering of security for costs against a foreign award creditor in the earlier stage of the enforcement of an award should also apply to the present stage, and this should be a sufficient counterveiling factor against requiring Hongri to provide security.

It would not be appropriate to impose a further condition on Hongri in its enforcement of the award by requiring it to provide security for costs on appeal.

50. I will exercise my discretion to decline ordering security in this situation.

Quantum

51. In view of the above decision, it is unnecessary to deal with Hongri's submissions on quantum.

Orders

52. I dismiss the application for security for costs of this appeal. I make an order *nisi* that **Petrochina** is to pay the costs of Hongri in this application in any event on a party and party basis, with a certificate for two counsel.

(Susan Kwan)
Justice of Appeal

Mr Adrian Lai, instructed by Hogan Lovells, for the Applicant

Mr Wong Chi Man Simon, of Mayer Brown JSM, for the Respondent