

LANDMARK HONG KONG COURT OF APPEAL DECISION ON DISPUTE RESOLUTION CLAUSES HAS GLOBAL IMPLICATIONS FOR CONTRACT DISPUTES

07 June 2022 | Hong Kong
News

Leading international law firm Herbert Smith Freehills has succeeded in a landmark case on escalation clauses in arbitration agreements before the Hong Kong Court of Appeal that will have significant consequences and could deliver cost savings for commercial contract disputes globally.

Many commercial contracts contain "escalation clauses" - which require negotiation or mediation before either party can begin formal proceedings. These clauses are intended to promote the efficient resolution of disputes, but often lead to costly litigation.

Where the dispute is ultimately referred to arbitration, an argument about compliance with the escalation mechanism can derail proceedings, leaving any decision of the arbitrators vulnerable to challenge in the courts.

Earlier today (7 June), the Court of Appeal in Hong Kong resolved this issue by finding that any dispute about escalation clauses should be resolved by the arbitrators chosen by the parties, not the courts.

In other words, the arbitration tribunal's findings on this issue will be final and binding and cannot be used as a basis to challenge the award.

[Simon Chapman QC](#), Herbert Smith Freehills Asia head of disputes, appeared as advocate before the Court of Appeal and at First Instance, and commented:

"This is a hugely significant ruling, with important practical consequences around the world. Hong Kong is a model law jurisdiction, with arbitration legislation similar to that adopted in over 100 other jurisdictions.

"Today's ruling is the highest authority on this point in any model law jurisdiction, so commercial parties around the world can now have confidence that their arbitration agreements will be upheld, even if there are questions about compliance with contractual pre-conditions to arbitration.

"The international significance of this case is also reflected by the body of case law and academic writing from across the world cited in the judgment, including authorities from the United States, Australia, England & Wales, and Singapore, as well as prior rulings from the Hong Kong courts."

A full copy of the judgment has been uploaded to the Hong Kong judiciary website and can be found [here](#).

For more details on the history and background to the case, read the full articles on our [Arbitration blog](#) or [Asia Disputes blog](#).

What does this mean in practical terms?

There are three key takeaways from today's ruling:

1. **An allegation that a party has failed to comply with a pre-condition to arbitration should not prevent the case from moving forward.** Ultimately, it will be for the arbitrators to determine whether the clause has been complied with and, if not, what the consequences of that should be. The tribunal still retains jurisdiction to hear the dispute, and so any award cannot subsequently be challenged before the courts on this point. This brings much greater certainty (and finality) to the process, and should avoid costly and protracted litigation.
2. **This does not mean that escalation clauses are not enforceable.** Arbitral tribunals can take many different steps to ensure that escalation clauses are respected. They can, for example, decline to hear a dispute until the parties have complied with the contract. They can adjourn proceedings to allow negotiation or mediation to take place. They can impose cost sanctions on the party that has breached the escalation provision. Or they can proceed to hear the dispute regardless, on the basis that compliance with the clause was likely to be futile. The key point is that, now, these are questions for the arbitrators alone to decide, and whatever decision they make should not lead to further review by

the courts.

3. **There may be certain (limited) exceptions to this rule.** Although today's ruling will apply to the vast majority of escalation clauses, the Court of Appeal made clear that in each case the question is to be answered by ascertaining the intention of the parties. There may be extreme circumstances where the contract makes clear that failure to follow the escalation mechanism will have jurisdictional consequences. For example, a contract could in theory stipulate that, before any dispute is to be referred to arbitration, the parties must negotiate in good faith for a period of 30 days, and that any subsequent arbitral tribunal will lack jurisdiction to hear the case unless these provisions are strictly met. Such drafting is exceptionally rare, however, and would not be recommended (indeed, it would create a recipe for precisely the sort of costly litigation that today's Court of Appeal ruling is designed to prevent).

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



SIMON CHAPMAN
QC
REGIONAL HEAD OF
PRACTICE - DISPUTE
RESOLUTION, ASIA,
HONG KONG
+852 21014217
Simon.Chapman@hsf.com



JOJO FAN
PARTNER, HONG
KONG
+852 28456639
Jojo.Fan@hsf.com



KATHRYN SANGER
PARTNER, HONG
KONG
+852 21014029
kathryn.sanger@hsf.com



MAY TAI
MANAGING PARTNER,
ASIA, HONG KONG
+852 21014031
may.tai@hsf.com

MEDIA CONTACT

For further information on this news article, please contact:

**CORINNE MCPARTLAND, HEAD OF
COMMUNICATIONS, UK & US**

LONDON

Tel: +44 20 7466 2057

Mob: +44 7912 394 304

Email: corinne.mcpartland@hsf.com

**KELLY MURRAY, EXTERNAL
COMMUNICATIONS LEAD**

SYDNEY

Tel: +61 2 9322 4472

Mob: +61 429 115 625

Email: kelly.murray@hsf.com

**SALLY GREIG, HEAD OF
COMMUNICATIONS, ASIA**

HONG KONG

Tel: +852 21014624

Email: sally.greig@hsf.com