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The loser pays it all: Hong Kong Court of Appeal confirms principle of indemnity costs for failed set aside application

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The Hong Kong Court of Appeal recently awarded indemnity costs against an applicant who attempted unsuccessfully to set aside an arbitral award. In a decision that many will welcome, the Hong Kong court has sent another strong message of support for the finality of the arbitral process.

In *Pacific China Holdings Ltd v Grand Pacific Holdings Ltd* CACV 136/2011, the Hong Kong Court of First Instance set aside an ICC award in favour of Grand Pacific, a Hong Kong-based investment company, on the basis of breaches of Article 34(2)(a)(ii) and (iv) of the UNCITRAL Model Law. The Court held that Pacific China had been "unable to present its case", and that the arbitral procedure was "not in accordance with the agreement of the parties".

In May 2012, the Hong Kong Court of Appeal unanimously overturned the decision and reinstated the award, finding that the matters complained of did not constitute grounds for setting the award aside under Article 34(2) of the UNCITRAL Model Law. The Court clarified that "only a sufficiently serious error" undermining due process could be regarded as a violation of Article 34(2)(a)(ii) (the principal ground on which Pacific China had based its application). In order to establish a breach, it must be shown that the tribunal's conduct was of a "serious" or even "egregious" nature. The Court also placed heavy emphasis on the wide, discretionary case management powers of the arbitral tribunal. Click here for a copy of the judgment.

In a separate decision , the Court of Appeal ordered Pacific China to pay Grand Pacific's costs from the court below and the Court of Appeal proceedings on the indemnity basis.

The Court of Appeal adopted the approach of the Hong Kong Court of First Instance in *A v R* [2009] 3 HKLRD 389 and its own approach in *Gao Haiyan & Anor v Keeneye Holdings Ltd & Anor (No 2)* [2012] 1 HKC 491, holding that, in proceedings arising out of or in connection with arbitral proceedings (for example, an unsuccessful application to challenge or resist enforcement of an arbitral award), and in the absence of special circumstances, the Court will normally consider it appropriate to order costs on an indemnity basis.

The Court cited Reyes J in *A v R*; where a party unsuccessfully makes such an application, he should **in principle** (emphasis added) expect to pay costs on a higher basis, because a party seeking to enforce an arbitral award should not have to contend with such a challenge. If the losing party is made to pay costs on a conventional party-to-party basis only, the winning party would in

effect be “subsidising the losing party’s abortive attempt to frustrate enforcement of a valid award”. This would not be consistent with promoting just, cost-effective and efficient resolution of a dispute. In the Court’s view, the fact that Pacific China’s complaints against the arbitral award were considered by the court below and other overseas courts to be “reasonably arguable” was not a special circumstance.

The Hong Kong court’s approach was echoed in a recent U.S. decision. In *Digitelcom, Ltd v Tele2 Sverige AB* (No.12 Civ.3082), a New York court sanctioned a law firm, after finding that a motion to vacate an ICDR award against its client caused “unnecessary expense”. Normally, parties to New York litigation bear their own costs. However, in this case, one of the parties applied for costs on the basis that counsel on the other side had multiplied the proceedings “unreasonably and vexatiously”. The judge imposed costs on the opposing counsel and noted that, where parties agree to arbitration as an efficient and lower-cost alternative to litigation, both the parties and the system itself should respect the finality of the arbitration award. Litigants must therefore be discouraged from defeating the purpose of arbitration by bringing petitions based on mere dissatisfaction with the tribunal’s conclusions.

While the Grand Pacific costs decision no doubt underscores the “arbitration friendliness” of the Hong Kong courts, it is interesting to compare it with the position in a number of other arbitration-friendly jurisdictions, e.g. England & Wales and Australia.

In *Grand Pacific*, the Hong Kong Court of Appeal considered, but ultimately departed from, a decision of the Court of Appeal of Victoria (Australia). In *IMC Aviation Solutions Pty Limited v Altain Khuder* [2011] VSCA 248(the “IMC decision”) the Victorian Court of Appeal expressly declined to adopt the approach of Reyes J in *A v R*, holding that there was nothing in the Victorian civil procedure statute or in the nature of enforcement proceedings for arbitral awards which, of itself, warranted costs being awarded against an unsuccessful party on a basis different from that on which they would have been awarded in other civil proceedings.

In Australia, costs are ordinarily awarded against the unsuccessful party on a “party-and-party” basis, unless special circumstances can be established by the successful party. The special circumstances usually involve misconduct, for example where a party has maintained a cause of action with no real prospect of success (*Fountain Selected Meats (Sales) Pty Ltd v International Produce Merchants Pty Ltd* (1988) 81 ALR 397), or with wilful disregard for known facts or clearly established law (J-*Corp Pty Ltd v Australia Builders Labourers Federation Union of Workers (WA) (No2)* 1993 46 IR 301).

In England, costs are always in the court’s discretion, under Rule 44.3 of Civil Procedure Rules. Although the discretion is wide, case law demonstrates that indemnity costs tend to be ordered only when there is some culpability or abuse of process, or something “out of the norm”, on the part of the paying party. When considering an application for the award of costs on the indemnity basis, the court is concerned, principally, with the losing (paying) party’s conduct of the case, rather than the substantive merits of its position. Examples of conduct which may give rise to indemnity costs include a claimant acting unreasonably in trying to delay the trial of an action (*Naskaris v ANS Plc* [2002]EWHC 1782) or changing its case constantly throughout the proceedings and producing wholly unacceptable volumes of documentation (*ABCI v BFT* [2002] EWHC 567 Comm). To justify an indemnity costs order, the litigant’s conduct must amount to “misconduct deserving moral condemnation”, or be unreasonable to a high degree, and not just be wrong or misguided in hindsight (*McPhilemy v Times Newspapers No 2* [2001] EWCA Civ 993). An order for indemnity

costs is not justified by the mere fact that the paying party has been found to be wrong, either in fact or in law, or both, or by the fact that, in hindsight, the result of the case now being known, the position adopted by that party may be thought to have been unreasonable (*Healy-Upright v Bradley & Another* [2007] EWHC 3161).

In the context of arbitration, the English courts will generally award indemnity costs where proceedings are brought in breach of a binding arbitration agreement: see *A v AJ and others* [2007] EWHC 54 (Comm), in which the court confirmed that, as a general principle the appropriate costs order in such circumstances will usually be indemnity costs. In another case, the English court rejected a party's application to set aside an arbitration award on the ground that no dispute existed because the party had admitted liability. The court took the view that, if a party admits liability for a specific claim but does not render payment, there is a sufficient dispute for the matter to be referred to arbitration. Costs were awarded to the respondent on an indemnity basis, on the grounds that the applicant had acted in its own perceived commercial interest and without merit, and should pay the commercial price of doing so (*Exfin Shipping (India) Ltd. Mumbai v. Tolani Shipping Co. Ltd Mumbai*, [2006] EWHC 1090 (Comm)).

However, there are still cases in which the English courts have declined to award indemnity costs in an unsuccessful application to set aside an arbitral award, despite the fact that the application was unmeritorious. In *Price Waterhouse SARL and PWE Conseil SARL v. PricewaterhouseCoopers International Limited* [2010] (Unreported), the court held that the circumstances were not sufficiently "outside the norm", nor demonstrated such a high degree of unreasonableness, as to justify an award on the indemnity basis.
It will be interesting to see whether other courts follow the Hong Kong line of authority. Having been refused leave to appeal by the Hong Kong Court of Appeal, Pacific China is seeking leave from the Court of Final Appeal on the set aside application, and has indicated its intention to seek leave from the Court of Final Appeal on the indemnity costs issue.
In the meantime, the Hong Kong Court of Appeal's decision is a further reminder to think very carefully indeed before applying to set aside, or resist enforcement of, an arbitral award in Hong Kong – or be prepared to pay the price of failure.

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