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Hong Kong: ADR Clauses and a Duty to Negotiate in Good Faith
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Hong Kong has one of the most modern and enlightened arbitration laws in the world. Litigation (and indeed arbitration) costs in Hong Kong are prohibitive. There are over 300 qualified and accredited mediators in Hong Kong. They have honed their skills in a number of simulated mediations and their names are readily available on a list at the Hong Kong International Arbitration Centre.

Nevertheless, until now, only a small number of them have ever had the opportunity to mediate a real dispute.

The Hong Kong government pilot project in family law cases was a notable success, but funding problems prevented its continuation. The Hong Kong Mediation Council has done a great deal to foster the knowledge and use of mediation, including two free (or nearly free) schemes for the construction and insurance industries. So far however, there have been no takers. ADR, except in exceptional cases, has simply not shown up on the radar screen. Despite its excellent reputation in the arbitration world, in terms of alternate dispute resolution Hong Kong is still in its infancy.

That infant however, is about to come of age – thanks to pressures from both ends of the litigation line: the clients and the judiciary. From the client's standpoint, contracts for large construction projects in Hong Kong now frequently contain ADR clauses, stipulating recourse to mediation or some other form of non-binding technique as a prerequisite to litigation or arbitration. At the other end of the spectrum, Hong Kong's judges are sending some compelling messages encouraging the use of ADR.

The Chief Justice's Working Party on Civil Justice Reform, in its Report of March this year, was supportive of mediation on a voluntary basis, although it did not go so far as to recommend any kind of court-ordered ADR.[2] Then Reyes J., in the case of *Hyundai Engineering & Construction Co Ltd v Vigour Ltd (2004)* addressed the relationship between mediation and arbitration. The *Hyundai* case involved a construction dispute which one party refused to negotiate unless the other would give up its right to arbitrate or litigate. They did sign an agreement that stipulated, "... failing an ultimate agreement then both parties shall agree and submit to Third Party Mediation procedure which shall be conducted and completed as soon as possible and in any case no party will exercise the right to sue..." No agreement ensued, and eventually Reyes J was asked to consider the enforceability of the ADR clause.

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[2] The Final Report of the Judicial Working Party on Civil Justice Reform appeared in March 2004. The judges recommended that Legal Aid be able to make mediation a condition of receiving a certificate, using costs as a penalty for unreasonable refusal to mediate, and instituting court-facilitated mediation. For fuller information, see Alder, E, *Mandatory Mediation for Commercial Disputes in Hong Kong?* Hong Kong Lawyer, June 2004.

Article 8 of the UNCITRAL Model Law (adopted in Hong Kong) provides for a stay of state court proceedings in favour of arbitration, but not of ADR, so that a judge staying in favour of an ADR clause would do so by relying on inherent jurisdiction to prevent an abuse of process. Reyes J had to consider whether the ADR clause constituted merely "an agreement to agree" – and historically such agreements were not enforceable[3]. Developments in other jurisdictions however[4], have eroded that premise. Reyes J referred to the continental concept of "good faith" in adjudicating commercial disputes, and to the concern of English courts to ensure that fiduciaries do not act in bad faith towards beneficiaries. In light of this experience he said, "...it is difficult to see why an English or Hong Court should have any real difficulty in assessing whether parties have objectively acted in a spirit of cooperation and good faith." Citing Queensland's Judge Kirby,[5] Reyes J said there is no blanket rule against the enforcement of all agreements to agree. Rather, the court needs to ask whether there are objective criteria against which reasonable compliance with the agreement can be assessed. If there are such criteria, the agreement may be enforced.

In reaching this conclusion, the judge also considered the Judicial Working Party Report's Proposal # 674, recommending that judges be empowered to make adverse costs orders in cases where mediation has been unreasonably refused, saying:

> *"It would be odd and contrary to commonsense expectation for the law to say that, if one side deliberately flaunts the agreement by not participating in mediation at all, the bargain cannot be enforced and the time and expense which both parties sought to minimise by agreeing to mediate cannot be avoided. ...It would be equally strange for the Court to say that in all cases an agreement to mediate...is unenforceable, while the Court reserves to itself a power to penalise a party in costs for failing to mediate..."*[6]

Shortly after the *Hyundai* case, the Hong Kong Court of Appeal released its decision in *Kenon Engineering Ltd v Nippon Kokan Koji Kabushiki Kaisha (NKKK)*[7] in May 2004. A dispute between a sub-contractor and a specialist sub-contractor on a remeasurement contract gave rise to a series of actions. Their contract contained an unfortunately drafted dispute resolution clause:

> *"21.1 All disputes...shall finally be settled by the Mediation Procedure under the laws of Hong Kong /SAR of PRC. The award rendered by the mediation procedure shall be final and binding on both [parties]."*

One party sought a stay of the court action in favour of arbitration, or failing that, in favour of whatever mediation process *was* envisaged by clause 21.1. The Court of Appeal upheld the First Instance ruling that the clause was not an arbitration clause.

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[3] See *Courtney & Fairbairn Ltd v Tolaini Brothers (Hotels) Ltd.*,[1975] 1 WLR 297

[4] See *Cable & Wireless plc v IBM United Kingdom Ltd* [2002] All ER 1121

[5] *Coal Cliff Collieries Pty Ltd v Sijehama Pty Ltd* (1991) 24 NSWLR 1

[6] *Hyundai*, para 102-3

[7] [2004] HKEC 542, 2004 WL 6184 (CA). On a separate issue, the Court of Appeal agreed with the lower court judge's characterisation of article 16 of the Hong Kong Ordinance as giving concurrent jurisdiction to determine the jurisdiction of the tribunal, to the arbitral tribunal and the Court.

While declining to interfere with the lower court's refusal to stay the court actions in favour of the clause 21.1 process, Pichon JA approved the criteria used by Reyes J in *Hyundai.*

In response to these developments, a Working Party has recently been formed under chairman Colin Wall, one of Hong Kong's few mediators working full-time in the field. The group will follow up the Proposals of the Judicial Report as they can apply to the specialist construction and arbitration list.

We can expect within a few months, recommendations for the implementation of the Judges' Proposals, including broad powers of the Court to encourage and facilitate, if not to mandate, the use of mediation or other non-binding processes before cases go before the judge. With this in mind, the Hong Kong Mediation Council is working within the community on a series of seminars targeting various business sectors, in order to educate the public about mediation and to promote its acceptance.

The writing is on the wall. Sophisticated clients are insisting on ADR clauses for commercial reasons, and Hong Kong's judges have shown themselves willing to enforce those clauses. It should not be too long before most of those 300 mediators in Hong Kong have more work than they can handle.