L&P

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Current Legal Developments in Hong Kong

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In the following newsletter, we would like to inform you about the latest legal developments in Hong Kong. The main focus of this newsletter is on recent decisions regarding tax and arbitration law.

Hong Kong

I. Tax

Tax Haven Hong Kong – Blacklist Published

In June 2015, the European Commission ("**EC**") listed Hong Kong as a non-cooperative tax jurisdiction ("*Blacklist*"). The *Blacklist* currently names 30 countries and is part of the EC's "Action Plan" to reform corporate taxation in the European Union. Key objectives are to tackle tax avoidance and to enhance tax transparency.

On 18 June 2015, the Hong Kong government expressed its disappointment and rejected the allegations. It named specific reasons as to why Hong Kong is a cooperative tax jurisdiction:

- Hong Kong is a member of the "Global Forum on Transparency and Exchange of Information for Tax Purposes", and the peer reviews (completed in 2011 and 2013 respectively) recognise Hong Kong's commitment to meeting the international standards on tax transparency;

- Hong Kong has made serious efforts to expand its networks on "Comprehensive Avoidance of Double Tax Agreements" ("**CDTA**") and "Tax Information Exchange Agreements" ("**TIEA**"). It has signed 13 CDTAs and two TIEAs with EU member states, and negotiations with five other member states are ongoing.

II. Arbitration

1. Limited Rights to Appeal in Arbitration Cases upheld by Court of Appeal
[*China International Fund Ltd v Dennis Lau & Ng Chun Man Architects & Engineers (HK) Ltd* [2015] HKEC 1626]

a) The Case

The Hong Kong Court of Appeal ("**CA**") decided that the limitation on rights of appeal in arbitration cases under sec. 81 (4) of Hong Kong's Arbitration Ordinance [Cap. 609] ("**AO**") is constitutional.

The unsuccessful party of an arbitration applied to the Court of First Instance ("**CFI**") to set aside the award. The CFI ruled against the Applicant. Subsequently, the Applicant sought leave to appeal from the CFI to the CA. According to sec. 81 (4) AO, the leave of the CFI is required for any appeal from a decision of the court regarding decisions of an arbitral tribunal. The CFI rejected the application.

Therefore, the Applicant applied to the CA for leave to appeal to the CA, claiming sec. 81 (4) AO would violate the constitution.

b) The Decision

The CA ruled that sec. 81 (4) AO is constitutional. The provision is necessary to preserve the goals of arbitration: a fast and final decision due to the swiftness of arbitration. It falls within the sole jurisdiction of the CFI to rule on applications for leave to appeal against

decisions regarding enforcement of arbitrational awards.

The CA highlighted that the actual goal of arbitration proceedings (swift, final and less expensive) would be thwarted by allowing multiple leave applications. Therefore, the limitations on rights to appeal are consistent with the purpose of arbitrational proceedings. However, the CA also emphasized that it does retain jurisdiction to supervise the process in the CFI, but this jurisdiction will be invoked extremely rarely.

c) Comment

The decision underlines Hong Kong's positive approach towards arbitration. Hong Kong's courts recognise and protect the benefits of arbitration: fast, final and binding decisions that shall not be subject to endless appeals.

2. CPC Construction Hong Kong Limited vs. Harvest Engineering (HK) Limited and another [HCA 2096/2013]

a) The Case

"CPC Construction Hong Kong Limited" ("Plaintiff") subcontracted a construction project to "Harvest Engineering (HK) Limited" ("1st Defendant"). Mr. Lau ("2nd Defendant"- together: "the Defendants") was shareholder and director of the 1st Defendant. The subcontract between the Plaintiff and the 1st Defendant stipulated that all disputes were to be resolved by arbitration:

> *„All disagreements or disputes arising from this subcontract agreement shall be resolved by arbitration between the parties in accordance with the Arbitration Ordinance Cap. 341, after the completion of CPC's main Contractor after the termination of this subcontract agreement."*

After some time, the Plaintiff agreed to grant various loans to the 1st Defendant. The 2nd Defendant agreed to guarantee and indemnify the 1st Defendant's obligations under the agreements.

The loan agreements and the 2nd Defendant's guarantees did not include an arbitration clause but contained a jurisdiction clause referring to the non-exclusive jurisdiction of the courts of Hong Kong.

However, the Plaintiff recalled the loans in accordance with the loan agreements. The 1st Defendant did not comply, stating that the sums advanced by the Plaintiff were special payments.

The Plaintiff then applied for a summary judgement against the Defendants. The Defendants applied for a cross-summon to stay the proceedings in favour of arbitration and submitted a counterclaim regarding payments resulting from the subcontract.

b) The Decision

As the counterclaim arose directly out of the subcontract, the Court stayed the counterclaim's procedures in favour of arbitration.

Regarding the claim for repayment of the loans, the Court decided that it was not connected to the subcontract and therefore not subject to the arbitration clause.

However, this result would lead to court-based litigation regarding the repayment if the loans and arbitration regarding the counterclaim even though the issues overlap. Considering this, the Court asked the Plaintiff whether he would like the court to order a suspension of the court proceedings as long as the arbitration proceedings lasted to avoid duplication of time and resources and possible inconsistent results. The Court made clear that this would not mean staying the claim in favour of arbitration completely, i.e. the Court would not abandon the proceedings completely and let the arbitration decision stand in its place.

c) Comment

This case is another example of a Hong Kong court taking a proactive approach to try to avoid related arbitration and litigation proceedings in favour of arbitration.

III. Construction Industry

1. Proposed Security of Payment Legislation for the Construction Industry

a) Background

In the construction industry, unfair payment terms, payment delays and disputes are causing widespread problems and disputes between contractors, sub-contractors, suppliers and consultants.

Since 1996, "Security of Payment Legislation" („**SOPL**") has been introduced in the United Kingdom, Australia, New Zealand, Singapore, Malaysia and Ireland.

Hong Kong, considering similar legislation, published a consultation document on SOPL. The consultation period ended on 31 August 2015.

b) Contracts covered

According to the proposal, the SOPL will apply to written and oral contracts regarding construction works, consultancy services and the supply of materials for purposes in Hong Kong. The SOPL shall also apply to contracts between non-Hong Kong parties, and even if foreign laws govern the contract.

Coverage will be different in the public and private sector.

Public Sector – SOPL will apply to

- all contracts and subcontracts including maintenance and renovation notwithstanding the value of the contract.

Private Sector – SOPL will only cover

- construction contracts regarding a "new building", where the main contract has an original value of the costs of services of more than HKD 0.5 million;

- all subcontracts regardless of value when SOPL applies to the main contract

SOPL does not apply

- to the private sector procuring maintenance, repair, renovation and restoration works.

Therefore, the majority of individuals and small businesses procuring routine construction works will remain unaffected by SOPL.

2. Key Statutory Provisions

a) Removal of Unfair Payment Terms

Payment terms generally considered unfair, (in particular „pay when paid") will be prohibited. Payment periods

- of more than 60 calendar days (interim payments) or
- 120 calendar days (final payments) after a claim can be made

will be prohibited.

b) Right to make Statutory Payment Claims

The SOPL allows statutory "Payment Claims". If these are ignored or disputed, they can be taken to adjudication for a binding decision.

c) Adjudication of Disputes

Adjudication is a process where a third party adjudicator (comparable to arbitration) ren-

ders a binding decision without the delays and formalities of ordinary proceedings in court or arbitration.

Under SOPL, adjudication must be commenced within 28 calendar days of the dispute arising and concluded 55 working days from the day of appointment of the adjudicator unless both parties agree to a longer period.

The adjudication dispute may be taken to court ("*fresh start*") but the adjudicator's decision stands in the interim and can be enforced in court immediately.

d) Right to Suspend

A winning party of adjudication has the right to slow down work if the awarded amount is not being paid.

IV. Intellectual Property - Trademark Rights

„Sushi" or a Director's Fiduciary Duties
[Poon Ka Man Jason and Cheng Wai Tao [2015] HKEC 1600 / FAMV 22 of 2015]

a) The Case

Ricky Cheng, the siblings Jason and Daisy Poon and others were shareholders in the "Ajisen Group" which operated several Japanese restaurants in Hong Kong.

In 2004, Chen, the Poons and others founded "Smart Wave Limited" to manage the first "Itamae Sushi" restaurant in Kowloon. Cheng and the Poons were the three major shareholders of "Smart Wave Limited" and Cheng became the sole director.

Within the next two years, Cheng established six more companies operating six more "Itamae Sushi" restaurants in Hong Kong with Cheng being the sole director and shareholder of each company. These activities led to disputes between Cheng and the other shareholders at "Smart Wave".

Cheng and the Poons agreed on setting up "Hero Elegant Ltd.". Their rights as shareholders were outlined in a shareholder agreement. This company and its subsidiaries were founded to manage and operate the restaurants. However, Cheng did not transfer the shares to the company as agreed upon in the shareholder agreement and continued to run the restaurants mentioned above. Furthermore, Cheng established additional sushi restaurants named and marked "ITACHO SUSHI". The other shareholders sued Cheng for damages and breach of his fiduciary duties as director of the common company.

b) The Decision

The case has a long litigation history with the CFI ruling in favour of Cheng regarding the six "Itamae" restaurants but awarded damages to the Plaintiffs regarding the "ITACHO" restaurants. The court ruled that operating these competing and similarly named restaurants constituted a breach of the Defendant's fiduciary duties.

The CA, however, ruled that Cheng was in breach of his fiduciary duties regarding all restaurants (ITACHO and ITAMAE) and, therefore, allowed the appeal. It found that it was Cheng's fiduciary duty as a sole director to act in Smart Wave's best interest. Operating competing sushi businesses was not.

The CA refused the permission to appeal, so Cheng sought permission to appeal from the Court of Final Appeal which was granted to appeal two of the six submitted questions concerning the scope of a director's fiduciary duties.

c) Comment

The case demonstrates the difficulties regarding the scope of directors' fiduciary duties.

The new Hong Kong Companies' Ordinance ("**CO**") codifies various directors' duties. However, such duties remain subject to the established common law rules in Hong Kong. Among the director's fiduciary duties are

- the duty to act in good faith, i.e. a director has to act in the company's best interests;
- the duty to exercise powers for the purposes for which they are conferred;
- the duty to avoid conflicts of interest; and
- the duty not to make any personal profit out of their directorship.

We hope that the information provided in this newsletter was helpful for you.
If you have any further questions please do not hesitate to contact us.

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