

HONG KONG / JUDGMENT

A v. B AND OTHERS

[2024] HKCFI 751**COURT**

Court of First Instance

DECIDED

13 March 2024

CASE / FILE NUMBER

HCCT26/2023

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bjbj HCCT 26/2023

**[2024] HKCFI 751 [redacted copy] IN THE HIGH COURT OF THE HONG KONG SPECIAL
ADMINISTRATIVE REGION COURT OF FIRST INSTANCE CONSTRUCTION AND
ARBITRATION PROCEEDINGS NO 26 OF 2023**

IN THE MATTER of Enforcement of an arbitration award

BETWEEN A Applicant and B 1st Respondent C 2nd Respondent D 3rd Respondent

Before: Hon Mimmie Chan J in Chambers Date of Hearing: 22 December 2023 Date of Decision:
22 December 2023 Date of Reasons for Decision: 13 March 2024

REASONS FOR DECISION

Background

On 12 May 2023, this Court granted leave to the Applicant () to enforce an award dated 25 August 2022 (Award) made by the sole arbitrator in an arbitration commenced by A against the Respondents at the International Center for Dispute Resolution, under the Rules for International Commercial Arbitration of the American Arbitration Association (Arbitration). Under the Award, the Respondents were, firstly, held to be jointly and severally liable to pay to A royalty fees and other charges under the Licence Agreements made between A and the 1st Respondent (Licensee). Further, the Licensee, the 2nd and 3rd Respondents were prohibited

from engaging in any educational business (as specified in the Award) (Injuncted Activities) at any location in Hong Kong. On 23 June 2023, the Respondents applied to set aside the leave granted by the Court (Enforcement Order), on the stated grounds that the arbitral procedure was not in accordance with the parties agreement, it would be contrary to the public policy of Hong Kong to enforce the Award, and that there was material non-disclosure on A s part in obtaining the Enforcement Order. At the conclusion of the hearing on 22 December 2023, this Court set aside the Enforcement Order, and the following sets out my reasons. The Arbitration related to 3 licence agreements (Agreements) executed between A and the Licensee for the Licensee s operation of learning centers which adopted and used the XXXXXX System Centers). A is a Maryland corporation with its principal place of business in Maryland USA, and is the franchisor of supplemental education businesses providing courses outside the school environment. It has established hundreds of centers and satellite locations, with licensees throughout the USA and other countries. The Licensee is a Hong Kong company, and was the corporate licensee of A for many years. The 2nd Respondent () and 3rd Respondent () are the shareholders of the Licensee and the operators of the Centers under licence from A. In dispute are the 3 Agreements dated 31 August 1994 and 29 October 1999 for operation of the Centers in different locations in Hong Kong. The Agreements were signed by C on behalf of the Licensee as its Managing Director. It is not disputed that on 1 February 2020, the Licensee closed all the Centers in Hong Kong, and C and D commenced operation of another education centre (X Centers) through a separate company (). The X Centers were operated out of the same locations as the Centers operated by the Licensee. A relies on a notice dated 25 February 2022 from the Licensee (Termination Notice), which terminated the Agreements. In the Arbitration, A sought: payment of royalty fees due under the Agreements for the period of 1 February 2020 (when the Centers were closed) to 31 March 2022 (which A claims to be the effective date of termination of the Agreements under the Termination Notice), in the total sum of US \$251,050.38. A also sought an injunction against the Respondents to restrain them from operating learning centers for a period of 2 years in Hong Kong from 31 March 2022, and arbitration costs and expenses of US \$380,496.61. A s claims against C and D in the Arbitration were on the basis of their being guarantors of the liabilities of the Licensee under the Agreements. In the proceedings before this Court, it was not disputed that the issues raised for determination in the Arbitration were: whether C and D had personally guaranteed the liabilities of the Licensee under the Agreements (Guarantee Issue); the applicability and enforceability of the restrictive covenant under the Agreements (Non-Compete Covenant Issue) and the liability and quantification of the damages payable by the Respondents (Breach Issue). The Award was in favor of A on all the issues, but the Respondents claim that the arbitrator had failed to give any reasons for her decisions. The Award simply made findings and conclusions, without any analysis of the Guarantee, Non-Compete Covenant, and Breach Issues at all. Failure to give reasons The principles applicable to the Court s consideration of a challenge against enforcement of an award on the ground of the tribunal s failure to give adequate reasons have all been set out in R v F [2012] 5 HKLRD 278, Z v Y [2019] 1 HKC 244, and LY v HW [2022] HKCFI 2267, and need not be repeated here. Awards are to be read generously, in a reasonable and commercial way expecting, as is usually the case, that there will be no substantial fault that can be found with it, and always bearing in mind the policy

of minimal curial intervention as highlighted in *AI & ors v LG II* [2023] 4 HKC 135. Any inference that a tribunal has failed to consider an important issue is to be made only if it is clear and virtually inescapable. However generously the Award in this case is read, I have to agree with the Respondents, that objectively read and in the context of the issues raised and submissions and arguments made before the tribunal, the arbitrator failed to adequately explain in the Award the reasons for her conclusions made on the key issues raised in the Arbitration, of the applicable governing law of the Agreements, on the effective date of termination of the Agreements, and on the enforceability or the reasonableness of the Non Compete Covenant, all of which were disputed by the parties. Non-Compete Covenant Issue: governing law As pointed out by Counsel for the Respondents, the enforceability of the Non-Compete Covenant was a key and central issue in dispute between the parties in the Arbitration. Clause 28 of the Agreements is a governing law clause, which provides that the Agreements are governed by the US Federal Arbitration Act and the laws of the State of Maryland. It appears that it was common ground in the Arbitration that under Maryland law, a contractual choice of law provision is not conclusive, and that the choice of law clause will not be enforced if: the chosen state has no substantial relationship to the parties or the transaction, or

- (2) the law of another state would apply in the absence of the particular choice of law provision; and
- (3) the application of the law of the chosen state would be contrary to a strong fundamental public policy interest of the other state which has a materially greater interest in the determination of the particular issue. The above was reflected in the Post-hearing Brief of A, where it was accepted that the above instances are exceptions to the honoring and enforcement of a choice of law provision, and also stated in the Post-hearing Brief of the Respondents, where it was contended that Hong Kong has a materially different interest than Maryland because the business which is the subject of the restrictive covenant is located in Hong Kong . On A s case, the last act necessary to make the Agreements binding on the parties was A s execution of the Agreements in Maryland, and Maryland law would apply even in the absence of the choice of law provision, and there is no need to weigh the laws of any other state. There were accordingly extensive arguments made before the tribunal as to whether Hong Kong law, or the law of Maryland, should govern the enforceability of the Non-compete Covenant. This turns (inter alia) on where the last act making the Agreements binding occurred. Both parties submitted that under Maryland s *lex loci contractus* rule, a contract is governed by the law of the place where the contract was made, and this depends on where the last act necessary to make the contract binding occurs. The Respondents argued that the last act was the signing and delivery of the Agreements by mail in Hong Kong, whereas A argued that the last act was the execution of the Agreements by A s representative, at A corporate headquarters in Maryland. In the Award, the arbitrator only stated on page 3, when describing how the Agreements were executed, that: (C) sent the signed License Agreements to Claimant (A) s corporate headquarters in Maryland where XXXXXXXXXXXX, an Assistant Secretary in (A) s legal department, signed each Agreement on October 29, 1999. License Agreement 5510 has an

effective date of August 31, 1994 to reflect the year that Respondents opened their first XXXXX Learning Center. License Agreements 5511 and 5512 have an effective date of October 29, 1999. EX 3, 13, and 15. The License Agreements provide that the laws of the State of Maryland govern the Agreements. EX 3, 13, and 15, Paragraph 28 of Addendum to License Agreement For Additional Terms. Nowhere else in the Award can there be found any analysis made by the arbitrator as to how, in the context of the submissions made by the parties, she came to the conclusion that the governing law clause can be enforced, and the law of Maryland applied to the Agreements. There was only a recitation of or reference to clause 28, the governing law clause, without any explanation from the arbitrator as to how she dealt with or considered the parties arguments as to the last act necessary to make the Agreements binding, to render the law of Maryland applicable. It is true that an arbitrator does not have to deal with each and every argument made by the parties but the *lex loci contractus* rule was an essential issue underpinning the decision on the enforceability of the Non-Compete Covenant, and although the last act argument was the key if not the only argument on this issue, it was not dealt with or explained by the arbitrator in the Award. There was not even a statement from the arbitrator that she accepted the submissions made by A on the issue. In the first sentence of the passage quoted above, both acts relied upon by the parties as the last act were referred to. The arbitrator could have, but did not explain that chronologically, A's act must have been the later, or last, act. Nor did she explain why she considered Maryland law to have the more substantial relationship to the parties or the transaction, and that Hong Kong law had no stronger public policy interest. In *Z v R* [2021] HKCFI 2312, this Court referred to the observations made by the English Court in *Buyuk Camlica Shipping Trading and Industry Co Inc v Progress Bulk Carriers Ltd* [2010] EWHC 442 (Comm): It is not sufficient for an arbitral tribunal to deal with crucial issues in pectore, such that the parties are left to guess at whether a crucial issue has been dealt with or has been overlooked: the legislative purpose of section 68(2)(d) is to ensure that all those issues the determination of which are crucial to the tribunal's decisions are dealt with and, in my judgment, this can only be achieved in practice if it is made apparent to the parties (normally, as I say, from the Award or Reasons) that those crucial issues have indeed been dealt with. (Emphasis added) Although the above observations were made in the context of an application made under section 68 of the Arbitration Act 1996 to set aside an award on the ground of serious irregularity, they apply with equal force in the context of whether enforcement of an award should be allowed on the ground that the arbitrator failed to deal with a key issue, or failed to give reasons for the decision, to render the arbitral procedure non-compliant with the agreed procedure, or to make enforcement of the award contrary to public policy. The key is that a party reading the award should understand why a central issue in the arbitration was decided against him. In this case, it cannot be said that the Respondents would so understand. Non-Compete Covenant Issue: reasonableness of covenant Even on A's submissions, as evident from its Post-hearing Brief, in the consideration of the enforceability of the Non-Compete Covenant under Maryland law, a covenant will be enforced if the restraint is confined within limits which are no wider as to area and duration than are reasonably necessary for the protection of the business of the

employer and do not impose undue hardship on the employee or disregard the interests of the public. On the Respondents part, they made extensive arguments before the tribunal that Hong Kong has a materially greater interest than Maryland, and that restrictive covenants are prima facie unenforceable in Hong Kong as they are restraints of trade and against public policy. The Respondents also argued that the onus of proving that a covenant is reasonable rests on the party relying on the term, and they contended that the Non-Complete Covenant imposed unreasonable restraints on trade under Hong Kong law and were unenforceable, because the covenants were not necessary to protect any legitimate interest in Hong Kong, and were unreasonable in scope and effect. In the Award, the arbitrator only referred to the contents of clauses 11.5.2 and 11.5.3 which contain the Non-Compete Covenant and its ambit or scope, and to clause 12 of the Agreements. On behalf of A, Counsel sought to argue that by setting out the express provisions of clauses 11.5.2 and 11.5.3, it was self-explanatory that the arbitrator had taken them into consideration and that the provisions were the reasons why she decided to grant the injunction under the Non-Compete Covenant. It is noted that clause 11.5.2 contains the statement: It is understood and agreed that the purpose of this covenant is not to deprive Licensee of a means of livelihood and will not do so, but is rather to protect goodwill and interest of (A) and the XXXXX System. Clause 12 which was recited by the arbitrator provides as follows: Licensee acknowledges that (A) s remedy at law for Licensee s breach of paragraph 3, paragraph 11.1, or paragraph 11.5 would be inadequate and that, accordingly, in such events, (A) shall be entitled to immediate injunctive relief... It may be said that the Arbitrator must have considered that a reason for her to grant the injunction was the Respondents acknowledgment (in clause 12 of the Agreements) of A s entitlement to injunctive relief, and that damages are inadequate. However, even on A s submissions in the Arbitration, the Non-Compete Covenant (for which the injunction was granted) is only enforceable if the restraint is no wider as to area and duration than are reasonably necessary for the protection of A s business. The fact that A has some legitimate interest to protect is not sufficient as it is only one factor to consider when deciding on the enforceability of the covenant, and it is necessary (even on A s own submissions) to also consider and decide on whether the restraint is reasonable in terms of the area and duration in time involved. In the latter regard, there was no analysis made in the Award as to the period of restraint, nor as to the area in which the Respondents were restrained, when the injunction sought extended to the whole of Hong Kong (when on the face of the Agreements, the Centers had been licensed to operate in designated locations of Hong Kong only, in Aberdeen/Pok Fu Lam, Tai Koo Shing/Chai Wan, and Wan Chai/North Point). There was no reason given, as to why the injunction granted by way of enforcement of the Non-compete Covenant was considered by the arbitrator to be reasonable under Maryland law. Breach Issue On the Breach Issue, the parties were in dispute as to the date when the Agreements had been effectively terminated. The damages payable were sought and ordered to be payable from the date of the effective termination. A relied on the Termination Notice issued by the Respondents dated 25 February 2022, which the arbitrator accepted to be the notice of termination which became effective on 31 March 2022. On the Respondents part, they argued that there had been an

earlier notice of termination by an email sent by C on 23 January 2020. In the Award, the arbitrator only stated on page 4 when reciting the history of the Agreements, that after expiration of the contractual terms of the Agreements, the parties had operated under a month-to-month arrangement, until the Agreements terminated pursuant to a notice of termination provided by the Respondents on February 25, 2022, effective March 31, 2022. At page 5 of the Award, the arbitrator stated: By email notice to Claimant sent by (C) on February 25, 2022, Respondents terminated the Licence Agreements effective March 31, 2022. By emails to Respondents on February 25 and March 31, 2022, Claimant acknowledged receipt and confirmed such termination effective March 31, 2022. The arbitrator then, on page 7 of the Award, concluded that the Respondents are jointly and severally obligated to pay to Claimant past due royalty fees and other fees and charges under the (Agreements), for the period February 1, 2020 through March 31, 2022 in an amount totaling The injunction was also granted for 2 years after the effective date of termination on 31 March 2022. I have to accept the Respondents claim, that the arbitrator did not give any reason why she rejected the Respondents case of the termination by the earlier email of 23 January 2020, which was not mentioned in the Award at all. She may have disbelieved the Respondents evidence, or she may have considered the email to be ineffective for some reason, but she did not say so, and never dealt with this claim of the Respondents with regard to the date of termination at all. The Respondents have legitimate cause for concern as to why their case was not considered, when the effective termination date was important for calculation of the damages and the royalties found due, and for the duration of the injunction granted by way of enforcement of the Non-compete Covenant. Findings From the above, it can be seen and my conclusion is that what the arbitrator did in the Award was to set out the provisions of the Agreements which were applicable (the interpretation and effect of which were in dispute between the parties), and then simply stated the orders she made. In between, there was no analysis made nor any explanation given, however brief, as to why she accepted the effect as held by her, and why the Respondents contentions - as to the clauses on governing law, on the enforceability and unreasonableness of the Non-Compete Covenant, and as to the effective date of termination of the Agreements - were rejected by her, or were considered by her to be irrelevant to her conclusions. I am satisfied that these failings of the arbitrator were sufficiently serious to affect the structural integrity of the arbitral process, and to have undermined due process. The Respondents, as parties who had submitted their dispute under the Agreements to the tribunal for arbitration and determination, were entitled to expect key issues which affected their rights and liabilities to be dealt with and explained with sufficient reasons in the Award. Under the Agreements, the Arbitration was to be conducted under the International Arbitration Rules (Rules) and the Supplementary Procedures for International Commercial Arbitration of the American Arbitration Association (Procedures). Under Article 33 of the Rules, the tribunal shall state the reasons upon which an award is based, unless the parties have agreed that no reasons need be given. Paragraph 5 of the Procedures contains an identical provision. There is no suggestion that the parties had waived the need for reasons. The Award does not comply with Article 33 of the Rules and paragraph 5 of the Procedures as no reasons were given, and cannot be said to

have been made in accordance with the procedure of the Arbitration to which the parties had agreed. As found in A v B HCCT 40/2014, 15 June 2015, it is fundamental to concepts of fairness, due process and justice, as recognized in Hong Kong, that key and material issues raised for determination, either by a court or the arbitral tribunal, should be considered and dealt with fairly. An award should be reasoned, to the extent of being reasonably sufficient and understandable by the parties, within the confines set out in R v F [2012] 5 HKLRD 278. Readers of the award, namely the parties themselves, should understand how and why the tribunal reached its conclusion on a particular issue, in the context of how the relevant issues had been argued before the tribunal. Having carefully considered the Award, the Respondents are entitled to query whether the Non-Compete Issue, the governing law, and the effective date of termination issues had been considered at all by the arbitrator, and if considered, why the issues were determined against them. It would in my judgment be contrary to public policy to enforce and recognize the Award when those important issues, which the parties were entitled to expect to be addressed in the Award, were not in fact addressed or explained (A v B HCCT 40/2014, 15 June 2015). Other grounds Having found that the Enforcement Orders should be set aside on the above grounds, it is not necessary to consider in further detail the claims made that the arbitrator had failed to give reasons on the Guarantee Issue, or that there had been material non-disclosure in relation to the failure to include the Rules and the Procedures in the ex parte application. Briefly, I do not consider that the omission of the Rules and Procedures is material in this case. The failure to deal with or give clear reasons on the Guarantee Issue has not been clearly established, in the light of the arbitrator's reliance on the express terms of clause 20 of the Agreements and the definition of Licensee therein, and the expressed agreement by the shareholders of the Licensee to be bound by the Agreements and to agree to the restrictions in the Agreements. That could reasonably be understood as implicit in the Award.

Disposition

For all the reasons set out above, the Enforcement Order was set aside and enforcement of the Award refused, with the usual costs order that A should bear the costs of the application to set aside on indemnity basis (including costs reserved), with certificate for Counsel. (Mimmie Chan) Judge of the Court of First Instance High Court Ms Flora Lam, instructed by Ribeiro Hui, for the applicant Mr Val Chow, instructed by Reynolds Porter Chamberlain, for the 1st to 3rd respondents PAGE - A B C D E F G H I J K L M N O P Q R S T U V A B C D E F G H I J K L M N O P Q R S T U V A B C D E F G H I J K L M N O P Q R S T U V A B C D E F G H I J K L M N O P Q R S T U V h%k% gd9O h20X gd9O gd9O gd\J gd\J h20X hO* h\$@| hO* hVpb h)0 gdLJ h%k% hEL^ h%k% h%k% h%k% h%k% gdEL^ h%k% h%k% h%k% h%k% h%k% h%k% h%k% h%k% h%k% h%k% h%k% h%k% h%k% h%k% h%k% h%k% h%k% h%k% h%k% (#p# [Content_Types].xml _rels/.rels theme/theme/ themeManager.xml K Y, sQ}# theme/theme/theme1.xml \$O}) Xp90 +PHI| PP yu 9xu5 fs+W VF7H q=. 8}d- qyI@ j!Q- jyV` |PZ+ T ""p < 4V O&x\$ A8>v ;EUC n 8r *~P(5 .}x E /EE\} theme/theme/_rels/ themeManager.xml.rels 5 6?\$Q K(M&\$R(.1 [Content_Types].xmlPK _rels/.relsPK theme/theme/ themeManager.xmlPK theme/theme/theme1.xmlPK theme/theme/_rels/

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