The International ADR Mooting Competition 2013

28 July 2013 – 3 August 2013

City University of Hong Kong

MEMORANDUM FOR CLAIMANT

Team No: 394C

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MEMORANDUM FOR CLAIMANT

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I. STATEMENT OF FACTS

1. The Claimant, Energy Pro Inc. has applied for Arbitration against the Respondent, CFX Ltd relying upon the Arbitration agreement found in Clause 20 of the Purchase Contract.

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2. In the Purchase Contract, which was concluded on 10 April 2011, the Respondent committed to purchase from the Claimant minimum quantities of 1.5 MW wind turbines at fixed prices over a five-year period.

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3. On 10 February 2012, the Respondent issued a purchase order for 100 gearboxes and transferred the first part payment of USD 2 million to the Claimant on 13 March 2012 after receiving the gearboxes.

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4. On 18 April 2012, Future Energy Inc. notified the parties that one of its engineers had wrongly certified the gearboxes as appropriate for sale in Catalan.

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5. Therefore, the Respondent suspended performance of the Purchase Contract on 21 May 2012, pending further confirmation from the Claimant that it would be able to comply with its own obligations

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under the Purchase Contract.

6. In response, the Claimant terminated the Purchase Contract on 28 December 2012 and requested Future Energy Inc. to join as a third party to the arbitration between the Claimant and the Respondent on 1 January 2013.

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II. THE CLAIMANT'S SUBMISSIONS

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A. The Claimant can bring Future Energy Inc. into the arbitration proceedings.

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1. Though Future Energy Inc. is a not a signatory to the arbitration agreement, it has impliedly consented to arbitrate any dispute arising from or in connection with the Purchase Contract.

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a) A non-signatory has impliedly consented to arbitration if (1) its dispute with a signatory party is intertwined with the contract containing the arbitration clause and (2) the non-signatory has a contractual relationship with at least one of the signatories.

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7. This rule arises from the doctrine of intertwined arbitral estoppel

(Stavros L Brekoulakis, *Third Parties in International Commercial Arbitration,* United States, Oxford University Press, 2010, at page 129, *'Stavros'*). The doctrine originates from US jurisprudence (*Stavros*, at 4.07). It is used to determine whether a third party to an arbitration agreement has consented to arbitration through its conduct (implied consent); notwithstanding its failure to sign the arbitration agreement. Where found, the doctrine will estop the non-signatory party from avoiding arbitration with the signatory party (*Stavros,* at 4.04).

8. Under Clause 20.1 of the Purchase Contract, the Parties have agreed that any arbitration between them will be governed by the arbitration rules of the China International Economic and Trade Arbitration Commission (CIETAC). However, CIETAC's arbitration rules are silent on the joinder and intervention of third parties to the arbitration (*Stavros*, at 3.104). Under the PRC Contract Law, there is no applicable (to the facts of the present dispute) contractual theory to determine whether the arbitration clause in the Purchase Contract can be extended to a non-signatory. The governing law of the arbitration agreement is the law of the seat of arbitration since the parties have not agreed upon an applicable law (Michael J Moser, *Arbitration in Asia,* New York, USA: JurisNet LLC, 2009 at Arbitration in China, para 3.2.7). Since the place of arbitration is Beijing, the arbitration law of China is the governing law of the arbitration agreement. Arbitration Law of China is also silent on the joinder of third party non-signatories as well.

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9. Where, specific contractual theories, institutional rules and arbitration laws are silent, the theory of implied consent is to be relied upon to determine whether the third party has consented to arbitration (*Stavros*, at pg 128). Thus, intertwined arbitral estoppel is a viable method.

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b) <u>The facts of the dispute satisfy both requirements under the doctrine of intertwined arbitral estoppel. Hence, Future Energy Inc. has impliedly consented to arbitration.</u>

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10. The first condition states that the non-signatory's dispute with the applying signatory party must be intertwined with the contract containing the arbitration clause (*Choctow Generation v American Home Assurance* 271 F 3d 403 2nd Circ 2001, '*Choctow*'). In *Choctow*, the court held that the dispute between the signatory (owner) and non-signatory (surety) was textually linked to the contract containing the arbitration clause and that its merits were 'bound up' or intertwined with the dispute between the two signatories. Here, Future Energy Inc. is liable to the Claimant under the 'agreement for certification' for breach of contractual obligation to use reasonable care and skill in the certification of the gearboxes. Due to Future Energy Inc.'s negligence, the Claimant delivered gearboxes that did not satisfy the technical requirements of the Respondent's 1.5MW Wind Turbine as stipulated

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under the Purchase Contract. These specifications were also stipulated in the ‘agreement for certification’. This has led to the contractual dispute between the Claimant and Respondent. As such the dispute between non-signatory Future Energy Inc. and the signatory Claimant is intertwined with the Purchase contract containing the arbitration clause.

11. The second condition states that the non-signatory party must have a contractual relationship with at least one of the signatories (*McBro Planning Development v Triangle Electrical Construction* 741 F 2d 342, 11th Circ 1984*).* Future energy Inc. has a contractual relationship with both the Claimant and the Respondent. All three are parties to the ‘agreement for certification’, wherein Future Energy was nominated as the certifier of the Claimant’s gearboxes to be used for the Respondent‘s turbines.

12. Both conditions of intertwined arbitral estoppel are satisfied. Thus, Future Energy Inc. can be presumed to have consented to arbitration and can be brought into the arbitration proceedings.

13. The Claimant’s clear indication to Future Energy Inc. that legal proceedings will be brought against Future Energy if it did not participate in the arbitration, is not duress. Though Future Energy Inc. only explicitly consented to arbitrate upon the Claimant’s indication, it is nevertheless valid consent and not tainted by duress. Non-signatories who choose to participate in arbitration to avoid legal proceedings are

considered willing non-signatories (Bernard Hantiau and Eric A Schwartz, *Multiparty Arbitration*, France: International Chamber of Commerce, 2010). Their willingness to arbitrate is deemed as valid consent to arbitration. Hence, there is no duress.

14. Furthermore, the doctrine of intertwined arbitral estoppel, where implied consent is found, estops the non-signatory party from avoiding arbitration with the signatory party (*Stavros*, at 4.04). It thus becomes Future Energy Inc.'s obligation to take part in arbitration with the Claimant. Further express consent by Future Energy Inc. is in fact not required for the arbitration clause to be extended to Future Energy Inc. And hence, the issue of whether Future Energy Inc.'s consent to arbitrate (provided on 3rd January 2013) has been vitiated by duress is not relevant and need not be raised. The doctrine of intertwined arbitral estoppel is not applied on consensual premises at (*Stavros*, at 4.38).

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B. Ms. Arbitrator 1 can resign during the arbitration proceedings.

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15. Pursuant to Article 32 of the CIETAC arbitration rules, an arbitrator is unable to participate in the deliberations after the oral hearing for any reason can leave the proceedings. In this dispute, Ms. Arbitrator 1 had initially agreed to the fees to be paid. However, upon subsequent discussions, which revealed that the issue of quantum will take longer, she has threatened to resign from her duties unless additional fees are paid for the further 3 days. However, the Claimant feels economically exploited by Ms. Arbitrator 1 and thus will not be paying the added fees demanded. This would lead to Ms. Arbitrator 1's resignation from the panel.

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16. Furthermore, pursuant to Article 32, the resigning arbitrator may be substituted or more significantly, with the approval of the parties and the Chairman, the other two arbitrators may be allowed to continue the proceedings without a third member. As such, the respondent's concerns as to the loss of great time and money will be addressed. Hence, Ms. Arbitrator 1 can resign from the arbitration proceedings.

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C. The Claimant validly terminated the contract.

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1. The applicable laws to this dispute are the UNIDROIT principles, supplemented by the UNCISG.

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17. UNIDROIT is applicable when parties ‘have agreed that their contract be governed by them’ and is applicable for ‘international commercial contracts’ [UNIDROIT – Preamble].

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18. The contract entered into is an international one because it contains an ‘international element’ [*UNIDROIT commentary, p.2*]. Both parties to the contract are from differing countries. The Respondent is a company registered in Catalan, whereas the Respondent is one based in Syrus. As such, the international contract is aptly governed by UNIDROIT Principles. In addition, under Clause 29.1, the parties have expressly chosen UNIDROIT as the governing law of the contract, supplemented by the United Nations Convention on Contracts for the International Sale of Goods 1980 [*UNCISG*] on

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matters not covered by UNIDROIT Principles.

19. Thus, UNIDROIT is the law governing the contract, supplemented by *UNCISG*.

2. The Respondent had breached its obligations to make the necessary part payments as required under the Purchase Contract.

a) <u>The Claimant validly terminated the contract because the Respondent had breached its obligations to make the necessary part payments as required under the Purchase Contract.</u>

20. After receiving the written notice of the breach from the Claimant, the Respondent did not make any payment nor provide any reasonable evidence that the breach has not occurred as required by the Purchase Contract. Therefore, according to Clause 15.1 of the Purchase Contract, the Claimant has rightfully terminated the Purchase Contract. Since Clause 15.1 of the Purchase Contract makes express provision for the right to terminate the contract when there is a breach of material obligation, reference to the general rule in the UNIDROIT Principles is not necessary [*ICC International Court of Arbitration*

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10422].

21. Alternatively, even if the terms of the Purchase Contract are not relied upon to prove that the Claimant validly terminated the Purchase Contract, the UNIDROIT Principles governing the right to termination allow the Claimant to terminate the contract. Based on Article 7.3.1, the Claimant may terminate the contract since the failure of the Respondent to make the necessary part payments amounts to a fundamental non-performance. This non-performance by the Defendant is fundamental since most of the criteria laid down in Article 7.3.1 (2) are met [*30 November 2006 Centro de Arbitraje de México*]: first, the Respondent's failure to make the payments deprived the Claimant of the benefit it was entitled to expect under the contract; second, the Respondent's breach of the Clause 15.1 was intentional; and, third, these two circumstances were enough to give the Claimant, the reason to believe that it could not rely on the Respondent's future performance. Therefore, the Claimant did validly terminate the contract.

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3. The Respondent did not have any right arising neither from the Purchase Contract nor from the UNIDROIT Principles to suspend the contract.

22. Since the Purchase Contract does not provide the Respondent with any expressed right to suspend the contract, the Respondent's decision to withhold payment is certainly a breach of its obligation to make

payments.

23. However, the Respondent argues that they have a right to withhold performance because the Claimant failed to uphold its obligations under clause 10 of the Purchase Contract.

24. Although Article 7.1.3 of the UNIDROIT Principles gives the aggrieved party a right to withhold performance, as stated in the official comment to the principles, the text does not explicitly address the situation where the non-performing party performs in part but does not perform completely, which is the case before the tribunal in this application for arbitration. Therefore, some guidance can be sought from the principles found in *UNCISG* in this instance [Damien Nyer, *Withholding Performance for Breach in International Transactions: an Exercise in Equations, Proportions or Coercion?* 18 *Pace International Law Review* (2006) 29-81].

25. Similarly, Article 71 of the UNCISG does not give the Respondent the right to withhold payment for deliveries already occurred [Case No. 9448, 11 ICC BULL 2, at 103,105, International Chamber of Commerce, July 1999]. Therefore, even though the goods delivered by the Claimant proved to be defective, since the delivery has already occurred, the Respondent cannot use this as an excuse to avoid payments, which it is contractually obliged to pay the Claimant. Furthermore, the Claimant is willing and has agreed to change the

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certification company picked solely by the Respondent in the certification of the remaining 400 gearboxes. Hence, the Respondent is unlikely to succeed under any principles of anticipatory breach as well.

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D. The Claimant can claim the termination penalty.

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1. The Claimant is entitled to claim the full termination penalty because the Respondent breached its main obligation by withholding payment. The termination penalty is hence a reasonable amount and not 'grossly excessive'.

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a) Although the contract has been terminated and brought to an end, this does not deprive the aggrieved party of its right to claim damages for non-performance [*Art. 7.3.5(2), UNIDROIT*].

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26. In addition, a party who does not perform can be obligated to pay a 'specified sum to the aggrieved party for such non-performance' [*Art. 7.4.13(1), UNIDROIT*]. In this case, the termination penalty is in the form of an agreed payment for non-performance that is valid under the UNIDROIT Principles [*UNIDROIT Commentary p284*].

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27. However, the non-performance must be 'one for which the non-performing party is liable, since it is difficult to conceive a clause providing for the payment of an agreed sum in case of non-performance operating in a force majeure situation' [*UNIDROIT commentary, p285*].

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b) The termination penalty is an agreed payment for non-performance as Clause 15.2 specifies the mechanism to arrive at the sum that the Respondent shall pay in the event of termination.

28. In this case, the Respondent was obliged to make payments for the second and third payments but defaulted [*Exhibit No. 7*]. Hence, they were liable for the non-performance of the contract, enabling the Claimant to terminate the contract and claim the termination penalty pursuant to Clause 15.2.

2. The Termination Penalty is reasonable in the circumstances.

29. The validity of such clauses is subject to a judicial discretion to reduce the amount where it is 'grossly excessive' to a reasonable sum [*Art. 7.4.13(2)*]. The court found that the termination penalty was excessively high for breaches apart from the 'main obligation to sell shares' [*28 January 1998 Ad hoc Arbitration, Helsinki*]

30. Furthermore, this 'proportionality and conformability with the negative consequences of the breach of the obligations to the sum of the penalty claimed' is in accordance with the UNIDROIT Principles as a 'code of the well-established rules of international trade reflecting the approaches of the principal legal systems" [*4 April International Arbitration Court of the Chamber of Commerce and Industry of the Russian Federation (No. 134/2002)*]

31. Thus, the non-payment of the Respondent would be considered breach of a main obligation of the contract for the sale of gearboxes. This would mean that the termination penalty would be reasonable and not 'grossly excessive', entitling the Claimant to claim the full termination penalty without adjustment.

III. RELIEF REQUESTED

32. The Claimant respectfully requests that the Arbitral Tribunal find that:

- Energy Pro Inc. can bring Future Energy Inc. into the arbitration proceedings.
- Ms. Arbitrator 1 can resign during the arbitration proceedings.
- Energy Pro Inc validly terminated the contract.
- Energy Pro Inc can claim the termination penalty.

Dated this 20th of June 2013

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