The International ADR Mooting Competition 2013

28 July 2013 – 3 August 2013

City University of Hong Kong

MEMORANDUM FOR RESPONDENT

Team No: 394R

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MEMORANDUM FOR RESPONDENT

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I. STATEMENT OF FACTS

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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 RESPONDENT'S SUBMISSIONS

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A. The Claimant cannot bring Future Energy Inc. into the arbitration proceedings.

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1. Future Energy cannot be brought into the arbitration proceedings since it not a party to the arbitration agreement concluded in the Purchase Contract.

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7. A third party non-signatory cannot be brought into the arbitration proceedings unless it has been a party to the arbitration agreement in the first place.

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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 L Brekoulakis, *Third Parties in International Commercial Arbitration*, United States, Oxford University Press, 2010, at 3.104 *'Stavros'*).

9. 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.

10. Thus, evidence of international practice is significant. The UNCITRAL Arbitration Rules explicitly state at Article 17(5) that any third person to be joined in the arbitration may only do so provided such person is a party to the arbitration agreement. The inclusion of multiparty provision on the issue of third parties was carefully considered and rejected by the Working Group of the UNCITRAL Arbitration Rules (*Stavros* at 3.92). This reinforces that strictly only signatories to the arbitration agreement may participate in the arbitration proceedings. Hence, Future Energy cannot be brought in the arbitration as it has not signed the arbitration agreement and thus is not a party to it.

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2. Even if Future Energy can be brought into the proceedings, the Claimant may only do so with the consent/agreement of the Respondent and Future Energy.

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11. Even if a signatory party is allowed to bring in a third party non-signatory into the arbitration proceedings, it can only do so with the agreement of the third party non-signatory and all original parties to the arbitration agreement.

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12. International practice, especially that in Asia has provided clear evidence of this rule. The Singapore International Arbitration Centre Rules provide at Article 24(b) that a third party may be allowed to join in the arbitration only if all original parties consent. Pursuant to Article 30 of the Arbitration Law in Indonesia, parties not originally party to the agreement to arbitrate can join in an arbitration if they have related interests and their participation is agreed by the parties in the dispute and by the arbitrator or arbitration tribunal hearing the dispute.

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13. Hence, Future Energy cannot be added to the arbitration agreement without the Respondent's agreement to its addition. Since the Respondent does not agree to the inclusion of Future Energy, it cannot be added as a third party to the arbitration proceedings until such agreement is obtained.

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14. On the other hand, the London Court of Arbitration (LCIA) Rules, pursuant to Artcile 22.1(h) states that a signatory or applicant party may add a third party to the arbitration proceedings without the consent of the other original party. (Peter Turner and Reze Mohtashami, *A Guide to The LCIA Arbitration Rules*, US: Oxford University Press, 2009, at 6.44, '*LCIA*') However, this rule lacks sufficient authority in practice as there has not been any case in which the third party had been joined against the wishes of one of the original parties under the LCIA Rules. (*LCIA* at 6.54)

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3. The tribunal should be slow to find any implied consent of Future Energy to participate in the arbitration.

15. Arbitration is at the outset a consensual process. Though theories of implied consent may be used where the arbitration law, procedural rules and contract law are inapplicable to the fact situation (*Stavros* at page 128), the presumption of consent may lead to a compromise of the requirement of consent in arbitration. With presumed consent, the existing arbitration agreement requires less consent or less evidence of consent to become binding upon a non-signatory party than a normal contract. (*Stavros* at page 196). Furthermore, the threshold required for conduct to amount to implied consent is high as seen in the seminal English decision in *Dallah v Pakistan* [2008] EWHC 1901 (Comm). Hence, the tribunal should be slow to allow the use of doctrines such as arbitral estoppel and 'group of companies' in adducing implied consent of the parties.

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B. Ms. Arbitrator 1 cannot resign during the arbitration proceedings.

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1. Ms. Arbitrator 1 cannot resign from the proceedings because she is still able to fulfil her functions in accordance with the CIETAC Rules.

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16. It is expressly stated that an arbitrator may 'voluntarily withdraw from his/her office' in the event that an 'arbitrator is prevented de jure or de facto from fulfilling his/her functions' [*Article 31 of the CIETAC Rules*].

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17. However, there is no explanation in the CIETAC Rules with regards to when an arbitrator is prevented from 'fulfilling his functions'. Thus, alternative arbitration rules will be referenced to for the purposes of ascertaining on what grounds the court would accept an arbitrator's resignation.

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18. Inability to perform an arbitrator's functions may arise if the arbitrator is seriously ill or dies, or where an arbitrator is 'legally or physically prevented' from performing his functions [*Kerr, 'Concord and Conflict in International Arbitration', 13 Arb Int 121 (1997) 136-138*].

Hence, the threshold set for an arbitrator's resignation is high and restricted to extreme circumstances that disable an arbitrator from performing his functions.

19. This is because when an arbitrator accepts an appointment, he/she 'undertakes and has a duty to hear the dispute and make an award.' Thus, the Association of Arbitrators in Southern Africa prevents one party from unilaterally demanding that an arbitrator resign [*Section 13(1) of the Arbitration Act, No. 42 of 1965*]. Although the arbitration rules of Southern Africa do not govern this proceeding, they are still highly instructive in revealing the court's willingness to allow for an arbitrator's resignation.

20. The high threshold reduces the disruptions caused by an arbitrator's resignation. A replacement arbitrator could also face a steeper learning curve if he joins the arbitration later in the proceedings, which might affect the fairness of the outcome of the arbitration.

21. In addition, the ICC Rules of Arbitration have a similar article specifying that an arbitrator is replaced when he is unable to perform his function only 'on the Court's own initiative' [*Article 12(2), ICC Rules*]. It is not intended for parties to initiate the replacement for their own private or personal reasons.

22. In this regard, Ms. Arbitrator 1 should be prevented from resigning

because the request for additional fees does not prevent her from performing her duties as an arbitrator. The court should not adopt an unduly broad approach towards allowing the resignation because of the aforementioned policy reasons which could threaten the fairness of the arbitration.

C. The Claimant unlawfully terminated the Purchase contract.

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

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

24. The contract entered into is an international one because it contains an

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'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 matters not covered by UNIDROIT Principles.

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

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2. The Claimant did not validly terminate the contract because the Respondent had lawfully suspended the contract.

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a) <u>According to Clause 10.1 of the Purchase contract, the Respondent has no obligation to purchase goods from the Claimant that does not meet the established requirements.</u>

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26. Clause 10.1 expressly states that the Respondent's obligation to purchase the gearboxes is subject to the Claimant being able to meet the 'established quality, technical and qualification requirements'

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under Clause A of the contract.

27. Thus, the Respondent did not have an obligation to purchase the defective gearboxes from the Claimant and had the right to suspend the contract [*Exhibit 6*] by withholding payment till the gearboxes were of the agreed requirements. Since the suspension of the contract by the Respondent was lawful, the Claimant had no right to terminate the contract pursuant to clause 15.1 because of the Respondent's 'failure to make payment'.

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28. This also precludes the Claimant from terminating the Contract based on the UNIDROIT Principles under Article 7.3.1 where the right to terminate depends on the 'non-performance substantially depriving the other party of its expectations' [*Article 7.3.1(2a)*]. Having lawfully suspended the contract, non-payment by the Respondent would not have substantially deprived Claimant of its expectations.

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b) <u>Furthermore, the Respondent has no obligation to purchase the goods because the risk of burden is on the Claimant to ensure that the goods meet the requirements.</u>

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29. Due to a dearth of UNIDROIT Principles regarding the passing of risks between buyer and seller, the UNCISG Articles are used to

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supplement the analysis of this area of the law.

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30. Under Article 66 of the UNCISG, the buyer (CFX) is discharged from its price obligation in cases where 'the loss or damage is due to an act or omission of the seller'. This Article was applied in the case of *14 December 2006 OLG Koblenze.* Although the Article primarily deals with situations involving carriage of goods, the principle and logic of the allocation of risks between seller and buyer can be instructive in other situations.

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31. Besides, the 'act or omission' of the seller can be 'interpreted broadly' to allow the buyer to 'suspend or withhold payment for a variety of reasons connected to the behavior of the seller'. [*CISG Articles 66-70: The Risk of Loss and Passing it*, p8].

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32. Thus, the negligence of the employee at Future Energy can be attributed to either an 'act or omission' by the Claimant, as the seller, to ensure that the gearboxes are of the correct requirements. Without doing so, the buyer was accordingly discharged from its price obligation.

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c) <u>Alternatively, the Respondent has the right to</u>

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suspend payment according to the UNIDROIT Principles.

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33. An aggrieved party may withhold its performance until performance has been effected by the other party. (*Article 7.1.3, UNIDROIT Principles*).

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34. In the event of non-conformity of goods, the buyer only has to inform the seller of it. He will then have the right to suspend payment until an agreement concerning the lack of conformity is reached. This would not be a violation of contractual duties. In fact, it would 'amount to a curtailment of the rights of the buyer if he had to continue payment of the goods without knowing what will happen in regard to the non-conformity'. [*January 1999 Arbitral Award ICC International Court of Arbitration, Paris 8547*]

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35. As such, the non-conformity of the gearboxes would have entitled the Respondent to lawfully suspend payment until the Claimant delivers gearboxes of the correct conformity. This would have eliminated the need to make the subsequent payments and hence preclude the Claimant from terminating via Clause 15.1.

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D. The Claimant must not be allowed to claim the termination penalty.

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1. Even if the Claimant validly terminates the contract, the Claimant is not entitled to claim the termination penalty because the Respondent is not liable for non-performance of the contract.

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36. 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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37. 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*]. This is in the form of an agreed payment for non-performance, which is valid in principle [*UNIDROIT Commentary p284*].

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38. 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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39. Therefore, the termination penalty specified in the Purchase Contract 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.

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40. However, the Respondent is not liable for the non-performance because the negligence of Future Energy Inc. is akin to a force majeure situation that would prevent the Claimant from claiming the termination penalty. The principles and exclusion underlying the exclusion of force majeure situations can be extended to the present situation. The negligence of Future Energy Inc. was 'beyond the control' of the Respondent and could not have been 'reasonably expected', akin to a force majeure situation [*Art 7.17, UNIDROIT Principle*].

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2. Even if Energy Pro is entitled to claim the termination penalty, it cannot claim the full amount because it is grossly excessive.

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41. 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*].

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42. 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)*].

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43. With regard to the Claiamnt's losses, the penalty of the 'difference between the total value of this Purchase Contract and the value of the Gearboxes already delivered' [*Clause 15.2*] would amount to 8 million dollars, a disproportionate amount compared to the 2 million

dollars worth of gearboxes already delivered and paid for by the Respondent.

44. Thus, the Claimant would not be entitled to claim the full sum of the termination penalty.

III. RELIEF REQUESTED

45. The Respondent respectfully requests that the Arbitral Tribunal find that:

- Energy Pro Inc. cannot bring Future Energy Inc. into the arbitration proceedings.
- Ms. Arbitrator 1 cannot resign during the arbitration proceedings.
- Energy Pro Inc did not validly terminate the contract.
- Energy Pro Inc cannot claim the termination penalty.

Dated this 21st of June 2013.
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