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Table of contents

1. Index of authorities 3
2. Summary of facts 5
3. A. Energy Pro Inc. can bring Future Energy Inc. into the arbitration proceedings. 6
    i. Future Energy should be regarded as genuine party in the arbitration agreement. 6
    ii. Future Energy Inc. may join the arbitration proceedings as a third party in an intertwined commercial project. 7
    iii. Energy Pro. Inc. legal threat is a legitimate negotiation. 8
4. Ms Arbitrator 1 can resign during the arbitration proceedings. 9
5. Energy Pro Inc. validly terminated the contract. 12
6. Energy pro can claim the termination penalty. 13

Index of Authorities

Cases

1. Air Conditioner case, SYF-95008 (China International Economic & Trade Arbitration Commission [CIETAC] (PRC) 5 April 1999).
2. Arnold v Arnold Corporation-Printed Communications for Business 860 F2d 1078.
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4. Kuan Yew v Chee Soon Juan [2003] 3 SLR 8.
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9. Swiss Company v Hunan Company.
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Summary of Facts

It was in February 2010 that CFX Ltd was established in Catalan by Mr. Yuen to assemble wind turbines with another company, TurboFast. The wind turbine technology was developed by one Future Energy. Energy Pro entered the picture when it wanted to expand its business in Catalan by manufacturing gearboxes for the wind turbine. Energy Pro approached TurboFast to discuss a possible co-operation. However so, as TurboFast had already granted the license to CFX Ltd, it advised Energy Pro to strike a deal with CFX Ltd instead. Heeding TurboFast's advice, Energy Pro succeeded in sealing a contract with CFX Ltd whereby it has to manufacture and subsequently own all the wind turbines whilst CFX Ltd would buy the wind turbines and sell them in Catalan. Future Energy held the duty of certifying the wind turbines before Energy Pro manufactures it. The problem arose when an engineer of Future Energy wrongly certified a wind turbine which Energy Pro subsequently manufactured. CFX Ltd refused to buy the wind turbines as it was of no value for sale in Catalan. As a result Energy Pro initiated an arbitration proceeding for breach of contract against CFX Ltd when the latter defaulted in the agreed payment. Energy Pro also invited Future Energy to join the proceedings as a third party.

A. <u>Energy Pro Inc. can bring Future Energy Inc. into the arbitration proceedings.</u>

1. Future Energy should be regarded as genuine party in the arbitration agreement.[1]

1.1 Future Energy is an agent to certify and approved the gearboxes manufactured by CFX Ltd meet the established quality, technical and qualification requirements.

1.2 Agent is the party in the contract that will carry out the obligations of his principal and must act within the authority. When the agent has entered a contract contained an arbitration agreement, the agent can not initiated an action or defend in the arbitration proceedings on its own personal capacity.[2]

1.3 **Economic Chambers of the Beijing Higher People's Court issued an opinion in 1994**, when an agent acting beyond the remit of his agency, that agent will incur all liabilities.[3]

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[1]Brekoulakis, Stavros. (2009). The Relevance of the Interest of Third Parties in Arbitration: Taking a Closer Look at The Elephant in the Room. *Pennsylvania State Law Review, 1134*(4) 1165-1188.

[2]Halsbury's Law of England (4th edition) page 151.

[3]*Opinion on Some Issues Regarding the Determination of an Application for Ascertaining the Validity of an Arbitration Agreement and Motions to Revoke an arbitral award*. (1999). Beijing Higher People Court.

1.4 In the case of ***Swiss Company v Hunan Company***, arbitral tribunal held that, the contract shall be binding on the agent and the third party.[4]

1.5 In the case of ***Arnold v Arnold Corporation-Printed Communications for Business***[5], the court held that arbitration proceedings may include "non-signatory" parties based upon various theoretical constructions such as by agency.

2. Future Energy Inc. may join the arbitration proceedings as a third party in an intertwined commercial project.

2.1 Contractual arrangements in intertwined contracts set out a wide network of rights and duties binding all parties to the several bilateral contracts. Here the genuine and third party to the arbitration agreement will be contractually linked, on obligations relate to the same commercial project.

2.2 Therefore, parties bound by an arbitration agreement will coincide with those parties bound by the substantive contracts.[6] This could happen by discrepancy arising from the conduct of third party.[7]

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[4]Tao, Jingzhao. (2008). *Arbitration Law and Practice in China.* Netherlands: Kluwer law International.

[5]860 F2d 1078.

[6]Note 1 at page 1179.

[7]Note 1 at page 1181.

2.3 When a third party interferes with transaction between two signatory parties by committing legal wrong, the parties in the arbitration agreement may include the third parties in the arbitration proceedings.

2.4 This has been illustrated in the case of ***McBro Planning & Dev. Co. v Triangle Elec. Constr. Co. Inc.***[8], where the manager invoked the arbitration clause for an order to compel the electrical engineer to arbitrate on the allegation that they have hampered with the construction work.

3. Energy Pro. Inc. legal threat is a legitimate negotiation.

3.1 Threat to enforce one civil right's could not be amounted to duress.

3.2 Bona fide legal threat which is not manifestly frivolous or vexatious is not an unlawful intimidation. This is because it is a threat to do what one has legal right to do.

3.3 In the case ***Kuan Yew v Chee Soon Juan***[9], court held that in order to establish duress, not only the pressure or threats were made but that they were illegitimate. Even a threat to bring proceedings where there is no ground of action in law is prima facie not an unlawful threat.[10]

[8]741 F. 2d 342 (11th Cir. 1984).

[9][2003] 3 SLR 8.

[10]Beale, H.G. (1999). *Chitty on Contracts* (28 ed.). London: Sweet & Maxwell Ltd. Para 7-035.

3.4 In the present case, Future Energy is an agent with an obligation to perform the task to certify the gearboxes. Therefore, according to the exception under the privity of contract, Future Energy is a genuine party to the contract. Thus, the arbitration agreement in the main contract binds Future Energy Inc. as an agent.

3.5 In addition to that, may join the arbitration agreement as a third party in an intertwined contract in a same commercial project. This is because they had committed a legal wrong which is negligence that has been admitted by them.

3.6 Finally, a threat of legal action by Energy Pro is not amounted to duress but a legitimate negotiation to bring Future Energy as a third party in the arbitration proceedings. Energy Pro have a legal right to initiate a civil action against Future Energy, and it will not constitute a unlawful intimidation.

B. <u>Ms Arbitrator 1 can resign during the arbitration proceedings.</u>

1. **CIETAC Arbitration Rules 2012** contains provisions for resignation of an arbitrator.

1.1 **Article 31(1)** permit resignation of an arbitrator:

> "In the event that an arbitrator is prevented de jure or de facto from fulfilling his/her functions or fails to fulfil his or her functions … Chairman of CIETAC shall have the power to decide to replace the arbitrator. **Such arbitrator may also voluntarily withdraw from his/her office.**"

1.2 **Article 32(2)** permit continuation of arbitral proceeding without replacement being made for the arbitrator whom had resign or withdraw from office:

> "After the conclusion of the last oral hearing, if an arbitrator on a three-member tribunal is unable to participate in the deliberations and/or to render the award … the other **two arbitrators may request the Chairman of CIETAC to replace that arbitrator** pursuant to Article 31 of these Rules. After consulting with the parties and upon the approval of the Chairman of CIETAC, **the other two arbitrators may also continue the arbitration proceedings and make decisions, rulings, or render the award**. The Secretariat of CIETAC shall notify the parties of the above circumstances."

2. In regards to the resignation of an arbitrator, the matter has been dealt with in accordance with CIETAC rules in the ***Peppermint Case***[11] .In this case a replacement arbitrator has been appointed to continue the arbitration proceedings.

3. **CIETAC Rules 2012** expressly conferred the rights of an arbitrator to resign on the qualification that they unable to fulfil their functions. Therefore, arbitrator right to resign should not be contested.

4. In the case of ***Zeiler v Detsch***[12], the court held that when a substantive issues of the dispute has been settled, and the remaining issue need to be solved is on the determination of liabilities, choice for the arbitral panel to continue its proceedings

[11] Case no 19990630, decided on 30 June 1999.

[12]500 F. 3d 157 (2nd Cir).

with two members is sufficient to avoid wasted resources and manipulation of process.

5. In the case of ***re Arbitration between Dow Coming Corporations v Safety National Cas. Corporations*** [13], the remaining panel of arbitrators acknowledged that the proceedings would continue with re-appointments by substitute party arbitrators. Therefore, the court allowed the arbitration panel to be filled in accordance with the agreement to arbitrate.

6. **Article 25 of CIETAC Rules 2012** stated that, the parties shall have the liberty to appoint an arbitrator of their choice within 15 days, or the power of appointment shall be conferred to the Chairman.

7. The challenge made to the resignation of Ms Arbitrator 1, together with the contention that it will result in the great loss of time and money for CFX Ltd is unjustifiable. This is because the delay that will cause loss of time and money is preventable.

8. In addition to that, Energy Pro has also expressed their willingness to appoint a replacement, failure which the power of appointment will be conferred to the CIETAC's Chairman. This has been stated in the **Article 25 of CIETAC Rules 2012**.

Therefore, the resignation of Ms Arbitrator 1 and her absent during the determination of quantum should not cause any loss of time and money to CFX Ltd as it is preventable.

[13] 335 F.3d 742 (8th Cir. 2003)

C. <u>Energy Pro Inc. validly terminated the contract.</u>

1. According to the termination clause, Energy Pro has the right to suspend or terminate the Purchase Contract if CFX Ltd substantially breaches a material obligation, representation or warranty including failure to make any payment when it is due provided. Energy Pro has issued CFX Ltd a written notice of the breach and CFX Ltd has failed, within 30 days after the receipt of the notice to either: (i) commence and diligently pursue cure of the breach, or (ii) provide reasonable evidence that the breach has not occurred.

1.1. Energy Pro had sent the first and second notice of default as CFX Ltd failed to make the second and third payment, on 20 June 2012 and 20 august 2012.

1.2. The termination is indeed in accordance to the law as avoidance of the contract releases both parties from their obligations under, subject to any damages which may be due,[14] and the action of CFX Ltd avoiding their part of obligation to make the second and third payment of the contract releases both parties from their obligations under the contract.

1.3. However, CFX Ltd shall be liable to restitute the contract as they are the one who breached the contract[15].

[14] **Article 81(1) of the United Nations Convention on Contracts for the International Sale of Goods.**

[15] **Article 81(2) of the United Nations Convention on Contracts for the International Sale of Goods.**

1.4. As decided in a case, the tribunal noted that since the buyer failed to pay the deposit and the seller failed to perform test runs and train the buyer's personnel, both parties failed to perform their obligations under the contract, and they should bear the responsibility on their own[16].

1.5. This is further supported by **Article 28 of the CISG** that the aggrieved party may require performance of the other party's obligations, claim damages or avoid the contract. Hence, it is due the law stated that Energy Pro has the right to terminate the contract.

D. <u>Energy pro can claim the termination penalty.</u>

1. The termination penalty provided, in the event Energy Pro. terminates the Purchase Contract as provided: a) Energy Pro. shall be entitled to retain any part payment(s) made by CFX Ltd; and b) CFX Ltd shall pay to Energy Pro. a termination penalty equal to the difference between the total value of the Purchase Contract and the value of Gearboxes already delivered to CFX Ltd as of the termination date.(USD 8,000,000)

1.1. In this case, on 28 December 2012, Energy Pro sent a notification of termination of the Purchase Contract to CFX Ltd as CFX Ltd failed to make the required payments.

[16] ***Air Conditioner case***, SYF-95008 (China International Economic & Trade Arbitration Commission [CIETAC] (PRC) 5 April 1999).

1.2.The first issue is whether Penalty Clause is allowed by the CISG.

1.2.1. As decided in a case, since penalty clause is excluded from CISG, in order to ascertain its validity, in accordance with **Art. 4**, the arbitral tribunal referred to the domestic law otherwise applicable to the contract[17].

1.2.2. The parties may prescribe that if one party breaches the contract, it will pay a certain sum of liquidated damages to the other party in light of the degree of breach, or prescribe a method for calculation of damages for the loss resulting from a party's breach[18].

1.2.3. This is similar case to the situation at hand where prescription of payment is given. Though the name in the statute is liquidated damages and not penalty clause, the essence is the same where there is prescription of payment in a case of a breach and the amount must not be too large and appropriate[19].

[17] ***No 9978*** (ICC Arbitration Award of March 1999).

[18] **Article 114 of the Contract Law of the People's Republic of China 1999**. Retrieved from http://www.novexcn.com/contract_law_99.html

[19] Professor Marcus S Jacobs, Q. a. (2005). *An Arbitrator's Powers and Duties Under Art 114 of Chinese Contract Law in Awarding Damages in China in Respect of a Dispute Under a Contract Governed by CISG.* China: Mealy's International Arbitration Report.

1.2.4. In this case, the penalty clause claimed is appropriate as it only claims for the balance of the total amount of the contract's value. Thus, penalty clause should be allowed.

1.3. As penalty clause is allowed, the question moves on to whether the penalty clause is a reasonable one. The first limb of the termination clause is valid in law as a party who seek damages can claim for a sum equal to the loss, including loss of profit in consequence of the breach.[20]

1.3.1. Energy Pro is foreseeing a total profit of USD 10,000,000 upon completion of the contract. However, CFX Ltd breaches the contract and the contract cannot be completed. The claim of Energy Pro to retain any part payment is valid because the part payment which is USD 2,000,000 is included in the total sum of the contract which Energy Pro deserve upon completion of the contract.

1.4. Regarding the second limb of the termination clause, it is allowed under the CISG which a party claiming for damages can claim to recover the difference between the price fixed by the contract, and the current price at the time of avoidance as well as any further damages recoverable under **article 74.**[21]

[20] **Article 74 of the United Nations Convention on Contracts for the International Sale of Goods.**

[21] **Article 76(1) of the United Nations Convention on Contracts for the International Sale of Goods.**

1.4.1. This means that the priced fixed under the contract is USD 10,000,000 and at the time of the breach (the avoidance), the price has downed to USD 8,000,000 as the USD 2,000,000 has been paid earlier.

1.4.2. In a decided case, it was decided that according to **Article 74 of CISG**, a seller should be compensated for its loss, including loss of profit so as to compensate the loss of seller resulting from buyer's breach of contract[22].

1.4.3. Similar to the case at hand, the buyer is required to pay the balance of the value of the contract to the seller.

1.4.4. It is undeniable that the gearboxes were not in conformity with specification. However, CFX Ltd has failed to give a notice on the matter to Energy Pro after Future Energy has sent a letter on that matter to CFX Ltd.

1.4.5. Though, an email was sent by CFX Ltd on that matter to Energy Pro, an email cannot be considered as a notice as it must be in written form according to the practice.

1.4.6. As decided in a case, the goods were delivered over the course of one year, but the buyer did not provide any written evidence to the seller indicating any quality problems. The tribunal held that the examination certificates

[22] ***CD-R and DVD-R production systems case***, No. SA747-500 (China International Economic & Trade Arbitration Commission (CIETAC) Arbitration Award October 2007).

were not issued within a reasonable time under the contract and **article 38(1) CISG.**[23]

1.4.7. Thus, CFX Ltd loses the right to rely on a lack of conformity of the goods if they do not give notice to the Energy Pro specifying the nature of the lack of conformity within a reasonable time after he has discovered it or ought to have discovered it[24].

1.4.8. Apart from that, Energy Pro. cannot be liable for the negligence committed by Future Energy's engineer in the wrong certification of the gearboxes as the CISG provides an indirect message that a party cannot be blamed for a third party's wrong doing. This is because, it is stated that a party may be exempted from paying damages by virtue of an impediment beyond his control.[25]

1.4.9. A party even exempted from any consequences or paying of any damages for impediment caused beyond the party's control or in this case the third

[23] Note 14.

[24] **Article 38(1) of the United Nations Convention on Contracts for the International Sale of Goods.**

[25] **Part 3, Section C, No. 30 of the Explanatory Note by the UNCITRAL Secretariat on the United Nations Convention on Contracts for the International Sale of Goods.**

party's fault and it is ridiculous to put that a party is blameworthy for any third party's act.[26]

1.4.10. As a conclusion since the retainment of the payment made by the CFX Ltd is because the part payment which is USD 2,000,000 is included in the total sum of the contract which Energy Pro deserves upon completion of the contract and the USD 8,000,000 is to complete the amount of the full value of the contract.

[26] **Part 3, Section F, No. 34 of the Explanatory Note by the UNCITRAL Secretariat on the United Nations Convention on Contracts for the International Sale of Goods.**