FOURTH ANNUAL

INTERNATIONAL ALTERNATIVE DISPUTE RESOLUTION MOOTING COMPETITION

28 JULY – 3 AUGUST 2013

HONG KONG

MEMORANDUM FOR RESPONDENT

ON BEHALF OF:	**AGAINST:**
CFX Ltd	Energy Pro Inc.
RESPONDENT	**CLAIMANT**

TEAM NO. 716R

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LIST OF ABBREVIATIONS

Arbitration Agreement	arbitration clause between Parties
Art.	article / articles
CLAIMANT	Energy Pro Inc.
No.	number
p. / pp.	page / pages
Para.	paragraph
Parties	CLAIMANT and RESPONDENT
Purchase Contract	contract for the sale of gearboxes between Parties
RESPONDENT	CFX Ltd
Tribunal	China International Economic and Trade Arbitration Commission
v.	versus

INDEX OF AUTHORITIES

Karton, J.	Contract Law in International Commercial Arbitration: the Case of Suspension of Performance, ICLQ vol. 58, 2009 *cited as: Karton*	**19,24**
Onyema, E.	International Commercial Arbitration and the Arbitrator's Contract, Routledge, 2010 *cited as: Onyema*	**16**
Redfern, A.; Hunter, M.	The Law and Practice of International Commercial Arbitration, 3rd ed., Sweet & Maxwell, 1999 cited as: Redfern/Hunter	**1**
Weigand, F.B.	Practitioner's Handbook on International Commercial Arbitration, Oxford University Press, 2009 *cited as: Weigand, Frank-Bernd*	**9**

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	cited as: Cable drums case	
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INDEX OF LEGAL INSTRUMENTS

	cited as: CIETAC Rules	**13,14,17**
CISG	United Nations Convention on Contracts for the International Sale of Goods of 1980 *cited as: CISG*	**19,20,21, 22**
UNIDROIT	UNIDROIT Principles of International Commercial Contracts of 2010 *cited as: UNIDROIT*	**4,8,18, 19,20,20, 24,26,27, 28,29,31**
PECL	The Principles of European Contract Law (PECL) of 2002 *cited as: PECL*	**33**
PRC Arbitration Law	Arbitration Law of the People's Republic of China of 2004 *Cited as: PRC Arbitration Law*	**1,3,9**

ARGUMENT ON JURISDICTION

I. FUTURE ENERGY CANNOT BE BROUGHT INTO THE ARBITRATION PROCEEDINGS

1. Pursuant to Art. 6 of CIETAC Rules, Tribunal is competent to determine the existence and validity of arbitration agreement and its jurisdiction over an arbitration case [*Art. 20, PRC Arbitration Law; Born, pp. 855-856; Redfern/Hunter, pp. 5-39*].
2. CIETAC Rules is the law applicable to the arbitration agreement because parties opted for it [*Claimant exhibit No. 2; Art. 4(2), CIETAC Rules*]. According to these rules an agreement to arbitrate must be made in compliance with the law applicable to it (**A**). Additionally, there must be consent from RESPONDENT (**B**) and an arbitration agreement must fulfil formal criteria (**C**). Neither of these criteria is fulfilled by Future Energy and thus cannot participate in the present proceedings and Tribunal doesn't have jurisdiction over its claims.

A. Future Energy's agreement to arbitrate was unlawfully induced

3. PRC arbitration law as the *lex loci arbitri* [*Art. 5(3), CIETAC Rules; Art. 5(1,a) NY Convention*] shall be applicable to the material validity of arbitration agreement. It prohibits conduct when *"one party forces the other party to sign an arbitration agreement by means of duress,"* but does not provide a legal definition of the term [*Art. 17(3) PRC Arbitration Law*].
4. UNIDROIT, which is the law applicable as *lex causae* [*Art. 5(1)(a), NY Convention*] defines duress under the heading Threat in Article 3.2.6. It requires unjustified character that leaves no reasonable alternative and the act constituting threat may be but does not necessarily have to be wrongful in itself [*Art. 3.2.6, UNIDROIT*]. According to Claimant

Exhibit No. 5, CLAIMANT explicitly intimidated Future Energy by litigation. UNIDROIT itself considers *"bringing of a court action for the sole purpose of inducing the other party to conclude the contract on the terms proposed"* as threat [*UNIDROIT commentary, p. 107*].

5. Importantly, the agreement *"would not otherwise have been made either at all or, at least, in the terms in which it was made"* and that precisely is the case at hand [*Huyton SA, 637*]. It is clear that *"the consent of* [*Future Energy*] *was overborne by compulsion so as to deprive him of animus contrahendi"* and hence must be invalid [*Occidental, 293*].

B. RESPONDENT never agreed to arbitrate with Future Energy

6. The intention not to bind third parties such as Future Energy to the arbitration agreement between Energy Pro and CFX is clear from the facts **a)** and even if Tribunal decided otherwise, *contra proferentem* interpretation should be used **b)**. Moreover, no contract law principles can be invoked to supplement CFX's consent **c)**.

a) <u>There is no consent from CFX prior to arbitration</u>

7. The validity of an arbitration clause is related to the issue whether Parties consented to arbitration [*Art. 5(2) CIETAC Rules; Zurich, 682, 687*]. Pursuant to the arbitration clause arbitration on one hand covers *"all disputes arising from or in connection with* [*it*]*"* but on the other hand *"is binding upon both parties"* hence it seems that disputes with third parties are not covered. Accordingly, the task conferred on every arbitrator is to follow the clearly expressed intentions of parties [*BGH, 1955; ICC Award No.2138; ICC Award No.4392*].

b) <u>Arbitration Agreement must be read *contra proferentem*</u>

8. The principles of interpretation applied to arbitration agreements are the same as general principles frequently adopted with respect to all contracts [*Centre International, 226-33*]. Thus, the *contra proferentem* rule provides that *"if contract terms supplied by one party are unclear, an interpretation against that party is preferred"* [*Art. 4.6, UNIDROIT*]. *"The party responsible for drafting the ambiguous or obscure text should not be entitled to rely on that ambiguity or obscurity" [Fouchard/Gaillard/Goldman, p. 479; ICC Award 4727*]. Accordingly *"is binding upon both parties"* must be interpreted as not having regard to Future Energy.

c) Common law principles of implied consent are inapplicable

9. Even if recognized by Tribunal, these principles are widely used only in the USA pursuant to the *"federal policy favoring arbitration"* [*Seaboard, 657, 660*]. However, according to *lex loci arbitri*, attempts have occasionally been made to join third parties, by relying on those concepts [*veil- piercing, alter ego, etc.*], however the traditional view is that PRC law adopts a relatively restrictive approach to such attempts [*Weigand, Frank-Bernd, p. 252*]. Without *"threaten*[*ing*] *to overwhelm the fundamental premise that a party cannot be compelled to arbitrate a matter without its agreement"* [*Bridas, 347*], Tribunal should find that Future Energy shall not participate in the proceedings.

C. Formal criteria of Future Energy's agreement are not fulfilled

10. Alternatively, according to standards of international commercial arbitration, the agreement to arbitrate has to fulfil certain formal criteria, namely it shall be in writing or contained in an exchange of letters, telegrams or even emails [*Art. 5(1), CIETAC Rules; Art. II(2), NY Convention*]. In the case at hand, CLAIMANT's letter dated 1 January 2013 could ad absurdum be viewed, as an offer to conclude a submission agreement to arbitrate

but it would not match the said formal criteria. Moreover, even if there were subsequent appearance by both parties before the arbitrator [*OLG Düsseldorf, p. 237*] or subsequent tacit acceptance [*Marc Rich, p. 544; OLG Rostock*] this would not stand as a valid agreement to arbitrate. Needless to say that such an agreement was never signed. [*Delta, p. 854*]. Future Energy never agreed to arbitrate *"in writing"* and as a result cannot participate in the proceedings.

II. MS. ARBITRATOR CANNOT RESIGN DURING THE PROCEEDINGS

11. Chairman of CIETAC Rules is entitled to make a final decision on whether or not an arbitrator should be replaced [*Art. 31(2), CIETAC Rules,*]. CLAIMANT failed to fulfils its obligations under CIETAC Rules and it has to rectify the situation by deposing additional fees to Ms. Arbitrator, which would lead to her non- resignation (**A**). Even if her right to remuneration was not proved, her resignation is unjustified (**B**). Alternatively, there is no sound legal basis under CIETAC Rules to substantiate her resignation (**C**).

A. Ms. Arbitrator is entitled to remuneration

12. According to art. 72 par. 1 CIETAC Rules a party to arbitration is legally obliged to pay arbitrator's remuneration. Moreover, it is unquestionable that remuneration for arbitrator's services is *a sine qua* non obligation and is accordingly recognized in international instruments [*Art. 72, CIETAC Rules; Arts. 40- 43, UNCITRAL Rules; Art. 28(1) LCIA Rules, etc.*] and national laws [*§28(2), English Arbitration Act 199; Art. 814, Italian Code of Civil Procedure; §40(1), Singapore Arbitration Act*]. It is so important that an arbitrator is entitled to [*her*] remuneration even when the award is worthless to the parties, as long as [*she*] was not negligent [*Cohen, 731*].

13. It is also clear from the facts that the only reason standing behind Ms. Arbitrator's resignation is the lack of remuneration for her services [*Procedural Order No. 1, p. 22; Procedural Order No. 2, par. 10*]. *"*[*Ms. Arbitrator*] *is entitled to make a reasonable demand for interim payment and to enforce it with the sanction of resignation"* [*Turner, 316*]. Stemming from CLAIMANT's obligation under Art. 72, CIETAC Rules and *"bona fide cooperation"* under Art. 9 CIETAC Rules, it must rectify the situation by deposing the additional fees.

14. The imperative outcome of the CLAIMANT's non-conforming conduct envisaged by CIETAC Rules is that it *"shall be deemed not to have nominated the arbitrator"* [*Art. 72(2), CIETAC Rules*]. Consequently a new arbitrator would be appointed by the Chairman of CIETAC Rules [*Art. 25 (1) CIETAC Rules,*]. This would, on one hand, lead to the CLAIMANT's loss of the right to nominate an arbitrator. On the other hand it could also result in a repetition of the proceedings [*Art. 31 (4), CIETAC Rules*] with a new full panel [*Marine Products, 68*].

15. Consequently, CLAIMANT is to be bound to pay the additional fees on the basis of a procedural order issued by Tribunal under Art. 21 CIETAC.

B. Ms. Arbitrator's resignation would be unjustified

16. Before entry into the mandate, the arbitrator can decline to act if the rate of fees is unacceptable to him [K/S *Norjarl, 524; Art. 1689, Arbitration Law Belgium; Onyema, p. 134*]. This is, however, not the case of Ms. Arbitrator. *"Once appointed an arbitrator cannot unilaterally change the terms of* [*her*] *appointment* [*...*] *unless there is a significant and substantial change in the commitment required of him such as to justify the payment of further consideration"* [*K/S Norjarl, 535*]. An increase in workload can typically be avoided by refusing to accept further work that conflicts with existing commitments

[*Gusy/Hosking/Schwarz, p. 125*]. Moreover, at that stage, parties would be *"so committed to* [*her*] *services at a hearing that they would be in an inferior bargaining position to refuse"* [Turner, 316]. As a result, Ms. Arbitrator's resignation is unjustified.

C. Alternatively, even if it was justified, Ms. Arbitrator's resignation falls outside the scope of CIETAC Rules

17. In accordance with CIETAC Rules Ms. Arbitrator's resignation could only be based on explicit grounds provided for in articles 30 and 31 without encompassing lack of remuneration after the procedures commenced. Unlike the UNCITRAL Model Law for example, which includes resignations *"for any other reasons"* [*Art. 15, UNCITRAL Model Law*]. However, the choice of law by the parties is clear hence the "stricter" CIETAC regime shall be upheld.

III. ENERGY PRO COULD NOT VALIDLY TERMINATE PURCHASE CONTRACT

A. CLAIMANT's termination of contract is prevented because of its prior suspension by RESPONDENT

18. RESPONDENT may withhold performance under Art. 7.1.3 UNIDROIT **a)** based on timely non-conformity notice delivered to CLAIMANT **b)**, which corresponds in effect to civil law concept *exceptio non adimplenti contractus* preventing termination of contract previously suspended **c)**.

a) Notion of withholding of performance under Art. 7.1.3 UNIDROIT

19. "Where the parties are to perform consecutively, the party that is to perform later may withhold its performance until the first party performed" [*Art. 7.1.3(2), UNIDROIT; Art.*

6.1.4, UNIDROIT]. Purchase Contract implies the consecutive character of parties´ performances, under which RESPONDENT is obliged to make the payment only after the gearboxes are delivered, which allows the application of the aforementioned article [*Art. 1 par. 1.2 (b.)(iii.), Purchase Contract*]. UNIDROIT does not determine any further requirements, which must be met in order to withhold the performance. Therefore it is accepted that UNIDROIT addresses the issue of withholding (or suspension, as used in CISG) as a general right to suspend [*Karton, p. 866*].

20. RESPONDENT validly suspended its performance under Purchase Contract on the grounds of performance of non-conforming goods other than stipulated by the parties in the Clause (A) of Purchase Contract [*Claimant's Exhibit No. 6*]. However, UNIDROIT, unlike CISG, does not require notice for withholding of performance, but, on the other hand, CISG must be applied to the question of non-conformity notice, which is not governed by UNIDROIT. The issue of non-conformity notice is addressed further.

21. Non-performance may be excused on the ground of force majeure if non-performing party proves all necessary conditions [*Art. 7.1.7 (1), UNIDROIT*]. However, UNIDROIT expressly excludes certain remedies for non-performance. Among other remedies it guarantees preservation of right to withhold performance of the party, which has not received performance [*Art. 7.1.7 (4), UNIDROIT*]. Even if negligence of Future Energy during certification of gearboxes was established as force majeure, CLAIMANT of its contractual obligation to deliver conforming gearboxes cannot rely on negligence of Future Energy as an excuse for its non-performance because force majeure has no impact on the suspension of performance by RESPONDENT. Therefore the non-performance, although excused by reason of force majeure, does not prevent RESPONDENT from withholding its performance under Purchase Contract.

b) Non-conformity notice was given to CLAIMANT in time under Art. 39 CISG

22. If a party wants to rely on non-conformity of goods and subsequently seek remedies it must issue a notice of non-conformity within "reasonable time" period [*Art. 39, CISG*].

23. As to the issue of timeliness of non-conformity notice, the Swiss Federal Supreme Court upheld that it is not necessary to apply *"strict standard […] to the time limit for the examination"* and consequently *"the buyer should not be burdened with strict legal standards when a breach of contract by the seller is at issue"* [*Cable drums case*]. The period, in which the notice was given to CLAIMANT, does not exceed the reasonable time, considering the fact that it was CLAIMANT who had breached its primary contractual obligation – to deliver goods in conformity with Purchase Contract. RESPONDENT reasonably relied on the certification of Future Energy, which was appointed jointly by both parties in Purchase Contract as a certification company and which developed the 1.5 MW wind turbines, presuming its expert knowledge for examination of goods.

c) Exceptio non adimplenti contractus and its effects on termination

24. Official Commentary to UNIDROIT states with regard to Art. 7.1.3(2) that *"this Article…corresponds in effect to the civil law concept of exceptio non adimplenti contractus." "The exceptio non adimplenti contractus is pleaded to assert that the creditor's obligation never came into existence because of non-performance by the debtor"* [*Karton, p. 868*]. A buyer is entitled to withhold its performance providing he notifies the seller about the non-conformity of goods first and *"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"* [*Award No. 8547*]. ICC also expressly invoked the *exceptio non adimplenti contractus* principle, in a sense that it is a

right of a party to suspend performance after raising the *exceptio*. As the legal basis for the withholding of performance ICC mentioned general principle embodied in Art. 7.1.3 of UNIDROIT.

25. In terms of the concept of *exception non adimplenti contractus* RESPONDENT argues that its obligation to pay the purchase price never came into existence because CLAIMANT failed to fulfil its obligation to deliver gearboxes of quality stipulated by the Parties under Clause (A) [*Art. 10.2, Purchase Contract*] and consequently the contract cannot be terminated by CLAIMANT, as RESPONDENT never breached any of its payment obligations.

IV. CLAIMANT is not entitled to claim termination penalty

A. Termination penalty claimable only upon valid termination of Purchase Contract

26. CLAIMANT is entitled to termination penalty only if it validly terminates the contract [*Art. 15.2, Purchase Contract*]. Based on the arguments regarding issue of termination of Purchase Contract addressed above, CLAIMANT did not terminate the contract validly and therefore his claim to termination penalty has never arisen.

B. Even if termination penalty was adjudicated to RESPONDENT, stipulated amount shall be mitigated as "grossly excessive" pursuant to Art. 7.4.13 UNIDROIT

27. Termination penalty stipulated between Parties is "grossly excessive" pursuant to Art. 7.4.13 UNIDROIT **a)** and shall be mitigated by Tribunal to amount appropriate to circumstances of case **b)**.

a) Termination penalty "grossly excessive" under the circumstances of case

28. Termination penalty falls within scope of agreed payment for non-performance pursuant to Art. 7.4.13 UNIDROIT, which, however, must be adequate to the circumstances, especially to the harm sustained by aggrieved party [*UNIDROIT commentary, p. 285*].

29. Close parallel to the case at hand was drawn by drafters of UNIDROIT in the commentary to the said article, where the contract between the parties was concluded with clause allowing seller to terminate the contract and keep payments for all instalments already paid plus claim additional amount of money representing outstanding payments in case buyer fails to pay one of its instalments. At this point UNIDROIT Commentary expressly states that *"the court will reduce the amount"* because it would amount to the grossly excessive benefit for the seller [*UNIDROIT commentary, pp. 285-6*].

30. The situation in the case at hand is practically the same, while USD 2 mil. represents payments already made by CFX and termination penalty in the amount USD 8 mil. equals to future, still outstanding payments which amounts to the total value of the relief claimed by Energy Pro - USD 10 mil., which is given the circumstances *"grossly excessive"*.

b) Tribunal should mitigate *"grossly excessive"* termination penalty

31. Tribunal is entitled to mitigate the amount of *"grossly excessive"* termination penalty stipulated by Parties [*Art. 7.4.13 (2), UNIDROIT*]. This provision is of exceptional importance as it is one of the mandatory provisions referred to by Art. 1.4 UNIDROIT, from which the parties to the contract may not derogate [*UNIDRIOT commentary, p. 285*] and some publicists list this principle among those, which should receive more weight than others [*van Houtte, p. 184*].

32. This right to mitigate penalties or damages stipulated by the parties in their contract prior to the occurrence of harm or damage has been used in several cases by national courts as well as international tribunals, *e.g.* before the International Arbitration Court of the Chamber of Commerce and Industry of the Russian Federation [*Case No. 88/2000; Case No. 134/2002*] or by the ad hoc Helsinki Tribunal in 1998 [*Ad hoc Helsinki*] and others.

33. Support for this principle may be found also in other instruments relating to international commerce, such as PECL in Art. 9:509 (*"agreed payment for non-performance"*), as well as in the Council of Europe Resolution, which among main characteristics of civil law on contractual penalties includes also judicial review of penalties on the ground of equity. [*Marín García, Art. 3.1*] Even in the most national legal systems, Courts are entitled to review and mitigate penalties, which are disproportionate to the extent of harm or damage (such as Germany, France, Belgium, Luxembourg, Italy, Portugal, etc.) [*Fontaine/ De Ly, p. 342*].

34. Therefore, based on the aforementioned, should the tribunal find Claimant´s claim for termination penalty legitimate, Respondent requests the tribunal to mitigate penalty to the amount reasonable in the circumstances of the case at hand.

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PRAYER FOR RELIEF

35. In light of the submissions made above, RESPONDENT respectfully requests Tribunal to declare that:

- CLAIMANT cannot bring Future Energy into the arbitration proceedings;
- Ms. Arbitrator cannot resign during the arbitration proceedings;
- CLAIMANT did not validly terminate the contract; and
- CLAIMANT cannot claim the termination penalty.

Respectfully signed and submitted by counsel on June 21, 2013.