JUDGMENT : Mr Justice David Steel : Commercial Court. 2nd February 2005

Introduction

1. The Claimants' application is under Section 67 of the Arbitration Act 1996. It challenges an Appeal Award No.3923 of the GAFTA Board of Appeal dated 9th May 2002 in regard to substantive jurisdiction. In the award, the Board of Appeal found that the Respondents ("GROUPCO") were not bound by a contract for the sale of 300,000 mt. of soybean meal to the Claimants ("CEL") and, accordingly, that the Board had no jurisdiction to entertain CEL's claim against GROUPCO under the contract.

2. CEL is a trading company incorporated in Bermuda with a branch office in Hong Kong. GROUPCO is an agri-business company engaged in poultry processing based in the Shandong Province of China.

3. By a contract dated the 2nd July 1997, CEL agreed to sell 300,000 mt. Brazilian and/or Argentinean soybean meal C&F FO one safe Chinese port, shipment in six instalments of 50,000 mt. between May and September 1998 ("the July contract")

4. The buyers were identified in the contract as GROUPCO. GROUPCO contend that this contract was void on two principal grounds:

   a) that, by reason of the limited scope of business permitted by its articles of association and/or by reason of the absence of a Ministry of Foreign Trade and Economic Co-operation ("MOFTEC") licence to import goods into China, GROUPCO did not have the legal capacity to enter into the contract and, accordingly, it was void

   b) or alternatively that, by reason of the absence of a MOFTEC licence, the contract was void for illegality.

5. There was an affiliate of GROUPCO called Shandong Zhucheng Foreign Trade Co. ("FTC") which had been granted a MOFTEC licence in 1994. A further contention of GROUPCO to the effect that the identification of GROUPCO as the buyers in the July contract was a mistake (in the sense that the true intention of the parties was to effect an agreement between CEL and FTC) played a further but subordinate role in the argument.

6. The July contract provided as follows: -

   "*13. ARBITRATION*

   Any dispute arising under or in connection with this contract, the parties shall attempt in the first instance to resolve such dispute through friendly consultations. If the dispute is not resolved in this manner within forty-five (45) days after the commencement of discussion, then the dispute shall be referred to arbitration in accordance with the rules as per GAFTA CONTRACT No.125 and with arbitration to be held in Hong Kong.

   14. FORCE MAJEURE

   Sellers shall not be responsible for delay of the shipment of the goods or any part thereof occasioned by any Act of God, strike, lockout, riot or civil commotion, combination of workmen, breakdown of machinery, fire or any other causes beyond Seller's control subject to usual force majeure practice.

   15. OTHER TERMS

   All import duties, taxis, licences, levies, dues etc, present or future to be for Buyer's account and risk. Buyer guarantees import licence. Failure to obtain import licence cannot be claimed as "Force Majeure". Buyer shall bear all costs and consequences associated with a failure to secure proper import licences and quotas for the import of the goods.

   …All other terms and conditions where applicable and not in contradiction to the above are as per GAFTA CONTRACT No.100….

   16. GOVERNING LAW

   This contract will be governed by English laws."

7. On the 9th March 1998, the July contract was amended by Addendum I (revised). Some of the details relating to the May and August shipments were changed, the June and July shipments were cancelled at par and the September shipments were postponed to October and November (with an option for the buyer to request a wash-out).

8. In late April 1998 the buyers sought to open a letter of credit in respect of the first shipment. The issuing bank appears to have taken the point that, since GROUPCO did not have an appropriate import licence, it was not entitled to apply for a letter of credit. The "buyers" accordingly requested that the July Contract and Addendum I should be cancelled and a new contract in the name of FTC be entered into.

9. In response CEL furnished a draft Addendum II for execution by GROUPCO. This provided: -

   "i. Shandong Zhucheng Foreign Trade Group Co. nominates Shandong Zhucheng Foreign Trade Co. as buyer to execute the above contract.

   ii Shandong Zhucheng Foreign Trade Group Co. will guarantee the performance of Shandong Zhucheng Foreign Trade Co."

10. The outcome, following a series of faxes and telephone conversations, was that this Addendum II was not executed but both the July contract and Addendum I were amended by deletion of the word "Group" where it appeared (an amendment confirmed by FTC) together with a cancellation by FTC of GROUPCO's earlier signature and stamp or chop ("the April agreement").

11. An Addendum II was in due course made on the 21st May 1998 between FTC and CEL but this was confined to postponing the May shipment to June/July and reducing the price for that shipment from $231 per mt to $200 per mt.

12. This initial shipment was duly performed. The second and third shipments had been cancelled by virtue of the terms of Addendum I. However, the buyers did not open a letter of credit at the contractually stipulated time in respect of the fourth, fifth and sixth shipments. In the result CEL notified FTC in September 1998 that the buyers were in default and invoiced FTC for damages, the market price now having fallen to about $150 per mt.

13. In November 1998 CEL instituted arbitration proceedings against FTC and then later, in February 1999, against GROUPCO. On the 9th November 2000 award No.12550A was produced by the first instance tribunal in respect of the claim brought by CEL against GROUPCO. The tribunal found that by reason of the April agreement FTC were substituted for GROUPCO and that GROUPCO were thereafter no longer a party to any agreement with CEL. CEL appealed and, as noted earlier, by Appeal Award No.3923 dated 9th May 2002, the first instance tribunal's award was upheld.

14. On the 27th November 2000 award No. 2550 was produced by the GAFTA first tier tribunal which found FTC to be in breach of contract and liable in the sum of $9.5 million. That award was also upheld on appeal (see Award No.3926). This latter award is still the subject of enforcement proceedings in the Shandong High Peoples' Court. Those proceedings were commenced as long ago as October 2002. FTC challenges both recognition and enforcement of the award. The basis of that challenge is somewhat obscure. One documentary source suggests that FTC are relying on the existence and content of the present proceedings as justifying the Chinese court re-examining the contractual position. Another source asserts that FTC are complaining that the GAFTA tribunal failed to act fairly and impartially by refusing to order CEL to call a particular witness and in refusing to make an order for further disclosure.

Background

15. There had been a number of earlier contracts between CEL and the Zhucheng organisation although most of them involved smaller parcels of soybean for relatively prompt delivery. Notably, although the buyer had been from time to time initially identified as GROUPCO, those contracts were amended by deletion of the word "Group" so as to specify the buyers as FTC, an amendment sometimes formally recognised by the re-execution of the contract and sometimes not.

16. A much larger transaction was entered into in December 1996 for the supply of 150,000 mt tons of soybean meal for delivery in May, June and September 1997. This time the buyers were named as Golden Link Trading Limited ("GL"). GL was a brokerage company largely owned by GROUPCO and based in Hong Kong through which all these agreements were negotiated. The principal of GL was a Mr Simon Wong.

17. The sales recap for the July agreement named GROUPCO as the buyer. Shortly thereafter CEL despatched a draft contract to GL by fax. This particular document is no longer available (or at least was not produced by either party on disclosure). GL quickly returned the document by fax with various alterations bearing its chop. The buyers in this version of the contract are identified in type as "GOLDEN LINK TRADING LTD FOR AND ON BEHALF OF THE SHANDONG ZHUCHENG FOREIGN TRADE GROUP CO". The signature page recorded the buyer as GL (for which an authorised signature was applied) to be "confirmed by" GROUPCO.

18. It was GROUPCO's case that the insertion of GROUPCO's name in the draft contract had been mistakenly made by CEL and included in the draft sent to GL. It was also GROUPCO's case that the mistake was soon spotted, the word Group was struck out and the alteration signed and stamped by FTC. In contrast it was CEL's case that GROUPCO's name was inserted by GL, that GROUPCO did in due course confirm the contract and that no suggestion was made that GROUPCO's name should be removed until April the following year.

19. In resolving this issue I had the benefit of a number of witness statements, including statements from Simon Wong and from Nelson Cheng, a commodity trader at CEL who was responsible for negotiating the July contract. In addition to their statements, I also heard oral evidence from Mr Christian Topuz, President of CEL at the relevant time and from Miss Zhao Lijun, the Import Manager of FTC and Mr Wang Jing Ou, the General Manager of both GROUPCO and FTC at the relevant time. (The latter two gave evidence by video link with Beijing and the court is grateful to them for sitting very late into the evening (gmt plus 8) to assist the court.)

20. There were problems with the oral evidence. Mr Topuz was not directly involved in the negotiations and accordingly his evidence was in large part based on reconstruction from the documents. In contrast, the defendants' witnesses had been intimately involved but had some difficulty in facing up to the inconsistencies between their evidence and the content of the documents. This was no doubt exaggerated by the manner in which their evidence was taken and by the need for interpretation from Mandarin. In the result, I have inevitably placed considerable reliance on the contemporary documentary material.

21. I am not sure that the determination of this issue takes matters very far. But for what it is worth, I have no doubt that CEL's version is to be preferred: -

    a) GL had put its chop against the buyer's name and the box for "confirmation" by GROUPCO. This is only consistent with it being an amendment introduced by GL and not, as suggested by Miss Zhao, with highlighting an existing entry as requiring further clarification or amendment.

b) The draft contract despatched by CEL on the 7th July has the buyer's name and address in a different typeface to any other part of the document. This typeface matches amendments made by GL on other documents.

c) Miss Zhao had apparently discussed the amendments on the telephone with Miss Aubrey Ou of GL on the 7th July. Miss Zhao suggested in her evidence that on the 8th July she saw copies of both the original faxed draft contract from CEL and the amended version that had been prepared by GL following the earlier telephone call. She claims to have thereupon crossed out the word GROUPCO, obtained the signature of Mr Wang together with the FTC chop and faxed the same back to CEL via GL. This is a surprising and unconvincing account for various reasons. First, the document identified by Miss Zhao as having been faxed back by her does not appear to have been originally sent by fax from GL to GROUPCO. Second, if Miss Zhao had discussed the terms of the contract and any suitable amendments with Miss Ou, there is no apparent reason for not having given instructions to her to cross out GROUPCO before application of the GL chop. Third the document does not form part of CEL's disclosure and Mr Topuz does not recall its receipt. Fourth it seems wholly improbable that Mr Wang would mistakenly sign the final hardcopy contract in the name of the wrong company and allow his secretary to apply the wrong chop if in fact the mistake had already been identified. Fifth, it is clear from the amendments made by GL to Addendum I in April 1997 that Mr Simon Wong of GL still regarded it as appropriate when amending GL's status from that of buyer to that of agent not to change the name of the buyer from GROUPCO. Sixth, it is clear from the terms of the application for the letter of credit for the May shipment (and indeed the reported response of the bank) that the buyer was still being treated by Zhucheng as GROUPCO and there was no suggestion when the bank objected to an application in their name that the "mistake" had emanated from CEL.

22. For all these reasons I conclude that the July contract was made with GROUPCO as buyer. Certainly CEL on any objective analysis might have intended to contact with GROUPCO. GL equally intended to act on behalf of GROUPCO having entered their name on the contract and maintained it for Addendum 1. In my judgment, no proposal to alter the name of the buyer by way of crossing out the word Group was promoted until after the initial rejection of the letter of credit application in March 1998. It follows that to the extent that the point is still alive I hold that no mistake was made as to the identity of the buyers. Further, there is no basis for seeking rectification of the July contract and indeed no such claim was ever pleaded. If any mistake was made by GROUPCO/FTC it was entirely unilateral and unknown to CEL.

23. On the other hand I should make it plain that I also reject the submission made on behalf of CEL that CEL was only prepared to enter into the contract if the buyer was GROUPCO. If such had been the case, CEL would indeed have inserted their name in the draft contract. I have not forgotten the evidence of Mr Topuz that GROUPCO were identified as the flag ship company with a sufficient net asset worth to support the scale of the contract. In this regard he placed particular emphasis on the note prepared by him following a meeting between Jens Ripken and Nelson Cheng of CEL and Simon Wong of GL on the 17th July. The purpose of this meeting, from CEL's perspective, had been to sound out GL's relationship with Zhucheng. The conclusion was that GL (with whom the large scale December 1996 contract had been entered into) was largely a "speculative" organisation with an exclusive agency "for any imports and exports for Zhucheng Foreign Trade". Mr Ripken's recommendation was that CEL should be careful and look to "Zhucheng Foreign Trade" rather than GL as the final receiver.

24. The day after the meeting Nelson Cheng sent to Mr Topuz an e-mail identifying the asset position of Zhucheng Foreign Trade Corporation. In his e-mail dated the 25th July Mr Topuz emphasised the disparity between GL the buyer under the contract on the one hand ("no asset, no value and can only be considered/analysed through its parent Zhucheng") and the co-signatory Zhucheng on the other hand ("undoubtedly a strong and solid counterpart"). He went on: -

"Mr Wang started in 1989 this small company with the direct blessing of Moftec and top officials in Beijing including Jiang Zeming and Li Peng to name a few of them. He turned it into a successful group of companies quite diversified…. They obtained recently according to what they say the "comprehensive status" which gives them a lot of flexibility for import and export…. Last but not the least we have the beginning of a track record with them": [and thereafter are set out the 1996/7 contracts with FTC and/or GL.]

In particular, I do not accept that any distinction between GROUPCO and FTC was being focused upon. The only contrast was between GL and Zhucheng.

April Contract

25. Miss Zhao started preparing the first letter of credit application in March 1998. The application form was filled out in the name of GROUPCO and reflected the amendments contained in Addendum I. The beneficiary was to be GL. (Although GROUPCO at some stage proposed that the letter of credit should be opened directly with CEL, in fact GL later applied to open a back-to-back credit in favour of CEL.) Both applications seemed to have been filed in late April.

26. In the meantime CEL had fixed a vessel for the shipment with laycan dates in May. On being pressed for the opening of the letter of credit, Miss Zhao sent the following fax to Nelson Cheng on the 7th April: -

"Regarding the contract signed on July 2 1997…. and the Addendum I (revised) dated March 9 1998 at both the beginning and the end there were the name of "Shandong Zhucheng Foreign Trade Group Co. After signed by Mr Wang, it was also chopped. Due to negligence, we used the chop of the group company according to the English name. Since it was long before the performance date, we did not notice the mistake.

When we approached the bank to apply for the letter of credit, the bank discovered during examining the documents we submitted that the party confirmed the contract was "Shandong Zhucheng Foreign Trade Group Co." Since this

company is not approved to be engaged in export trade, therefore it cannot be the party to the contract or the LC applicant. It should be amended to be "Shandong Zhucheng Foreign Trade Co."

In order to secure the LC for the shipment at the end of May and facilitate future custom clearing on our side, please cancel the …. Contract and the addendum I (revised) then conclude a new contract. The new contract will be final. The name of our parties should be Shandong Zhucheng Foreign Trade Co.". …

27. Mr Cheng duly reported the request to CEL's administration in an internal e-mail. He reported the fact that the buyers needed the name of the contractual party to be amended for the purposed of opening the documentary credit. In response, Mr Raymond Cheng, CEL's Trade Administration Manager, sent a proposed form of Addendum II whereby it was contemplated, as already noted, that FTC would be nominated as buyer and GROUPCO would guarantee the performance of FTC. In his covering fax, he said: "Attached please find an addendum amending the name of the buyer to [FTC] to perform the contract". Later the same day Nelson Cheng sent an e-mail to FTC and to Simon Wong at GL which said…. *"We herewith pleased to inform you that enable for you to open the letter of credit immediately for 50,000 mt of …soyabean meal pellets in bulk for May shipment, we agree to amend the name of the buyer as per your request. Please kindly find the amendment contract which we sent it to you by fax this morning. Please urgently expedite and advise when the said letter will be ready to collect in our bank."*

28. However matters had been overtaken by events. As appears from a manuscript note on the fax accompanying Raymond Chan's proposed draft, GROUPCO/FTC had in the meantime taken steps to delete the word "Group" from the July contract and Addendum I so as to prosecute the letter of credit application. The resulting documents were forwarded on the 28th April to CEL. The amendments, including the confirmation by FTC and the cancellation of GROUPCO's confirmation, were seen by both Nelson Cheng and Mr Raymond Chan. The former chopped and signed the amendments.

29. By now the market price had fallen substantially, indeed to under $200 per mt. (Notably in early May the bank to whom GROUPCO had made its original application sent a fax to FTC giving a somewhat different reason for not issuing the letter of credit namely that the contract price was "obviously too high" in contrast with the current CIF price and that therefore "this transaction is risky to the bank".) The parallel concern of CEL is well advertised by the terms of an internal e-mail of the 12th May from Mr Soren Schroder, CEL's General Manager of International Risk based in Switzerland, to Mr Topuz: -

"At $200 mt basis pellets we are still about $30 above replacement … The pellets are being produced and the vessel is fixed. We have to execute otherwise we lose the quality pick-up as well as costs of "reselling" somewhere else.

My suggestion is therefore pragmatically is to do whatever it takes to get the l/c opened at $200 even if it includes amending this part of the CTR tpo $200 w/o having a clear agreement of how they will repay $1.5 million. The $1.5 million is "nothing" compared to the outstanding on the balance…. and this will have to be dealt with as a global issue at a later stage. The KEY is to get this vessel first executed…. almost whatever it takes….."

30. These considerations duly led to the execution of Addendum II with FTC on the 21st May whereby the price for the first shipment was reduced to $200.

The Primary Issues

31. Numerous issues were raised during the course of the hearing but the primary ones can be summarised as follows:
    a) Was the July contract a valid and enforceable agreement between GROUPCO and CEL or did GROUPCO lack legal capacity to enter into the agreement or was it void by reason of illegality?
    b) If the July contract was not valid and enforceable, who were the parties to the April contract? Was FTC purporting to act on behalf of GROUPCO and if so did it have authority to do so? If not, did Nelson Cheng have authority to conclude a contract with FTC?
    c) If the July contract was valid and enforceable, what was the effect of the April contract? Was it a new or novated agreement whereby FTC replaced Group Co as buyer? If so, did Nelson Cheng have authority to agree to this substitution on CEL's behalf? Or alternatively did GROUPCO remain liable under the July contract with FTC acting as agent for GROUPCO? If so, did FTC have authority to act on GROUPCO's behalf?

Was the July Contract valid and enforceable?

32. In one sense this question may be beside the point given the nature of the challenge to the award being one relating to the tribunal's substantive jurisdiction. There is potentially a prior question as to whether the arbitration clause survived any invalidity of the underlying contract. The GAFTA Tribunal held that there was no arbitration clause in existence between GROUPCO and CEL. It is CEL's contention however that the arbitration clause is severable and that accordingly the tribunal, despite its view on the merits, had jurisdiction. Thus it was submitted its entire award had to be set aside.

33. GROUPCO's submission on this issue underwent several upheavals. In their written opening, GROUPCO contended that the arbitration clause did not survive the invalidity of the July contract. This was soon overtaken by a supplementary skeleton in which the reverse was contended with the add-on submission that accordingly it was open to the tribunal to find that the whole contract was void, a finding which this court had no jurisdiction to reverse. During the trial, GROUPCO had second thoughts and reverted to their previous stance.

34. I propose to put aside this threshold issue for the moment, since both parties have invited me to decide all the issues raised before me, regardless of whether the tribunal in fact had substantive jurisdiction and regardless of whether in those circumstances my conclusions on the merits would be binding in the event of any rehearing before the tribunal.

Expert Evidence

35. The questions of legal capacity, illegality and authority raised issues of Chinese law. In this regard I had the benefit of very distinguished experts being called to give evidence by each party. The claimants called Professor Bing Ling an associate professor at the School of Law at the City University of Hong Kong. The defendants called Mdme. Zhang Yuejiao, now with the Asian Development Bank, but formally director of the Trade Law Division of MOFTEC. Whilst I derived great assistance from both of them, on the major controversial issues I felt greater confidence in the evidence of Mdme. Zhang supported as it was by first hand experience in the field.

Trade Licence

36. The Foreign Trade Law of the People's Republic of China 1994 provides as follows:

1. "Article 8 Foreign trade operators as used in this Law refer to the legal persons or other organisations engaged in the operative activities of foreign trade in accordance with the provisions of this Law.

Article 9 Foreign trade operators handling the import and export of goods or technologies must satisfy the following conditions and obtain the permission from the competent department in charge of foreign economic relations and trade under the State Council:

…….

2. having clear-cut business scopes of foreign trade

3. having premises, funds and professionals needed for the foreign trade business they are engaged in

4. having filled the required performance or having necessary sources of goods for import and export in the case of entrusting others to handle imports and exports."

37. It was CEL's case that, despite this provision, GROUPCO did not require permission from MOFTEC (for convenience called a "foreign trade permit") to enter into the July contract. The thrust of this argument was that the July contract was a C&F free-out contract with provision for documents to be tendered to a first class bank in Hong Kong. Such a contract, so the submission ran, is a contract for the sale of documents without any obligation to import the goods: see e.g. ***Congimex Companhia Geral je Commercio Importadora and Exportadora Sarl against Tradex Export S.A.*** [1983] 1 Ll.Rep.250, ***Bangladesh Export Import Company v Sugden Kerry S.A.*** [1995] 2 Ll.Rep.1. Accordingly the contract did not, CEL submitted, involve GROUPCO in 'handling the import or export of goods' within the meaning of Article 9.

38. I reject this submission. In my judgment this would not reflect the approach of Chinese courts to the issue. I accept the evidence of Mdme. Zhang that the rationale for the permit system was to ensure orderly and efficient engagement by Chinese entities in foreign trade. At the time of the execution of a contract, it was intended by both parties that all (or at least some) of the parcels of cargo should be imported into China. When in due course a letter of credit was applied for, the bank correctly concluded that the contract required a foreign trade permit to have been issued to the buyer.

Capacity

39. It is common ground that GROUPCO did not have a foreign trade permit. GROUPCO contended that, accordingly, it did not have the 'legal capacity' to enter into the July contract and it was void. CEL's response was that the absence of a foreign trade permit did not create any want of legal capacity, albeit it might raise issues of legal validity.

40. The Rome Convention governs the choice of law relating to contractual obligations. There are some exceptions. The exceptions include questions governed by the law of companies, such as legal capacity. At common law, the capacity of a corporation to enter into a legal transaction such as a contract is governed primarily by the constitution of the corporation which in turn is governed by the law of the place of incorporation: **Dicey & Morris**, **Conflict if Laws**, 13th Edition, Rule 154. Mr Bing Ling contended in his oral evidence that as a matter of Chinese law, a company, once incorporated, had unlimited capacity. This surprising proposition is, in my judgment, not well founded. In particular, I was unable to accept the suggestion that the express limit on capacity in relation to natural persons in Article 58 of the General Principles of Civil Law of the People's Republic of China gave rise to any inference that the capacity of legal persons was not subject to any limitation.

41. By the same token, I was not persuaded that there was any want of capacity directly arising from the absence of a foreign trade permit. If there was any lack of capacity, it arose from the more fundamental deficiency, namely the limitations in the permitted scope of GROUPCO's business as set out in its Articles of Association.

42. Article 11 of the Company Law of the People's Republic of China reads:- *"Companies shall engage in business activities within their registered scope of business…": see also Article 42 of the General Principles of Civil Law.*

Miss Zhang rightly, in my judgment, emphasised the stark contrast between the articles of GROUPCO and those of FTC. Chapter II of the Articles of FTC read as follows:-

"Article 6. The company will carry on the export business of the commodities such as grain…

Article 7 The company will carry in the import business of the commodities such as machinery…

…

Article 8 The company will act as agent for other companies in dealing with the import and export business…

The supervisory role of Moftec is confirmed by Article 18: *This Articles of Association and its amendments come into effect subject to the examination and approval of the Ministry of Foreign Trade and Economic Co-operation of the People's Republic of China."*

43. In contrast, GROUPCO's Articles make no direct reference to non-domestic import or export business: see e.g. Article 7 "The mode of operation of the GROUPCO includes: production, purchase, processing, warehousing, sale, transportation, trade in trust and commission, whole and retail trade." Nor were they approved by (or subject to the approval of) MOFTEC.

44. I accept Miss Zhang's evidence that GROUPCO would need to change its Articles if it wanted to apply for a permit. Pending an appropriate amendment (and approval by MOFTEC), GROUPCO would have no entitlement to engage in foreign trade. This is unaffected, in my judgment, by the terms of any business or trading licence issued to GROUPCO.

45. In short, I accept that a Chinese court would hold that GROUPCO had no capacity to enter into the July contract and accordingly the contract was void: see ***Zhong Jinhua and Williams, Foreign Trade Contract Laws in China*** 1998 page 108.

46. CEL contended that, nonetheless, the contract was saved by virtue of the April agreement. This was said to be by reason of the operation of Article 9 of the PRC Law on Economic Contracts involving a Foreign Interest 1985: -

> *"9. Contracts that violate the law or the public interest of the People's Republic of China, shall be void.*
>
> *In case any terms in a contract violate the law or the public interest of the People's Republic of China, the validity of the contract shall not be affected if such terms are cancelled or modified by the parties through consultations.*

47. I reject this submission. I accept the evidence from Ms Zhang that Article 9 is concerned with preserving a contract which contains provisions that violate the law of China (i.e. illegality). It is not apt to save the entirety of a contract which is void for want of capacity. In short I hold that the Chinese court would conclude that no cancellation or modification of a term or terms of the July contract could save it for want of one party's capacity.

Illegality

48. This conclusion on capacity means it is strictly unnecessary to deal with GROUPCO's alternative contention that the July contract was void for illegality. I will nonetheless deal with the point shortly. (In saying this, I have not forgotten that it is CEL's case that the effect of the April agreement was to render FTC a party to the agreement as agent for GROUPCO. It is to this issue that I must turn in due course.)

49. Article 8 of the Rome Convention provides that all questions of material validity are governed by the applicable law, thus, in this case, English law: -

a) Reliance on the common law rule (as exemplified by ***Ralli Brothers v Capagnia Navaria*** [1921] KB 614) that a contract is invalid insofar as the performance of it is unlawful by the law of the country where the contract was to be performed was not really pressed by GROUPCO. This is not surprising since the July contract was not, at least from an English law of perspective, a contract for the import of goods into China: see ***Congimex Companhia*** supra. Further, insofar as a foreign trade permit was required by GROUPCO to engage in foreign trade, let alone import goods, clause 15 of the contract expressly contemplated that requirement and imposed an obligation on the buyers to obtain the necessary licence. In my judgment, such a requirement was not illegal (even if it may have been impossible to comply with).

b) Aspects of public policy are governed by article 16 of the Rome Convention: - "*The application of the rule of law of any country specified by this convention may be refused only if such application is manifestly incompatible with the public policy ('Ordre Publique') of the forum.*"

Even assuming Chinese law is engaged, an agreement by GROUPCO by way of engagement in foreign trade is not a matter, in my judgment, 'manifestly' contrary to English public policy. The default lay in regard to non-compliance with the permit system, not breach of some form of absolute prohibition.

Mistake

50. GROUPCO's initial submissions made much of the contention that the naming of GROUPCO as buyer was a mistake. This fails on the facts for the reasons already set out.

The April Contract

51. The issue as to the effect of the April contract remains the primary issue between the parties. In one sense, the question whether the July contract was void or not is only part of the background. But the context in which the April agreement was entered into may be influential. If, as I have found, the July contract was void, the primary question arises as to whether FTC concluded the April agreement on GROUPCO's behalf, and, if so, whether FTC had actual or ostensible authority to do so. In contrast, if I am wrong in my conclusion that the July contract was void, the primary question which arises is whether the parties agreed to release GROUPCO from its obligations and, if so, whether Nelson Cheng had authority to agree to that release.

52. There is a substantial degree of overlap on the matters material to these issues and I will try and treat them together.

Did the parties intend that GROUPCO should become (or remain) a party to the April contract?

53. The narrative is set out earlier in this judgment. Once the bank refused to open the letter of credit, Ms Zhao sent the fax of 27th April requesting CEL to cancel the July contract and conclude a new contract. The reply proposed an addendum 'nominating' FTC as buyer, with GROUPCO guaranteeing FTC's performance. In the event, an alternative way forward was promoted and FTC were named as buyers with GROUPCO's signature and chop being cancelled. Nelson Cheng chopped each amendment. He then added the chop of CEL and his initials to a further copy on 29th April and onto the hard copy version on 30th April.

54. Viewed in isolation, this account is only consistent with the substitution of FTC for GROUPCO. There was no suggestion that FTC were acting on GROUPCO's behalf so as to seek to maintain or install GROUPCO as the substantive party to the agreement. In short, there is no manifestation of any intention to add FTC as purchasing agent on GROUPCO's behalf. To the contrary, the contemporary material is only consistent with the substitution of FTC for GROUPCO as had occurred with the earlier contracts in 1996 originally made in GROUPCO's name. The only role promoted for GROUPCO was as guarantor, a suggestion never pursued.

55. That this is an accurate perception of the outcome is confirmed by the terms of Addendum II in which FTC were duly named as buyers. Thereafter the contracts were performed exclusively between CEL and FTC. Indeed CEL held FTC liable on default and initially instituted proceedings against FTC alone.

Chinese law and agency: authority

56. In any event, there are further obstacles to any case that FTC was acting as GROUPCO's agent in entering into the April agreement, save in the sense of acting pursuant to GROUPCO's authority to cancel the July contract on their behalf.

57. First, GROUPCO contended that there could be no actual authority as contended by CEL in the absence of a written agency agreement. The basis of this submission was article 5 of the Provisional Regulations concerning the Foreign Trade Agency System of the PRC: - *"Article 5. The commission agreement shall be adopted in written form and shall generally include the following content….*

Whilst it was accepted by the experts that this was just a regulation and not 'law', it is clear that the Chinese courts would almost invariably enforce such a regulation, particularly where, as here, there is no inconsistency with the primary law, namely the Foreign Trade Law Article 13 which provides: *"Organisations or individuals without permits for foreign trade business may entrust foreign trade operators within China to conduct foreign trade businesses on their behalf within the business scope of the trustees… The trustors and trustees shall conclude a trusteeship contract in which the rights and obligations of both parties shall be specified."*

58. However, I recognise that there is some potential for the retroactive application of article 36 of the new Contract Law which provides: 'Where laws and administrative regulations stipulate that the contract is to be concluded in writing… but where the parties fail to conclude the contract in writing and one side has already performed a major obligation under contract and the other party has accepted the said performance, the said contract shall be concluded.' More to the point I am not persuaded that want of writing is material to the existence of third party rights against the principal as opposed to the rights and liabilities of the principal and the agent inter se. This was not a topic investigated in any depth during the course of the hearing.

Direct contractual relations with third parties

59. A much more formidable point was contained in GROUPCO's submission that by virtue of Chinese law GROUPCO and CEL could not enter into direct contractual relations since GROUPCO could not authorise FTC to engage in foreign trade on its behalf. The starting point for this contention is Article 2 of the Foreign Trade Agency Rules:

"When a company, enterprise, institution or individual (commissioning party) which does not possess foreign trade operating rights, requires to import or export commodities… it shall commission a company or enterprise (commissioned party) which does possess foreign trade operating rights concerning those commodities in accordance with relevant state regulations. These provisional regulations shall apply to the rights and duties of both parties concerned."

60. The outcome, GROUPCO contended, was that two separate contracts arose - one between the principal and the agent and the other between the agent and the third party. It was clear from the remaining rules, so the argument ran, that the domestic principal and the overseas third party could not be in direct contractual relations. The crux of the submission was said to be in Article 15 of the FTA rules: *"A commissioned party shall sign the import or export contract with foreign businesses using its own name in accordance with the commission agreement and a duplicate of the contract shall be supplied to the commissioning party in a timely manner. Changes and amendments to import and export contracts with foreign businesses by the commissioned party shall not be permitted to violate the commission agreement. A commissioned party shall bear responsibility for contractual duties to foreign businesses and shall enjoy contractual rights".*

61. I accept this submission. The starting point is the last sentence of Article 15. There was a striking degree of common ground between the experts as to the effect of a very similar phrase to that sentence contained in Article 421 of the New Contract Law: *"Where the commission agent concludes a contract with a third person, the commission agent shall directly enjoy rights and assume responsibilities in relation to the said contract. Where the principal sustains losses due to the failure of the third person to perform its obligations, the commission agent shall be liable to provide compensation for the losses sustained, unless the commission agent and the principal have agreed otherwise."*

62. Indeed, in **Contract Law in China** [2002] written by the claimants' expert Mr Bing Ling there is this passage at page 162 under the heading 'Commission Agency: - *"The most significant difference between commission agency and the indirect agency as governed by articles 402 and 403 is that, under Article 421(1) 'where the commission agent concludes a contract with a third party, the commission agent shall directly have rights and undertake obligations under that contract'. The effect of this provision is that, unlike the indirect agency under articles 402 and 403, the contractual relationship that the commission agent enters into with the third party is limited to the commission agent and the third party and the principal cannot directly assume rights or obligations and sue or be sued under that*

contract. This is so regardless of whether the third party, at the time the contract is concluded, knows the identity of that principal. …".

63. This approach finds support in **Zhong and Williams** page 73: see also **Appraisal, Analysis and Application of International Economic Trade Law** Zhang 1997. It has been further confirmed by the decision of the Supreme People's Court of the People's Republic of China in **Jing Yin FTC v. Voest – Alpine Trading USA Corp** 1996 J.Z.Zi No. 263.

64. In short GROUPCO could not authorise FTC to enter into a contract with CEL on GROUPCO's behalf. Any agreement with CEL must, as originally suggested by the bank, be with FTC.

65. CEL sought to escape this conclusion by reference to the 1999 New Contract Law which was said to have a potentially a retroactive effect wherever there was formerly no existing law governing the issue in question. In particular reliance was placed on Article 402 in the chapter on Mandate Contracts: "*Where the agent concludes a contract in its own name with the third party and to do so is within the scope of the authorisation given by the principal and at the time of concluding the contract, the third party knows of the relationship of agency existing between the principal and agent, the said contract shall directly bind the principal and the third party unless there is conclusive evidence which proves that the contract only binds the agent to the third party.* "

66. There are several obstacles to this contention: -

(a) In general, laws, regulations and rules do not have retroactive effect: see article 84 of the Legislative Law of the People's Republic of China. The only relevant exception is to be found in the Supreme People's Court, Explanations on Certain Questions 1 December 1999: –

'…Where disputes arise and are submitted for adjudication to the People's Courts over contracts that were concluded before the implementation of the Contract Law, the provisions of the law of the previous time apply except as otherwise provided in these Explanations; where the law of the previous time has no provisions, the relevant provisions of the Contract Law may be applied.

b) There was on my findings pre-existing law on the relevant topic. In any event any retroactive application is discretionary rather than compulsory and I accept Miss Zhang's evidence that the Chinese courts would not apply the new law in cases of foreign trade.

c) Furthermore, even if the new Contract Law was applicable I prefer the view that the relevant chapter of the new law would be that relating to commission contracts (Article 421 the terms of which has already been noted).

Nelson Cheng's authority

67. If, as I have concluded, the purported effect of the April agreement was to create a sale agreement between FTC and CEL as principals, it was CEL's case that Nelson Cheng had no authority to enter into such an agreement (whether it was the initial agreement or the novation of an earlier agreement).

68. The credibility of this position was somewhat undermined by its late emergence – well after the conclusion of the original appeal arbitration hearings. Indeed, the claimants' representatives as recently as March 2003 had asserted: *"It has never been disputed that CEL voluntarily consented to the amendments on 28th April".*

Nor have I forgotten that little if any disclosure was made by the claimants on this topic.

69. As I understand the claimant's case, it was contended that Nelson Cheng's authority was limited to agreeing to an arrangement whereby GROUPCO were either directly liable under the contract or guaranteed FTC's performance of it but not otherwise. In support of this contention, CEL placed particular reliance on the content of some taped telephone conversations between Nelson Cheng and Simon Wong in November 1998. I accept that the effect of the conversations reflected recognition on the part of Nelson Cheng that he was probably not able to sign a contract of the size of the April agreement without specific authority let alone a washout of the same contract.

70. But I am wholly unpersuaded that he was not given actual authority to enter into the April agreement. The background position was that CEL were desperate to do 'whatever it takes' to get the letter of credit opened. Nelson Cheng was clearly instructed to seek a guarantee. When no guarantee was forthcoming, the responsive fax from GROUPCO/FTC containing the amended version of the agreement with GROUPCO removed was immediately chopped and initialled by Cheng. The very same fax was sent to Raymond Chan (Nelson Cheng's immediate superior in whose office the correction chop was kept) who confirmed in his evidence that it 'did not seem to require any action on his part'.

Survival of the arbitration agreement

71. As I have already found, the proper analysis of what happened in April was that a new contract was entered into rather than an existing one amended. There was never any valid contract between GROUPCO and CEL since the July agreement was void for want of capacity on the part of GROUPCO.

72. Does this want of capacity vitiate the arbitration clause as well? In my judgment it does. Albeit article 19 of the Arbitration Laws of the PRC provides that an arbitration agreement exists independently and is not affected by the invalidity of the contract in which it is contained, article 17 provides:

" An arbitration agreement shall be null and void under one of the following circumstances …

(2) one party that concluded the arbitration agreement has no capacity for suitable conduct or has limited capacity for civil conduct ...."

I accept that 'party' for this purpose includes both natural and legal persons. A Chinese court would thus conclude that a Chinese party without a foreign trade permit would not be entitled to enter into a GAFTA arbitration agreement. The issues of policy are the same: see ***Harbour Assurance v. Kansa*** [1993] 1 Lloyd's Rep 455 per Lord Hoffman at p. 469.

Conclusion

73. It follows that, for all these reasons, the Claimants' challenge to the Appeal Award fails.

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