FUNG SANG TRADING LTD v KAI SUN SEA PRODUCTS & FOOD CO LTD - [1991] 2 HKC 526

HIGH COURT
KAPLAN J

MISCELLANEOUS PROCEEDINGS NO 2674 OF 1991

29 October 1991

Arbitration -- Model Law -- Whether arbitration domestic or international -- Place where substantial part of the obligations of the commercial relationship is to be performed -- Delivery of goods to China -- Uncitral Model Law art 1

Arbitration -- Arbitrators -- Jurisdiction -- Whether arbitrators can decide question as to their jurisdiction -- Claim that there was no concluded contract between the parties -- Principle of separability -- Options for arbitrators when faced with challenge to jurisdiction -- Uncitral Model Law art 16

Words and Phrases -- 'Place where substantial part of the obligations of the commercial relationship is to be performed' -- Uncitral Model Law art 1

By a document purporting to be a contract in writing, two Hong Kong companies with their places of business in Hong Kong, entered into an agreement for the sale and purchase of Chinese soybean FOB Dalian, China. The place of delivery was stated to be Dalian, China, and payment by letters of credit through a Hong Kong bank. The document provided for arbitration in Hong Kong and under the laws of Hong Kong. A dispute having arisen between parties, the plaintiff nominated its arbitrator and invited the defendant to appoint its own arbitrator. No such appointment was made and the plaintiff applied to the court for an appointment. The issues for the court were whether the arbitration was an international or domestic one and whether there was a concluded contract between the parties.

The plaintiff argued that as a substantial part of the commercial obligations between it and the defendant was to be performed in China (delivery of the goods), the dispute was an international arbitration to which the UNCITRAL Model Law applied. The defendant argued that the arbitration was a domestic one as, inter alia, payment was to be made in Hong Kong and the breach consisted of the defendant's failure in Hong Kong to nominate a vessel and put in place the necessary letter of credit. The defendant further argued that there was in fact no concluded contract between the parties because the person who signed the contract allegedly on behalf of the defendant did not have the necessary authority to bind the defendant; therefore, there was no arbitration clause.

Held, appointing an arbitrator of the court's choice:

(1) Under art 1(3) of the Model Law, the test of whether an arbitration is international is initially a place of business test. However, an arbitration will still be international, despite both parties having their places of business in the same state, if 'any place where a substantial part of the obligations of the commercial relationship is to be performed or the place with which the subject-matter of the dispute is most closely connected' is outside the state in which the parties have their place of business. Thus it is possible for two Hong Kong parties to enter into

a contract in Hong Kong under Hong Kong law and still find themselves in an international arbitration if substantial performance of the obligations of the commercial relationship is outside Hong Kong. In those circumstances, unless the parties have opted out of the Model Law into the domestic regime, the Model Law regime will apply.

(2) The place where a substantial part of the obligations of the commercial relationship is to be performed is not limited to the place where a breach occurs. To apply art 1(3) of the Model Law, it was necessary to take a wider view and look at the position at the date the contract was entered into and see what obligations each party had to perform under the contract. *Medway Packaging Ltd v Meurer Maschinen GmbH* 1990 2 Lloyd 's Rep 112 distinguished.

(3) Although payment and nomination of the vessel were important obligations in a contract of this nature, it could not be argued that delivery in a sale of goods contract was insignificant. In the present case it was clear beyond any doubt that 'a substantial part of the obligations of the commercial relationship' was to be performed in a place where the parties did not have their place of business, namely, China. Therefore, this was an international arbitration to which the Model Law applied.

(4) It was inappropriate for the court to rule on the validity of the contract at this stage. Article 16 of the Model Law provided for the tribunal to rule on its own jurisdiction.The tribunal could rule as a preliminary issue on the question of whether the contract had ever been entered into. If in favour of the plaintiff, the defendant could apply to the court for a final decision on the question. *Aboitiz Jebsen Bulk Transport Corp v KIT Shipping Agency* [1990] 1 HKC 390 doubted.

Per curiam:

An arbitrator faced with a challenge to his jurisdiction should first see whether the parties wish to seek declaratory relief. If not, he has three choices. First, he may decide he has no jurisdiction and that is the end of the matter unless the court takes a contrary view. Second, he may issue an interim award on jurisdiction and see whether it is effectively challenged before he goes on to consider merits. Third, he may decide jurisdiction and the merits and render the award. Each case will depend on its own particular facts. However, it was clear that arbitrators should not pull down the shutters on the arbitral process as soon as one party objects to the jurisdiction of the tribunal.

Cases referred to

Aboitiz Jebsen Bulk Transport Corp v KIT Shipping Agency [1990] 1 HKC 390 (to be reported in [1990] HKC)

Christopher Brown v GOWHRGBH [1954] 1 QB 8

De Bloos, A Sprl, Etablissements v Etablissements Bouyer SA (No 14/76) [1976] ECR 1497

Harbour Assurance Co (UK) v Kansa General International Insurance Co [1992] 1 Lloyd's Rep 81

Heyman v Darwins [1942] AC 356

Marc Rich & Co v Societa Italiana Impianta (EC, 25 July 1991, unreported) default

Medway Packaging v Meurer Maschinen GmbH [1990] 2 Lloyd's Re[112

[1991] 2 HKC 526 at 528

Metal Scrap Trade Corp v Kate Shipping Co [1990] 1 WLR 115

Shenavai v Kreischer [1987] 3 CMLR 782

Legislation referred to

(HK) Arbitration Ordinance (Cap 341) ss 2(3), 2B, 2E, 2K, 2M, 3, 14(3A), 21, 23B(8), 31, 34C, Pt IIA, Fifth Schedule, Sixth Schedule

(HK) Arbitration (Amendment) (No 2) Ordinance 1989 s 26

(UK) Arbitration Act 1979 [UK]

(UK) Civil Jurisdiction and Judgments Act 1982 [UK]

Other legislation referred to

Analytical Commentary on Draft Text of a Model Law on International Commercial Arbitration (United Nations Document A/CN9/264, 25 March 1985) p 13 para 29

Broches Commentary on the UNCITRAL Model Law (1990) pp 74-75

Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters (Brussel's Convention) art 5

Holtzmann and Neuhaus A Guide to the UNCITRAL Model Law on International Commercial Arbitration (1989)

Kaplan, Spruce and Cheng Hong Kong Arbitration -- Cases and Materials (1991) pp 33, 180

Mustill and Boyd Commercial Arbitration (2nd Ed) pp 7, 108-109, 575-576

New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards

UNGA Resolution 40/72

Uncitral Model Law arts 1(3), (4), 6, 8, 10(2), (3), 11(5), 16, 34, 36, Chapter VIII

Uncitral Arbitration Rules

Application

This was an application to the court to appoint an arbitrator. The facts appear sufficiently in the following judgment.

SS Davidson (Holman Fenwick & Willan) for the plaintiff.

MT Yeung (Paul CW Tse & Co) for the defendant.

KAPLAN J

I have before me an application to appoint an arbitrator. This issue raises for the first time in the High Court the application of the Uncitral Model Law, which has been part of our law of arbitration since 6 April 1990, namely, the date of coming into force of the Arbitration (Amendment) (No 2) Ordinance 1989. The Model Law appears as the Fifth Schedule to the Arbitration Ordinance (Cap 341) (the Ordinance).

This case also raises the question whether an arbitrator or arbitral tribunal should rule on the very existence of the contract which contains the arbitration clause.

Because of the importance and novelty of these points in the context of the Model Law, I heard argument in chambers but said that I would hand down my judgment in open court.

The Arbitration (Amendment) (No 2) Ordinance 1989 (the 1989 No 2 Ordinance) made substantial and far-reaching amendments to Hong Kong's law of arbitration. These legislative changes came about as a result of recommendations from the Law Reform Commission which considered the desirability of adopting the Model Law in Hong Kong.

Uncitral stands for the United Nations Commission on International Trade Law. On 21 June 1985, the Commission of Uncitral completed their drafting of a Model Arbitration Law, which was designed to assist in the harmonization of the world's differing arbitration laws. On 11 December 1985, the General Assembly of the United Nations passed Resolution 40/72 to the following effect:

> All States give due consideration to the Model Law on International Commercial Arbitration in view of the desirability of uniformity of the law of arbitral procedures and the specific needs of international commercial arbitration practice.

Part IIA of the Arbitration Ordinance (Cap 341) applies to an international arbitration agreement and to an arbitration pursuant to an international arbitration agreement. Section 34C of the Ordinance provides that:

> (1) An arbitration agreement and an arbitration to which this part applies are governed by Chapters I to VII of the Uncitral Model Law.
>
> (2) Article 1(1) of the *Uncitral*Model Law shall not have the effect of limiting application of the *Uncitral* Model Law to International Commercial Arbitration.
>
> (3) The court that is competent to perform the function specified in Article 6 of the *Uncitral* Model Law is the High Court.

Certain points need to be noted. Firstly, Hong Kong has not adopted Chapter VIII of the Model Law although it is to be noted that this is still set out in Sch 5. Chapter VIII contains two articles dealing with the recognition and enforcement of awards. This was not thought necessary in Hong Kong because Hong Kong is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards by reason of the United Kingdom's accession to that treaty on its behalf. China has also acceded to this convention on 21 April 1987.

Secondly, s 34C(2) of the Ordinance expressly deletes the word 'commercial' from the phrase 'international commercial arbitration'.

Thirdly, it is the High Court of Hong Kong which is competent to perform the functions assigned to the court in the Model Law.

The major philosophy behind the Model Law is that of party autonomy. In recent years there has been a general shift away from court intervention in arbitration towards provisions which solely support the arbitration

process and keep judicial review to a minimum. The leave to appeal provisions of the English 1979 Act followed in Hong Kong in 1982 are examples. Under the Model Law, the court cannot intervene on the merits. It can make a number of orders in support of the arbitration process and these are specified. It can, in very limited circumstances, set aside an award or refuse recognition and enforcement on grounds virtually identical to the New York Convention grounds.

The Model Law has been adopted in a number of jurisdictions including Scotland, Australia, Canada, Cyprus, Nigeria, Bulgaria and a number of States in the United States of America. Adoption seems imminent in a number of other jurisdictions. Some countries, who have not adopted the Model Law, have in fact amended their arbitration law to bring it more into line with the philosophy behind the Model Law.

It is important to note the transitional provisions of the 1989 (No 2) Ordinance.These were contained in s 26 thereof and now appear as a footnote to s 31 of the Arbitration Ordinance. Section 26 reads as follows:

> Transitional
>
> (1) An arbitration commenced, within the meaning of s 31(1) of the principal Ordinance, after the commencement of the principal Ordinance but before the commencement of this Ordinance, shall be governed by the principal Ordinance as if this Ordinance had not been enacted.
>
> (2) An arbitration commenced, within the meaning of s 31(1) of the principal Ordinance, after the commencement of this Ordinance under an agreement made before the commencement of this Ordinance, shall be subject to sections 2B, 2E and 14(3A) of the principal Ordinance but, subject to that, shall be governed by the principal Ordinance as if this Ordinance had not been enacted.

Thus, where the arbitration is commenced before 6 April 1990, the old law applies. When it is commenced after 6 April 1990 but in respect of an arbitration agreement entered into before that date then the old law applies save that ss 2B, 2E and 14(3A) of the Ordinance apply in addition to the old law. Section 2B deals with the power of an arbitrator to act as a conciliator, s 2E deals with restrictions on reporting of proceedings heard in chambers and s 14(3A) disapplies the strict rules of evidence for arbitration.

Thus it will readily be seen that the old law will remain relevant for some considerable time in relation to arbitration agreements entered into before 6 April 1990. The case before me, however, deals with an agreement, and consequently a commencement, which occurred after that date.

Prior to 6 April 1990, the Arbitration Ordinance merely contained a definition of 'domestic arbitration agreement'. Section 23B(8) provided as follows:

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> In this section 'domestic arbitration agreement' means an arbitration agreement which does not provide, expressly or by implication, for arbitration in a State or territory other than Hong Kong and to which neither:
>
> > (a) An individual who is a national of, or habitually resident in, any State or territory other than Hong Kong; nor
> >
> > (b) A body corporate which is incorporated in, or whose central management of control is exercised in, any State or territory other than Hong Kong is a party at the time the arbitration agreement is entered into.

The scope of application of the Model Law can be found in arts 1(3) and (4). Article 1(3) reads as follows:

> An arbitration is international, if:
>
> > (a) The parties to an arbitration agreement have, at the time of the conclusion of that agreement, their places of business in different States; or
> >
> > (b) One of the following places is situated outside the State in which the parties have their places of business:
> >
> > > (i) The place of arbitration if determined in, or pursuant to the arbitration agreement;
> > >
> > > (ii) Any place where a substantial part of the obligations of the commercial relationship is to be performed or the place with which the subject-matter of the dispute is most closely connected; or
> > >
> > > (iii) The parties have expressly agreed that the subject-matter of the arbitration agreement relates to more than one country.
> > >
> > > (iv) For the purposes of paragraph (3) of this article:
> >
> > (a) If a party has more than one place of business, the place of business is that which has the closest relationship to the arbitration agreement;
> >
> > (b) If a party does not have a place of business, reference is to be made to his habitual residence.

Thus it can be seen that the test is initially a place of business test. However, an arbitration will still be international, despite both parties having their places of business in the same State, if 'any place where a substantial part of the obligations of the commercial relationship is to be performed or the place with which the subject-matter of the dispute is most closely connected' is outside the State in which the parties have their place of business.

Thus it is quite possible for two Hong Kong parties to enter into a contract in Hong Kong under Hong Kong law and still find themselves in an international arbitration if substantial performance of the obligations of the commercial relationship is outside Hong Kong. In those circumstances, unless they have opted out of the Model Law into the domestic regime, the Model Law regime will apply (see s 2M).

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Interpretation

It should be noted that s 2(3) of the Ordinance exhorts judges interpreting the Model Law to have regard to its international origin. The subsection states:

> In interpreting and applying the provisions of the Model Law regard shall be had to its international origin and to the need for uniformity in its interpretation, and regard may be had to the documents specified in the Sixth Schedule.

By s 2K, the Governor in Council may by order published in the *Gazette* amend the Sixth Schedule.

The Sixth Schedule documents are as follows:

> 1 The report of the Secretary-General dated 25 March 1985 and entitled 'Analytical Commentary on Draft Text of a Model Law on International Commercial Arbitration' (United Nations Document A/CN9/264).
>
> 2 The report of the United Nations Commission on International Trade Law on the work of its eighteenth session (3-21 June 1985) (United Nations Document A/40/17).
>
> 3 The report of the Law Reform Commission of Hong Kong on the Adoption of the UNCITRAL Model Law.

In the course of considering this judgment I have followed the above legislative exhortations and considered relevant parts of the Sixth Schedule documents, one of which I will quote from later.

Facts of this case

I have had placed before me a document which purports to be a contract in writing dated 9 November 1990, made between the plaintiff as seller and the defendant as buyer. Both parties have chopped the documents with signatures thereon.

By this document, the plaintiff agreed to sell and the defendant agreed to buy 5,000 tonnes of Chinese soybean extraction meal at US$179 per tonne in bulk or US$184 in bags in both cases FOB Dalian. Shipment was to be made between 1-30 December 1990 and the place of delivery was stated to be Dalian, which is in China. Payment was to be made by 100% irrevocable, transferrable at sight letters of credit in favour of the plaintiff or its nominees. The advertising bank was to be the Hong Kong and Shanghai Bank in Hong Kong. There was the usual list of conditions and documents to be provided. The last clause on the third page of this document states:

> Should any dispute arise between the contracting parties, it shall be settled through friendly negotiation. But if there is no agreement to be reached, the case in dispute shall be submitted for arbitration which shall take place in Hong Kong or governed by Hong Kong Laws and court. The fees for arbitration or legal proceeding shall be borne by the losing party unless otherwise ordered.

The plaintiff alleges that the defendant failed to nominate a vessel to take delivery of the soybean within December 1990 or at all and that they failed to put in place the required letter of credit. They claim damages in the sum of US$124,000, being the amount they were required to pay their head suppliers.

A letter before action was sent by the plaintiff's solicitors on 11 July 1991. This letter was sent to the defendant's registered office but was returned 'moved address unknown'.

On 1 August 1991, the plaintiff's solicitors wrote to the defendant informing them that they had appointed Mr Ian Ferguson as their arbitrator. They pointed out that the contract did not specify the number of arbitrators but under art 10(2) of the Model Law it is provided that there shall be three arbitrators in the absence of agreement. The defendant was invited to appoint their arbitrator. It was further stated that if they did not do so within 30 days, the plaintiff would apply to the court to have an arbitrator appointed on its behalf.

No reply being forthcoming, the plaintiff issued its original summons on 10 September 1991 asking the court to appoint Mr Robin Peard or such other person as the court deems fit.

I should have added that Mr Davidson for the plaintiff made it clear that there were further correspondence which had not been exhibited. No point was taken by Mr Yeung for the defendant. In any event, the letter of 1 August 1991 is clearly a sufficient commencement of the arbitration within art 21, which provides:

> Unless otherwise agreed by the parties, the arbitral proceedings in respect of a particular dispute commences on the date on which a request for that dispute to be referred to arbitration is received by the respondent.

In addition to sending the aforesaid two letters to the registered office of the defendant, they were also sent to the defendant's address as stated on the sales contract. Article 3 of the Model Law deems receipt of communications sent to a party's place of business, habitual residence or mailing address.

The defendant was clearly served with the originating summons. They were represented by counsel and solicitors.

Mr Davidson for the plaintiff submitted that this was a plain and obvious case. A substantial part of the obligations of the commercial relationship was to be performed in China and thus this dispute was an international arbitration to which the Model Law applied. There being no agreement to the contrary, there has to be three arbitrators (art 10(2)).

He submits that because the defendant has failed to appoint an arbitrator, art 10(3) comes into place. This provides that where there are to be three arbitrators and one party fails to appoint an arbitrator within 30 days of a request so to do, 'the appointment shall be made, upon request of a party by the court or other authority specified in art 6' that is the High Court of

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Hong Kong. Once two arbitrators have been appointed, then these two will appoint the third.

It is important to point out that by reason of art 11(5) there is no appeal from the decision of this court in appointing an arbitrator.

In support of this contention that this is an international arbitration within the definition contained in art 1(3), Mr Davidson relies heavily on the fact that delivery was to take place in China and he relies upon the effect of a contract FOB. He submits that whatever view is taken of the obligation to pay, it must be clear that delivery is a substantial part of the obligation of this commercial relationship.

Mr Yeung for the defendant takes two points. Firstly, he submits that this is not an international arbitration but is in fact a domestic one. He relies upon the fact that payment was to be made in Hong Kong and that the breach consisted of a failure by the defendant in Hong Kong to nominate a vessel and to put in place the necessary letter of credit. He submitted that, applying art 1(3)(ii), Hong Kong was the relevant place and thus this was a domestic arbitration.

He took a second and more fundamental point. He put in an affidavit on behalf of the defendant which contended that there was in fact no concluded contract between the parties because the person who signed the contract allegedly on behalf of the defendant did not have, and was known not to have, the necessary authority to bind the defendant. He submitted that an arbitrator did not have jurisdiction to rule on whether or not a contract had been concluded. He submitted that if there was no contract then there was no arbitration clause. He then invited me to decline to appoint an arbitrator so that the matter could be decided in the High Court. If I were against him on this issue, then he asked me to treat the dispute as a domestic dispute with the result that there would be a sole distributor.

Because art 16 of the Model Law specifically permits an arbitrator to rule on his own jurisdiction, I think I should first decide whether I am dealing with an international or domestic arbitration.

Mr Yeung relied upon the following matters to support his contention that this was a domestic arbitration:

(1) Both parties were Hong Kong companies.

(2) The defendant's failure to nominate a vessel occurred in Hong Kong.

(3) Acceptance of repudiation occurred in Hong Kong.

(4) The commercial relationship commenced in Hong Kong in that the contract was made here.

(5) The plaintiff was to cause its head supplier to deliver the cargo at Dalian.Thus he says causation was in Hong Kong. (I am uncertain as to what he meant by this)

(6) The defendant failed to open a letter of credit in Hong Kong.

(7) Hong Kong law would seem to be the applicable law of the contract.

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He says that all these factors show that the commercial obligations of the contract were to be performed in Hong Kong.

Mr Yeung referred me to *Medway Packaging Ltd v Meurer Maschinen GmbH* 1990 2 Lloyd 's Rep 112, which was a case concerning the applicability of the Convention on Jurisdiction and the Enforcement of Judgments

in Civil and Commercial Matters (Brussel's Convention) which was incorporated into English law by the Civil Jurisdiction and Judgments Act 1982. Article 5 of the convention provides:

> A person domiciled in a Contracting State may, in another Contracting State, be sued:
>
> (1) In matters relating to a contract, in the courts for the place of performance of the obligation in question ...

In that case, a German company appointed an English company their exclusive distributor of certain products. The English company alleged breach by permitting another company to distribute their goods. The English company accepted this as a repudiation, issued a writ and served it on the defendant in West Germany. The German defendant sought to set aside the writ on the grounds that the English court had no jurisdiction over them. This raised a question as to the construction of art 5.The court held that the defendant's obligation being a negative one could be taken either in England or Germany.

The court in *Medway* was faced with three decisions of the European court in this area. In *De Bloos, A Sprl, Etablissements v Etablissements Bouyer SA (No 14/76)* [1976] DEFAULT7 ECR 1497 , the court made clear that art 5 does not refer to any obligation under the contract but to the contractual obligation forming the basis of the legal proceedings. In other words, it hones in on the breach. A different approach was adopted in an employment case, but in *Medway*, the Court of Appeal regarded that case as having special features. *De Bloos* was followed in *Shenavai v Kreischer* 1987 3 CMLR 782. (See now *Marc Rich & Co v Societa Italiana Impianta* default (EC, 25 July 1991, unreported).)

The approach of the court to art 5 does not assist me in the present case. The reference to 'the place of performance of the obligation in question' clearly relates to the obligation broken. In the case before me the definition is far wider in scope, concentrating as it does on the place where a substantial part of the obligations of the commercial relationship is to be performed. That is not limited to the place where a breach occurs. To apply art 1(3) of the Model Law one has to take a much wider view and look at the position as at the date the contract is entered into and see what obligations each party has to perform under that contract.

I accept that payment and nomination of the vessel are important obligations in a contract of this nature. However, it is hard to see how it can be argued that delivery in a sale of goods contract is insignificant.

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The definition refers to 'substantial part of the obligation'. What is meant by substantial? In *Hong Kong Arbitration -- Cases and Materials* (Butterworths, 1991), one finds the following at p 180:

> 'Substantial' means 'considerable', 'solid' or 'big'. In one case, a substantial amount was held to be 13 out of 80 but it will be dangerous to try to apply any mathematical formula. In one case, it was held that 1,000 firms out of 6,000, and 150,000 employees out of 474,000 were not insubstantial and, therefore, substantial. (*Thorneloe v Board of Trade* default [1950] 2 All ER 245).

It is worth noting that at para 29 on p 13 of the Analytical Commentary on the Draft Text of the Model Law dated 25 March 1985 (the first of the six Schedule documents to aid interpretation), the following appears:

> Under sub-para (ii), internationally is established if a substantial part of the obligation of the commercial relationship is to be performed in a State other than the one where the parties have their places of business. This would be the case, for example, where a producer and a trader conclude a sole distributorship agreement concerning a foreign market or where a general contractor employs an independent sub-contractor for certain parts of a foreign construction project. While the arbitration agreement must cover any dispute or certain disputes arising out of this relationship, it is not necessary that the dispute itself relates to the international element.

This passage shows a clear indication to take a different approach to the interpretation of the Brussel's Convention considered in *Medway* default . What art 1(3) attempts to achieve is certainty as at the date of the agreement as to whether the possible future arbitration is international or not.

Applying the above principles to the facts of this case, I find it clear beyond any doubt that 'a substantial part of the obligations of the commercial relationship' was to be performed in a place where the parties did not have their places of business, namely, in China. The plaintiff's obligation under this FOB contract was to deliver the goods on board the vessel named by the defendant at Dalian in China within the month of December 1990 and to notify the defendant thereof without delay.

The defendant's obligation was to nominate the vessel to accept delivery of the goods at Dalian and to open a letter of credit as specified in the contract.

I, therefore, conclude that this is an international arbitration to which the Model Law does apply.

(It may be helpful for practitioners to be aware of two books on the Model Law. The fullest guide to the Model Law is *A Guide to the UNCITRAL Model Law on International Commercial Arbitration* written by Howard Holtzmann and Joseph Neuhaus published by Kluwer in 1989. This is a substantial treatise which takes each article of the Model Law, comments on it and sets out the various travaux preparatoires. For a

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shorter and more succinct commentary, there is Aron Broches' *Commentary on the UNCITRAL Model Law* also published by Kluwer in 1990.)

I now turn to the question raised by Mr Yeung, namely, that the defendant denies that they ever entered into any agreement and that for this reason no arbitrator should be appointed.

One has to start with art 16 of the Model Law.

> Competence of arbitral tribunal to rule on its jurisdiction:
>
> > (1) The arbitral tribunal may rule on its own jurisdiction, including any objections with respect to the existence or validity of the arbitration agreement. For that purpose, an arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract. A decision by the arbitral tribunal that the contract is null and void shall not entail ipso jure the invalidity of the arbitration clause.
> >
> > (2) A plea that the arbitral tribunal does not have jurisdiction shall be raised not later than the submission of the statement of defence. A party is not precluded from raising such a plea by the fact that he has appointed, or participated in the appointment of, an arbitrator. A plea that the arbitral tribunal is exceeding the scope of its authority shall be raised as soon as the matter alleged to be beyond the scope of its authority is raised during the arbitral proceedings. The arbitral tribunal may, in either case, admit a later plea if it considers the delay justified.
> >
> > (3) The arbitral tribunal may rule on a plea referred to in paragraph (2) of this article either as a preliminary question or in an award on the merits. If the arbitral tribunal rules as a preliminary question that it has jurisdiction, any party may request, within 30 days after having received notice of that ruling, the court specified in article 6 to decide the matter, which decision shall be subject to no appeal; while such a request is pending, the arbitral tribunal may continue the arbitral proceedings and make an award.

It is important to appreciate the scope of art 16 and the way in which it is affected by other provisions in the Model Law.

The tribunal's decision on its jurisdiction is neither exclusive nor final. It is subject to immediate but final review under art 16(3). The tribunal's decision may later be considered in an application to set aside the award under art 34 and although art 36 does not apply in Hong Kong (being part of Chapter VIII), the enforcement of the award may be refused under the New York Convention ('the agreement is not valid under the law to which the parties have subject it'). It is also pertinent to point out that where a stay of legal proceedings is sought under art 8 the court may have to consider whether an arbitration agreement is null and void.

It is also to be noted that the Uncitral Arbitration Rules which have been adopted by the Hong Kong International Arbitration Centre and are in wide use throughout the world give the arbitral tribunal power to rule 'on objections' that it has no jurisdiction.

Article 16(1) enshrines the doctrine of separability which English law has partially recognized since *Heyman v Darwins* 1942 356 AC . Thus

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the arbitration clause is separable from the contract containing it so that if the contract is repudiated and the repudiation is accepted, the arbitration clause survives the repudiation, thus enabling the arbitrator to render an award on the claim resulting from the alleged repudiation. *Mustill and Boyd* at pp 108-109 suggest that where the initial existence of the contract is challenged, the arbitrator can rule on this point but he cannot bind the court. They refer to the doctrine of separability at p 7 and express the view that however widely

drawn an arbitration clause is, it cannot 'give an arbitrator jurisdiction to decide upon issues which go to the essential validity of the substantive contract'. However, in a footnote, they recognize that the wider doctrine of separability recognized in other jurisdictions has not been recognized in English law although the English form leads frequently to the same result.

Very recently the Commercial Court in London had cause to consider the very scope of the separability principle under English law. In *Harbour Assurance Co (UK) Ltd v Kansa General International Insurance Co* 1992 1 Lloyd 's Rep 81, Steyn J (as he then was) delivered a detailed and closely reasoned judgment on the principle of separability of the arbitration clause in an integral written contract. At the outset of his judgment he referred to the question whether arbitrators could under English law decide a question as to their own jurisdiction.He summed up the position thus:

> The approach in English law is simple, straightforward and practical. As a matter of convenience arbitrators may consider, and decide, whether they have jurisdiction or not: they may decide to assume or decline jurisdiction. But it is well settled in English law that the result of such preliminary decision has no effect whatsoever on the legal rights of the parties. Only the court can definitively rule on issues relating to the jurisdiction of the arbitrators. And it is possible to obtain a speedy declaratory judgment from the Commercial Court as to the validity of an arbitration agreement before or during the arbitration proceedings.

On the scope of the doctrine of separability he concluded that the doctrine was applicable to cases concerning the initial invalidity of the contract. However, in cases where illegality is raised to render the agreement containing the arbitration clause void ab initio he said:

> ... while the distinction between invalidity and illegality is not one which in my view should nowadays prevail ... I conclude that ... the separability principle does not extend to ab initio illegality of a contract in which the arbitration is imbedded.

Returning to the Model Law, at pp 74-75, Aron Broches in his commentary on art 16(1) summarizes the position as to competence and separability in the following useful passage:

> 4 The concept of 'competence-competence' concerns the degree to which an arbitral tribunal may rule on its own jurisdiction as defined by the arbitration agreement. It does not imply the power of an arbitral tribunal
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> *[1991] 2 HKC 526 at 539*
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> to take a final and binding decision as to its jurisdiction. It rather denotes a tribunal's power to adopt an initial ruling as to its own jurisdiction. The issue is not the finality of the arbitrators' decision on their jurisdiction and the consequent ouster of the jurisdiction of the courts, but rather the time at which and the conditions under which the courts may play their role as the final authority on the question of arbitral jurisdiction. It is therefore an issue which is to be resolved on the basis of practical rather than doctrinal considerations. The basic problem is how to reconcile the realization of the objectives of commercial arbitration, which would be defeated if an arbitral tribunal would have to suspend or terminate its proceedings each time a party pleaded invalidity of the arbitration agreement, with an effective measure of court supervision to ensure that the arbitral tribunal does not finally confer on itself a jurisdiction which by reason of the consensual nature of arbitration can only derive from the agreement of the parties.
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> 5 The power to investigate its own jurisdiction is inherent in the appointment of an arbitral tribunal and is now generally accepted. Notwithstanding its essential role in the discharge of an arbitral tribunal's task, it has in the past not been explicitly stated. The tendency over the last few decades has, however, been to set this power of arbitral tribunals forth in express terms. The explicit recognition of competence-competence in the Model Law is in accordance with this tendency and lends it additional authority.
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> 6 The second principle enunciated in para (1) is 'separability'. It must be carefully distinguished from 'competence-competence'. While the latter, as we have just seen, recognizes the power of an arbitrator to rule, at least initially, on his own jurisdiction, separability of the arbitration clause is intended to have the effect that if an arbitrator who has been validly appointed and who stays within the limits of the jurisdiction conferred upon him by the arbitration clause concludes that the contract in which the arbitration clause is contained is invalid, he does not thereby lose his jurisdiction. This concept, which is relatively new, has been accepted by judicial decisions or by doctrine in a large number of countries. It has, however, not been universally accepted and with few exceptions it has not been enacted as statutory law anywhere, otherwise than through adoption of the Model Law, of which the Canadian legislation is an example. There is, moreover, no evidence that it has the same meaning and effect in the countries and among the authors which has accepted it. Nor has its precise meaning been defined in art 16 or in the discussions leading to its adoption.

Mr Davidson invited me to rule on the issue as to whether there was in fact a binding agreement between the parties. Tempting as it was to dispose of the matter on the affidavits, to adopt such a course would have been to turn art 16 on its head. What should happen is this: I should appoint an arbitrator. The two appointed

arbitrators will then appoint the third to make up the tribunal of three. If the defendant wishes to rely on the point that they never entered into an agreement at all, then they must do so 'not later than the submission of the statement of defence'. The tribunal may rule on this point as a preliminary issue or as part of an award on the

[1991] 2 HKC 526 at 540

merits. If done by way of preliminary question, and if in favour of the plaintiff, the defendant will then have 30 days in which to invite this court to decide the question. Such decision of this court is final. It should be noted that the arbitration can continue whilst a request is pending to the court. In Hong Kong, this will not be as important a provision as elsewhere because of the speed with which parties will be able to come before this court.

If the tribunal makes an award on the merits, which clearly would encompass a finding that they had jurisdiction to do so, then the defendant will have an opportunity to apply to set the award aside under art 34 if they can establish that the agreement is not valid under Hong Kong law.

Mr Yeung submitted that the position would be very different if this dispute were a domestic one because he submitted arbitrators could not rule on their own jurisdiction. He relied on *Christopher Brown v Genossenschaft Oesterreichischer Waldbesitzer Holzwirtschaftsbetriebe Registrierte Genossenschaft mit Beschrankter Haftung* 1954 1 QB 8, 12-13, where Devlin J (as he then was) said:

> It is not the law that arbitrators, if their jurisdiction is challenged or questioned, are bound immediately to refuse to act until their jurisdiction has been determined by some court which has power to determine it finally. Nor is it the law that they are bound to go on without investigating the merits of the challenge and to determine the matter in dispute, leaving the question of their jurisdiction to be held over until it is determined by some court which had power to determine it. They might then be merely wasting their time and everybody else's. They are not obliged to take either of those courses. They are entitled to inquire into the merits of the issue whether they have jurisdiction or not, not for the purpose of reaching any conclusion which will be binding upon the parties -- because that they cannot do -- but for the purpose of satisfying themselves as a preliminary matter whether they ought to go on with the arbitration or not. If it became abundantly clear to them, on looking into the matter, that they obviously had no jurisdiction as, for example, it would be if the submission which was produced was not signed, or not properly executed, or something of that sort, then they might well take the view that they were not going to go on with the hearing at all.They are entitled, in short, to make their own inquiries in order to determine their own course of action, and the result of that enquiry has no effect whatsoever upon the rights of the parties.

It follows that every arbitrator should, preferably before accepting an appointment but certainly shortly thereafter, check the arbitration agreement and ensure that he comes within any qualification therein contained. When he sees the nature of the claims being made, he should likewise check to see that they come within the scope of the arbitration agreement. If he is in doubt he will take the matter up with the parties. He should not be too astute in this process, leaving it basically to the parties to raise points as to his jurisdiction.

[1991] 2 HKC 526 at 541

If, however, an issue is fairly and squarely raised as to his jurisdiction he can, of course, enquire of the parties as to whether one of them wishes to seek declaratory relief to clarify the matter.In the absence of their doing this, he has two choices. These are succinctly set out in Mustill and Boyd *Co mmercial Arbitration* (2nd Ed) at pp 575-576:

> (1) To decide the question of jurisdiction himself, subsequently continuing or abandoning the arbitration according to what he decides;
>
> (2) to set the question of jurisdiction on one side, leaving the parties to raise it in court, either before or after the award has been published.
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> Which course the arbitrator should adopt will depend on the circumstances. If the objection is straightforward, he may consider it better to rule at once, always bearing in mind that if either party is dissatisfied, the matter can be reopened by the court. On the other hand, if the question of jurisdiction is difficult, or if the hearing on the merits is unlikely to be expensive, so that even a null award will not involve a great waste of costs, the arbitrator may think it better to proceed with the reference, warning the claimant that he goes ahead at his peril.

It is appropriate in this context to refer to some observations of Lord Mackay in *Metal Scrap Trade Corp v Kate Shipping Co* default [1990] 1 WLR 115, 117, where he said:

> I would like to emphasize two matters. I believe it is highly desirable that the question whether or not there was a concluded contract and if there was whether or not there was an arbitration clause included in it, should be decided before costs are incurred in the arbitration.

In my judgment, an arbitrator faced with a challenge to his jurisdiction should first see whether the parties wish to seek declaratory relief. If not, then he appears to have three choices. Firstly, he may decide he has no jurisdiction and that is the end of the matter unless a court subsequently takes a contrary view. Secondly, he may issue an interim award on jurisdiction and see whether it is effectively challenged before he goes on to consider the merits. Thirdly, he may decide jurisdiction and the merits and render an award.

If the case is fairly simple, he may wish to take the third course if he is satisfied that not too much expense will be incurred by deciding liability at the same time as jurisdiction. If the case on the merits is difficult and likely to be costly, then he may go for the second alternative, namely, rendering an interim award on jurisdiction. In both these ways, Lord Mackay's injunction as to wasted costs will be adhered to.

Thus, each case will depend on its own particular facts. One thing, however, is clear. Arbitrators should not pull down the shutters on the arbitral process as soon as one party objects to the jurisdiction of the tribunal. The arbitrator can rule on the question as to whether he has

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jurisdiction but he cannot make a binding and final decision on that issue as the matter can always be taken to court either by direct challenge or at the setting aside or enforcement stage.

In so far as Mr Yeung might have been contending that the separability principle does not apply where the initial validity of the agreement containing the arbitration clause is challenged, then I agree with Steyn J in *Harbour Assurance*(supra) that commercial reality is to be preferred to logical purity.

I would like to refer to the case of *Aboitiz Jebsen Bulk Transport Corp v KIT Shipping Agency* [1990] 1 HKC 390 which is a decision of Bokhary J given on 16 March 1990 and referred to at p 33 of *Hong Kong Arbitration -- Cases and Materials*. In that case, the learned judge in considering whether or not to grant a stay stated that the question whether or not there had been a submission to arbitration is not to be decided by the arbitrator but by the court. If by that the learned judge meant that the arbitrator could never ever rule on the question of jurisdiction, I must respectfully but profoundly disagree. If he meant, however, that an arbitrator could never make a binding ruling as to his jurisdiction because the matter would always be considered by the court, then I respectfully agree. In any event that case was quite extraordinary as the party seeking the stay was the same party who alleged that he was not a party to the arbitration agreement!

If this case were a domestic one, I would still appoint an arbitrator if asked to do so and I am confident he would act in accordance with the principles above stated.

Whom should I appoint?

The summons seeks the appointment of Mr Robin Peard who is well known to this court as an able, experienced and impartial arbitrator. Mr Peard was a partner in Johnson, Stokes & Master and is now a consultant with that firm. Mr Davidson quite properly told me that up to two years' ago, Johnson, Stokes and Master used to act for the plaintiff but Mr Peard had no involvement whatsoever in those matters. Mr Yeung has asked me not to appoint Mr Peard on behalf of the defendant in the light of this fact. Although I have not the slightest doubt that Mr Peard would act impartially if appointed, I think it is important that when the court is appointing on behalf of the defaulting appointing party, it should go out of its way to ensure that no sense of grievance is felt, however unreasonable that attitude might appear to others. Fortunately, there is now a pool of experienced, talented and trained arbitrators in Hong Kong and this makes my task in appointing a substitute for Mr Peard every easy indeed. I propose to appoint Mr Philip Yang, who is at present chairman of the Hong Kong branch of the Chartered Institute of Arbitrators and is one of

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the most experienced arbitrators in Hong Kong with particular experience in the field of international sale of goods.

I propose to make a costs order nisi in favour of the plaintiff.