YORK AIRCONDITIONING & REFRIGERATION INC v LAM KWAI HUNG T/A NORTH SEA A/C ELECT ENG CO - [1995] 1 HKC 287

HIGH COURT
KAPLAN J

ACTION NO 8176 OF 1993

16 December 1994

Bills of Exchange -- Claim on dishonoured cheque -- Whether claim covered by arbitration clause in underlying sales contract -- Whether bill of exchange autonomous from underlying transaction under Chinese law -- Whether proper law of the underlying contract relevant to claim

Conflict of Laws -- Bill of exchange -- Claim on dishonoured cheque -- Proper law of underlying contract Chinese law -- Bill of exchange governed by Hong Kong law -- Relevance of proper law of underlying contract to claim under bill of exchange

Conflict of Laws -- Contract -- Proper law -- Arbitration clause referred disputes to arbitration in China -- Strong indication that proper law of contract was China

The plaintiff contracted to supply the defendant with four cooling machines to be installed in a building in Beijing by a Chinese company. Both the plaintiff and the defendant carried on business in Hong Kong. The contract, which was written in Chinese, contained a clause which required that any difference relating to the contract be referred for arbitration in China. The plaintiff sued the defendant for non payment of a bill of exchange drawn by the defendant for part payment of goods supplied under the contract, the bill having been dishonoured upon presentation. The defendant applied for stay of the proceedings pending arbitration, which was refused by a master.

On appeal, the issue was whether a claim on a cheque issued in Hong Kong given in part payment of a liability contained in a written agreement which contained a Chinese arbitration clause should be arbitrated in China or whether it was governed by Hong Kong law as to cheques and thus susceptible to an application for summary judgment. The first issue to be decided was whether the proper law of the underlying contract was the law of China, as argued by the defendant, or the law of Hong Kong, as argued by the plaintiff. The next issue was whether, under Chinese law, a bill of exchange stood separately from the original contract between the parties, as was the case under the law in Hong Kong, or was governed by the arbitration clause. The final issue was whether the proper law of the underlying contract was relevant to the claim under the bill of exchange.

Held, dismissing the appeal:

(1) The proper law of the contract was Chinese law. The fact that the contract provided for arbitration in China was a very strong indicator that the proper law of the contract was China. The various issues raised by the plaintiff did not amount to an 'overwhelming combination of factors' such as to displace the strong inference that the proper law of the contract should be determined by the

place of arbitration. *Compagnie Tunisienne de Navigation SA v Compagnie D'Armement Maritime SA* [1971] AC 572 applied.

(2) On the basis that Chinese law was the applicable law and based on the expert evidence, under Chinese law a bill of exchange was to be treated separately from the underlying contract in re-

spect of which the bill was given. Therefore, there was no arbitration clause covering the claim on the bill.

(3) There was no doubt that under English and Hong Kong law claims under bills of exchange were treated differently to claims for debt or damages. The bill of exchange in the present case was given and accepted in Hong Kong and as such was governed by Hong Kong law. The proper law of the underlying contract was irrelevant for the purposes of considering the claim made under the a bill of exchange which had a separate law applicable to it, namely Hong Kong law.

(4) Accordingly, there were, in effect, two contracts: the contract comprised in the bill of exchange and the underlying sales contract between the parties. Under the law of Hong Kong, which applied to the former, there is no defence to the plaintiff's claim and that the arbitration clause relied upon by the defendant did not apply to it.

Cases referred to

Amin Rasheed Shipping Corp v Kuwait Insurance Co [1984] AC 50 ; [1983] 2 All ER 884

The Assunzione (1954) P 150 ; [1954] 1 ALL ERR 278

Compagnie Tunisienne de Navigation SA v Compagnie D'Armement Maritime SA [1971] AC 572 ; [1970] 3 All ER 71

Di Sora v Phillipps (1863) 10 HL Cas 624

Fung Sang Trading Ltd v Kai Sun Sea Products [1992] 1 HKLR 40

Glynn (H) (Covent Garden) Ltd v Wittleder [1959] 2 Lloyds Rep 409

Handel My J Smit Import-Export NV v English Exporters (London) Ltd [1955] 2 Lloyds Rep 317

Harbour Assurance Co (UK) Ltd v Kansa General International Insurance Co Ltd [1993] QB 710 ; [1993] 3 Al ER 897

Jacobs v Credit Lyonnais (1884) 12 QBD 589 ; [1881-5] All ER Rep 151

Nova (Jersey) Knit Ltd v Kammgarn Spinnerei [1977] 2 All ER 463 ; [1977] 1 WLR 713

Offshore International SA v Banco Central SA [1976] 3 All 749 ; [1977] 1 WLR 399

Paul Smith v H&S International Holding [1991] 2 Lloyds Rep 127

United Railways of Havana and Regla Warehouses Ltd, Re [1960] Ch 52 ; [1959] 1 All ER 214

Whitworth Street Estates (Manchester) Ltd v James Miller & Partners Ltd [1970] AC 583 ; [1970] 1 All ER 796

Legislation referred to

(HK) Bills of Exchange Ordinance (Cap 19) s 72

(HK) Rules of the Supreme Court O 14

(CH) Law on Civil Procedure of the People's Republic of China (Interim) [PRC] 1982

(CH) Law on Civil Procedure of the People's Republic of China 1991 [PRC] arts 189-192

(CH) Law on Negotiable Instruments 1949 [PRC] (repealed)

(CH) Law on Negotiable Instruments of the People's Republic of China Procedures for Bank Settlements 1988 [PRC] rts 14 para 5, 22

Other legislation referred to

Dicey & Morris Conflict of Laws (12th Ed) pp 1225, 1425, 1427

Convention for the Settlement of Certain Conflicts of Laws in Connection with Bills of Exchange and Promissory Notes (Geneva), 7 June 1930

Fazhi Ribao (the Legal System Daily) May 1992 [PRC]

International Convention on the Recognition and Implementation of Foreign Arbitration Awards 1958

Sykes & Pryles Australian Private International Law (3rd Ed) pp 143, 622

UNCITRAL Model Law arts 8, 16

Uniform Customs on Documentary Credits of the International Chamber of Commerce

Appeal from

This was an appeal by the defendant against the order of Master Woolley on 7 December 1993 refusing to stay proceedings brought by the plaintiff against the defendant on a dishonoured bill of exchange. The facts appear sufficiently in the following judgment.

Audrey Eu QC and Adriana Ching (SK Lam, Steven Cheng & Co) for the plaintiff.

Raymond Faulkner (Ho and Chan) for the defendant.

KAPLAN J

This is the defendant's appeal against the order of Master Woolley dated 7 December 1993 whereby he dismissed the defendant's application to stay the proceedings in favour of a CIETAC arbitration clause providing for arbitration in China.

The issue in this case is whether a claim on a cheque issued in Hong Kong given in part payment of a liability contained in a written agreement which contains a Chinese arbitration clause should be arbitrated in China or whether it is governed by the Hong Kong Rules as to cheques and thus should be susceptible to an application for summary judgment. If there is no defence on the cheque then it is submitted that there is nothing to go to arbitration. As Ms Eu QC for the plaintiff puts it 'the arbitration clause in the contract only extends to the contract of sale and not to the bill of exchange'.

The matter first came before me on 28 January 1994. On 4 February 1994, I made certain directions and I made further directions on 24 March 1994. I adjourned the appeal on terms, inter alia, that the parties had leave to file and serve expert evidence and to file and serve a written argument on Chinese law, if so advised. The time within which the said expert evidence was to be received by the court has been extended many times. I have now received all reports; the plaintiffs expert's report being the last

and being dated 5 August 1994. In late November 1994, I refused an application by the defendant to produce an additional report by Professor Chen An on the grounds that it was too late and in the special circumstances there was no opportunity for Mr Dicks QC, the expert on the other side, to reply to it in sufficient time.

The basic chronology is as follows:

Chronology

Date: Event Remarks

19 07 93: Bill of Exchange dishonoured

11 09 93: Writ of Summons/Statement of Dishonoured cheque claim

Claim

24 09 93: D's Summons for stay

27 09 93: P's Order 14 Summons
07 12 93: Order of Master Woolley D's Summons for stay dismissed
P's Summons for Order 14 adjourned
Originally fixed for 14 01 94
08 12 93: D's Notice of Appeal against
order of Master Woolley
dismissing D's Summons for stay
04 01 94: D's Summons for appeal dates to
be vacated
26 10 94: Affidavit of PD Emerson
adducing purported expert evidence
from Mr Guo Xiaowen
28 01 94: Hearing of Appeal before Kaplan J
04 02 94: Directions by Kaplan J For parties to submit in writing on
(1) proper law of contract; (2) scope
of arbitration clause as a matter of
Chinese law if Chinese law applies
03 03 94: Parties' written submissions
10 03 94: 1st Expert Report by Professor D's Expert
Chen An
24 03 94: Parties' appearance before 1. D file and serve by 4pm
Kaplan J for further discussions on 15 04 92 2 experts'
affidavits on Chinese law
2. P file and serve by 4 pm on
05 05 94 2 experts' affidavits on
Chinese law
3. Each party to file and serve
written argument on Chinese
law, if so advised
4. No further affidavits, reports,
skeleton arguments or hearing
thereafter.

The facts are straightforward. On 31 December 1992, the plaintiff agreed to supply to the defendant four sets of York Water Cooling Machines for a total consideration of US$522,760 (the contract). Clause 7 of the contract (as translated) stated:

> Any difference relating to the contract will be resolved by compromise. If compromise cannot be reached, it will be submitted to the China International Trade Arbitration Committee for decision/arbitration.

I shall refer to this clause as 'the arbitration clause'. [No point is taken on the wording of this clause as it was common ground that it referred to CIETAC].

By a writ dated 11 September 1993, the plaintiff commenced the present proceedings. It sues the defendant for non payment of a bill of exchange drawn by the defendant for the sum of US$339,749 in respect of part payment of goods supplied under the contract. The bill was dishonoured on 19 July 1993 upon presentation for payment.

By a summons dated 24 September 1993 the defendant applied for a stay of proceedings under article 8 of the Model Law. By a summons dated 27 September 1993 the plaintiff applied for summary judgment under Order 14 of the Rules of the Supreme Court. That summons has been stayed pending this appeal.

In order to resolve this issue, I must first determine whether it would be right for me to decide the main issue in this application or whether I should stay the proceedings under article 8 of the Model Law and allow the Chinese Tribunal to make a decision on that issue. It seems to me that I must have regard to following matters:

(i) What is the proper law of the underlying contract?
(ii) Under Chinese law does the bill of exchange stand separately from the original contract between the parties or is it governed by the arbitration clause?
(iii) Is the proper law of the contract relevant to the bill of exchange?

In case this matter goes further, I feel I should deal with all these points even if at the end of the day they may not all be relevant to my decision.

Mr Faulkner, who appeared for the defendant, submitted that the issue whether the arbitration clause covered the bill of exchange dispute was, in itself, a 'difference relating to the contract' which should be resolved by the CIETAC tribunal. In the circumstances the court should not predetermine that issue at this stage but should stay the proceedings at least for the purpose of allowing the tribunal to make a decision on that issue. Mr Faulkner further submitted that it was only necessary for the court to decide that the issue was 'not unarguable'. Once it was determined to be arguable, the court should stay the proceedings for the arbitrator to determine the issue. Mr Faulkner submitted that the point was 'certainly arguable'.

As to the jurisdiction of an arbitrator, Mr Faulkner submitted that the law should be looked at in its post Model Law state. He referred to several recent authorities which, he argued, indicated that the courts were willing to permit the arbitrator to rule on issues of jurisdiction where the issue was not merely (as here) as to the construction of the clause and/or its extent but which went to the very validity of the contract containing the clause: *Paul Smith v H&S International Holding* 1991 2 Lloyds Rep 127; *Harbour Assurance Co (UK) Ltd v Kansa General International Insurance Co Ltd* [1993] QB 701 ; *Fung Sang Trading Ltd v Kai Sun Sea Products Co Ltd* 1992 1 HKLR 40.

Mr Faulkner further submitted that since, in this case, the contract containing the clause was signed in China, was written in the Chinese language, required an arbitration in China, and, arguably, was governed by Chinese law, the ambit of the arbitration clause should be determined by a Chinese speaking tribunal in China.

Mr Faulkner then referred to the House of Lords authority of *Nova (Jersey) Knit Ltd v Kammgarn Spinnerei* 1977 1 WLR 713, in which, he said, two of its members were in conflict with one another on the very issue of whether or not, under English Law, an arbitration clause extends to cover a dispute under a bill of exchange.

In that case, the plaintiff company brought an action on several bills of exchange which had been dishonoured by the defendant. The original agreement between the parties had contained a clause which stated that all disputes arising from the partnership relationship were to be decided by an arbitration tribunal in Germany. The House of Lords were therefore concerned with an arbitration clause governed by German law. Three members of the House, Lord Wilberforce, Lord Fraser and Viscount Dilhorne appeared to be solely concerned with the German law position. Lord Russell, however, although appearing to decide the matter on the basis of the evidence as to German law, went on to give his view as to the position under English law, namely that the defendant had not established that the plaintiff's actions on the bills of exchange were 'in respect of a matter agreed to be referred' to arbitration. Lord Salmon took a totally different view from all of the above and relied upon the case of *Di Sora v Phillipps* 1863 10 HL Cas 624, 633 as deciding that the question of construction was a matter for the English courts. He then went on to find that, on an English con-

struction of the issue, the dispute, albeit in relation to a bill of exchange, was a dispute within the meaning of the arbitration clause.

Mr Faulkner therefore submitted that since Lord Russell and Lord Salmon had come to quite difference conclusions, the issue of whether the arbitration clause extends to a dispute under the bill of exchange is at the very least arguable and should therefore he determined by the Chinese tribunal.

[1995] 1 HKC 287 at 293

Ms Eu QC, who appeared for the plaintiff, argued that the court did have jurisdiction to decide whether the bill was a matter which was subject to the arbitration clause. She stated that the issue arose under article 8 of the Model Law; that is, the defendant must show that the action on the bill is a matter which is the subject of an arbitration agreement. It was up to the court to determine the matter, namely the action on the bill, before a stay could be granted and the matter referred to an arbitrator. The court could not abdicate its decision in favour of an arbitrator. Further, this was not, she submitted, a case under article 16 of the Model Law where an arbitrator rules on his own jurisdiction or the existence or validity of the arbitration agreement.

In summary, the plaintiff's case was that the Hong Kong court must determine the question under article 8 according to Hong Kong law which included Hong Kong's conflict of laws provisions.

What is the proper law of the underlying contract?

It appeared to be common ground that in deciding what is the proper law of the contract, and in the absence of an express choice, it is established law that the court should first consider whether, from the terms and nature of the contract, and from the general circumstances of the case, there were any other indications of the parties' intention and, only if there was no such intention, go on to consider the system of law with which the contract had its closest and most real connection: *Amin Rasheed Shipping Corp v Kuwait Insurance Co* default [19841 AC 50; *Whitworth Street Estates (Manchester) Ltd v James Miller & Partners Ltd* default [1970] AC 583 at 611.

When the intention of the parties to a contract with regard to the law governing the contract is not expressed in words, their intention is to be inferred from the terms and nature of the contract, and from the general circumstances of the case, and such inferred intention determines the proper law of the contract: *Jacobs v Credit Lyonnais* 1884 12 QBD 589 at 601; *Amin Rasheed* (supra).

However, in practice, in the absence of an express choice of law clause, since the tests of inferred intention and close connection merge into one another, the courts tend to move straight to the test of close connection: *Amin Rasheed Shipping Corp v Kuwait Insurance Co* default (supra).

Mr Faulkner went on to list 6 factors which he said were relevant to the question of proper law: (a) the place of contracting; (b) the place of performance; (c) the place of business or residence of the parties; (d) the nature and subject matter of the contract; (e) the language of the contract; and (f) the currency of the contract.

Mr Faulkner then submitted that the proper law of the contract was the law of China. He cited, inter alia, the following factors in support of this submission:

[1995] 1 HKC 287 at 294

> A. The name of the project was the 'Cooling Station of China Central Broadcast'; in short, the end user of the cooling system was, as the plaintiff well knew, a Chinese company.
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> B. The system was, as the plaintiff knew, to be installed in Beijing.
>
> C. The contract was not simply for the sale of goods and the place of performance of the contract was only, in part, Hong Kong. For example:
>
> 1. Appendix III, Specification, D1(1) provides:
>
> Within 15 days after the seller receive (sic) the written notice from the Buyer, staff will be sent to do adjustment and testing and submit the adjustment plan to the Buyer.
>
> This part of the contract was clearly to be performed at the place where the equipment was finally installed, that is, in Beijing.
>
> 2. Certain essential parts of the contract goods -- namely, the electronic cards and software for the control systems -- were not delivered in Hong Kong but were only to be installed at the stage of commissioning and testing in Beijing;

> 3. Article V of the contact provides for 'repair or any changing of parts' and responsibility for 'adjustment and testing'; this would clearly take place in Beijing.
>
> D. The contract was signed in Beijing contemporaneously with two other relevant contracts involving PRC entities.
>
> E. The contact was signed by the Beijing representative of the plaintiff.
>
> F. The contract was written in the Chinese language.

Finally, Mr Faulkner submitted that the fact that the arbitration clause provides for submission of differences to CIETAC was a very strong indicator that the proper law of the contract was the law of China. In support of this submission, he cited the following passage from Dicey & Morris, *Conflict of Laws* (12th Ed) at 1225:

> ... other matters that may impel the court to the conclusion that a real choice of law had been made might include ... the choice of a place where disputes are to be settled in arbitration in circumstances indicating the arbitrator should apply the law of that place. ... Prior to the 1990 Act it had been held that an agreement that litigation or arbitration should take place in a particular country usually permitted the inference that the law of that country was intended to be the governing law of the contract. Although it had at one time been thought that an arbitration clause raised an irresistible inference to that effect, the House of Lords held in *Compagnie Tunisienne de Navigation SA v Compagnie D'Armement Maritime SA* default [1971] AC 572 that an arbitration clause was merely one of the factors to be taken into account, albeit a 'weighty indication' or giving rise to a 'strong inference'. But Lord Wilberforce said 'that the selection
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> *[1995] 1 HKC 287 at 295*
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> of a certain place for arbitration ... is an indication that the parties intended the law of that place to govern is a sound general rule' [at p 526] and Lord Diplock added that 'an arbitration clause is generally intended by the parties to operate as a choice of the governing law and should be so construed unless there are compelling indications to the contrary in the other terms of the contract or the surrounding circumstances of the transaction' [at p 609]. The practical effect of the decision was that the courts continued to presume that a contractual submission to arbitration in a particular country was generally an implied choice of law.

In sum, Mr Faulkner submitted that applying the tests of inferred intention and/or closest and real connection, the proper law of the contract was that of the PRC.

Ms Eu QC rejected all of these factors. Without prejudice to her primary argument that the proper law of the contract was irrelevant to the bill of exchange, she submitted, firstly, that the *locus contractus* was not a decisive factor in the determination of the proper law of a contract: see, for example, *Handel My J Smit Import-Export NV v English Exporters (London) Ltd* 1955 2 Lloyds Rep 317 at p 323 where it was held that the *locus contractus* was 'some guide but not so helpful as the place of performance'. Further, she submitted, it would be a question of inference in each case whether the emphasis given to the locus contractus indicated an intention to subject the contract to the law of that place and the court would not easily draw that inference where it found that the contract was more closely connected with another legal system: *The Assunzione* [1954] P 150.

Ms Eu suggested that, although the contract was signed in China, it was most probably negotiated and concluded in Hong Kong. The plaintiff had only executed the contract in China because the defendant had contracted to sell the goods to Chinese parties. The Chinese parties were holding a formal ceremony for the execution of their contracts and the plaintiff was invited to participate in the same. Accordingly, the *locus contractus* could not be a decisive factor in the determination of the proper law of a contract.

As to the fact that the contract was in the Chinese language, Ms Eu submitted that only a very cautious inference should be drawn from the use of a particular language: see, for example, *Compagnie Tunisienne de Navigation SA v Compagnie D'Armement Maritime SA* [1971] AC 572 at pp 583 and 594. Further, since many contracts in Hong Kong, which are governed by Hong Kong law, are written in Chinese and since Chinese is the language of the Hong Kong parties, it was not surprising that the contract was written in Chinese. Indeed, it was an equal indication that the proper law was Hong Kong law.

Ms Eu finally turned to the matter of the arbitration clause. She submitted that in *Compagnie Tunisienne* (supra), the contract had no connection with any other system of law other than a clause providing for arbitration in

London. The House of Lords therefore held that French law was the proper law and that the arbitration clause was only one of the factors to be taken into account. She argued that in this case little, if any, inference could be drawn from the arbitration clause. China may have been chosen as the forum for arbitration because the defendant had contracted to sell the goods to China. After the sale of the goods by the defendant, the goods would be installed in China; accordingly, any disputes rising out of the quality of the goods would be most conveniently dealt with in China.

Ms Eu went on to propose that the proper law of the contract was in fact Hong Kong. She stated that great weight should be placed on the law of the place of performance or the principal place of performance as being the proper law of the contract, that is, the law of Hong Kong: *Re United Railways of Havana and Regla Warehouses Ltd* [1960] Ch 52 at p 56. This was especially so where the contract was signed in one country but was to be performed wholly or principally in another: *The Assunzione* (supra). I was referred to a number of authorities which illustrated the above propositions: *Jacobs v Credit Lyonnais* 1884 12 QBD 589 at 601; *Glynn (H) (Covent Garden) Ltd v Wittleder* 1959 2 Lloyds Rep 409; *Offshore International SA v Banco Central SA* 1977 1 WLR 399.

In addition, she listed the following factors as an indication that the contract was intended to be governed by Hong Kong law:

(a) Both the plaintiff and the defendant are in Hong Kong. The plaintiff is the Hong Kong branch of a US company. The defendant is apparently a Hong Kong citizen.
(b) Both the plaintiff and the defendant carry on business in Hong Kong.
(c) The contract was probably negotiated and concluded in Hong Kong.
(d) The goods were to be delivered to the defendant in Hong Kong (see clause 11(2) of the contract).
(e) The goods were to be inspected in Hong Kong (see clause vi of the contract).
(f) Inspection reports in respect of any quality claims were to be submitted to the plaintiff in Hong Kong.
(g) 30% of the price had been paid in Hong Kong.
(h) 5% of the price was to be affected by a bill drawn in Hong Kong (together with the initial 30%, this adds up to 95% of the price).
(i) The bill was drawn on a Hong Kong party.
(j) The bill was accepted by the defendant in Hong Kong against documents delivered to the defendant or its bank in Hong Kong.
(k) The bill was presented for payment and dishonoured in Hong Kong.

(l) The balance of the price was intended to be paid in Hong Kong.

In addition, I have considered Sykes & Pryles, *Australian Private International Law* (3rd Ed) at p 143, where having referred to *Compagnie D'Armement Maritime* (supra), they state:

> Nevertheless, a clause specifying arbitration in a particular country remains a strong inference that the proper law is that of the country where the arbitration is to be held. The inference can be displaced only by an express choice of law clause or by a fairly overwhelming combination of factors pointing to another legal system. Thus, often the proper law of a contract (including the arbitration clause) will be the law of the place where the arbitration is to be held.

I have carefully considered all of the issues raised by Ms Eu QC as to what is the proper law of this contract. However, I am not satisfied that those issues, taken together, amount to an 'overwhelming combination of factors' such as to displace the strong inference that the proper law of the contract should be determined by the place of arbitration. On that basis, I am therefore unwilling to find that any law other than Chinese law is the proper law of the contract.

Applying the law of PRC, is the bill of exchange covered by the arbitration clause?

It is common ground that under the law of Hong Kong, a bill of exchange is autonomous from the underlying transaction; for example, so long as a defence of total failure of consideration is not raised, it will always be possible to obtain Order 14 judgment on such bill -- and, arguably, such a bill would not be covered by an arbitration clause. The position under the law of China is, however, not so well established.

I have therefore been referred to the following experts' reports, all of which seek to shed some light on the issue of whether, under Chinese law, the bill of exchange is subject to the arbitration agreement or whether it is an autonomous contract in itself:

1 Professor Chen An, the Dean of the Institute of Political Science and Laws in Xiamen University, for the defendant dated 10 March 1994;
2 Yao Zhuang, Professor of International Law Research Institute of Foreign Affairs School for the defendant dated 4 April 1994;
3 a supplementary report by Professor Chan An, the Dean of the Institute of Political Science and Laws in Xiamen University, for the defendant dated 7 April 1994;
4 Anthony Richard Dicks QC, Visiting Professor of Law at the School of Oriental and African Studies in the University of London, for the plaintiff dated 5 August 1994.

Professor Chen produced 2 reports. The gist of his evidence is that, under Chinese law, the bill of exchange in the present case is bound up with the

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underlying contract of sale between the parties and that it is therefore subject to the arbitration clause. In support of this view, he states the following propositions:

(1) The facts of the case reveal that the question of the bill of exchange is a dispute between the parties arising from the obligations to pay the purchase price. It is therefore a 'difference relating to the contract' within the meaning of the arbitration clause and therefore falls within the said arbitration clause.
(2) In view of the special nature of the sales contract, it is not possible for the bill of exchange dispute to be isolated from and considered independent of the sales contract in this case. 'Otherwise this bill of exchange would be like a tree without root, a stream without source or a "semi-heart" with no body -- it has lost its own life.'
(3) Clause I of the sales contract provides for the obligation of the vendor to supply goods; clause III of the sales contract sets out the obligation of the purchaser to make payment. Accordingly, the clauses have spelled out the basic rights and obligations of both the vendor and purchaser. 'They correspond to each other, coexisting and are integrated together. They are inseparable from the contract and form the soul and heart of this agreement'; it is irrelevant that the details of how payment is to be made are to be left to subsequent discussion.
(4) Since none of the parties deny that the dispute as to the quality of the goods is a dispute directly under the contractual obligations, then the bill of exchange dispute arising out of those facts must also be a dispute directly under the contractual obligations.
(5) In sum, since the bill of exchange dispute, which is directly related to the payment of the purchase price, should be referred to the arbitration authority in China, it would be a breach of contract if it were to be resolved by the Courts of Hong Kong.
(6) Further, the dispute concerning the definition of the arbitration clause could also be defined as a 'difference relating to the contract' to be determined by the arbitration authority in China.

In his supplemental report, Professor Chen reiterated his opinion that the bill of exchange and underlying sales contract were bound up with one another. He exhibited the sales contract to this report and stated, inter alia, that the price shown on the bill of exchange was part of the total price of the sale contract itself; that the bill of exchange was an 'undivided component part' of the sale contract and that therefore the arbitration clause should be applicable to the disputes on the said bill of exchange.

Professor Yao deals with the legal position when there is a valid arbitration clause, namely that under the 1958 International Convention

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on the Recognition and Implementation of Foreign Arbitration Awards (the New York Convention), of which China, USA and the United Kingdom are all signatories, no court shall have jurisdiction to hear the dispute. He further states that where there is no express choice of law provision in a contract, the court/arbitrator shall decide the applicable law according to the 'closely related' principle; as the equipment in the present case was installed and operated in Beijing, the law of China shall be the applicable law. Finally, he states that, in Chinese law, the phrase 'contract disputes' should be widely interpreted. Since this dispute arose from the

refusal of one party to make payment for certain goods, the dispute is covered by that phrase and therefore shall be subject to the proper law of the contract, namely the law of China.

I also have had placed before me a letter dated 26 January 1994 from Mr Guo Xiaowen in which he states as follows:

> As an experienced arbitrator in the PRC I state my opinion that any PRC arbitrator would consider that the dispute concerning the bill of exchange would fall to the arbitrator in the arbitration arising out of the main contract relating to the goods. This is because the dispute concerning the bill for payment is arising in connection with the contract for the supply of the goods. Chinese law does not note the distinction that the bill dispute is entirely separate and apart from contractual disputes arising out of a supply contract.

In my considered view, the arbitration of the issues between the buyer and the seller should be opened in PRC and the arbitrator would deal with both the bill of exchange aspect and the contractual disputes between the parties.

The plaintiffs have adduced an expert affidavit from Mr Anthony Dicks QC who is an expert in Chinese law and has special expertise in relation to the development of various payment mechanisms including bills of exchange within the PRC. He made the following fundamental point in relation to the reports prepared by Professors Chen and Yao. He stated that neither professor appeared to appreciate that where a bill of exchange was drawn in Hong Kong by a company in Hong Kong to the order of a bank in Hong Kong on another Hong Kong company for acceptance and eventual payment in Hong Kong, and where the bill itself remained in Hong Kong, the mandatory provisions of the Bills of Exchange Ordinance (Cap 19) would give rise to a series of contracts between the parties to the bill -- which in the instant case could only be governed by Hong Kong law. Secondly, he stated that neither appeared to have considered the fact that the bill in the present case appears to have been a fully negotiable instrument, or to the legal implications in the law of China of that fact.

The essence of Mr Dicks' evidence was therefore that in neglecting to take into consideration the special character of bills of exchange as negotiable instruments, both Professors had adopted a view which did not take into account or accord with the legal principles applicable in China to bills of exchange and other payment instruments. In particular, they had

failed to consider the distinction between the underlying legal obligations arising from the transaction which would give rise to the necessity to make a payment -- and the obligations specifically created by the payment instrument used to discharge the underlying obligation; Mr Dicks described this principle as 'autonomy', although he stressed that that expression was not, as far as he knew, used in China in that connection. Nevertheless, it was his view that it was the essence of bills of exchange, in Chinese law as in other systems, that they could stand independently of the underlying transaction.

In relation to the law governing bills of exchange in China, Mr Dicks stated that, in fact, there has been no such law enacted by the national legislature and analogous to the Bills of Exchange Ordinance in China since the abolition of the Law on Negotiable Instruments on 29 September 1949. After that date, bills of exchange and other negotiable instruments were largely abolished and all commercial payments within the internal economy of China were dealt with by a complex system of 'settlements' based upon the equivalent system in the Soviet Union.

In the mid-1980's, with the need for new forms of commercial credit in internal trade, the use of old style 'Renminbi' bills of exchange was revived. Such bills of exchange are now governed by the Procedures for Bank Settlements promulgated by the People's Bank of China on 19 December 1988 which came into force on 1 April 1989 (the Settlement Procedures 1988).

Mr Dicks states that one of the most important features of the commercial bills of exchange regulated by the Settlement Procedures 1988 is that they are transferable by indorsement (Settlement Procedures 1988, art 14, para 5). By virtue of art 22, such endorsements have legal effects comparable to those recognised in other legal systems:

> Where a payment instrument which in accordance with these Procedures is transferable by indorsement suffers dishonour by reason of non payment, the holder of the instrument is entitled to exercise a right of recourse against the

> drawer, indorsers and other persons liable [on a payment instrument]; all persons liable on a payment instrument are jointly and severally liable to the holder.

Mr Dicks stated that the effect of these and of other provisions in the Settlement Procedures 1988 has been to create a new category of obligations which are distinct from and independent of the obligation of the parties under civil law or economic law arising from the underlying transaction. In other words, Mr Dicks says, the bills are 'autonomous'. In support of this proposition, I was referred to a very interesting article by Mr Guo Feng which appeared in May 1992 in the *Fazhi Ribao* (the *Legal System Daily*), an official daily newspaper published under the auspices of the Ministry of Justice which, Mr Dicks said, was read widely by both judges and lawyers. Mr Dicks said that this approach had also been supported in recent years by academic lawyers.

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In addition, he mentions one further point to arise from some writing; namely, that the rights and duties attaching to bills of exchange have not been treated as arising from a series of contracts, but are essentially *sui generis* arising under a special statutory regime. A breach of these rights is treated in a manner resembling a tort, rather than a breach of contract. It would therefore, Mr Dicks says, be difficult to conceive of them as forming an integral part of a contract, as apparently contemplated by Professors Chen and Yao.

The Settlement Procedures 1988 does, however, only apply to Renminbi payments. There is, Mr Dicks tells me, no comparable legislation for payment instruments denominated in other currencies, whether these are used in international trade or employed entirely within China. Further, there is as yet no specific legislation in China which lays down rules for the conflict of laws with respect to bills of exchange and no published interpretations of either the Supreme People's Court or the People's Bank of China appear to have dealt with this question. China is not a party to the Convention for the Settlement of Certain Conflicts of Laws in Connection with Bills of Exchange and Promissory Notes (Geneva, 7 June 1930).

Accordingly, Mr Dicks says that the applicability of the general rules regarding conflict of laws in relation to contract must be a matter requiring great caution -- particularly in the light of the fact that under the domestic law of China, the obligations to which bills of exchange give rise are not regarded as contractual obligations at all.

Mr Dicks then turned to the matter of procedural law. He said that the re-introduction of various kinds of payment instruments, including bills of exchange, was one of the factors felt to necessitate various amendments or additions to the original Law on Civil Procedure of the PRC (Interim) (which had been promulgated in 1982) in order to provide a form of summary relief, inter alia, in cases where a sum of money was due on such an instrument. Articles 189 to 192 inclusive of the new Law on Civil Procedure of the PRC, which came into force on 9 April 1991, and which, Mr Dicks says, are equally applicable to foreign and Renminbi bills, embody a so-called 'supervisory procedure' of a kind found in the procedural codes of other civil countries. It enables a plaintiff claiming a sum of money on delivery of a valuable security to obtain ex parte and serve on a defendant a 'payment order' which, if not contested by the defendant within 15 days, can be enforced. It is subject to the right of the defendant to submit a written 'opposition' showing that the right to payment (or delivery) is the subject of dispute between the parties, on the basis of which the court must decide whether or not to discharge the payment order.

This procedure did, however, give rise to misunderstandings in its application to payment instruments: see further Mr Guo Feng, Part 2, para 3 (pp 9-12 of the translation). Mr Dicks states that, in his opinion, the view

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expressed by Guo Feng in relation to the limited scope for opposition to claims arising from payment instruments is entirely consistent with, and lends further support to, the principle of autonomy of bills of exchange as a feature of Chinese law.

In concluding, Mr Dicks says that the apparent assumption by Professor Chen and Professor Yao that the bill of exchange is or became an integral part of the sale contract is certainly not borne out by the relationship of payment instruments and the underlying contracts which give rise to their use under Chinese legislation as expounded by Guo Feng. Further, in the international sphere, Chinese banks have long adopted the *Uniform Customs on Documentary Credits* of the International Chamber of Commerce, which for many years have expressly required acceptance of the principle of autonomy of the credits; ie, in numerous transactions, contracts of a kind similar to the contract of sale in the present case have coexisted with credits which are clearly

autonomous, without giving rise to conceptual problems of the kind referred to in Professor Chen's conclusion.

I have received careful submissions on the issue of Chinese law and I do not propose to burden this judgment with setting them out. I have been much impressed with the evidence of Mr Dicks which does appear to me to deal with the relevant issue in a logical and coherent manner supporting it with references to the development of the law relating to negotiable instruments within China. On the other hand, I regret to say that I have found the evidence on the other side far too simplistic. We all know that the bill of exchange was given in part payment of a contractual liability contained in the main contract which itself contained an arbitration clause. However it does not appear to me that the evidence on the other side has attempted adequately to analyse the development of the law in this regard. Mr Dicks himself makes certain criticisms of the views of the opposing experts and I think it suffices for me to say that I adopt his criticisms. I am also impressed by Mr Dicks' reference to the article contained in the *Legal System Daily* by Mr Guo Feng which strongly supports the conclusions at which Mr Dicks has arrived. Guo Feng referred to the limited scope for opposition to claims arising from payment instruments and this is entirely consistent with and supports the principal of autonomy of bills of exchange as a feature of Chinese law. I am prepared to accept the conclusion made by Mr Dicks which he sets out in paragraph 33 of his affidavit which reads as follows:

> For all the foregoing reasons, I am unable to agree with the construction placed on the arbitration clause by Professor Chen and Professor Yao. If an arbitral tribunal in China were fully appraised and able to take full account, first, of what I have referred to as the principle of autonomy of bills of exchange as recognized by the provisions of Chinese statutory law, secondly, of the negotiable character of the bill in question under Hong Kong law, and thirdly on the implications arising from these two factors, I do not believe it will adopt the construction advanced by Professor Chen and Professor Yao, which completely ignored all three of these points.

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I therefore conclude that on the basis that Chinese law is the applicable law, a bill of exchange is to be treated separately from the underlying contract in respect of which the bill was given and that there is thus no arbitration clause covering the claim on the bill.

Is the proper law of the contract relevant to the bill of exchange?

I now turn to consider, perhaps somewhat belatedly, whether the proper law of the contract is relevant to the bill of exchange.

Ms Eu QC submitted that the proper law of the contract could not affect the bill. Like a letter of credit, a bill of exchange was an autonomous contract in itself; any other decision would undermine the value of a bill as the life blood of commerce. In support of her argument, she cited Lord Wilberforce in *Nova Knit* (supra) at p 716D where he stated that a bill is not a valid bill if it incorporates an arbitration clause and submitted that the court should therefore be slow to hold that a bill could be affected by or could be made subject to an arbitration clause in a contract.

She further cited *Dicey & Morris* (12th Ed) at p 1427:

> The principles governing the conflict of laws with reference to bills do not apply to contracts commercially connected with negotiable instruments but not embodied in the instrument itself.

And at p 1425:

> ... Though it may be rare or non-existent in practice for a bill to contract a choice of law, such a choice is not, in principle, unacceptable if it appears on the face of the instrument.

Ms Eu concluded that the proper law governing the bill could therefore be different from that governing the contract and that, whatever the law of the underlying contract, this should not be allowed to affect the plaintiff's rights to the bill under Hong Kong law. In her submission, since it was common ground that acceptance of the bill in this case was completed by delivery and notice of acceptance in Hong Kong, the proper law governing the bill of exchange was the law of Hong Kong.

Ms Eu further contended that there were no defences to the claim on the bill of exchange. It cannot be argued, she submitted, that there was any total failure of consideration because the defendant had taken de-

livery of and accepted the goods despite the delay and the defects certified at arrival in Hong Kong. The defendant has been partially paid by his purchaser. She dismissed the allegations of illegality under Chinese law and US law. Finally she submitted that even if the alleged illegality affected the contract of sale between the plaintiff and the defendant it did not affect the bill of exchange the proper law of which is governed by s 72 of the Bills of Exchange Ordinance (Cap 19).

Mr Faulkner for the defendant submitted quite simply that this was a claim based upon the bill of exchange which was given in respect of a contractual obligation contained in a written agreement which itself had a

Chinese arbitration clause. On that basis he submitted that the matter should be decided in China in accordance with CIETAC rules. He challenged the assertion of Ms Eu that the bill of exchange, as it were, had a life of its own and had to be considered not under Chinese law but under Hong Kong law and under the Bills of Exchange Ordinance.

I am quite satisfied that Ms Eu's submissions are correct. There is no doubt that under English and Hong Kong law claims under bills of exchange are treated differently to claims for debt or damages. This bill of exchange was given and accepted in Hong Kong and as such is governed by Hong Kong law. The bill of exchange does not contain an arbitration clause. I am not prepared to hold that the arbitration clause in this case is sufficiently widely drawn to cover a claim arising under a bill of exchange. Unusual though it may be, I accept that it is possible for an arbitration clause to be drafted wide enough to cover a claim made under a bill of exchange. It seems to me that the bill of exchange in this case creates a free standing contract separate and apart from the underlying contract between the parties which is the one which contains the arbitration clause. Mr Faulkner says that the claim in respect of the bill of exchange is itself a 'difference relating to the contract'. I respectfully disagree. In effect, one is dealing here with two contracts. One is the contract comprised in the bill of exchange and the other is the underlying sales contract between the parties. This point was expressed felicitously by Sykes & Pryles, *Conflict of Laws*, (supra) at page 622 where they say:

> There is a further fact that the piece of negotiable paper occupies a position of intrinsic significance so that dealings with it have a legal life of their own which tends to be divorced from the particular contracts which inspire them.

In all the circumstances therefore, I conclude that the proper law of the underlying contract is irrelevant for the purposes of considering this claim made under a bill of exchange which has a separate law applicable to it, namely the law of Hong Kong. Under that law, I am quite satisfied that there is no defence to this claim under the bill of exchange and that the arbitration clause relied upon does not apply to it.

In the final analysis it seems clear that I must refuse the stay as the claim made in this action is not covered by the arbitration clause relied upon and that means dismissing the appeal against the decision of the master who came to the same conclusion.

I propose to make a costs order nisi to the effect that the defendant shall pay the plaintiff the costs of the stay application. The Order 14 summons can now be restored for hearing before a different judge.