

Unofficial Translation

ED & F Man (Hong Kong) Co., Ltd. v. China National Sugar & Wines Group Corp.

Reply of the Supreme People's Court regarding the Request of Instruction by Beijing Higher People's Court on the Recognition and Enforcement of a London Sugar Association Arbitral Award by the Applicant ED & F Man (Hong Kong) Co. Ltd.

(1 July 2003, [2003] Min Si Ta Zi No. 3)

Beijing Higher People's Court,

Your Court's Request for Instruction on the Recognition and Enforcement of a London Sugar Association Arbitral Award by the Beijing Higher People's Court, from the Applicant, ED & F Man (Hong Kong) Co. Ltd. (reference number Jing Gao Fa [2003] No. 7) dated on 15 January, 2003 has been received. Upon discussion of the Judicial Committee of this court, we reply as follows:

China National Sugar & Wine Group Corporation ("**China Sugar Group**") and ED & F Man (Hong Kong) Co. Ltd ("**ED & F Man**") agreed in their contract (No. 8008) on 14 December, 1994 that any dispute arising from the contract should be settled by the London Sugar Association under the Association's rules. The dispute between the two parties arose under the No. 8008 contract, therefore the London Sugar Association has requisite legal basis to settle the dispute according to said agreement. Upon investigation, we did not find any of the grounds laid down in Article V(1) of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("**New York Convention**") applied to this case.

The dispute arising from the performance of the contract is a commercial contractual relationship. Under Chinese laws, parties can choose to settle disputes of this kind by arbitration. According to Chinese laws, domestic enterprises are not allowed to participate in offshore future transactions without official approval. The offshore future transaction conducted by China Sugar Group should be invalid under Chinese laws. However, the violation of compulsory rules under Chinese law should not be equal to breaking Chinese public policy. Therefore, neither of the two grounds laid out in Article V(2) of the New York Convention concerning the subject matter of the difference and the public policy are present this case.

According to Article 269 of the Civil Procedure Law of the People's Republic of China ("**Chinese Civil Procedure Law**") and Article V of the New York Convention, the people's court should recognize and enforce the arbitral award in this case.

Above is the reply to your Court's Request.

Annex

Request for Instruction of Beijing Higher People's Court for the Recognition and Enforcement of No. 158 London Sugar Association Arbitral Award by the Applicant ED & F Man (Hong Kong) Co. Ltd.

Jing Gao Fa [2003] No. 7

Supreme People's Court,

The case on the recognition and enforcement of No. 158 London Sugar Association Arbitral Award dated August 6, 2001, by the applicant ED & F Man (Hong Kong) Co. Ltd. was put on record by the Beijing No. 1 Intermediate People's Court on February 20, 2002. According to the review of the case by our court, the recognition or enforcement of the award would be contrary to the public policy of our country. Therefore, we dismiss the application of ED & F Man and deny the recognition and enforcement of arbitral award No. 158 made by London Sugar Association. We hereby report the case to you as follows:

I. The Basic Facts of this Case

China Sugar Group and ED & F Man entered into a contract (No. 8008) on 14 December 1994. The parties agreed as follows: ED & F Man undertook to sell raw sugar to the China Sugar Group, dividing the sale into two installments. One batch was to weigh 7,500 metric tons, approximately 5%. At the choice of the seller the date of delivery was to be from July to September 1995 and the method of payment was to be in US dollars with negotiation in Hong Kong. The buyer was also required to obtain an irrevocable letter of credit in favor of the seller. The second batch was to weigh 100,000 metric tons, approximately 5%. At the choice of the seller, the date of delivery was to be from October to December 1995. The date for claiming the choice should not be later than 15 September, 1995. The method of payment was to be by letter of credit within 4 days after the choice was made and claimed. The sale price for both batches of raw sugar should be 345 US dollars/metric ton, C&FFO the main ports in China. For all disputes arising under the contract, the parties opted for arbitration by and under the rules of the London Sugar Association. The performance of the contract should follow the rules of the London Sugar Association regardless of whether or not the parties are members or representatives of members of the Association.

The China Cereal Corporation entered into a contract to import the first 7,500 metric ton batch under Contract No. 8008 contract with ED & F Man at the authorization of the China Sugar Group. The contract was performed and there was no dispute related to the first batch.

China Sugar Group and ED & F Man signed 19 Attachments to Contract No. 8008 from 14 June 1995 to 29 June 1998. According to Attachment 6, the two parties agreed to postpone the period of delivery of the 100,000 metric tons of raw sugar from March – May 1996 to July – September 1996 as the China Sugar Group did not have an import quota during that period. Later on, according to the Attachment 19, the two parties agreed to postpone the period of delivery again to October 1998 – 15 December 1998.

ED & F Man opened an account for Contract No. 8008 in the New York Future Exchange and conducted future speculation on the 100,000 metric tons of raw sugar in order to benefit from it. The China Sugar Group clearly knew the future speculation by ED & F Man and benefited from charging the ED & F Man for compensation fees or undercutting the ED & F Man's selling price. China Sugar Group also authorized ED & F Man to participate in the future transaction on behalf on it and directly participated in the transaction.

China Sugar Group did not open a letter of credit according to Attachment 19, and ED & F Man did not deliver the goods. On 26 January 1999, ED & F Man sent a fax to the China Sugar Group indicating that it was terminating Contract No. 8008.

II. Arbitration

ED & F Man submitted the dispute concerning Contract No. 8008 and its Attachments to the London Sugar Association for arbitration and claimed damages based on the difference between the contract price and the market price. They claimed that the measure of the market price should follow "the most appropriate standard of the market price of the date or during the few dates while the applicant supplies the goods" arriving at the average of the futures transaction price for the period of October, November and the first half of December.

China Sugar Group and ED & F Man both participated in the arbitration procedure.

The London Sugar Association made an arbitral award (No. 158) on 6 August 2001. The award held as follows: (1) China Sugar Group shall pay damages of \$14,162,505 for breach of contract and interest of \$2,508,533.70 (the amount calculated according to the proposal of ED & F Man); (2) The China Sugar Group shall pay the interest at 4.5% annual rate based on the amount of \$16,671,038.70 until the debt is settled; (3) the China Sugar Group shall pay the arbitration fee, totaling 156,434.00 GBP, to the London Sugar Association; and (4) the China Sugar Group shall pay ED & F Man the standard arbitration fees.

III. Applications and Arguments of the Parties

ED & F Man applied for recognition and enforcement of arbitral award No. 158 made by London Sugar Association on 22 January 2002. The Beijing No. 1 Intermediate People's Court put the case on file on 20 February 2002.

The China Sugar Group applied for refusal of recognition or enforcement of arbitral award No. 158 made by London Sugar Association on 1 March 2002 based on the following arguments:

1. The China Sugar Group did not have legal capacity when it entered into the contract and the arbitration agreement with ED & F Man under Chinese law. (1) Although the China Sugar Group had the qualification of conducting import and export business when it entered into the contract with ED & F Man, it did not have the qualification of foreign trade franchising on importing raw sugar because at that time importing raw sugar required a special license. Therefore, the China Sugar Group did not have legal capacity to form a contract under Chinese law. The China Sugar Group still did not have legal capacity to contract when it was granted the foreign trade franchising right for raw sugar without the import quota. (2) The contract signed between the China Sugar Group and ED & F Man is a futures transaction contract. The China

Sugar Group did not have the legal capacity to participate in the futures transaction under Chinese law. (3) The China Sugar Group did not have the legal capacity to enter into any arbitration agreement since it did not have the legal capacity to enter into Contract No. 8008 with ED & F Man. (4) The fact that the China Sugar Group participated in the arbitration does not imply that China Sugar Group has given up any defense based on its contracting capacity or that the court could not dismiss the enforcement of the arbitral award basing on lack of legal capacity of one party. (5) The court has the right to judge the issue of legal capacity to contract regardless of whether or not the arbitral tribunal has made its award on this issue. In conclusion, the China Sugar Group as one party to the arbitration agreement did not have contracting capacity when it entered into the arbitration agreement under the *lex personalis*, the Chinese law.

2. The subject matter of the dispute is not capable of settlement by arbitration under Chinese law. (1) Contract No. 8008 that China Sugar Group and ED & F Man entered into on 14 December 1994 and its Attachments are fraudulent futures transaction contracts which violated compulsory law in China; and (2) Contract No. 8008 is excluded from the legal futures transaction contract under Chinese laws; so the contract does not belong to the contractual/non-contractual commercial contract recognized by Chinese laws. In conclusion, according to Article V(2) of the New York Convention, the illegal futures transaction contract, which is outside of the contractual/non-contractual commercial contract recognized by Chinese laws, is not capable of settlement by arbitration under Chinese laws.

3. Arbitral award No. 158 contains decisions on matters beyond the scope of the submission to arbitration. The China Sugar Group is not able to foresee the risk arising from a futures transaction other than the risk arising from the sales contract. Therefore, the China Sugar Group is not able to foresee the dispute which would arise from a futures transaction. The arbitral award made by the arbitration tribunal on the dispute of a futures transaction, which is not relevant to the sales contract, goes against the genuine intention of the China Sugar Group at the time it entered into the contract. Therefore, the arbitral award contains decisions on matters beyond the scope of the submission to the arbitration.

4. Due to the serious injustice during the arbitration process, the China Sugar Group was unable to adequately state its case. The tribunal did not conduct a thorough investigation of what the China Sugar Group required or into the fraudulent acts conducted by ED & F Man. Accordingly, the China Sugar Group was unable to fully argue its case.

5. Recognition and enforcement of arbitral award No. 158 made by London Sugar Association will be contrary to the public policy of China. The arbitration tribunal recognized illegal interests obtained by way of an unlawful future transaction contract. (1) Contract No. 8008 and its Attachments are against the Chinese compulsory rule on prohibiting offshore futures transactions. The arbitral award recognizes the benefits the parties attained by evading the Chinese administrative laws on offshore futures transactions. The Arbitral Award violates Chinese compulsory rules. (2) The court should interpret the public policy according to the basic legal principle and the basic legal system. (3) Contract No. 8008 is a futures transaction contract with a lawful form but an unlawful purpose. This kind of futures transaction contract violates the compulsory rules under Chinese law and goes against the basic legal system and social public interest in our country. Chinese law should refuse the enforcement of the Arbitral Award since it recognizes illegal benefits attained under a lawful form but unlawful contract.

(4) The English Appeal Court made a decision in the *Soleimany case* in 1998 stating that the English court should refuse the enforcement of any arbitral award which recognizes an unlawful benefit attained under an illegal contract based on the principle of preservation of public policy. The principle in this case could be an important reference for the People's Court when applying the principle of preservation of public policy.

Based on the above facts and reasons, the China Sugar Group requested the court to refuse the recognition and enforcement of arbitral award No. 158 made by London Sugar Association according to Article V (1)(a) and (b) and Article V (2)(a) and (b) of the New York Convention and the relevant Chinese laws and regulations.

ED & F Man's main arguments include:

1. The China Sugar Group has legal personality, the ability to conduct foreign trade business and the capacity to contract for the importation of raw sugar. Accordingly, Contract No. 8008 is lawful and valid.
2. The China Sugar Group has the contracting capacity to consent to the arbitration clause in the No. 8008 contract; the reason being the same as above.
3. The No. 8008 contract is a commercial contract, the subject matter of the dispute is capable of being settled by arbitration.
4. Arbitral award No. 158 does not contain any decision on matters beyond the scope of the submission to arbitration. In Contract No. 8008, the parties agreed to have any of their disputes arising from the contract settled by London Sugar Association under the arbitration rules of said Association.
5. The arbitrators were fair and impartial during the arbitration procedure. The fact that two members of the London Sugar Association (who were not the arbitrators in this case) are from ED & F Man's parent company group does not affect the ability of arbitrators in this case to be impartial. The China Sugar Group never challenged the composition of the arbitral tribunal or the legal consultants during the arbitration. The China Sugar Group was able to adequately argue its case during the two and a half year arbitration. The arbitrators considered the opinions and evidence from both parties carefully and applied the English law correctly.
6. Recognition and enforcement of arbitral award No. 158 made by London Sugar Association do not go against Chinese public policy. Contract No. 8008 is a lawful sales contract and not a speculative futures transaction contract according to its contents. The applicant, ED & F Man, expressly rejected China Sugar Group's demand to transform Contract No. 8008 into a futures transaction contract. The several amendments to the delivery of goods could not change the nature of the No. 8008 contract into a futures transaction contract.

IV. Our Court's Reviewing Opinion

1. Arguments 1 to 5 presented by the China Sugar Group above on refusing recognition and enforcement of arbitral award No. 158 should not be accepted.

The China Sugar Group as a legal person has contracting capacity. There is no such rule under Chinese law indicating that the illegal futures transaction contract does not have contractual or non-contractual commercial legal relationship. The China Sugar Group did not object to the jurisdiction of the arbitration or the composition of the arbitral tribunal. Arguments 1 to 5 presented by the China Sugar Group above lack supporting evidence of facts and legal basis.

2. Recognition and enforcement of arbitral award No. 158 constitute a violation of public policy in our country.

Contract No. 8008 and its Attachments are futures transaction contracts. This kind of futures transaction violates the prohibitive rules under Chinese law. Arbitral Award No. 158 recognises the illegal benefits which were obtained by the parties who conducted an unlawful offshore futures transaction and evaded Chinese administrative law. Therefore, the recognition and enforcement of this arbitral award would violate the compulsory rules under Chinese law and the public policy of China.

In conclusion, according to Article V (2)(b) of New York Convention, our court would dismiss the application from ED & F Man and refuse recognition and enforcement of arbitral award No. 158 made by the London Sugar Association.

We report the above case to you and seek your advice on this case.