NEWSLETTER

# NEW DEVELOPMENTS ON INTERNATIONAL COMMERCIAL ARBITRATION IN CHINA

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## New Developments on International Commercial Arbitration in China


**ABSTRACT**

In general, arbitration is always favored over litigation by foreign investors when they conduct business in China. However, the recognition and enforcement of foreign arbitration may be both time-consuming and unnecessarily costly, or even not appropriately applicable. In the past few years, China has gradually refined its arbitration system. It has opened up its attitude towards foreign arbitration, as illustrated by some of the newly adopted regulations for the Free Trade Zone ("FTZ"), and new rules regarding interim measures in Hong Kong. In this article, we will firstly go over some tradition issues regarding the recognition and enforcement of the arbitral award, and then we will proceed to introduce new developments in international commercial arbitration procedures. Lastly, we will provide some suggestions for foreign companies about their available options when it comes to choosing an arbitration institution and highlight some important arbitration clauses.


(Please note that "China" in this context should be in reference to Mainland China.)

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## Part 1 - Tradition Issues: Recognition and Enforcement of the Arbitral Award

### 1.1 Arbitral Awards Made by Foreign Arbitration Institutions Outside of China

China has been a contracting party of the New York Convention ("NYC") since 1986. For an arbitral award made by the arbitration institution in another contracting state of the NYC, the court will make the decision in accordance with the NYC. However, if the award is made in a non-contracting state of the NYC, but has a separate treaty with China, then the ruling will be based on that treaty and the Chinese civil procedure law. For all other awards, the recognition and enforcement of the arbitral award will be based on the "reciprocity principal". However, in practice, it is difficult for Chinese courts to accept such applications.

According to Article 5 of the NYC, the Chinese courts will not recognize and execute the arbitral award if: (a) the arbitration agreement or clause was invalid, or the party therein is under some legal incapacity, (b) the party was not properly informed about the tribunal, or was unable to present his or her case, (c) the issue arbitrated is not arbitrable under Chinese law, or is beyond the scope of the arbitration agreement, (d) the arbitration procedure is not legitimate, (e) the arbitral award is not, or is no longer, effective or enforceable, (f) the award was against Chinese public policy. Except for reasons concerning issues that are non-arbitrable and/or violate public policy, the judge will not, on its own initiative, make a decision to not execute the arbitral award unless the party so requests.

### 1.2 Arbitral Awards Made by Foreign Arbitration Institutions Inside of China

In China, whether an arbitral award is a Chinese award or non-Chinese award is determined by whether the arbitration institution's registered head office is located in China or not. However, the NYC determines such grounds through the seat of arbitration. As a result, this generates some legal limbo regarding arbitral decisions made by foreign arbitration institutions while the seat of arbitration is in China.

Traditionally, legal academic thought that these decisions cannot be deemed as Chinese awards under Chinese arbitration laws, nor are they governed by the NYC in China (since the NYC only applies to arbitral awards made by foreign arbitration institutions outside of China). Thus, in judicial practice, Chinese courts did have a tendency to refuse the recognition of such arbitral awards. The court's overarching opinion was that an arbitration agreement/clause which designates a foreign arbitration institution while its seat of arbitration was set in China is considered invalid. This is because such designation is considered ambiguous, thus rendering it unenforceable. However, this attitude has started to slowly shift. Since 2013, the Supreme Court has recognized various cases of arbitration clauses which designate a foreign arbitration institution to arbitrate in Shanghai. However, in general, it remains risky to assume that Chinese courts will recognize such arbitral clauses or decisions.

### 1.3 Arbitral Awards Made in Hong Kong SAR ("HK")

An arbitral award made in HK is recognizable and executable under certain circumstances which are subjected to special arrangements between the Mainland and HK .

In comparison with the NYC, the recognition and enforcement of arbitral awards made in HK under the special arrangements have following advantages:

- The scope of issues arbitrable extends to certain civil arbitration matters;
- The court will not examine the arbitral award on its own initiative, unless the parties therein so request;
- The procedures of notarization and legalization are easier, and documents written in English are acceptable in HK.

### 1.4 Ad Hoc Arbitration

Chinese arbitration laws do not regulate ad hoc arbitrations. In this case, if the award is made by an ad hoc arbitration in China, and the application law of the arbitration procedure is the Chinese law, then the award might not be recognized by Chinese courts. However, Chinese courts will recognize the award made by ad hoc arbitrations in HK, a contracting country of NYC, or a country that has a bilateral treaty which favors ad hoc arbitrations.

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## Part 2 - New Developments on International Commercial Arbitration in China

### 2.1 Supreme Court's Opinion on Judicial Protection

Under Chinese law, if a dispute does not involve a foreign element (neither at least one party is a foreign entity, nor the subject matter has a foreign characteristic), then it shall not be subjected to a foreign arbitration. Otherwise, if done so, the arbitral award might not be recognized by Chinese courts. Nonetheless, the newly established opinion of the Supreme Court introduces foreign arbitration as an option for foreign invested companies established in the FTZ. The agreement designates that foreign arbitration between two WFOEs that are set up in the FTZ should be valid. However, if only one party in the dispute is a foreign invested company set up in the FTZ, then the agreement on a foreign arbitration should remain valid only if no objection from the other party is raised before the first arbitration hearing.

There are no standard ad hoc arbitration practices under Chinese law. However, the Supreme Court's newly established opinion introduces ad hoc arbitration under certain limits as follows:

- Both parties should be a company set up in the FTZ;
- The seat of arbitration is located in the Mainland, the rule of the arbitration process and who the arbitrator(s) are should be specified;
- The court always holds a discretion on the validation of ad hoc arbitrations;
- The invalidation of ad hoc arbitrations should be decided by the Supreme Court.

### 2.2 Representative Office of Foreign Arbitration Institution in Shanghai FTZ

So far, four international arbitration institutions have established their representative offices in Shanghai. These are the ICC (France), HKIAC (Hong Kong), SIAC (Singapore) and KCAB (South Korea). The objective of these representative offices is to provide a platform for academic cooperation and experience sharing. Unfortunately, they are unable to hear cases in Shanghai.

### 2.3 Arbitration Rules for China (Shanghai) FTZ (SHIAC FTZ rules)

SHIAC FTZ rules are formulated by the Shanghai International Economic and Trade Arbitration Commission ("SHIAC") for the purpose of resolving disputes within the Shanghai FTZ. Under these guidelines, the parties can choose to adopt these rules into their arbitration agreement if they wish, even if they have no connections within the FTZ.

SHIAC FTZ rules contain some advancements on interim measures, the emergency tribunal process, arbitrators who are outside the official panel of arbitrators, the joinder of parties under the same arbitration and the joinder of a third party, the awards for "ex aequo et bono" claims and the procedure for small claims that are less than 100,000 RMB.

### 2.4 New Regulation Regarding Establishing Business Office by Non-domestic Arbitral Institution in Lin-gang FTZ

From 1 January 2020, HK, Macao, Taiwan and foreign arbitral institutions are able to establish business offices in the Lin-gang special area of Shanghai to provide arbitral services. The authority for the registration and supervision of these business offices is Shanghai Justice Bureau.

The business office can undertake civil and commercial disputes in the fields of international commerce, maritime affairs and investment. The scope of operation includes: to accept, hear, adjudicate cases involving foreign elements, administrate the cases, consult, guide, organize training and conduct seminars sharing arbitration operation experience.

### 2.5 Arrangement Concerning Interim Measures in Arbitral Proceedings between Mainland and HK

The new arrangement between Mainland and HK is the first time that Mainland has executed a mechanism to provide interim measures in aid of arbitral proceeding in another jurisdiction. The scope of interim measures in the Mainland includes property preservation, evidence preservation and conduct preservation.

As we can see from the recent practices of HKIAC, when requesting for interim measures at the relevant court, the applicant can submit a Letter of Acceptance made by HKIAC. Alternatively, such Letter of Acceptance can also be provided by HKIAC directly to the court.

## Part 3 - The effect on the foreign company and foreign invested company

### 3.1 When making a choice on arbitration institutions

Generally, when parties are making a choice about which arbitration institution they would like to proceed with, they usually consider the following elements: (a) the applicable law that they have chosen for the arbitration agreement, (b) the location of the arbitration institution, (c) the arbitration rules and procedures, (d) the possibility of enforcement and (e) the interim measures of the arbitral award, etc.

Under these circumstances, the most commonly chosen arbitration institutions for foreign companies and foreign invested companies when conducting business in China are listed as follows:

| Classification | Name | Advantages |
|---|---|---|
| Mainland arbitration institution | CIETAC (Beijing)<br>SHIAC (Shanghai)<br>BAC (Beijing)<br>SCIA (Shenzhen)<br>SHAC (Shanghai) | - More experience in applying Chinese laws;<br>- Higher potential and an easier procedure for the enforcement of arbitration;<br>- Easier in requesting for interim measures, such as property preservation, evident preservation, conduct preservation. |
| HK arbitration institution | HKIAC (Hong Kong) | - Largely recognized and executed by Chinese courts;<br>- Possible application for interim measures;<br>- Completed and robust set of arbitration rules;<br>- Often endorsed by both parties as a neutral third party. |
| Foreign arbitration institution | SIAC (Singapore)<br>ICC (Paris)<br>LCIA (London)<br>SCC (Stockholm) | - Completed and robust set of arbitration rules;<br>- More trusted by a foreign party;<br>- SIAC is often endorsed by both parties as a neutral third party as well. |

- **For Shareholder Agreements**

A Chinese investor and a foreign investor in a Joint Venture company ("JV") can agree to submit the dispute(s) arising from their Shareholders Agreement to a Chinese or foreign arbitration institution.

The applicable law for a dispute resolution of such Shareholder Agreements should be Chinese law . Nonetheless, under the new Foreign Investment Law that will come into force starting from the 1 January 2020, there is no longer any set statutory applicable law for such disputes. Instead, the parties of the JV company can stipulate the appropriate applicable law that they have mutually agreed to in the Shareholders Agreement.

Since the performance of the Shareholders Agreement is mainly in China, and the applicable law is mostly Chinese law, it is recommended that foreign companies choose a Mainland arbitration institution or a HK arbitration institution.

- **For International Commercial Contract**

If the parties wish to proceed with an ad hoc arbitration, then it is advised that parties choose a HK arbitration institution, and Chinese law should not be chosen as the applicable law. This is primarily because ad hoc administration proceedings are not regulated under Chinese law in general. However, if both parties are a WFOE set up in the FTZ, then they can designate an ad hoc arbitration and arbitrate their issues in China.

After the business offices of foreign arbitration institutions have been officially set up in the Lin-gang FTZ, then foreign companies and foreign investors will have more options for arbitration.

### 3.2 When stipulating Important arbitration clause

To ensure the validity of the arbitration agreement, it is advised to look at the rules surrounding the validity of an arbitration agreement under the applicable law of the contract, and the arbitration laws of the location where the seat of arbitration is set at. Based on the relevant rules, it is generally recommended to specify the name of the arbitration institution, the seat of arbitration and the arbitration rules.

- **Seat of arbitration**

It is advised that the seat of arbitration should have a close connection with the elements of the contractual transaction that are in dispute. Other factors to consider include whether the country/region has a welcoming attitude towards the arbitration, whether it is a contracting country of the NYC, the rules regarding validation of the arbitration agreement in that country/region and the limitations on issues that are arbitrable. In general, HK is seen by many as an equalizing arena for arbitration procedures and the enforcement of awards between Chinese and foreign parties.

- **Arbitration rules**

If there are no specific guidelines outlined regarding arbitration rules, then the standard arbitration rules of the chosen arbitration institution should be applied.

In addition, SHIAC FTZ rules offer comprehensive safeguards for interim measures and possible ad hoc arbitrations. When the parties have to proceed with a Chinese arbitration, the SHIAC FTZ rules can be taken into consideration.

- **Appointment of arbitrators**

Parties can still stipulate the nationality, professional experience, and background of the arbitrators in advance to ensure efficient and impartial standing. In addition, parties can choose to appoint an arbitrator who is outside the arbitrator panel.

- **Consolidated arbitration clause**

If a transaction includes several independent contracts which are interconnected, the party can stipulate an arbitration clause in the framework of the contract. This allows for the adoption of other contracts to be referenced in a single standalone contract and set up the rules for consolidated arbitration. The use of a reference clause might avoid conflicts that may arise from a difference in dictions. The consolidated arbitration clause can enhance efficiency and save costs associated with arbitration proceedings in most cases.

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## Contacts


**Alban RENAUD**

Email : alban.renaud@adamas.com.cn

**Huini LI**

Email : li.huini@adamas.com.cn

**Denis SANTY**

Email : denis.santy@adamas-lawfirm.com


## Offices of ADAMAS

We warmly welcome you to contact with our offices in **Beijing** and **Shanghai**:

Suite 2108, Zhongyu Plaza
A6 North Gongti Road
Chaoyang District
Beijing, 100027
Tel: +86 10 8523 6858
Fax: +86 10 8523 6878

Suite 5J-1, Huamin Empire Plaza
726 West Yan An Road
Changning District
Shanghai, 200050
Tel: +86 21 6289 6676
Fax: +86 21 6289 6672

Moreover, ADAMAS collaborates closely with law firms in Guangzhou, Chengdu, Wuhan and Hong Kong.