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# Choosing a foreign arbitration institution in China – is the China arbitration market finally opening up?

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Arbitration has become an important part of commercial dispute resolution in China. For international investors, arbitration has considerable advantages due to its neutrality, enforcement, confidentiality, flexibility, and finality.

Through a set of laws, regulations, judicial interpretations, cases, and policies, China is gradually opening up its once-closed arbitral market by introducing international arbitral institutions that align with international best practice. These steps demonstrate China's resolve to give foreign investors more confidence and promote the growth of foreign direct investment (FDI), China's economy, and international trade.

China's pro-arbitration stance has been reinforced by the recent decision in *Daesung Industrial Gases Co. Ltd. v. Praxair (China) Investment Co. Ltd* [2020] Hu 01 Min Te No. 83, a judgment of the Shanghai No.1 Intermediate People's Court, which confirms that foreign arbitral institutions are not prohibited from administering arbitrations in mainland China.

Despite the judgment, there is still uncertainty regarding the legality of foreign arbitral institutions administering arbitrations in China and the recognition and enforcement of the arbitral awards as rendered.

**Issues considered**

The *Daesung* decision confirms that foreign arbitral institutions are not prohibited from administering arbitrations seated in Mainland China.

Back in 2013, in *Anhui Longlide Packaging Co. Ltd. v. BP Agnati S.R.L. (Longlide)* [2013] Min Si Ta Zi No. 13, the Supreme People's Court (SPC) issued a reply letter confirming that an arbitration agreement providing for International Chamber of Commerce (ICC) arbitration seated in China was valid on the ground that the requirement for arbitration agreements under Article 16 of the People's Republic of China (PRC) Arbitration Law had been satisfied.

The SPC in that case did not consider whether the ICC, as a foreign arbitral institution, constituted an "arbitral commission" under Articles 10 and 66 of the PRC Arbitration Law. Thus,

the key question of whether foreign arbitral institutions are allowed to administer arbitration in mainland China remained unanswered.

The issue considered by the Shanghai court concerned the validity of an arbitration agreement, which provided as follows:

**Article 14: Disputes**

14.1. This agreement shall be governed by the laws of the People's Republic of China.

14.2. With respect to any and all disputes arising out of or relating to this agreement, the parties shall initially attempt in good faith to resolve all disputes amicably between themselves. If such negotiations fail, it is agreed by both parties that such disputes shall be finally submitted to the Singapore International Arbitration Centre (SIAC) for arbitration in Shanghai, which will be conducted in accordance with its Arbitration Rules. The arbitration shall be final and binding on both parties. (Emphasis added).

Praxair's position was that the arbitration agreement under Article 14.2 was invalid under its proper law, i.e., PRC law, on the grounds that, inter alia:

- PRC law prohibits an arbitration which has its seat in the PRC from being administered by a foreign arbitral institution such as the SIAC. The SIAC is not an "arbitral commission" under the PRC Arbitration Law.
- Although at the judicial level, the SPC issued a reply letter in the *Longlide* case attempting to expand the definition of "arbitral commission", it does not follow that the definition of "arbitral commission" has been expanded at the legislative level.

The Shanghai court rejected Praxair's position and upheld the validity of the arbitration agreement on the following grounds:

- First, parties are free to agree to submit disputes to arbitration. Whether the arbitral market in China is "open" is irrelevant in the instant case.
- Second, the judicial interpretation issued by the SPC has full legal force, according to Article 5 of the court's provisions. The reply issued by the SPC is a recognized form of judicial interpretation. In *Longlide*, the SPC issued a reply letter confirming that an arbitration agreement providing for ICC arbitration seated in China was valid. The SPC's reply confirms that the parties' agreement on referring disputes to arbitration administered by a foreign arbitral institution in mainland China is valid – provided that such agreement complies with Article 16 of the PRC Arbitration Law.
- Third, there is no express law prohibiting a foreign arbitral institution from administering arbitration in mainland China. Such a prohibition is in contradiction with the prevailing trend in international commercial arbitration.
- Fourth, the judiciary cannot excuse itself from adjudicating an issue simply because ambiguity exists in the relevant legislation. The court recognized that the PRC Arbitration Law lacked an international perspective and did not conform to international practice when it was first drafted and promulgated in 1994. At the time, the law was mainly for the regulation of domestic arbitration, with ancillary provisions on arbitration involving foreign elements. While acknowledging that the definition of "arbitral commission" under the PRC Arbitration Law required further amendment by legislation, the court emphasised that judicial

interpretation had full legal force and could fill in the legislative gaps to keep abreast of the developing trends in international commercial arbitration.

### Unresolved issues

A number of questions remain unanswered after the *Daesung* case.

Are foreign arbitral institutions arbitral commissions within the meaning of the PRC Arbitration Law?

In the past, the arbitral market in mainland China has been regarded as a closed shop for foreign arbitral institutions. It is unclear whether foreign arbitral institutions can administer arbitrations seated in mainland China. The issue is whether they are "arbitral commissions" within the meaning of the PRC Arbitration Law.

Article 10 and Article 66 of the PRC Arbitration Law require "arbitral commissions" in China to be established by the departments and chambers of commerce of the People's Municipal Governments, or in the case of foreign-related arbitral institutions, by the China Chamber of International Commerce.

As the ICC, HKIAC, SIAC, and other renowned international arbitral institutions are not established in accordance with the procedures under Article 10 and Article 66, there are concerns that these institutions are not qualified "arbitral commissions" under the PRC Arbitration Law and therefore are not allowed to administer arbitrations seated in mainland China.

The recent judgment is a welcome development – the Shanghai Court in *Daesung* confirmed that foreign arbitral institutions are not prohibited from administering arbitrations. It undoubtedly provides comfort to those choosing a mainland seat in international commercial arbitration.

However there is still uncertainty as to the legality of foreign arbitral institutions administering arbitrations in China and the recognition and enforcement of their arbitral awards.

### No express provision under the PRC arbitration law

It is uncertain whether the approach adopted by the Shanghai Court in *Daesung* will be followed in judicial practice.

China has a civil law system that is primarily based on statute rather than case law. Traditionally, case precedents play a very limited role in the judicial process in China. When adjudicating cases, the People's courts primarily rely on statutes and regulations instead of giving weight to precedent.

The SPC has implemented a series of measures to elevate the relevance of precedent, for the purpose of unifying the application of codified law by the People's courts. On 27 July 2020 the SPC issued a new guidance note entitled "Opinion on Strengthening the Search for Similar Cases to Unify the Application of Law (for Trial Implementation)."

The note stipulates that judges must conduct similar case searches for important and complex cases from the "guiding cases" published by the SPC, "typical cases" published by the SPC, and judgments or rulings of the same court or higher court in the province. This new guideline undoubtedly represents a step forward by the Chinese judiciary in ensuring the consistency of its judicial decisions.

However, the regime established under this new guideline is distinct from the precedential system under common law. It does not make judicial practice in China similar to that of a

common law jurisdiction. In particular, unlike precedents in common law jurisdiction, similar cases (other than arguably the "guiding cases" published by the SPC), do not have any binding force on the People's courts.

Despite judges being mandated to conduct case searches, the reference value of the Shanghai court's judgment in *Daesung* may be limited. The SPC has not considered the direct question of whether foreign arbitral institutions are allowed to administer arbitration in mainland China, and has not issued any clear judicial interpretation in this regard.

The Shanghai court's judgment in *Daesung* represents its own interpretation and application of the SPC's reply in *Longlide*, which has not been confirmed by the SPC. The judgment in *Daesung* is not a "guiding case" published by the SPC and has no binding effect on other People's courts. It remains unclear whether other PRC courts will follow suit and construe the SPC's reply in a similar way.

In addition, although the judicial interpretation issued by the SPC has full legal force, the interpretation is intended to clarify legislative ambiguities and ensuring the correct application of legislation. Judicial interpretations do not rank above legislation (in this case the PRC Arbitration Law) and do not intrude on the National People's Congress' law-making prerogatives. The SPC's interpretation on this issue in both *Longlide* and *Daesung* cannot obviate the need for further legislation (as pointed out by the Shanghai Court in its judgment in *Daesung*). Certainty can only be afforded to users of arbitration by further amendment to the PRC Arbitration Law.

### The role of representative offices of foreign arbitral institutions in mainland China

Around early 2016, the HKIAC, SIAC, and ICC established representative offices in the Shanghai Free Trade Zone (Shanghai FTZ). Before that, no foreign arbitral institution had a presence in mainland China. The legal basis for this is the State Council's Circular on *Issuing the Plan for Further Promoting the Reform and Opening-up the China Shanghai Pilot Free Trade Zone* (promulgated on 8 April 2015) which supports the "introducing of international, renowned dispute resolution institutions" to Shanghai FTZ. This was supplemented by a further policy paper published in August 2020, stating that foreign arbitral institutions may be established in the Shanghai FTZ to, "conduct arbitration businesses in relation to civil and commercial disputes arising in the areas of international commerce, maritime affairs, investment, etc.," and to support the application and enforcement of interim measures such as asset and evidence preservation.

In 2017, the State Council promulgated a similar circular on the opening-up of international arbitration services in Beijing, which allowed foreign arbitral institutions to "establish representative offices in Beijing". This was followed, on 7 September 2020 by another circular[1] which said that foreign arbitral institutions would be allowed to set up in designated areas in Beijing to provide arbitration services, promote commerce and investments, and again to support the application and enforcement of interim measures.

Taken together, these circulars signal China's commitment to further liberalize international commercial arbitration practice on the mainland. However, the interpretation of the circulars and the precise scope of activities for the foreign arbitral institutions in mainland China remain unclear. For example, the "arbitration services" referred to in the circulars could mean promotional and marketing activities, instead of administering arbitrations. This uncertainty is highlighted by the PRC Arbitration Law and the absence of an express provision permitting foreign arbitral institutions to administer arbitrations seated in mainland China.

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[1] Work Plan for Deepening Comprehensive Pilot and New Round of Opening-Up of Services Sectors in Beijing and Building Comprehensive Demonstrative Area of Opening-Up of State Services Sectors.

In addition, the new Shanghai and Beijing circulars state that a foreign arbitral institution will be permitted to support and secure the application of interim measures. However, neither of them explains what this statement entails in practice nor particularize the legal basis that permits a foreign arbitral institution to do so.

As a result, the representative offices of foreign arbitral institutions in the Shanghai FTZ currently do not conduct any case management services and are, at least for now, merely a marketing tool to build up ties with potential users of their arbitration services.

### Recent judgment regarding nationality of arbitral awards

Another unresolved issue is the nationality of the arbitral awards and consequently the recognition and enforcement of such awards, from the perspective of PRC courts.

The New York Convention only applies to foreign arbitral awards. Article 1 of the New York Convention reads as follows:

> This convention shall apply to the recognition and enforcement of arbitral awards made in territory of a State other than the State where the recognition and enforcement of such award are sought, and arising out of differences between persons, whether physical or legal. It shall also apply to arbitral awards not considered as domestic awards in the State where their recognition and enforcement are sought.

The PRC courts have issued conflicting judgments as to whether an arbitral award issued by a foreign arbitral institution with a mainland seat is a foreign award – which can be recognized and enforced under the New York Convention, or a domestic award or foreign-related award, which can only be enforced under PRC domestic law.

In this respect, the PRC courts have previously focused on the nationality of the institution. In *Züblin International GmbH v. Wuxi Woke General Engineering Rubber Co., Ltd.* [2003] Min Si Ta Zi Di 23 Hao.2004, the ruling categorized the arbitral award issued by the ICC Court of Arbitration (an arbitral institution headquartered in Paris, France) seated in Shanghai as a foreign award and was therefore subject to enforcement under the New York Convention.

In *Duferco S.A. v. Ningbo Arts & Crafts Import & Export Co., Ltd.* (Duferco) [2008] Yong Zhong Jian Zi No. 4, the Ningbo Intermediate People's Court recognized and enforced an ICC award seated in Beijing based on the New York Convention, showing that the court considered the award issued by ICC Court of Arbitration (a French institution) to be a foreign award despite the arbitration being seated in Beijing. The correctness of these two decisions has been questioned.

Judge Gao Xiaoli, the deputy director of SPC's 4th Civil Division, expressed a very different view in the *Journal of Law Application* in early 2018.[2] One of the responsibilities of the SPC's 4th Civil Division is to direct the Chinese courts at all levels in the hearing of foreign-related civil and commercial cases, including the recognition and enforcement of foreign arbitral awards and foreign judgments.

Judge Gao's view was if the arbitral award is made by a foreign arbitral institution within China, she believes that it shall be deemed as a foreign-related arbitral award in China, rather than a foreign arbitral award, and the New York Convention shall not be applied. In her opinion, the nationality of the arbitral award should be consistent with "the seat of the arbitration", rather than with the nationality of the arbitral institution.

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[2] *Active Practice of Chinese Courts Recognizing and Enforcing Foreign Arbitration Awards*, Xiaoli Gao, Journal of Law Application, Issue 5, 2018.

In a recent judgment by the Guangzhou Intermediate People's Court, (2015) *Hui Zhong Fa Min Si* No. 62, 6 August 2020, the court followed the reasoning of Judge Gao and held that an arbitral award from foreign arbitral institution with a mainland seat is a Chinese foreign-related award, which can only be enforced under the PRC domestic law.

The court therefore rejected the application for recognition and enforcement based on the New York Convention. Instead, the applicant was recommended to commence a proceeding to enforce the awards under Article 273 of the PRC procedural law. Considering that the "Prior Reporting System" requires the SPC's review and approval of a lower court's decision to deny recognition and enforcement of a foreign arbitral award, it is likely that the Guangzhou Intermediate People's Court's position in this recent judgment has been vetted and approved by the SPC.

Notably, recognition and enforcement of domestic awards, foreign-related awards, and foreign awards are treated differently in China.

Domestic awards refer to awards made within mainland China without any foreign elements (e.g., an arbitral award issued by domestic arbitral institutions seated in mainland China regarding a domestic dispute). Domestic and foreign-related awards do not need to be recognized. As to the enforcement of a domestic award, PRC courts may conduct a substantive review of the award. For instance, the relevant PRC laws provide that a domestic award can be denied enforcement on the grounds that, "inter alia", the award is unclear, or that the evidence upon which the award was rendered is falsified, or that a party's concealment of material evidence has rendered the award unjust to the other side.

Foreign-related awards refer to awards made within the territory of China with a foreign element. Article 1 of the *Interpretation of Foreign-related Civil Relations* defines foreign-related civil relation as, "where a party concerned or both parties concerned is/are foreign citizen or foreign legal person; where the habitual residence of a party concerned or both parties concerned is located outside the territory of China; where the subject matter is located outside the territory of China; where the legal facts that trigger, change or terminate the civil relation take place outside the territory of China; or any other circumstances that can be determined as foreign-related civil relations."

Foreign-related awards do not require recognition. Foreign-related awards may be denied enforcement on the grounds that, "inter alia", the award is unclear, or a third party has provided evidence showing that the arbitration is frivolous or has been conducted by the parties in bad faith for the purpose of harming the said third party.

Foreign awards in the context of the New York Convention refer to the "non-domestic awards" defined under Article 1 of the New York Convention, i.e., awards made within another member state of the New York Convention outside the territory of China.[3] People's courts can only refuse recognition and enforcement based on the procedural grounds set out under Article 5 of the New York Convention, under Article 283 of the PRC Civil Procedure Law.

It is clear from the above that domestic awards and foreign-related awards are subject to a higher degree of scrutiny by a PRC supervising court pursuant to PRC domestic laws, whereas foreign

[3] Arbitral awards rendered in Hong Kong SAR, Macao SAR, and Taiwan are recognized and enforced in mainland China under their respective bespoke agreements, i.e., the Arrangement Concerning Mutual Enforcement of Arbitral Awards between the mainland and Hong Kong, the Arrangement Concerning Mutual Recognition and Enforcement of Arbitral Awards between the Mainland and Macau, and the Act Governing Relations between Peoples of the Taiwan Area and the Mainland Area enacted by Taiwan and the Regulations concerning Recognition by People's Courts of Civil Judgments of Taiwan Courts promulgated by the SPC.

awards under the New York Convention can only be denied recognition and enforcement under limited procedural grounds.

Judge Gao's opinion and the recent judgement by Guangzhou court both indicate that an arbitral award issued by a foreign arbitral institution with a mainland seat is likely to be deemed as a foreign-related award as opposed to a foreign award. If the parties choose to enforce the award in mainland China, such award cannot be recognized and enforced under the New York Convention. Instead, it will likely be subject to a higher degree of scrutiny by the supervising PRC court pursuant to the PRC Civil Procedure Law.

### Aligning with best practice

Undoubtedly, the recent judgment in *Daesung* is a welcome development, demonstrating the commitment of the Chinese judiciary to align its arbitration practice with international best practice.

Despite the Chinese judiciary's efforts, the uncertainties faced by the international commercial parties in choosing a foreign arbitral institution with a mainland seat are yet to be fully resolved. In particular, it remains unclear whether the Shanghai court's approach in *Daesung* will be confirmed by the SPC or followed by other Chinese courts.

Furthermore, even if an arbitration agreement designating a foreign arbitral institution with a mainland seat is valid under PRC law, arbitral awards so obtained are likely to be deemed as domestic awards. Domestic awards cannot be recognized and enforced under the New York Convention and are subject to a higher degree of scrutiny by the PRC courts.

International commercial parties should be cautious in choosing a foreign institution to administer their arbitration in mainland China. Provided there are foreign elements present, if parties want a foreign arbitral institution to administer their arbitration, it is recommended to choose a pro-arbitration seat outside mainland China, such as Hong Kong or Singapore, in order to avoid any uncertainty regarding the validity of the arbitration agreement and the recognition and enforcement of arbitral awards.

It is recommended that parties wishing to arbitrate in China use a recognized Chinese arbitration commission such as China International Economic and Trade Arbitration Commission, Shanghai International Economic and Trade Arbitration Commission, or the Beijing International Arbitration Centre, to administer their disputes.

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