

Chapter 2

The Arbitration Agreement

2.1 Definition

An arbitration agreement is an agreement by which the parties decide that they shall submit to arbitration any disputes, existing or future, concerning their relationship. For a Chinese person—keeping in mind, the definition of a “Chinese person” as found in § 1.3—, (validly) stipulating an arbitration agreement is the only way to subtract the relevant disputes from the jurisdiction of the People’s Courts: therefore, a careful drafting of the arbitral agreement is essential.

An arbitral agreement can be stipulated in two ways (Article 16(1) AL):

- (a) *Arbitration clause* incorporated in the contract
- (b) *Separate arbitration agreement*

2.2 Conditions for the Existence and Validity of an Arbitration Agreement

An arbitration agreement must satisfy certain substantive and formal requirements in order to be considered existent, valid and, therefore, legally binding. The lack of one or more of the conditions that are enumerated below is sufficient for a People’s Court to deny the existence of a (valid) arbitration agreement and therefore, to accept a case, thereby frustrating the intention of the parties to submit their disputes to arbitration (see § 3). The People’s Courts, in deciding whether or not they have jurisdiction over a certain case, tend to apply a rather restrictive interpretation of these requirements. Because of this it is often the case that they find the necessary elements of the agreement are absent. It is therefore necessary to carefully draft the arbitration agreement, so as to avoid any requirement to be deemed as not satisfied.

2.2.1 *Conditions for the Arbitration Agreement to Be Deemed Existing*

An arbitration agreement will only be created by the express intent of the parties to arbitrate. Additionally the subject matter to be submitted to arbitration and the appointment of the specific arbitration institution must be clearly indicated (Article 16(2) AL). Under Article 18 AL, the parties can make up for the lack of one or more of the following conditions by stipulating a supplementary agreement.

- (a) *Expression of the intention to apply for arbitration* (Article 16(2) no. 1 AL).
- (b) *Indication of the subject matter to be solved through arbitration* (Article 16 (2), no. 2 AL). The subject matter must be *arbitrable*: see § 2.2.2, (a).
- (c) *Designation of an arbitration institution* (Article 16(2), no. 3 AL).

This is the condition, which causes the most problems for the validity of arbitration agreements. Although the Arbitration Law does not explicitly state so, it is commonly believed that the requirement of designation of an arbitral institution excludes the possibility of recognizing so-called ad hoc arbitration in China. The definition “ad hoc arbitration” refers to arbitration not administered by an arbitral institution (such as the International Chamber of Commerce or, for China, CIETAC, SHIAC, etc.). Of course, ad hoc arbitration can per se be freely carried out; however, if the losing party does not implement the measures established in the arbitral award of its own accord, then the winning party will not be able to apply to the People’s Courts for its enforcement (see also § 5.2, (c)).

Nevertheless, the Supreme People’s Court has declared that the parties shall be deemed to have designated an arbitral institution when:

- (i) The name of an institution is indicated in an unclear way, yet it is possible to determine such institution (Article 3 ALI);
- (ii) The arbitral agreement only makes reference to certain arbitration rules, and not to an arbitration institution, yet it is possible to infer the designated institution (Article 4 ALI);
- (iii) The arbitral agreement makes reference to a particular place and only one arbitration institution is present in that particular place (Article 6 ALI).

Where the arbitration agreement designates more than one institution and there is no subsequent agreement as to what arbitration institution will have jurisdiction, the arbitration agreement shall be deemed invalid (Article 5 ALI); the same happens if the arbitral agreement makes a reference to a place in which more than one arbitration institution is present and there is no subsequent agreement as to which institution will have jurisdiction (Article 6 ALI).

Lastly, an arbitration agreement referring the matter solely to the parties' discretion whether to apply to an arbitration institution or to the People's Courts shall be deemed invalid. However, such an arbitration agreement shall not be invalid if one party applies for arbitration and the other party does not object, by invoking said invalidity of the arbitration agreement, before the first hearing of the arbitral tribunal (Article 7 ALI). Regardless, it is a good practice when drafting an arbitration clause to always designate an arbitral institution in a clear and precise manner, so as to avoid any possible doubt, which might lead to the agreement being declared invalid by a court.

2.2.2 *Circumstances Making an Arbitration Agreement Invalid (Article 17 AL)*

An arbitral agreement is deemed to be invalid where one of the following circumstances is present. Generally, in transnational practice, the arbitral tribunal itself will evaluate the validity or invalidity of the arbitration agreement; by contrast, the power to decide this matter is also vested in the People's Courts in the Chinese system (Article 20 AL; see also § 3).

- (a) *The agreed matters for arbitration exceed the range of arbitrable matters as specified by law* (Article 17, no. 1 AL).

The PRC Arbitration Law provides a somewhat problematic definition of arbitrable matters. According to its Article 2, “*Contractual disputes and other disputes over rights and interests in property between citizens, legal persons and other organizations that are equal subjects may be arbitrated*”. This provision, if read literally, excludes all non-property related matters from the scope of arbitration; this then casts doubt on the arbitrability of disputes involving torts and—according to some—intangible property.

In practice, it is generally possible for the parties to an arbitration agreement to raise both property-related claims and non-property-related claims.¹ Nevertheless, given the tendency of both arbitration institutions and State judges to expand the scope of their jurisdiction, one must take into account the possibility that, while an arbitration tribunal accepts a case not strictly related to property, a judge, based on a strict interpretation of the Arbitration Law, may consider the same case to fall outside the scope of arbitrable matters and therefore assume jurisdiction over it.

The Arbitration Law introduces a (albeit uncertain) limit to the scope of arbitration that does not have an equivalent in many foreign jurisdictions.

¹GU Zhenlong, *Some Considerations on Parties' Self-Determination in the Arbitration Law* (关于仲裁法中当事人意思自治的几点思考), 2012, in the legal database *pkulaw.cn*, Ref. Code CLIA.073818.

Compare, for example, Article 806 of the Italian Civil Procedure Code, according to which, in principle, the only non-arbitrable disputes are those involving non-negotiable rights (*diritti indisponibili*). Also compare Section 1029, Paragraph 1 of the German Civil Procedure Code, which is very clear in specifying that arbitration can regard a legal relationship “*that is contractual or non-contractual in nature*”. Likewise, Article II (1) of the New York Convention makes a reference to “*a defined legal relationship, whether contractual or not*”.²

Interestingly, the *Notice on Managing Arbitration of Securities and Futures Contract Disputes According to Law* jointly issued by the Legal Affairs Bureau of the State Council and by the China Securities Regulatory Commission in January 2004, specifies that the disputes arising between subjects of the securities and futures market regarding the trade of securities and futures fall within the scope of “civil and commercial disputes between equal civil subjects” and are therefore, arbitrable. Although this specification was probably not indispensable from a technical point of view, it does give a significant indication of the policy followed by the Chinese government in the last decade with regards to arbitration: the cited *Notice* aims to encourage recourse to arbitration for disputes involving trade in securities and futures, to take advantage of its flexibility, confidentiality, and (comparatively) low cost.³ The following matters are not arbitrable owing to a specific statutory provision:

- (i) Issues concerning marriage, adoption, guardianship, support and succession (Article 3, no. 1 AL);
- ii) Issues that are to be handled by administrative organs as established by law (Article 3, no. 2 AL).
- (b) *One party to the arbitration agreement has no capacity for civil conducts or has limited capacity for civil conducts* (Article 17, no. 2 AL).
- (c) *One party coerced the other party into concluding the arbitration agreement* (Article 17, no. 3 AL).

2.2.3 Formal Requirements

The arbitration agreement must be stipulated in writing; otherwise, it will held to be non-existent under Article 16(1) AL. The requirement of written form is held to be satisfied:

²*Ibidem*.

³See ZHU Sanzhu, “Legal Aspects of Commodity and Financial Futures Market in China”, in *The Brooklyn Journal of Corporate, Financial and Commercial Law*, 2009, 3 (2), 377–430.

- (i) Where the agreement has been concluded by means of letter, telegram, fax, electronic data exchange or e-mail (Article 1 ALI);
- (ii) Where the arbitral clause is included in general contract conditions, as long as these have been duly incorporated in the contract (Articles 39 and 40 of the PRC Contract Law).

2.3 Autonomy or Severability of the Arbitration Agreement

Regardless of the form through which it is expressed—arbitration clause or separate agreement—the arbitral agreement is commonly understood, in transnational practice, to be *autonomous* and *severable* from the main contract to which it refers. The amendment, rescission, termination or invalidation of the main contract does not affect the arbitration agreement, which remains valid and enforceable.

This principle, which has its *raison d'être* in the will to preserve the existence and the effectiveness of arbitration agreements, is enshrined in Article 19(1) AL. Nevertheless, a long time passed before this principle found correct and consistent application by the People's Courts. Some authors have remarked that, all through the 90s and well into the new millennium, many rulings passed by Chinese courts unduly restricted or expanded the application of the principle of autonomy of the arbitration agreement.⁴

The courts are at times unduly restrictive in that, if the main contract had not entered into force—resulting, for example, from the lack of an administrative approval—, then the arbitration clause was found not to be binding on the parties. By contrast, a misunderstanding of the principle of autonomy of the arbitration agreement sometimes leads to excessively expansionist decisions: in *Hong Kong Longhai v. Wuhan Zhongyuan*,⁵ the Intermediate People's Court of Wuhan held that the arbitral clause, being autonomous from the main contract, was not binding on the assignee of the contract.

With the Arbitration Law Interpretation of 2006, the Supreme People's Court put an end to the uncertainty of the courts by setting out that an arbitration agreement shall remain valid and enforceable even when the main contract has been revoked or has not yet taken effect. If the arbitration agreement refers not to a contract, but only to an agreement to contract, its validity and enforceability shall not be affected by the fact that no contract is stipulated afterwards (Article 10 ALI).

However, the principle of autonomy does not create two distinct expressions of contractual will; one related to the main contract and one to the arbitration clause.

⁴See, for example, Kun Fan, *Arbitration in China: A Legal and Cultural Analysis*, 1st ed., Oxford, Hart Publishing, 2013, pp. 31–34.

⁵*Hong Kong Longhai Co. v. Wuhan Zhongyuan Scientific Co.*, Wuhan IPC, [1998] n. 0277.

This means that a third party assignee cannot say he did not expressly agree to the separate agreement in order to avoid the arbitration clause; the intent to contract on the terms of the main contract also encompasses the arbitration agreement. As a result, the arbitration agreement is generally held to be binding on the assignee of the main contract (Article 9 ALI; see also the following paragraph).

Currently, the principle of severability of the arbitration agreement is also enshrined in the arbitration rules of the most important institutions (Article 5(4) CIETAC; Article 5(5) SHIAC; Article 10 SCIA, though referring to “independence”, not to “autonomy” or “severability”; Article 5 BAC, referring to “separability”).

2.4 Scope of the Binding Force of the Arbitration Agreement

As with other agreements (i.e. privity of contract), parties will only be bound by an arbitration agreement where they have expressly consented to it. There are some exceptions to this rule, which, being exceptions, tend to be interpreted by the People’s Courts in a restrictive way.

- (a) The entity generated by the merger or demerger of previously existing entities is bound by the arbitration agreements entered into by its predecessor(s) (Article 8(1) ALI), unless the opposite is expressly agreed when stipulating the arbitration agreement;
- (b) The arbitration agreement stipulated by a deceased person is binding on the persons succeeding the deceased (Article 8(2) ALI), unless the opposite is expressly agreed when stipulating the arbitration agreement;
- (c) Where any creditor’s rights or debts are assigned or transferred, in their entirety or partially, the arbitration agreements related to such rights or debts are binding on the assignee or transferee, unless:
 - (i) The parties have expressly agreed to the contrary;
 - (ii) The assignee or transferee has clearly objected to the arbitration agreement;
 - (iii) When agreeing to the assignment or transfer of the relevant rights or debts, the assignee or transferee was clearly unaware of the existence of an arbitration agreement separate from the main contract (Article 9 ALI).
- (d) Where a legal entity changes its name or legal form, the legal entity resulting therefrom shall be bound by the arbitration agreements entered into by its predecessor.

2.5 The Choice of Arbitrators

The PRC Arbitration Law theoretically emphasizes the *free will of the parties* as to every aspect of the conduct of arbitration. Parties to the agreement are free to choose arbitration as a method of dispute resolution (Article 4 AL), to choose the arbitration institution (Article 6 AL), as well as arbitrators (Article 31 AL). However, in practice, this principle suffers a number of limitations.

(a) No recognition of ad hoc arbitration

The parties are not totally free to submit their disputes to any person, or group of persons, that they deem to be professional and trustworthy: it is required that arbitration in China is administered by a recognized arbitration institution (see § 2.2.1 (c)).

(b) Requirements of arbitrators

While in transnational practice a prospective arbitrator does not need to meet any particular requirements in order to be appointed as an arbitrator, Article 13 of the PRC Arbitration Law establishes some rather strict requirements. Chinese arbitration institutions can only appoint their arbitrators among “righteous and upright persons”; such persons, in addition, must possess one of the following qualifications:

- (i) To have been engaged in arbitration activities for at least eight years;
- (ii) To have worked as a lawyer for at least eight years;
- (iii) To have served as a judge for at least eight years;
- (iv) To have been engaged in legal research or legal education, possessing a senior professional title; or
- (v) To have acquired knowledge of law, being engaged in the professional work in the field of economy and trade or other related fields, possessing a senior professional title or having an equivalent professional level.

(c) Panels of arbitrators

The names of the arbitrators of each institution are recorded in ad hoc registers; although the Arbitration Law does not expressly say so, it is commonly thought that the parties can choose arbitrators only among those included in the register of arbitrators of the relevant institution (the so-called *compulsory panel system*).

CIETAC, SHIAC and SCIA are all exceptions to this rule: the arbitrators for proceedings to be held at these institutions can be chosen among persons not included in the panels of arbitrators. Article 26 of the CIETAC Arbitration Rules provides that previous approval by the Chairman of the institution is needed in order to appoint an arbitrator from outside the panel of arbitrators; Article 21 of the SHIAC Arbitration Rules and Article 28 of the SCIA Arbitration Rules further specify that the arbitrators must in any case meet the requirements set forth by the law (see point b of this paragraph). Article 18 of the BAC Arbitration Rules, on the other hand, maintains a more restrictive

approach and does not make any provision as to the appointment of arbitrators from outside the official panel.

Given these requirements, it is usually not possible to appoint arbitrators that are technical specialists in a given field as the rules dictate the individual must have an expertise in law or economics. However, given the abundance of arbitrators listed in the panels of the main arbitration institutions—over one thousand for CIETAC; around eight hundred for SHIAC; around five hundred for SCIA and BAC—, in most cases it is possible to choose an arbitrator having some experience in cases regarding a certain technical topic.

Note also that neither the Arbitration Law nor the rules of the premier arbitration institutions contain any restrictions as to the nationality of arbitrators. After the application for arbitration, when the arbitration tribunal is formed, there will be an option between a three-arbitrator tribunal and a sole-arbitrator tribunal. If the tribunal is composed of three arbitrators, each party will select one and the remaining one will be chosen jointly by the parties or appointed by the Chairman of the arbitration institution. If there is a sole arbitrator, he will be chosen jointly by the parties or appointed by the Chairman of the arbitration institution (see § 4.7).

Keeping in mind these rules, it is common practice to establish right away in the arbitration agreement:

- (i) The number of arbitrators—one or three—forming the tribunal (if no choice is made, the tribunal will be composed of three arbitrators);
- (ii) The nationality of the arbitrator to be chosen jointly by the parties or appointed by the Chairman of the arbitration institution.

With regards to the second point, making a selection of this nature is imperative for foreign business operators given that when parties cannot agree, the institution has an tendency to appoint Chinese arbitrators which may pose linguistic difficulties in certain cases.

2.6 The Choice of the Seat of Arbitration

The parties are free to choose the place where the arbitration will have its seat. In the absence of any express provision by the parties, the seat of arbitration will generally be the place where the arbitration institution has its seat: for example, Beijing for CIETAC (Article 7 of the Arbitration Rules) and BAC (Article 26), Shanghai for SHIAC (Article 7), Shenzhen for SCIA (Article 4). An arbitral award is deemed to have been made at the seat of arbitration determined pursuant to these rules; therefore, the concept of “seat of arbitration” governs such fundamental issues as the court having jurisdiction for any preservation measures (see § 4.5), and for an action to set aside the award (v. 4.1), etc.

2.7 The Choice of the Substantive Law Applicable to the Dispute

It is advisable to determine from the very beginning of a contractual relation the substantive law pursuant to which the arbitral tribunal will decide any disputes arising from the said relation, keeping in mind the following observations.

(a) Disputes not involving any foreign element

If there is no “foreign element” to the case (see the definition provided in § 1.3) Chinese law will be applicable without an option for the parties to choose an alternative.

(b) Disputes involving a foreign element

As for disputes involving one or more foreign elements, it is possible for the parties to choose the applicable law (Article 126 of the PRC Contract Law; Article 3 of the PRC Law on the Laws Applicable to Foreign-Related Civil Relations). Chinese law will govern the following situations, regardless of whether an alternative applicable law was indicated in the arbitration agreement:

- (i) Contracts on the incorporation of a Sino-foreign Joint Venture (Article 126 of the PRC Contract Law);
- (ii) Contracts on the exploration and exploitation of natural resources to be carried out in China (Article 126 of the PRC Contract Law);
- (iii) Contracts on the transfer of shares in a Sino-foreign Joint Venture or in a Wholly Foreign-Owned Enterprise (Article 8, no. 4 of the *SPC Provisions on Some Issues concerning the Application of Law in Hearing Foreign-Related Contractual Dispute Cases Related to Civil and Commercial Matters* of 2007);
- (iv) Contracts on the operation by a foreign person of a Sino-foreign Joint Venture (Article 8, no. 5 of said SPC Provisions);
- (v) Contracts on the purchase by a foreign person of shares in a non-foreign-invested Chinese enterprise (Article 8, no. 6 of the SPC Provisions);
- (vi) Contracts on the subscription by a foreign person of a capital increase in a non-foreign-invested Chinese Limited Liability Company or Company Limited by Shares (Article 8, no. 7 of the SPC Provisions);
- (vii) Contracts on the purchase by a foreign person of assets of a non-foreign-invested Chinese enterprise (Article 8, no. 8 of the SPC Provisions);
- (viii) Other contracts to which Chinese law mandatorily applies.

Where the parties do not expressly make a provision as to the law applicable to their contract, the provisions of the PRC Law on the Laws Applicable to Foreign-Related Civil Relations apply. This Law has a general nature and its provisions are superseded by any different special provision (Article 2). As a general principle, the “the law that is most closely connected with the foreign-related civil relation” shall apply to a foreign-related civil relation (Article 2): the various

Chapters of the Law specify this principle as to particular cases. Below is a non-exhaustive list of the main rules:

- (i) Issues concerning the legal capacity, the capacity for civil conducts and the rights relating to personality of natural persons are decided according to the law of the place of habitual residence (Articles 11 and 12);
- (ii) Issues concerning the legal capacity and the capacity for civil conducts of legal persons, as well as their organizational structure and shareholder rights, are generally governed by the law of the place of registration; however, the law of the principal place of business may be applicable where such place is different from the place of registration (Article 14);
- (iii) Rights (*in rem*) in immovable property are regulated by the law of the place in which the property is situated (Article 36);
- (iv) Rights (*in rem*) in movable property are regulated by the law of the place in which the property is located, at the moment of the relevant legal fact (Article 37); if the property is in transit, the law of the destination of transportation applies (Article 38);
- (v) Contracts are generally governed by the law of the habitual residence of the party whose obligation is most characteristic of the contract or by the law presenting the closest connection with the contract (Article 41);
- (vi) Employment contracts are governed by the law of the place in which the employee works or, if such place cannot be determined, by the law of the place where the employer has his main place of business (Article 43);
- (vii) Issues regarding tortious liability are decided pursuant to the law of the place where the tortious act occurs; if the parties have common habitual residence, tortious liability is governed by the law of common habitual residence (Article 44);
- (viii) Issues regarding product liability are generally governed by the law of the place of habitual residence of the victim (Article 45);
- (ix) The content and ownership of intellectual property rights are governed by the law of the place where protection is applied for; the transfer and license of intellectual property rights are governed by the rule on contracts (see point (v); Article 49).

2.8 Arbitration *ex aequo et bono*

Arbitration can be conducted *ex aequo et bono*, i.e. it is governed by the principles of equity as opposed to the substantive laws of a jurisdiction; However, Chinese law does not provide for this possibility.

Pursuant to Article 7 AL, “disputes shall be resolved on the basis of facts, *in compliance with the law* and in an equitable and reasonable manner”. Therefore, arbitration according to law seems to be the rule in China. This provision aims at protecting the legitimate rights and interests of the parties, in light of a developing arbitration culture in China.

As we shall see in chapter 5, Chinese arbitration law contains the following distinction:

- Awards resulting from domestic arbitration can be refused enforcement on the grounds of violation of law;
- Awards deriving from foreign-related arbitration cannot be refused enforcement on such grounds. This may then indicate that in practice an award in equity is more easily admissible for foreign-related disputes than for domestic disputes.

To summarise this point; arbitration can be conducted in equity, as long as: (i) the parties have so consented expressly and in writing and (ii) the award does not run counter to mandatory law provisions and to public policy (Article 69(3) BAC; Article 56 of the Rules for Arbitration in the Shanghai FTZ).

2.9 The Choice of the Language of Arbitration Proceedings

The parties to the arbitration agreement are generally free to choose the language of the proceedings; absent any choice by the parties, the proceedings are conducted in Chinese (Article 81 of the CIETAC Rules; Article 60 of the SHIAC Rules; Article 6 of the SCIA Rules). Article 72 of the BAC Rules contains a slight variation: absent any choice of the parties as to the language of proceedings, the proceedings are conducted in Chinese and/or in any other language or languages chosen by the arbitral institution or by the arbitral tribunal.

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