



CHINA: THE SUPREME PEOPLE'S COURT'S NEW INTERPRETATION ON THE APPLICATION OF PRC ARBITRATION LAW

LILLIAN LIAN AND STEWART SHACKLETON*

Arbitration; China

China's current arbitration legislation dates from 1991 (Civil Procedure Law) and 1995 (Arbitration Law, "CAL"). Pending comprehensive reforms now under consideration, the Supreme People's Court issues general directions from time to time in the form of interpretations and, in September 2006, a major "Interpretation" comprising 31 Articles came into effect.¹

Following CIETAC's introduction of new rules in 2005, this Interpretation marks another step by China to harmonise and internationalise its arbitration law and practice. It provides guidelines that clarify a number of issues.

China's Arbitration Law developed together with the implementation of a market economy. It was partly modelled on provisions of the 1958 New York Convention and the UNCITRAL Model Law. The Interpretation addresses some features of the arbitration law which have caused confusion and attracted criticism by clarifying important points concerning formal requirements for a valid arbitration agreement, challenges to the validity of arbitration agreements as well as the setting aside and enforcement of arbitral awards.

Formal requirements for arbitration agreements

The CAL sets out strict requirements for a valid arbitration agreement. It must be in writing, express an intention to refer disputes to arbitration, stipulate the matters referable to arbitration, and designate an "arbitration commission" to hear the dispute.²

The Interpretation adopts a liberal approach to the application of these requirements, providing that a written arbitration agreement will include an agreement made in such forms as a written contract, a letter or

electronic message (including telegram, telex, facsimile, electronic data exchange and email),³ reflecting Art.7.2 of UNCITRAL Model Law.

The Interpretation now requires a broad approach to the scope of arbitration agreements setting up a presumption, where the scope of arbitration agreement is unclear, that any disputes arising from the formation, validity, modification, assignment, performance, breach, interpretation or rescission of the contract are referred to arbitration.⁴

A distinct feature of PRC arbitration law is the absence of any formal recognition of ad hoc arbitration. Parties must name an arbitration institution in their arbitration agreement. It is noteworthy that this requirement has been relaxed to a certain degree. Pursuant to the Interpretation, where the name of the arbitration institution is inaccurate or where the arbitration agreement only specifies the arbitration rules, the arbitration institution shall be deemed to have been selected so long as such institution can be ascertained.⁵ Furthermore, where an arbitration agreement stipulates that arbitration shall be conducted by an institution located in a certain place, the only institution in such a place shall be deemed to be designated.⁶ These rules will favour enforcement of arbitration under pathological clauses reducing the scope for attempts to avoid obligations to arbitrate that are mounted on technical grounds. Because ad hoc proceedings are not available, however, they continue to fall short of a more complete commitment to arbitration.⁷

3. Art.1 of the Interpretation.

4. Art.2 of the Interpretation.

5. Arts 3 and 4 of the Interpretation.

6. Art.6 of the Interpretation.

7. Reference to wholly non-existent arbitral institutions or procedures has not been an obstacle to enforcement of arbitration clauses where the parties' primary intent to arbitrate disputes may be established. See the Hong Kong decision of Kaplan J. in *Lucky Goldstar International (H.K.) Ltd v Ng Moo Kee Engineering Ltd* [1994] A.D.R.L.J. 49. In a manner similar to the analysis adopted in *Lucky Goldstar*, the Austrian Supreme Court drew a distinction between the arbitration agreement proper and agreement concerning procedure when it upheld as valid a clause referring disputes to arbitration pursuant to the rules of an institution which no longer existed (Oberster Gerichtshof, July 24, 1997 (1998) 23 Yearbook Comm. Arb. 163). See also the preliminary award of Marc Blessing in (1997) 22 Yearbook Comm. Arb. 211.

*Lillian Lian, Lawyer, China. Stewart Shackleton, Avocat au Barreau de Paris; Barrister, Canada; Solicitor-Advocate, England; Solicitor, China SAR.

1. September 8, 2006. See an English translation of the Supreme People's Court Interpretation of Issues Concerning the Application of the PRC Arbitration Law published in this issue of *International Arbitration Law Review* as an annex to this article.

2. Art.16 of the CAL.

The issue of concurrent arbitral and court jurisdiction is addressed in Art.7 of the Interpretation, which provides for the invalidity of the arbitration agreement in such cases unless one party commences arbitration and the other party does not raise any objection to jurisdiction prior to the tribunal's first hearing. This is still, perhaps, a somewhat conservative approach and jurisprudence in a number of jurisdictions has upheld the parties' intent to arbitrate evidenced under such clauses by narrowly reading the designation of a state court as concerned primarily to identify the supervisory jurisdiction.⁸

The Interpretation strengthens the principle of separability by providing that the validity of the arbitration agreement shall not be affected even if the underlying contract does not come into existence.⁹ This strong principle of separability accords with Model Law provisions and jurisprudential developments in other jurisdictions, notably France.¹⁰

8. See, for example, two decisions in England. The court rejected a suggestion that both clauses should fail in *Shell International Petroleum Co v Coral Oil Ltd*, May 22, 1998, Comm. Ct, unreported. In view of the parties' clear intent to submit substantive disputes to arbitration, Moore-Bick J., as he then was, construed these provisions as referring disputes about the proper law of the contract to English courts and all other substantive disputes to arbitration. In a similar case, *Alfred C. Toepfer International GmbH v Société Cargill France* [1998] 1 Lloyd's Rep. 379, a contract containing an arbitration clause also provided for the exclusive jurisdiction of "the Courts of England or arbitrators appointed in England as the case may be". The Court of Appeal, per Phillips L.J., held that the exclusive jurisdiction provision applied only to substantive disputes and that it was designed to operate in the absence of an arbitration clause. Because the contract contained an arbitration clause, the exclusive jurisdiction provision did not take effect.

9. Art.10 of the Interpretation.

10. Where the question has arisen in a number of cases under the Arbitration Act 1996, English courts have not given effect to the strong principle of separability set out at s.7 of Act: "an arbitration agreement which forms or was intended to form part of another agreement ... shall not be regarded as non-existent ... because that other agreement ... did not come into existence." The courts of other common law jurisdictions have enforced arbitration even where the host contract does not come into existence. See Shackleton, "Arbitration without a Contract" (2002) 17(9) *Mealey's International Arbitration Report*, Lexis Nexis. The French Cour de cassation reached a similar result without the benefit of Model Law statutory provisions: "le principe d'autonomie de la clause compromissoire ... permet de se prévaloir de cette clause même lorsque le contrat signé par les parties n'a pu entrer en vigueur, dès lors que le différend qui les oppose est lié à sa conclusion." (*Société Navimpex Centrala Navala v Société Wiking Trader* (1989) *Revue de l'arbitrage* 641 at p.642, note B. Goldman.) This general principle was criticised as too restrictive (Goldman, *ibid.*, at pp.649 and 650, argued that the principle should apply to a broader category of circumstances, notably, those where contract negotiations take place over a long period of time or are broken off in bad faith) and other decisions in France less supportive of arbitration without a contract met with doctrinal censure (see *Société L & B Cassia v Société Pia Investments*, Cour d'appel, Paris, February 26, 1988 (1990) *Revue de l'arbitrage* 851 and Cour de cassation, July 10, 1990

Challenging the validity of an arbitration agreement

Pursuant to the CAL, if a party objects to the validity of the arbitration agreement, a party may apply to the arbitration commission for a decision or to court for a ruling before the start of the first hearing. If one party applies to the arbitration commission, but the other applies to court, it will be for the court to rule on the matter.¹¹

The Interpretation introduces some finality to the process by taking the further step of clarifying that once the arbitral institution has decided on the validity of the agreement, the court will not hear an application to challenge the decision.¹² Presumably, the other party will have lost its rights to apply to court by allowing the decision to go ahead before the arbitral institution.

The formulation of a strong principle of separability at Art.10 of the Interpretation contrasts with the denial of autonomy in relation to the issue of the law governing the validity of the arbitration agreement at Art.16. This sets out a dependency of the arbitration agreement on the host contract providing that the law agreed by the parties as the governing law of the contract shall also apply to determine the validity of an international arbitration agreement. Where parties have not reached agreement on the applicable law, but agreed on the place of arbitration, the laws of the place of arbitration shall apply. Where neither the applicable law nor the place of arbitration has been agreed or is unclear, the *lex fori* shall apply. The Supreme Court has, thus, not accepted one of the implications of the autonomy of the arbitration agreement which is not necessarily governed by the same law that is applicable to the underlying contract.

Setting-aside and enforcement of the award

Enforcement of awards has been improved. For example, the Interpretation allows the People's Court to sever an award, if possible, and to set aside only that part of it which is outside the scope of arbitration.¹³ A party who has challenged the validity of the arbitration agreement during the arbitration proceeding may apply to court to set aside or resist enforcement of the arbitral award

(1992) *Cluent* 168, note E. Loquin), Fouchard, Gaillard and Goldman, *Traité de l'arbitrage commercial international* (Litec, Paris, 1996), p.376 and Y. Derains, note on *Société Gefimex v Société Transgrain* (1997) *Revue de l'arbitrage* 434 and 435. In *Société Omenex v M Hugon*, October 25, 2005, the Cour de cassation enforced arbitration despite the non-existence of the host contract under a clear statement of principle to this effect: "en application du principe de validité de la convention d'arbitrage et de son autonomie en matière internationale, la nullité non plus que l'inexistence du contrat qui la contient ne l'affectent."

11. Art.20 of CAL.

12. Art.13 of the Interpretation.

13. Art.19 of the Interpretation.

on the basis that the arbitration agreement is invalid.¹⁴ Where, however, a party does not raise challenges with respect to the arbitration agreement in the arbitration proceeding, such grounds will be deemed to have been waived.

The Interpretation is a sign of continuing progress, but a number of significant issues remain to be addressed. For example, the CAL does not allow ad hoc arbitration in China, contrary to accepted international practice, a matter not addressed by the Supreme Court in its recent Interpretation. The latest round of clarifications, however, is an obvious precursor to more important reforms that can be expected to bring Chinese law into line with practice in other leading arbitration venues.

Annex: Supreme People's Court Interpretation of issues concerning the application of the PRC Arbitration Law

(Adopted at the 1375th meeting of the Judicial Committee of the Supreme People's Court on December 26, 2005)

Judicial Interpretation No.2006/ 7

Pursuant to the provisions of the PRC Arbitration Law and the PRC Civil Procedure Law and other laws, certain issues concerning the application of laws by the People's Court in hearing arbitration cases are hereby interpreted:

Article 1 An arbitration agreement made "in another written form," as provided for in Article 16 of the PRC Arbitration Law, includes any arbitration agreement made in forms such as a written contract, a letter, or electronic message (including a telegram, telex, facsimile, electronic data exchange and email).

Article 2 Where parties agree to refer contractual disputes to arbitration, any disputes arising from the formation, validity, modification, assignment, performance, breach, interpretation, or rescission of the contract are to be regarded as matters referred to arbitration.

Article 3 Where the name of the arbitration institution stipulated in an arbitration agreement is inaccurate, but the specific arbitration institution is nevertheless ascertainable, the arbitration institution shall be deemed to have been designated.

Article 4 Where the arbitration agreement only stipulates the arbitration rules applicable to disputes, it shall not be deemed to contain any stipulation on the selection of an arbitration institution unless a supplementary agreement is reached by the parties or the arbitration institution can be ascertained pursuant to the arbitration rules.

Article 5 Where an arbitration agreement expressly stipulates two or more arbitration institutions, the parties may reach an agreement to select one of the arbitration institutions and refer disputes to such institution for arbitration. Where the parties are unable to agree on the

designation of an arbitration institution, the arbitration agreement shall be deemed invalid.

Article 6 Where an arbitration agreement stipulates that arbitration shall be conducted by an arbitration institution located in a certain locality and there is only one arbitration institution in such locality, the arbitration institution shall be deemed to be the designated arbitration institution. In the event that two or more arbitration institutions exist in the locality, the parties may select an arbitration institution by agreement and refer disputes to such institution for arbitration. Where the parties are unable to agree on the designation of an arbitration institution, the arbitration agreement shall be deemed invalid.

Article 7 Where the parties agree to resolve a dispute either by means of institutional arbitration or by action before the People's Court, the arbitration agreement shall be deemed invalid, unless one party refers disputes to the arbitration institution and the other party fails to raise an objection within the time limit stipulated in Article 20.2 of the PRC Arbitration Law.

Article 8 Where a party is merged or divided after an arbitration agreement is made, the arbitration agreement shall be binding on the successors who assume the rights and obligations of the original party.

Where a party dies after entering into an arbitration agreement, the arbitration agreement shall be binding on successors who assume rights and obligations involved in the matters for arbitration.

The preceding two paragraphs shall apply unless the parties agree otherwise when they enter into the arbitration agreement.

Article 9 In the event that rights and obligations are transferred, in part or in whole, the arbitration agreement will be binding on the transferee, unless the parties agree otherwise, or the transferee has expressly objected, or is not aware of the existence of a separate arbitration agreement at the time of transfer.

Article 10 After a contract has been formed, but before it has come into effect, or if it has been revoked, Article 19.1 of the PRC Arbitration Law shall apply to determine the validity of the arbitration agreement.

Where parties conclude an arbitration agreement referring disputes under a contract to arbitration, the validity of the arbitration agreement shall not be affected in the event that the contract does not come into being.

Article 11 Where a contract stipulates that any valid arbitration clause in any other contract or document shall apply to the resolution of any dispute arising from the contract, the parties shall refer disputes to arbitration in accordance with such arbitration agreement.

Where an international convention applicable to a foreign-related contract contains an arbitration agreement, the parties shall refer disputes to arbitration pursuant to such international convention when a contractual dispute arises.

Article 12 An application to the People's Court to confirm the validity of an arbitration agreement shall be subject to the jurisdiction of the Intermediate People's Court in

14. Art.27 of the Interpretation.

the locality of the arbitration institution designated in the arbitration agreement. Where the arbitration institution designated in the arbitration agreement is unclear, the Intermediate People's Court at the place of signature of the arbitration agreement or the respondent's place of domicile shall have jurisdiction.

An application to confirm the validity of a foreign-related arbitration agreement shall be subject to the jurisdiction of the Intermediate People's Court in the locality of the arbitration institution designated in the arbitration agreement, the place of signature of the arbitration agreement, or the place of domicile of the applicant or respondent.

Cases concerning the validity of an arbitration agreement in maritime disputes shall be subject to the jurisdiction of the maritime court in the locality of the arbitration institution designated in the arbitration agreement, the place of signature of the arbitration agreement, or the place of domicile of the applicant or of the respondent. Where there is no maritime court in the abovementioned localities, the maritime court in the neighboring area shall have jurisdiction.

Article 13 Where a party does not challenge the validity of an arbitration agreement before the first hearing of the arbitration tribunal pursuant to Article 20.2 of the PRC Arbitration Law and subsequently applies to the People's Court for a declaration that the arbitration agreement is invalid, the People's Court shall reject the application.

After a decision on the validity of the arbitration agreement has been made by the arbitration institution, any application to the People's Court to confirm the validity of the arbitration agreement or to set aside the decision of the arbitration institution shall be rejected by the People's Court.

Article 14 The "first hearing" provided for in Article 26 of the PRC Arbitration Law refers to the first hearing conducted by the People's Court upon the expiry of the time limit for a defence submission, and excludes various actions taken in pre-hearing proceedings.

Article 15 The People's Court shall form a collegial panel to adjudicate cases brought to confirm the validity of an arbitration agreement, and shall hear the parties.

Article 16 The applicable law agreed by the parties shall apply to determine the validity of a foreign-related arbitration agreement. Where the parties have not reached an agreement on the applicable law but have agreed on the place of arbitration, the laws of the place of arbitration shall apply. Where neither the applicable law nor the place of arbitration has been agreed upon, or the agreed place of arbitration is unclear, the *lex fori* shall apply.

Article 17 The People's Court shall not uphold an application to set aside an arbitral award on grounds other than those provided for in Article 58 of the PRC Arbitration Law or Article 260 of the PRC Civil Procedure Law.

Article 18 "No arbitration agreement" in Article 58.1 of the PRC Arbitration Law means that no arbitration agreement has been reached between the parties. Where an arbitration agreement is found to be invalid or is

rescinded, there shall be deemed to have been no arbitration agreement.

Article 19 Where a party applies to set aside an arbitral award on the ground that matters dealt with in the award are outside the scope of the arbitration agreement, and if the case is found upon examination to have merit, the People's Court shall set aside that part of the award which falls outside the scope of the arbitration agreement. Where the part of the arbitral award outside the scope of the arbitration agreement cannot be separated from the other parts of the award, the People's Court shall set aside the award.

Article 20 "Contrary to the statutory procedure" in Article 58 of the PRC Arbitration Law refers to circumstances in which the breach of the arbitration procedure provided in the PRC Arbitration Law or of the arbitration rules selected by the parties may affect the validity of the award.

Article 21 Where an application by a party to set aside a domestic arbitral award falls into any of the following categories, the People's Court may, pursuant to the provisions of Article 61 of the PRC Arbitration Act, remit the matter to the arbitral tribunal for a decision within a specified time limit:

- (1) evidence on which the arbitral award is made is fabricated;
- (2) the respondent conceals evidence which is sufficient to impair the impartiality of the award.

The People's Court shall specify in its notification its reasons for remitting the dispute to arbitration.

Article 22 Where the arbitral tribunal rehears the arbitration within the time limit specified by the People's Court, the People's Court shall order the termination of the setting aside proceedings. Where the arbitral tribunal has not reheard the arbitration, the People's Court shall grant an order to resume setting aside proceedings.

Article 23 Where a party is dissatisfied with the arbitration award following remission, such party may apply to the People's Court for setting aside such award pursuant to Article 58 of the PRC Arbitration Law within six months from the date of service of the arbitral award.

Article 24 Where a party applies to set aside an arbitral award, the People's Court shall form a collegial panel to adjudicate the case and shall hear the parties.

Article 25 Where a party applies to enforce an arbitral award after the People's Court has accepted an application by the other party to set aside the award, the People's Court which has accepted the application for enforcement of the arbitral award shall grant an order to suspend enforcement.

Article 26 After an application to set aside an arbitral award has been dismissed by the People's Court in enforcement proceedings, the People's Court shall not admit any argument to resist enforcement of the award on the same ground.

Article 27 Where a party does not challenge the validity of an arbitration agreement in the arbitral proceedings, but applies to set aside the arbitral award or to resist enforcement of such award on the ground of the invalidity

of the arbitration agreement after such award is made, the People's Court shall dismiss such application.

Where a party challenges the validity of the arbitration agreement in the arbitration proceedings and applies to set aside the arbitral award or to resist the enforcement of such award on ground of the invalidity of the arbitration agreement after the award is made, such application shall be upheld by the People's Court upon it being verified that Article 58 of the PRC Arbitration Law or Article 217 and 260 of the PRC Civil Procedure Law apply.

Article 28 The People's Court shall not support an application to resist enforcement of a conciliation reached in the course of arbitration proceedings or an arbitral award based on a settlement agreement between the parties.

Article 29 An application to enforce an arbitral award shall be subject to the jurisdiction of the Intermediate People's Court at the domicile of the respondent or of

the locality where the property subject to enforcement is located.

Article 30 The People's Court may request an explanation from an arbitration institution or call for the production of arbitration case files from the relevant institution where necessary to deal with applications to set aside or to enforce arbitral awards.

Rulings by the People's Court in proceedings concerning arbitration may be copied to the relevant arbitration institution.

Article 31 This interpretation shall come into effect from its date of promulgation.

In the event that there is any inconsistency between any previous judicial interpretation issued by this court and this interpretation, the provisions of this interpretation shall prevail.