

Drafting Efficient Arbitration Clauses with Chinese Parties

Réseau Asiallians | Asiallians network

Paris • Beijing • Tianjin • Qingdao • Shanghai • Fuzhou • Xiamen • Guangzhou • Shenzhen • Haikou • Hong Kong • Taipei

OVERVIEW

- I. WHAT IS AN ARBITRATION CLAUSE ALL ABOUT?**
- II. WHY IS AN EFFICIENT ARBITRATION CLAUSE SO IMPORTANT?**
- III. HOW TO DRAFT A VALID ARBITRATION CLAUSE?**
- IV. HOW TO DRAFT AN EFFICIENT ARBITRATION CLAUSE?**
- V. FIVE STEPS TO DRAFT A SOLID ARBITRATION CLAUSE**



I. What is an arbitration clause all about ?

1. What is an Arbitration Clause?

Definition

An arbitration clause is a clause in a contract which contemplates an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in relation to the contract, whether contractual or not.

Positive Effect

**Gives jurisdiction to the
arbitral tribunal**



Negative Effect

**Withdraws the jurisdiction
from the courts**



2. What is the role of an Arbitration Clause?

= Basis for the Entire Arbitration Proceedings



Key tool to manage the advantages and disadvantages of arbitration

3. Efficiency starts with the Arbitration Clause

In almost 90% of the cases where jurisdictional or admissibility objections are raised, it is related to a badly drafted arbitration clause.

- ➔ Ensure your arbitration agreement is bullet proof. Otherwise, you will lose time and money.
- ➔ Consider fast-track options



**II. Why is an efficient
arbitration agreement
so important ?**

1. What happens if you don't provide for an arbitration clause?

- Court proceedings
 - Where ? China ? Elsewhere ?
 - Lack of neutrality of forum in case of court jurisdiction
- ➔ **No control over the dispute forum and dispute resolution mechanism**

Providing for an arbitration clause allows you to control where and how a dispute will be resolved

2. What happens if you provide for a bad arbitration clause?

What happens if you provide for a bad arbitration clause?

**If you are
Claimant**

Best case scenario: Lose time & money

Worst case scenario (1): Not possible to launch arbitration at all

Worst case scenario (2): Able to launch the arbitration, but award not enforceable

**If you are
Respondent**

Best case scenario: No arbitration at all (by this you are only winning time, not the game)

Worst case scenario: Your client is drawn into an arbitration, but not able to properly defend its rights

3. Experience of non-enforcement due to invalid arbitration clauses

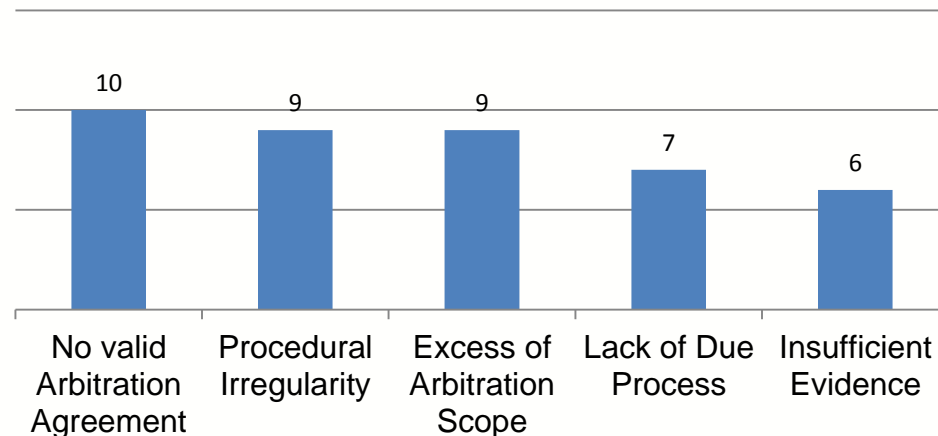
1. Most Popular Grounds for Non-Enforcement

Ranking of grounds most often retained by Chinese courts

1995 - 2012

N = 119

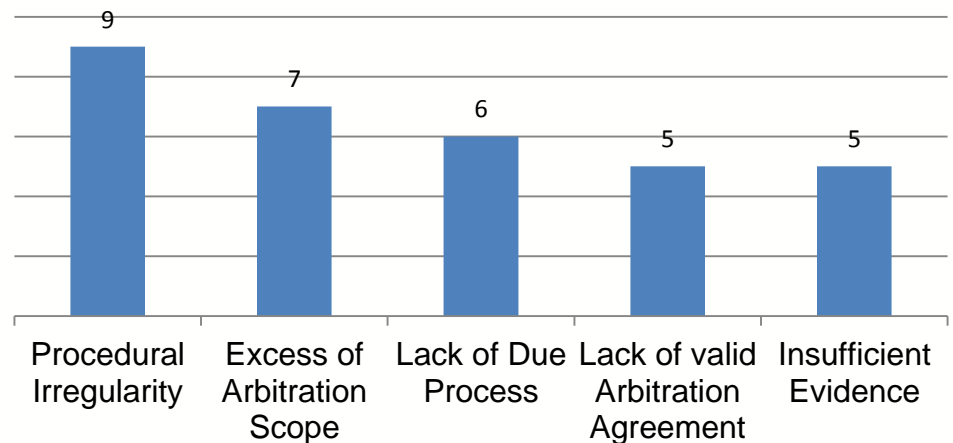
1. Lack of valid Arbitration Agreement
2. Irregularity in the Arbitration Procedure and/or Composition of the Arbitral Tribunal
3. Excess of Arbitration Scope
4. Lack of Due Process
5. Insufficient Evidence (not available anymore)



2005 - 2012

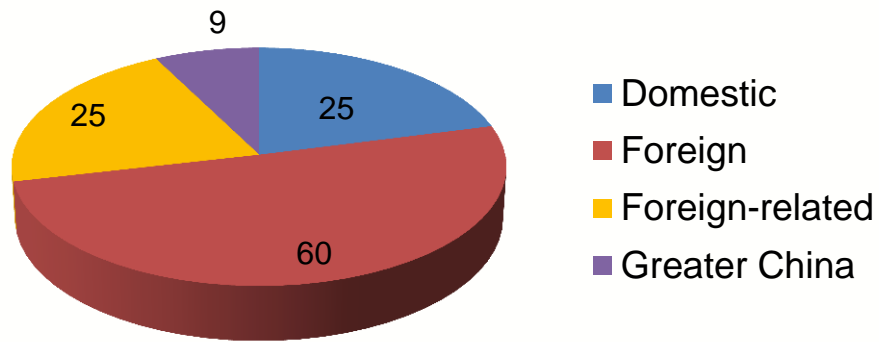
N = 77

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Survey of Judicial Enforcement Rate (1995-2012):

Total Number of Cases Collected & Analyzed by ASIALLIANS (1995-2012):



N = 119

Compared to:

- Number of Arbitration Institutions in 2012: 219.
- Total Number of Arbitration Cases from the 219 Arbitration Institutions in 2012: **96,378**.
- Number of Cases from different arbitration institutions in 2012:
 - CIETAC: 1,060
 - CMAC: 83
 - BAC: 1,473
 - SHIAC : 505

Random & Representative Sample ?

Legal Framework for Enforcement of Awards in China

• Legal Basis for Enforcement

- Domestic Awards
 - Art. 62-64 AL & Art. 237 CPL (2012)
- Foreign-related Awards
 - Art. 71-72 AL & Art. 274 CPL (2012)
- Foreign Awards
 - Art. 283 CPL (2012) + NYC
- Greater China Awards
 - ML- HK Mutual Arrangement (2000) (+ad hoc)
 - ML - Macao Mutual Arrangement (2008) (+ad hoc)
 - SPC Provisions on **Recognition** of Civil Judgments made in Taiwan (1998)

• Competent Court

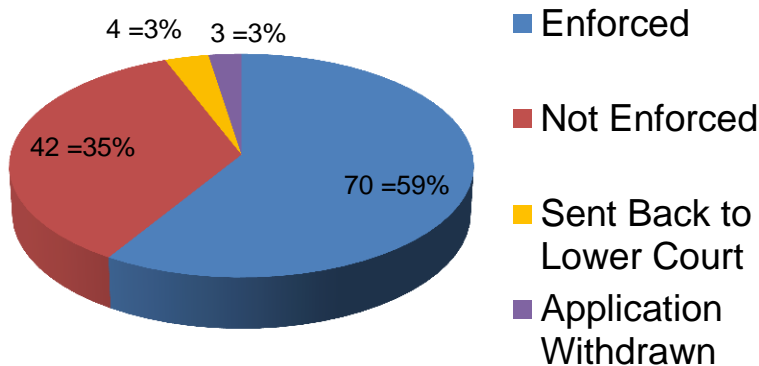
- Domestic Awards
 - BPC (sometimes higher court) at the place of domicile of the defendant and/or property.
- Other Awards (foreign-related, foreign, Greater China)
 - IPC at the place of domicile of the defendant and/or property (Art. 224 & 273 CPL (2012) & SPC Interpretations)

• Time Limit

- 2 years
 - Art. 239 CPL (2012)
- As of (i) last day of period for performance, or (ii) effective date.
 - Jwell Machinery v. Retech Aktiengesellschaft (SPC Guiding Case NO. 37)

Survey of Judicial Enforcement Rate (1995-2012):

In General 59%



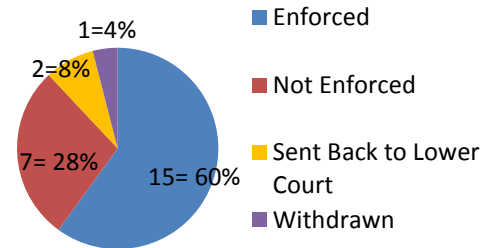
N=119

Compare to:

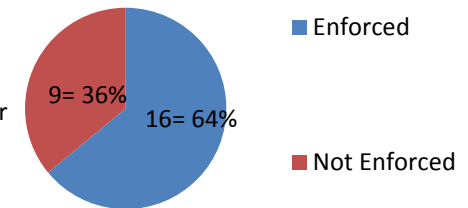
According to the SPC Judges, between 2002 and 2007, there were 178 cases submitted to the SPC, and the SPC granted enforcement in 96.15% for foreign-related awards, and 78% for foreign awards.

Per Category

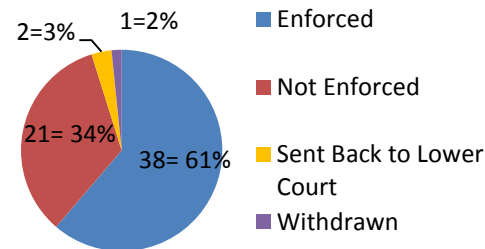
Domestic N=25 60%



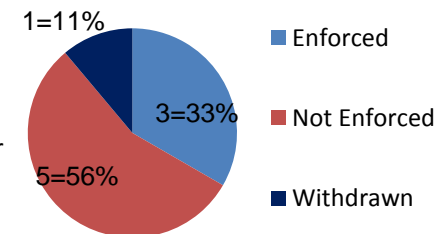
Foreign-Related N=25 64%



Foreign N=60 61%

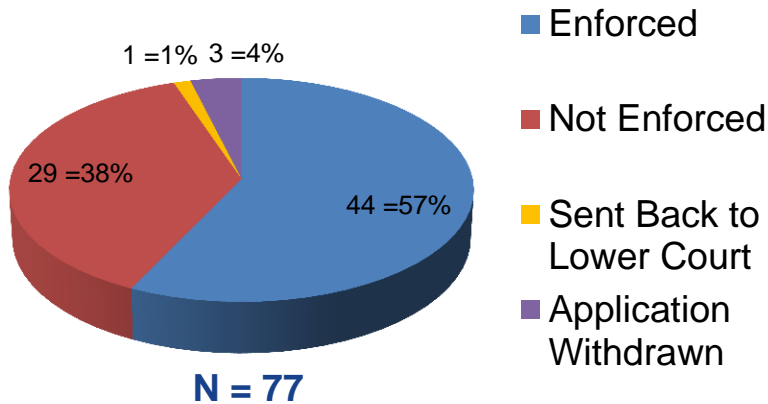


Greater China N=9 Not conclusive



Survey of Judicial Enforcement Rate (2005-2012):

In General 57%

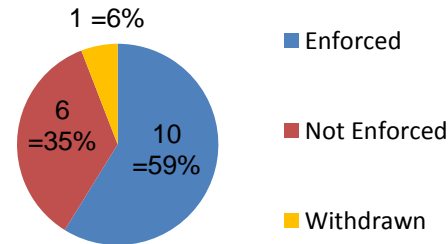


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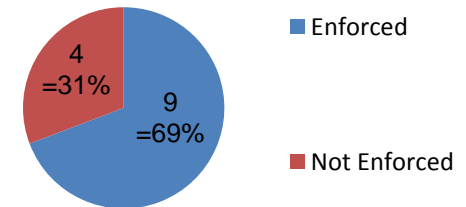
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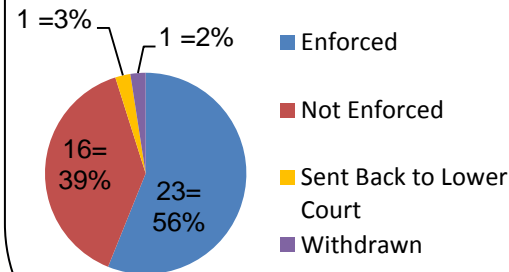
Domestic N=17 59%



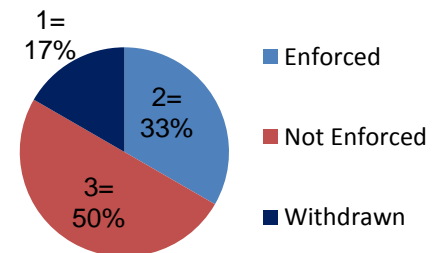
Foreign-Related N=13 69%



Foreign N=41 56%



Greater China N=6 Not conclusive





III. How to draft a valid arbitration clause?

1. What is the 'Law Applicable to the Arbitration Clause'?

3 Possibilities



Lex Arbitri: Law of the place of arbitration or law expressly chosen by the parties

Specific law chosen to apply to the arbitration agreement

Law applicable to the **substance of the case**, i.e. to the contract

NB: The preferred practice is for parties to include a specific choice of law for their arbitration agreements to avoid both the uncertainty and the cost of potential litigation regarding the question of which law should apply.

LCIA Rules (2014) provide that the law of the arbitration clause will be the law of the seat of the arbitration, unless otherwise specified.

HKIAC Model Clause (2014): included an optional provision that specifies the parties' choice of law to apply to an arbitration clause. *"This provision should be included particularly where the law of the substantive contract and the law of the seat are different. The law of the arbitration clause potentially governs matters including the formation, existence, scope, validity, legality, interpretation, termination, effects and enforceability of the arbitration clause and identities of the parties to the arbitration clause. It does not replace the law governing the substantive contract."*

2. What are the mandatory validity requirements?

	PRC ARBITRATION LAW	INT'L ARBITRATION PRACTICE	COMMENTS
Arbitrability	✓	✓	• More flexibility under Int'l Arb. Practice
Written Form	✓	✓	• Art. 11 Contract Law: Signature • Broader definition under Int'l Arb. Practice
Clear intention to arbitrate	✓	✓	• More flexible application in Int'l Arb
Matters subject to arbitration	✓	✓	• More flexible application in Int'l Arb and interpretation principles different
Designation of an arbitration institution	✓	✗	• Ad hoc arbitration allowed under int'l practice

3. What to do with ‘pathological arbitration clauses’?

China

- Art. 18 AL
 - unclear matters
 - unclear institution
- SPC Interpretations: piece-meal approach to interpretation of arbitration clauses
- Interpretation approach in favor of the parties’ intention to arbitrate. (SPC: Invista case (2013) MSTZ No.60)

UNCITRAL

- “Effet utile” interpretation
- Pro-arbitration approach

= Invalid
unless exception

= Valid,
but uncertain

Problems
bridged by
Interpretation



IV. How to draft an efficient arbitration clause? – Dos and Don'ts –

1. The Dos

The 'Must'

- Place of arbitration(**city!**) or law applicable to the arbitration proceedings (**Lex Arbitri**)
- Description of the matters subject to arbitration

The 'Should'

- Rules of arbitration or Arbitration Institution
- Language
- Cost sharing
- Coordinate with choice of law clause

The 'Can'

- Number of arbitrators (beware of costs) and special qualifications
- Expedited Procedure
- Additional guidelines
- Confidentiality
- Timelines
- Remuneration scheme of arbitrators
- Place of hearing
- Mediation clause
- Emergency Arbitrator

RECOMMENDATION:

This is the time and place to take advantage of the flexibility of arbitration, but flexibility also means uncertainty, so it is important that you know what you do. If you do not feel confident, stick to the **MUSTS & SHOULD** only.

Practical Example:

French Seller v. Chinese Buyer

- a. Arbitration institution?
- b. Place of arbitration? Neutral: BJ, SH, SZ?
- c. Language and arbitrators?: English
- d. Arbitrators: 3, president?

French Buyer v. Chinese Seller

- a. Arbitration?
- b. Place of arbitration?
- c. Language and arbitrators?
- d. Arbitrators?

2. The Don'ts

Avoid

- Choosing **two languages**
- Provide **too much details**, because you are taking away the flexibility

Do Not

- **Mix up** institutions and arbitration rules (e.g. SIAC to administer an arbitration under ICC Rules)
- **Mix up** Chinese arbitration institutions and foreign place of arbitration or foreign arbitration institution and Chinese place of arbitration
- **Mix up** a choice of lex arbitri with a different place of arbitration

ICC Arbitration in China?

1. Arbitration clause: ICC Rules + China ?

- (1) Before Sept. 2006: INVALID according to AL Art. 18 (for lack of designation of the arbitration institution and supplementary agreement); (See: *Züblin International v. Woke Rubber (2004)*, *Donghong PM v. DMT (2006)*).
- (2) After Sept. 2006: VALID according to SPC Interpretation on AL Art. 4 (no designation of arbitration institution except with supplementary agreement or the institution can be determined according to the arbitration rules.) (see: *Xiamen Xiangyu v. Mechel Trading (2004)*; *Farun Glass v. Stein Heurtey et al. (2006)*);
- (3) However, such approach provided in SPC Interpretation on AL Art. 4 is not consistently applied by Chinese courts (see: *Amoi Electronics v. Production Belge (2009)*). Suggestion would be to specify ICC as the arbitration institution in the arbitration clause.

2. Arbitration clause: ICC + China?

- A. ICC award enforceable: Non-domestic award? (see: *Duferco S.A. v. Ningbo Imp. & Exp. (2009)* ruled by Ningbo IPC)
- B. Arbitration clause valid: *Longlide Packaging v. BP Agnati (2013)* ruled by the SPC.
- C. Problems remains as to: “nationality of the award”? ICC + domestic dispute?
- D. To secure the enforceability of the award, we recommend that such clauses continue to be avoided.



5 Steps to draft a solid arbitration clause

FIVE KEY STEPS

Step 1:
Make an informed choice between arbitration and litigation

Step 2:
Determine an appropriate place of arbitration

Where is the other Party located? Where are relevant assets to be subject to enforcement?
Make sure to choose a UNCITRAL ML & NYC Country.

Step 3:
Check the validity requirements under the Lex Arbitri and do not assume it is the same as in China

Know the applicable validity requirements and know the approach of the courts at the place of arbitration towards defective arbitration agreements

Step 4:
Choose an appropriate arbitration institution and/or arbitration rules and **STUDY THEM**

Check the rules and the cost schedule to make sure they correspond to your clients' budget, needs and to the specificities of the case.

Step 5:
Check the 'Dos' and 'Don'ts'

Possible Arbitration Clause

Any dispute arising from or in connection with this Contract shall be submitted to Shanghai International Economic and Trade Arbitration Commission/ Shanghai International Arbitration Center for arbitration.

The Arbitration procedure shall be conducted in accordance with the Rules of Arbitration of Shanghai International Economic and Trade Arbitration Commission/ Shanghai International Arbitration Center for arbitration, and by three arbitrators appointed in compliance with the said rules.

Arbitration shall take place in Shanghai, at Shanghai International Arbitration Center, and shall be conducted in English only.

The Parties agree that the Seller shall appoint one arbitrator, and that the Buyer shall appoint one arbitrator.

The Third Arbitrator shall be appointed by the two Arbitrators as appointed by the Parties.

The Third Arbitrator shall act as the President of the Arbitration Tribunal and shall not be a citizen of France and/or China (PRC).



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