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Featured Article

Two Issues Concerning Validity of Arbitration Agreements Under Chinese Law

Introduction

In the past few years, several thorny issues have arisen concerning validity of arbitration agreements under Chinese law. Two of them have drawn much attention from Chinese arbitration practitioners, namely: (a) whether an arbitration clause[1] is valid where the underlying contract has not been duly formed; and (b) whether a dispute resolution clause is valid when it allows parties to resolve the dispute by litigation provided that arbitration does not work.

According to the available statistics in 2018, Chinese courts have become more prudent than before to interfere with the parties' autonomy on submitting their disputes to arbitration, and more willing than ever to uphold the validity of an arbitration agreement even if it is somewhat defective.

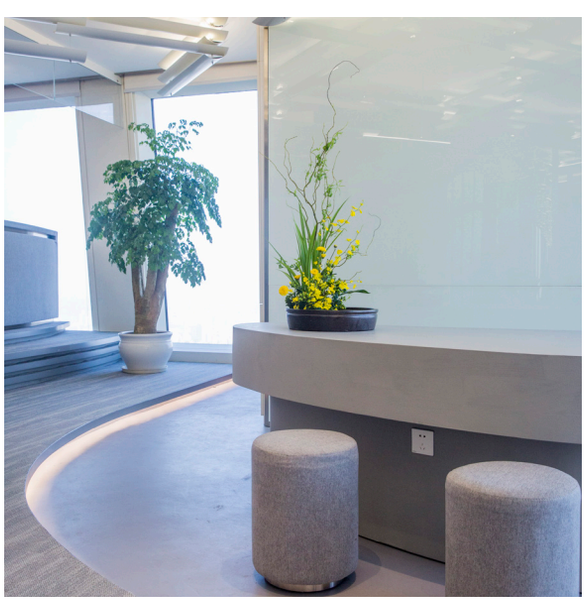
This article is derived from *A Practical Observation Report of PRC Courts Judicial Review on Arbitration in 2018* (Chinese version) prepared by Tiantong & Partners.

Would an arbitration clause stand validly where the main contract is not duly formed?

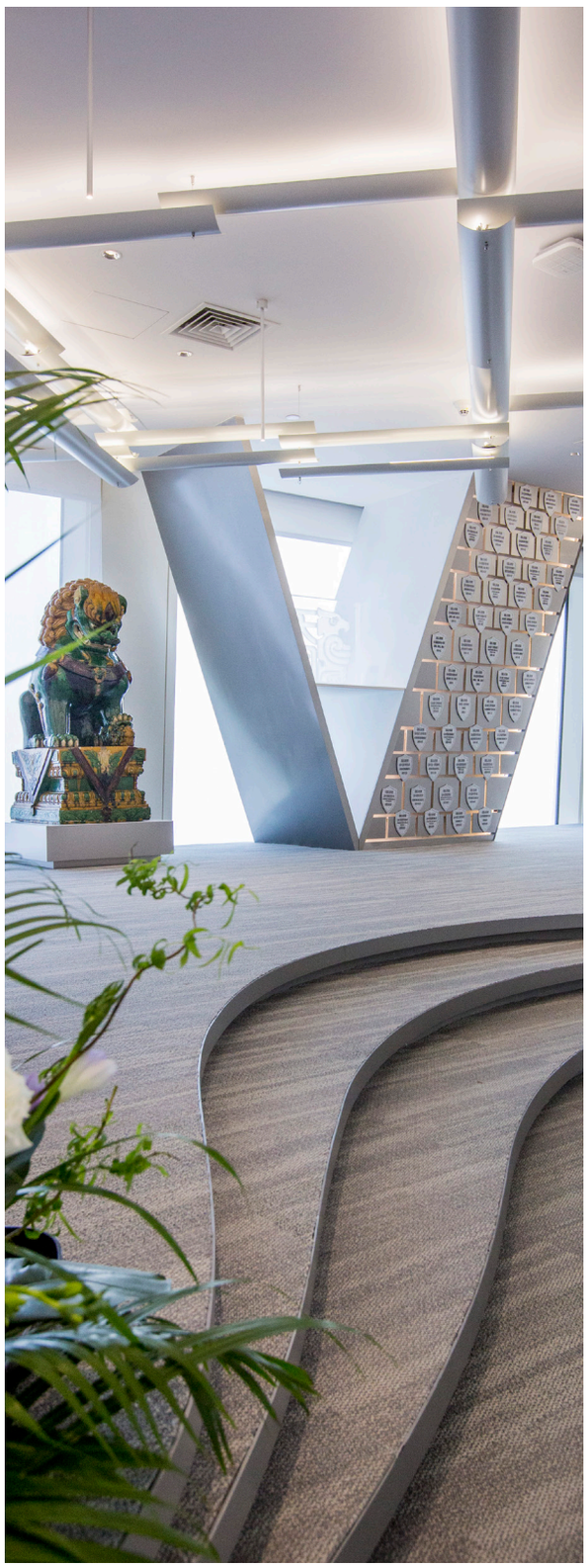
In *Wangshengda Limited v. Rongfeng LP*[2], Claimant Wangshengda requested that the Beijing Fourth Intermediate People's Court strike down the arbitration clause in an investment agreement, on the ground that only two of the four contracting parties executed the agreement which rendered the agreement not duly formed so that the arbitration clause, as part of the agreement, should be held not valid. The court was of the view that where the parties have reached an agreement to arbitrate at the conclusion of a contract, the validity of the arbitration clause is not affected by the non-existence of the main contract.[3] The court further held that since the arbitration clause in the investment agreement satisfied all the requirements for establishing a valid arbitration agreement in terms of Article 16 of the *PRC Arbitration Law*,[4] the arbitration clause was binding to the two signatory parties even though the investment agreement had not been executed by all contracting parties.

The above case demonstrates that the doctrine of separability has been a well-recognised principle under Chinese law. Article 19 of the *PRC Arbitration Law* provides that "the effect of an arbitration agreement shall stand independently and shall not be affected by the alteration, dissolution, termination or invalidity of the main contract." Following the doctrine of separability, the Beijing Court only assessed the validity of the arbitration clause regardless of the existence of the main contract.

In practice, there is another scenario where the doctrine of separability may be considered: when negotiating the draft contract texts, the parties did not comment on or complain of the arbitration clause; as such, would the arbitration clause stand validly even if the contract was not eventually executed by the parties? There are two divergent views pertaining to this issue. The first view supports the absolute



[1] For the purpose of this article, an arbitration clause is an exchangeable term of an arbitration agreement, and the two terms will be used in different contexts.
[2] 旺盛达公司与融丰中心申请确认仲裁协议效力案, 北京四中院(2018)京04民特239号 (Beijing Fourth Intermediate People's Court (2018) Jing 04 Min Te No. 239.
[3] The legal basis is Article 10 of the Interpretation of the Supreme People's Court Concerning Issues on Application of the PRC Arbitration Law ("the SPC Interpretation to Arbitration Law").
[4] Article 16 of the PRC Arbitration Law provides: "...An arbitration agreement shall contain the following: (1) The intent to arbitrate; (2) Matters to be arbitrated; (3) The chosen arbitration commission."



application of the doctrine of separability: the arbitration clause is binding upon the parties, as the validity of an arbitration clause does not depend on the existence of the underlying contract. The second view, however, suggests not applying the doctrine of separability per se but the court must find out whether the parties intended to be bound by the arbitration agreement.

The second view appears to have been supported by the Supreme People's Court, which in its publication *Understanding and Application of the SPC Interpretation on PRC Arbitration Law*[5] articulates that "The doctrine of separability does not necessarily apply to situations where the contract is not duly formed. To determine the validity of an arbitration clause under such circumstances, courts shall examine whether the parties have reached consensus about the arbitration agreement." This position is very similar to the one reflected in a Singapore High Court case, BCY v BCZ [2016] SGHC 249.

Would a dispute resolution clause be valid when it allows parties to resolve the dispute by litigation after arbitration does not work?

According to Article 7 of the *SPC Interpretation to Arbitration Law*, where the parties agree that if any dispute arises, they may refer it to be resolved by arbitration before an arbitral institution or by litigation before a court, such arbitration agreement shall be invalid...". Under Chinese law, it is uncontroversial that the parties are not allowed to choose either arbitration or litigation to resolve the dispute in a dispute resolution clause and that such an "optional" clause giving the parties choices between arbitration and litigation cannot stand.

Sometimes, however, it is observed that parties adopt a dispute resolution clause, which reads "when the dispute fails to be resolved by arbitration, either party may commence litigation before a people's court". Is the aforesaid dispute resolution clause valid? Published court decisions indicate three types of opinion as set out below.

[5] The Fourth Judicial Department of The Supreme People's Court et al., Understanding and Application of the SPC Interpretation on PRC Arbitration Law, 2015. Note that this is not a binding legal authority.

Opinion 1: the clause is an "optional" clause and therefore it is invalid on its entirety

In Lugang Limited v. Qili Limited,[6] the parties included a dispute resolution clause in the contract: "any dispute arising from this agreement shall be resolved by amicable negotiation between the parties; failing which, either party may submit the dispute to the local arbitration commission; failing which, either party may submit the dispute to a people's court." The court perceived this clause as an "optional" clause and held it invalid in terms with Article 7 *of the SPC Interpretation to Arbitration Law*.

Opinion 2: the clause is not an "optional" clause and is partially valid

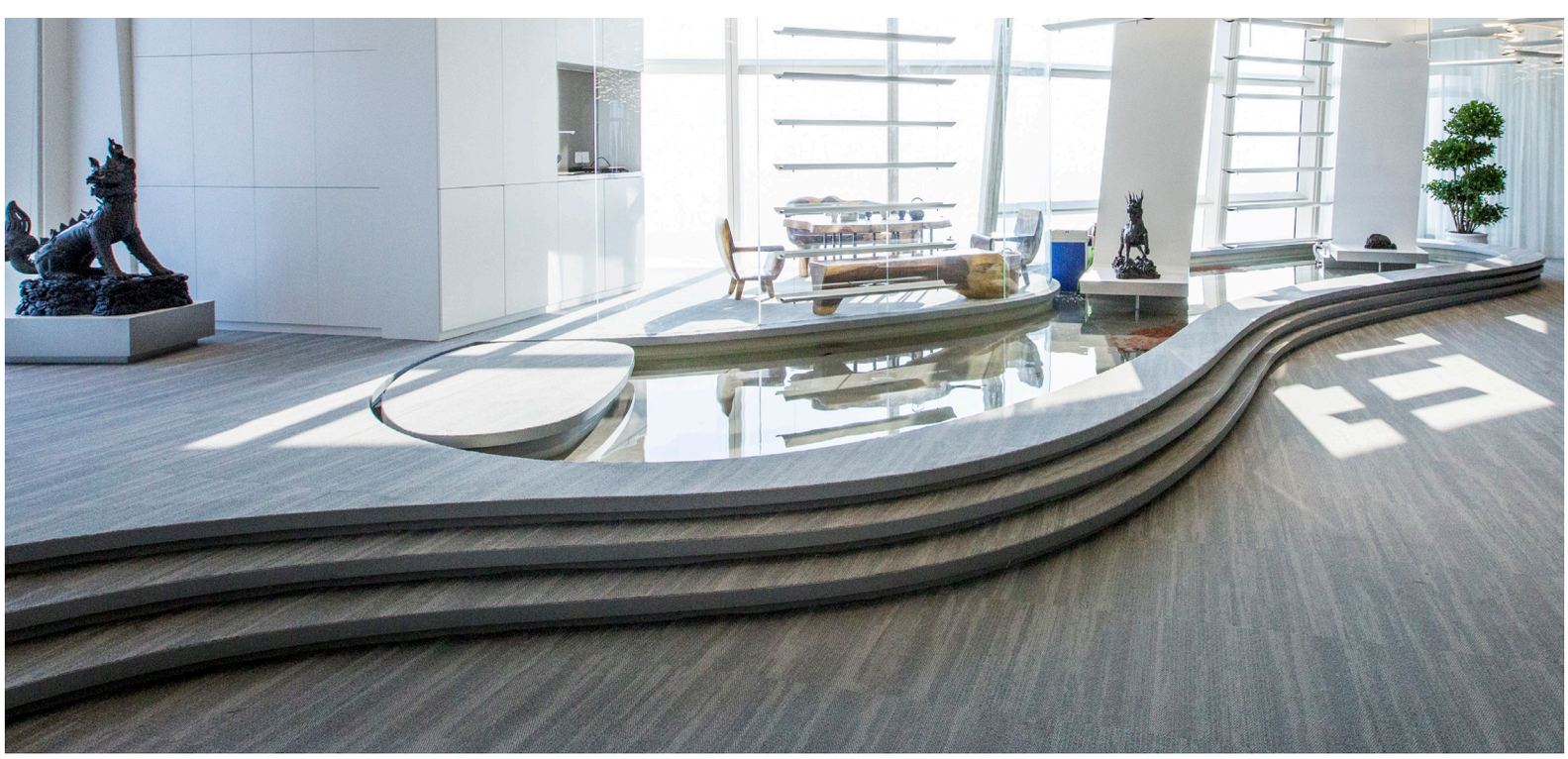
In Anhui Highway Science Center v. Xinyuqi Limited,[7] the parties agreed on a dispute resolution clause, which reads "if any dispute arise in connection with this contract, either party may submit the dispute to the Hefei Arbitration Commission; failing which, either party may appeal to the Intermediate People's Court of Hefei City". The court held that the clause indicated the parties' manifested intention to resolve the dispute by arbitration first. The term "failing which, either party may appeal to the Intermediate People's Court of Hefei City", as the court held, did not establish an "optional" clause although it was in contravention with the finality of an arbitral award, as it allowed the parties to challenge the award by appeal to the court. Accordingly, the court upheld the validity of the arbitration clause and struck down the parts of allowing the parties to appeal to Hefei court.

[6] 路港公司与淇励公司买卖合同纠纷管辖案，长沙中院（2018）湘 01 民辖终 645 号 (Changsha Intermediate People's Court (2018) Xiang 01 Min Xia Zhong No. 645).

[7] 安徽高速科研中心与新雨其公司申请确认仲裁协议效力案, 合肥中院（2017）皖 01 民特 317 号（Hefei Intermediate People's Court (2017) Wan 01 Min Te No. 317）.

Opinion 3: the clause is not an "optional" clause and is valid on its entirety

In *Southern China Materials Limited v. China Railway Seventh Group*, there was a dispute resolution clause in the contract that "if any dispute arises in connection with this contract, either party may submit the case to the arbitration commission at the place of the China Railway Seventh Group. If arbitration fails to resolve the dispute, either party may bring the case to the people's court at the place of China Railway Seventh Group." The claimant, Southern China Materials Limited, asked the court to declare this clause invalid. The court held that the first sentence of this clause clearly manifested the parties' intention to submit their case to arbitration and was therefore valid. As to the last sentence, the court held that it does not constitute an "optional" clause, because it allowed the parties to fall back on litigation only when arbitration was unable to resolve the dispute. Under Chinese law, when the arbitration clause is invalid, or an arbitral award could be set aside or be not enforced, the parties are entitled to commence litigation to resolve the dispute. As such, the arbitration clause was valid and the litigation clause was also valid as it did not violate the finality of arbitral awards.[8] Based on the foregoing reasons, the court upheld the validity of the entire dispute resolution clause.



[8] 中铁七局与华南物资公司申请确认仲裁协议效力案，郑州中院（2018）豫 01 民特 12 号 (Zhengzhou Intermediate People's Court (2018) Yu 01 Min Te No, 12).

Chinese Law Updates

The Taiwanese Court Declines to Enforce a CIETAC Arbitral Award Given Defects in Service

On 7 March 2019, the New Taipei District Court in Taiwan[9] rejected the appeal of the claimant in the recognition and enforcement proceeding for a CIETAC arbitral award, sustaining its decision that the award shall not be enforced in Taiwan because the service upon the respondent was defective.

The dispute arose out of a joint development agreement of video games between a Mainland claimant and a Taiwanese respondent, where the respondent, on the brink of bankruptcy, allegedly failed to carry out its contractual obligations. The claimant obtained a favorable arbitral award at CIETAC, under which the tribunal declared that the claimant was entitled to terminate the agreement and awarded damages to the claimant. Subsequently, the claimant requested that the Taiwanese Court recognize and enforce the award in Taiwan.

The Taiwanese court dismissed the claimant's application, on the ground that the arbitration documents were not properly served on the respondent and therefore the respondent was deprived of meaningful opportunities to defend its case. Article 74 of the *Act Governing Relations between the People of the Taiwan Area and the Mainland Area* provides that an application can be made to enforce a Mainland arbitral award to the extent that "it is not contrary to the public order or good morals of the Taiwan Area". Article 402(2) of the *Civil Procedure of Taiwan* constitutes such "public order or good morals", which requires that when a default judgment is rendered by a foreign court against the losing defendant, the notice or summons of commencing the action must have been legally served in a reasonable time in the foreign jurisdiction or *through judicial assistance provided under the laws of Taiwan.* Therefore, the Taiwanese court held that a Mainland award adverse to a Taiwanese party can only be enforced when the Taiwanese party has been afforded an adequate opportunity to make its case.

[9] (Taiwan New Taipei District Court 107 Appeal No. 134 Civil Order 台湾新北地方法院 107 年抗字第 134 号民事裁定).

While CIETAC had served respondent in accordance with its arbitration rules at all the addresses of respondent it was aware of, having examined the details of the service process, the Taiwanese court found the service was not in strict compliance with the civil procedural requirements of Taiwan, and therefore the award could not be enforced as the conduct of the arbitral proceedings was in contravention with the laws of Taiwan.

Chinese Investors Commence Treaty Arbitration against Greece

According to IA Reporter, on 27 May 2019, two Chinese investors, Wuxi T. Hertz Technologies Co. Ltd. and Jetion Solar Co. Ltd, submitted a Notice of Arbitration against the Greece government under the bilateral investment treaty between China and Greece ("BIT", effective from 1993). Article 10 of the BIT provides that a dispute between an investor and a host state shall be resolved by UNCITRAL arbitration, with the Secretary General of the International Centre for the Settlement of Investment Disputes acting as the appointing authority.
It is reported that the claims concern the claimants' unsuccessful photovoltaic project in Northern Greece, resulting from the recent political instability and financial crisis in Greece.

CAC Releases Draft Measures for Network Security Review for Public Consultation

On May 24, 2019, the Cybersecurity Administration of China ("CAC") released a draft of the Measures for the Network Security Review for public consultation, which will last till 24 June 2019. The draft was promulgated jointly by 12 government institutions, including the CAC, the National Development and Reform Commission, the Ministry of Industry and Information Technology ("MIIT"), the Ministry of Public Security, and the Ministry of National Security.

The draft measures provide further guidance on network security review in several aspects, including the scope of the security review, the government agencies in charge of the security review, the specific circumstances triggering the review, the key factors to be considered when evaluating the risks to national security, and

specific procedures of the review.

In particular, the draft measures provide that when an infrastructure operator of critical information purchases network products and services, it should conduct an assessment on the potential safety risks and report up for a network security review when certain risky situations are likely to arise. As to transactions under security review, there are also provisions requiring the operator to take legally binding measures (e.g., by express agreement in the contract), ensuring that the other contracting parties cooperate in the review and the contract will not come into force unless the security is cleared.

Upon coming into force, these measures will replace the Measures for the Security Review of Network Products and Services (for Trial Implementation), which became effective on 1 June 2017.

CAC Releases Draft Measures for Data Security Management for Public Consultation

On May 28, 2019, the CAC released a draft of Measures for Data Security Management for public consultation, which will last till 28 June 2019.

The draft measures apply to data-related activities, including data collection, storage, transmission, process and use as well as data protection and monitoring that take place in China. They demonstrate the Chinese government's continuing efforts to curtailing the illegal collection and misappropriation of personal information and important data in the cyberspace.

These measures formulate detailed protocols for the protection of personal information and important data in various stages of data-related activities, including data collection, data processing and utilization as well as data safety monitoring. They also impose specific requirements for certain activities, such as target advertising, disclosing information to a third party and data retention after an App is deleted.

Notably, these measures require network operators to make available to the users a set of clear and easily accessible "rules for data collection and utilization", by way of publications in the privacy policies or in other forms. The collection of personal data can only be conducted when the user gives her informed consent. In addition, these measures specifically prohibit the network operators from forcing or misleading users to give tacit consent by default authorization or function bundling and from discriminating against users who refuse to give consent for data collection.

MIIT Releases Draft Implementation Measures on Key Network Equipment Safety Inspection for Public Consultation

On 4 June 2019, the MIIT published a draft of Implementation Measures on Key Network Equipment Safety Inspection, which is open for public consultation, which will last till 4 July 2019.

These draft measures aim to promulgate specific implementation measures under Article 23 of the *PRC Cybersecurity Law*, which provides that key network equipment and specialized cybersecurity products shall, in accordance with the compulsory requirements of relevant national standards, pass the security test conducted by qualified institutions or meet the requirements of security inspection before it is sold or provided.

The critical network equipment covered by these measures is listed in the Catalog of Critical Network Equipment and Specialized Cybersecurity Products (First Batch) issued jointly by the CAC, the MIIT, the Ministry of Public Security, and the Certification and Accreditation Administration of China in 2017. These measures are applicable to businesses selecting security testing methods for the critical network equipment manufactured by them. The MIIT shall be responsible for coordinating the safety inspection work.

The draft also formulates detailed provisions on the specific process of the safety inspection, the responsibilities and obligations of manufacturers and testing institutions, as well as the supervision and management power of the MIIT.