

China Insight



New Draft for Modernising China's Arbitration Law – Signal for Internationalisation Instead of Decoupling?

Dear Sir or Madam,

Please find below the latest development in Chinese dispute resolution.

Kind regards,
CMS, China

Background

The current *Arbitration Law of the People's Republic of China* (the "**Arbitration Law**") was promulgated in 1994. Except for rather cosmetic amendments made in 2009 and 2017, it has been in force for 26 years nearly unchanged. The Arbitration Law has been gradually exposed to some problems that prevented it from keeping up with the practical needs of international arbitration. Despite the great popularity of arbitration among the Chinese and international business community, there is still a gap between the Chinese and the leading international arbitration institutions. Certain provisions of China's current arbitration legal system are not in line with international standards. Inter alia, the legal nature of arbitration institutions is unclear, disputes over the determination of the effectiveness of arbitration agreements can arise, and controversial cases and problems in the judicial review of arbitral awards emerged. In the Chinese legislator's opinion, this has seriously hindered the internationalisation process and development of arbitration in China. In this context, the Fourth Plenary Session of the 18th CPC Central Committee proposed to improve the arbitration system and the credibility of arbitration. In 2019, the CPC Central Committee and the State Council issued the *Opinions on Improving the Arbitration System and Improving the Credibility of Arbitration*, requiring that the Arbitration Law shall be revised.

New draft Arbitration Law

On 30 July 2021, the Ministry of Justice issued the *Revised Arbitration Law (Draft for Comment)* (the "**Draft**") for public comments by 29 August 2021, which aims to improve the arbitration system and enhance the credibility of arbitration by resolving existing problems in the current Arbitration Law. Among others, the Draft addresses:

1. Overseas arbitration institutions are allowed to set up branch offices

Back in 2015 and 2019, the relevant policies of the State Council had already permitted the establishment of branch offices of foreign arbitration institutions in the Free Trade Zone of Beijing, Shanghai and several other places. Furthermore, the PRC Supreme People's Court and other courts sporadically recognised arbitral awards made by foreign arbitration institutions with the arbitration being staged in China. The PRC courts have started to diverge from the strict application of Article 10 of the current Arbitration Law that only acknowledges Chinese arbitration institutions to administer cases in China. The Draft might further open the door for this practice as it

reflects the Free Trade Zone rules and further allows foreign arbitration institutions to establish branch offices within the whole territory of the PRC and authorises the State Council to formulate the related measures for the registration management of arbitration institutions. However, it is too early to predict which competencies these branch offices will have and if they will be granted with any actual powers to administer cases.

2. Failure to agree on an arbitration institution or unclear agreement does not invalidate the arbitration agreement

Article 16 of the current Arbitration Law stipulates that an arbitration agreement shall be invalid if no explicit arbitration institution is selected. Also, it does not expressly recognise the existence of foreign arbitral institutions. The restriction has been criticised by foreign investors for many years as it limits the parties' choices of arbitral institutions or procedural rules. This article is deleted in the Draft, meaning that if there is no agreement on the arbitration institution, the arbitration agreement will still be valid. An agreed arbitration institution is no longer a prerequisite for the validity of the agreement.

3. Adoption of "seat of arbitration"

The Draft no longer requires a case to be decided by an arbitration institution or "arbitration commission". It recognises ad hoc awards made under the "seat of arbitration" standard, aligning with international arbitration practice (as to ad hoc arbitration in general, see item 5 below). The seat of arbitration has a significant impact on international arbitration, closely related to the nationality, recognition and enforcement of arbitration awards. The revision would eliminate the previous oddity where awards issued in Mainland China under the auspices of a foreign arbitral institution were to be regarded foreign awards under the current Arbitration Law. It is to be expected that in the future they will be regarded PRC awards and can be enforced accordingly on the established basis of enforcement applicable to PRC awards.

4. Interim measures

The Draft entitles the arbitral tribunal to decide on interim reliefs, contrary to current Arbitration Law, which stipulates that the judicial court has an exclusive right to grant interim relief and other injunctions. Under the Draft, the parties may apply to the court or the arbitration tribunal for interim relief. Notwithstanding the above, such interim relief will ultimately be enforced by the courts with their judicial power.

5. Limited recognition of ad hoc arbitration

Ad hoc arbitration is very popular in international arbitration as dispute resolution method under a private agreement. So far, due to China's accession to the New York Convention, foreign ad hoc arbitral awards could be recognised and enforced in China, but domestic ad hoc arbitration was not permitted. Considering the equal treatment of domestic and foreign arbitration, the Draft now recognises ad hoc arbitration. However, the arbitral matters are limited to "foreign-related commercial disputes". This means that for domestic disputes, still no ad-hoc arbitration will be acknowledged. Remarkably, this would fall behind the current legal situation in China's Free Trade Zones which permit arbitration between foreign-invested enterprises in China and, by such, for a sub-category of domestic disputes. According to the *Opinions of the Supreme People's Court on Providing Judicial Safeguard to the Construction of Free Trade Zones*, where enterprises registered in the FTZ have agreed with each other to settle relevant disputes by a specific arbitrator in accordance with the specific arbitration rules at a specific place in Mainland China, the arbitration agreement may be deemed valid. To be at least as progressive as this Free Trade Zone regime, it is to be hoped that the Draft will be further amended during the next round of review.

6. Potential for expanded scope of arbitration

Especially disputes in the field of investor-state and sports had so far not been included in the scope of arbitration in China. Both areas are now not addressed in the Draft either, but referred to in the official statement on the Draft by the PRC Ministry of Justice, saying that coverage of investor-state and sports disputes is to be facilitated by deleting the previous restriction of arbitration to "equal subjects".

The first article in the Draft indeed replaces "equal parties" by "natural persons, legal persons and other organizations", which leaves possibilities for investor-state arbitration. However, the draft does not reveal too much information on this speculation. It is still hard to conclude whether the court would recognise and enforce an arbitrations award made in investor-state disputes. It can be inferred that the attitude of the Chinese government is to support domestic arbitration institutions in accepting investment arbitration cases after many arbitration institutions in China had issued their arbitration rules for investor-state arbitration in recent years. As the law with the highest hierarchy to regulate arbitration matters, it would be reasonable that the Arbitration Law was to be changed to reflect this trend.

Shortcomings

The reformed competence-competence mechanism still gives the judicial department, the court, in particular, the right to ultimately decide on the arbitrability of the case and jurisdiction of an arbitral tribunal. A party can apply to the intermediate court to review an arbitral decision on jurisdiction and arbitrability. Furthermore, ad hoc arbitration under the Draft only applies to foreign-related cases, which would create more incompatibilities of the enforcement system between domestic and foreign arbitration and would fall behind the current status in the Free Trade Zones, as explained in item 5 of the previous paragraph. Also, the judicial department has a filing requirement for ad hoc arbitration awards, including the status of a case and information of the award. The strict supervision of ad hoc arbitration may incur unnecessary exposure of the information of the parties and their case, which is contrary to the confidential principle of arbitration.

Conclusion and outlook

The changes proposed in the Draft, in particular, the change on allowing overseas arbitration institutions to set up branch offices (although based on the current Draft, it is unclear whether such branches will be granted with any actual powers to administer cases) and the adoption of “seat of arbitration” concept are very positive signals to show that China’s law makers have the intention to change the landscape of arbitration environment in China, and to develop gradually into seat that is more friendly to international arbitrations. This would indeed be a signal for more internationalisation rather than decoupling. If the Draft can be implemented with the few above-mentioned suggestions for improvement, and with the adoption of further rules setting out the implementation details on the changes, we predict it will have significant positive impact on China’s reputation in the international arbitration area.

Meanwhile, the authorities are also working on the other aspects to guide ongoing arbitration cases. The Draft may take a while to be implemented since some amendments are controversial. Also, there might be a second draft seeking another round of opinions. Or, if everything goes on well with this version, this Draft will be submitted to the Standing Committee of the National People’s Congress for further discussion, which may take another few months in the best scenario.

In case you have questions or for further information, please contact the authors of this newsletter:



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