More pro-arbitration measures in China for foreign investors

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The PRC Supreme People's Court recently announced changes promoting arbitration between companies incorporated in pilot free trade zones:

- wholly foreign owned enterprises incorporated in pilot free trade zones can now submit commercial disputes to foreign arbitration; and
- here is a possibility that China is opening the door to *ad hoc* arbitration.

These changes, issued on 30 December 2016 in the *Opinions on Provision of Judicial Safeguards to the Development of Pilot Free Trade Zones* (Fa Fa [2016] No. 34) ("**Opinions**"), are major pro-arbitration changes to promote business in China's free trade zones.

Development of the "foreign element" rule

Under the PRC law, a contract is foreign-related only if the contract contains a "foreign element" in at least one of the following aspects: nationality of the parties, habitual residence of the parties, subject matter of the contract, legal facts leading to establishment, change or termination of the contract, as well as other circumstances which a people's court may deem as a "foreign element".

The importance of the "foreign element" rule under the PRC law is indicated in the choice of the seat of arbitration, given that a dispute in connection with a contract without a "foreign element" may not be submitted to arbitration seated in a foreign jurisdiction. (See the SPC's Reply in *Zhaolai Xinsheng* [2013] Min Si Ta Zi No. 64.)

Change happened in the case of *Siemens v. Golden Landmark* ([2013] Hu Yi Zhong Min Ren [Wai Zhong] Zi No.2), whereby the No. 1 Intermediate People's Court of Shanghai Municipality innovatively upheld the "foreign element" in a contract based on, inter alia, the fact that the parties of the contract are two wholly foreign owned enterprises ("**WFOE**") incorporated in the Shanghai Pilot Free Trade Zone, even though the conventional thinking is that a WFOE in itself does not constitute a "foreign element". Nonetheless, given that PRC court judgments do not have binding effect on other PRC courts, it was not clear at the time whether other PRC courts would adopt a similar approach.

With the promulgation of the Opinions in December 2016, Article 9 of the Opinions clarified that

an "*arbitration agreement concluded between WFOEs incorporated in a pilot free trade zone submitting a commercial dispute to foreign arbitration should not be held as invalid solely based on lack of foreign element of the dispute*", thereby confirming the interpretation in *Siemens v. Golden Landmark* in the form of a judicial document.

Ad hoc arbitration in China possible

Under the PRC Arbitration Law, a designated arbitration commission is one of the mandatory requirements for a valid arbitration agreement. As a result, *ad hoc* arbitration is not permitted in China.

The Opinions in Article 9 provide that an "*arbitration agreement between companies incorporated in a pilot free trade zone submitting a relevant dispute to arbitration conducted at a specific place in the mainland, through specific arbitration rules, and by specific personnel may be held as valid*." Given that the designated arbitration commission is not required under this article, there are certain voices in the Chinese arbitration community suggesting that such article may be interpreted as China's attempt to open the door to *ad hoc* arbitration.

Nonetheless, given that Article 9 does not go into details for some issues such as the scope of the "*specific arbitration rules*" as well as the potential conflict between Article 9 and the mandatory requirement regarding designated arbitration commission under the PRC Arbitration Law, clarification may be needed for future application of Article 9, and its impact on *ad hoc* arbitration in China still remains to be seen.

For the full text of the Opinions (in Chinese), please **click here**.

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