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Arbitrating Chinese Disputes Abroad: A Changing Tide?

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Under Chinese law, disputes may only be submitted to arbitration outside China and/or under the auspices of foreign arbitral institutions if the dispute is "foreign related."[1] Historically, the Chinese courts have interpreted this requirement narrowly, and they have declined to find that the dispute is "foreign related" if both parties are registered in China, the subject matter of the agreement is in China, and the contract is concluded and performed in China. The "foreign element" requirement therefore has had practical ramifications for foreign businesses operating in China through locally registered subsidiaries, because any disputes arising out of local Chinese contracts between those local Chinese subsidiaries and another Chinese company must be submitted to arbitration in China.

However, two recent cases in the Beijing and Shanghai intermediate courts suggest that the tide may be turning, and Chinese courts may now be taking a more expansive approach towards determining whether a dispute is "foreign related."

The "Foreign Related" Requirement

Under Article 128 of the PRC Contract Law (stating that "parties to a foreign-related contract may, according to the arbitration agreement, apply to a Chinese arbitration institution or any other arbitration institution for arbitration") and Article 271 of the Civil Procedure Law (providing that where (1) any dispute arises out of foreign economic relations and trade or foreign-related transport and maritime activities, and (2) if the parties have agreed to arbitrate at a PRC arbitral institution or at any other arbitral institution, an action may not be brought before a PRC court), only disputes arising out of foreign-related contracts or foreign-related economic relations or trade may be submitted to foreign arbitration.

The Supreme People's Court ("SPC") has promulgated several interpretations clarifying the definition of "foreign related," including the Opinions of the Supreme People's Court on Several Issues concerning the Implementation of the General Principles of the Civil Law of the People's Republic of China (1988) (the "1988 Opinions")[2], the Opinions of the Supreme People's Court on Several Issues Concerning the Application of the Civil Procedure Law of the PRC (1992) (the "1992

Opinions")[3], the Interpretations of the Supreme People's Court on Several Issues Concerning Application of the Law of the PRC on Choice of Law for Foreign-Related Civil Relationships (2012) (the "2012 Interpretations") [4] and the Interpretation of the Supreme People's Court on the Application of the Civil Procedural Law of the PRC (2015) (the "2015 Interpretation")[5].

In sum, these interpretations and opinions provide that a dispute is "foreign-related" where: (a) one or more parties are foreign citizens or foreign legal persons, (b) the subject matter of the dispute is located in a foreign country, (c) the facts which create, modify or terminate the right or obligation occurred in a foreign country, (d) the habitual residence of one or more parties is located outside China, or (e) other circumstances exist that can constitute a foreign-related element.

The Historical Approach

Consistent with the statutory requirements, in determining whether a dispute is "foreign related," the Chinese courts have historically considered only (1) whether the parties were foreign entities, (2) where the subject matter of the contract was located, and (3) where the contract was concluded and/or performed.

For example, in *Jiangsu HangTianWanYuan Wind Power Manufacturing Co. Ltd v. LM Wind Power*, Supreme People's Court (2012), the SPC examined a Purchase Agreement for wind turbines entered into by a domestic joint venture company and a wholly owned foreign enterprise. The dispute resolution clause in that agreement provided that any disputes should be resolved through amicable negotiation, and if the dispute was not resolved through amicable negotiation within 90 days, then the dispute would be submitted to ICC arbitration in Beijing.

The SPC applied Article 178 of the 1988 Opinions and held that the arbitration agreement was invalid because the dispute was not "foreign related" where (1) the parties were both domestic legal persons, (2) the subject matter of the agreement was located in China, and (3) the agreement was entered into and performed in China.

The SPC went one step further in *Beijing Chaolaixinsheng Sports and Leisure Co. Ltd v. Beijing Suowangzhixin Investment Consulting Co. Ltd*, Supreme People's Court (2014), in which it confirmed for the first time that an arbitral award rendered by a foreign arbitral institution is unenforceable if the dispute is not foreign-related. That case involved a contract to operate a golf course in Beijing concluded between a Chinese company and a wholly foreign-owned enterprise that was registered in Beijing but owned by a Korean citizen. The arbitration clause in the contract provided that the parties shall seek to settle any disputes through amicable negotiation, and if that failed, the disputes should be submitted to the Korean Commercial Arbitration Board (KCAB) for arbitration. The dispute was submitted to the KCAB, which rendered an award. The applicant sought to enforce the award in the Chinese courts.

The SPC held that the arbitration clause was invalid, and rejected recognition and enforcement of the award. In reaching this decision, it applied Article 128 of the PRC Contract Law, Article 271 of the PRC Civil Procedure Law and Article 304 of the 1992

Opinions, concluding that there were no foreign elements in the contract because (1) the subject matter of the dispute was located in China, (2) the contract was concluded and performed in China, and (3) both parties (including the wholly foreign-owned enterprise) were registered in China, and were therefore both Chinese legal persons.

More recently, the Shanghai No. 2 Intermediate People's Court[6] and the Hebei Province Higher People's Court[7] have taken similar approaches in their analysis of "foreign elements," concluding that the disputes were not foreign-related because both parties are legally registered in China and the subject matter and performance of the contract is in China.

Recent Developments

In two recent cases, the Chinese courts have taken a more expansive approach, finding that "foreign elements" existed even when there did not appear to be any foreign elements at first blush.

In *Ningbo Xinhui v. Meikang Int'l*, Beijing No. 4 Intermediate People's Court (2015), the court considered a contract for the sale of goods through the Shanghai Free Trade Zone ("FTZ"). The dispute was originally submitted to CIETAC as a domestic arbitration, but during the hearings the tribunal held that this was an arbitration with foreign elements, and therefore the special procedures for setting aside foreign arbitrations should apply. After the tribunal made its decision, Xinhui applied to the Beijing No. 4 Intermediate People's Court to set aside the award, and the court held that it had to determine whether the case was foreign-related to determine whether the special set-aside procedure for foreign arbitration should apply in this case.

The court applied Article 304 of the 1992 Opinions and held that the case was foreign related because under the applicable customs laws, all goods pending clearance in the FTZ should be considered foreign goods. The court therefore concluded that the special procedure for setting aside foreign arbitral awards should apply.

Even more noteworthy is the *Shanghai Golden Landmark Co. Ltd v. Siemens International Trade Co. Ltd*, Shanghai No. 1 Intermediate People's Court (2015), which was the first instance of a Chinese court exercising its discretion to find foreign elements in "other circumstances." Shanghai Golden Landmark involved a contract for the sale and purchase of equipment between two wholly foreign-owned entities registered in China. That contract contained an arbitration agreement specifying that disputes should be submitted to arbitration before the Singapore International Arbitration Center (SIAC). The dispute was submitted to SIAC arbitration and an award was rendered awarding damages to the seller. The seller applied for recognition and enforcement of the award in the Chinese courts, and the buyer resisted arguing that the dispute had no "foreign element."

The Shanghai No. 1 Intermediate People's Court held that the arbitration agreement was valid and recognized the award. The court reasoned that even though the dispute did not contain any foreign elements prima facie, the nature of the contract and the process of contractual performance as a whole suggested this was a foreign-related

contract, for two reasons:

– The parties to the contract were foreign-related because despite being registered in China (and thus being Chinese legal persons), the parties are both wholly foreign owned entities registered within the Shanghai FTZ. The court noted that there is a significant distinction between the parties to the contract and other domestic entities because the wholly foreign owned entities' sources of capital are foreign; the ultimate beneficiary is foreign; and management and control are significantly related to foreign investors. The court further noted that additional weight should be placed on these factors taking into account the policy of promoting trade and investment within the FTZ.

– The performance of the contract is foreign-related because although the ultimate destination of the goods is within China, the process of transporting the goods that are the subject of the contract has certain characteristics similar to the international sale of goods (namely, the goods enter the FTZ, customs fees are paid, then the goods are transported outside the FTZ and delivered to the buyer). The court thus concluded that the performance of the contract can be distinguished from the performance of domestic sale of goods contracts because it involves the use of the special customs regulatory procedure within the FTZ.

On the basis of the above, the Shanghai court concluded that this dispute fell within the "other circumstances" prong of Article 1 of the 2012 Interpretations.

Future Implications

The *Ningbo* and *Shanghai Golden Landmark* cases have been hailed by some commentators as a significant shift by Chinese courts towards a broader interpretation of "foreign elements." This may indeed be the case, particularly given that *Shanghai Golden Landmark* has set the precedent for other courts to exercise their statutory discretion to find foreign elements under "other circumstances."

Moreover, the finding in *Shanghai Golden Landmark* that the parties were foreign-related (even though they were both registered in China) was also a notable departure from prior case law that suggests the Chinese courts may be prepared to adopt a broader approach going forward. As discussed above, prior to *Shanghai Golden Landmark*, the courts in *HangTianWanYuan Wind Power Manufacturing* and *Beijing Chaolaixinsheng* examined contracts involving wholly foreign-owned, local Chinese-registered companies, but concluded that both parties were domestic Chinese businesses because they were registered in China. The court in *Shanghai Golden Landmark* departed from this simplistic analysis by examining the sources of capital, beneficiaries and control of the local Chinese-registered entity, suggesting that the Chinese courts may now be willing to find foreign elements even with contracts between two local Chinese-registered businesses, if any of the local businesses are funded or controlled by foreign entities.[8)]

However, the unique factual circumstances of *Ningbo* and *Shanghai Golden Landmark* may limit the scope of their impact. Both *Ningbo* and *Shanghai Golden Landmark* involved contracts for the sale of goods through the Shanghai FTZ, and in both cases,

the courts relied on the treatment of the goods under the special customs laws applicable within the FTZ in holding that contractual performance was "foreign-related." The holding of both cases therefore appears to be limited to contracts relating to FTZs with their own special customs laws.

References

↑1 Chinese arbitration law adopts a two-track approach, applying different rules to domestic arbitrations and "foreign" or "international" arbitrations. This is consistent with the New York Convention and most national arbitration legislation. See Gary B. Born, *International Arbitration: Law and Practice* at pp. 51, 377-380 (Kluwer 2nd ed. 2015).

↑2 1988 Opinions, Article 178 (providing that "a foreign-related legal relationship is where: (1) one party or both parties are foreign nationals, stateless persons, or foreign legal persons; (2) the subject matter of the dispute is located in a foreign country, or (3) the legal facts which create, modify or terminate a right or obligation occurred in a foreign country.").

↑3 1992 Opinions, Article 304 (providing that a civil case is "foreign related" where (1) either contracting party is a foreign citizen, enterprise or organization; (2) the facts that trigger, change, or terminate the civil relationship takes place outside PRC territory, or (3) the subject-matter is located outside PRC territory.).

↑4 2012 Interpretations, Article 1 ("Where a civil relationship falls under any of the following circumstances, the people's court may determine it as foreign-related civil relationship: (1) Where either party or both parties are foreign citizens, foreign legal persons or other organizations or stateless persons; (2) Where the habitual residence of either party or both parties is located outside the territory of the People's Republic of China; (3) Where the subject matter is outside the territory of the People's Republic of China; (4) Where the legal facts that lead to the establishment, change or termination of the civil relationship happens outside the territory of the People's Republic of China; or (5) Other circumstances under which the civil relationship may be determined as foreign-related civil relationship.").

↑5 2015 Interpretation, Article 522 (providing that a civil case is "foreign related" where (1) either contracting party is a foreign citizen, enterprise or organization; (2) the facts that trigger, change, or terminate the civil relationship takes place outside PRC territory, (3) the subject-matter is located outside PRC territory, (4) the habitual residence of either or both contracting parties is located outside PRC territory, and/or (5) there exist 'other circumstances' that can constitute a foreign-related element).

↑6 See *Shanghai Kejiang IT Co. Ltd v. Fanstang Consultant Co. Ltd*, Shanghai No. 2 Intermediate People's Court (2014) (holding that an arbitration clause stipulating that disputes were to be submitted to HKIAC arbitration was invalid because there were no foreign elements where both parties to the contract were legal persons registered in Shanghai, and the subject matter of the contract was in China).

↑7 See *Meilv Aluminium Co. Ltd v. Inner Mongolia Aluminium Slab Co. Ltd*, Hebei Province Higher People's Court (2015) (holding that an arbitration agreement providing that disputes should be submitted to ICC arbitration in Hong Kong was invalid because both parties are registered in China and are Chinese legal persons, the subject of the agreement was manufactured and transported within China, and the performance of the contract was within China).

↑8 However, the court in *Shanghai Golden Landmark* was careful to note that additional weight was placed on these factors "taking into account of the policy of promoting trade and investment within the FTZ." The court therefore arguably limited this holding to the FTZ context.