Uncertainty in How PRC Courts Deal with Challenges to Validity of Arbitration Agreements

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Introduction

Parties to international commercial transactions not infrequently find themselves in disputes over whether a valid arbitration agreement exists between them or whether a court or an arbitral tribunal has the jurisdiction to hear this issue. These situations are especially perplexing because – despite the general international acceptance of the "*kompetenz-kompetenz*" doctrine – national laws and court practices do not always lead to predictable outcomes.

Different jurisdictions address this issue differently. In certain jurisdictions like England, the courts would generally refuse to determine the existence of a disputed arbitration agreement prior to the commencement of arbitration proceedings.[fn]*See, e.g.*, *HC Trading Malta Ltd v Tradeland Commodities S.L.* [2016] EWHC 1279 (Comm).[/fn]

In the People's Republic of China ("**PRC**"), this is less clear. PRC courts have adopted inconsistent approaches and it is hard to highlight a modern trend. Some PRC courts have held that the existence of an arbitration agreement is part of the question of validity and hence within the court's jurisdiction,[fn]*See, e.g.*, Wuhan Maritime Court's ruling (2018) E 72 Min Te No. 29.[/fn] while other PRC courts have referred these questions to the arbitral tribunal.[fn]*See, e.g.*, Guangzhou Intermediate People's Court's ruling (2018) Yue 01 Min Te No. 603.[/fn] This is further complicated by the unique reporting mechanism where courts' rulings against the "validity" of an arbitration agreement are required to be submitted to the Supreme People's Court of the PRC ("**SPC**") for approval, which can take years.[fn]In December 2017, SPC issued two long-awaited judicial interpretations ("SPC Interpretation [2017] No. 21" and "SPC Interpretation [2017] No. 22"), effective on 1 January 2018, to regulate the judicial review procedures and the reporting mechanism for arbitration. The reporting mechanism requires the lower courts – normally tasked with considering arbitral awards at first instance – to gain approval from higher people's courts, then the Supreme People's Court, before refusing enforcement of a foreign or foreign-related arbitral award or arbitration agreement, and in certain circumstances, a similar duty in arbitrations of a purely domestic nature.[/fn]

Do PRC courts have jurisdiction over the existence of an arbitration agreement? An application of the *kompetenz-kompetenz* doctrine.

It is established practice in the PRC that courts have jurisdiction to hear a party's challenge to, or application for verifying, the "*validity of an arbitration agreement*".[fn]*See* SPC Interpretation [2017] No. 21 and SPC Interpretation [2017] No. 22. *See also* Article 20 of the PRC Arbitration Law where a party is entitled to challenge the validity of an arbitration agreement before either arbitrators or the PRC courts.[/fn]

But what if the existence of the arbitration agreement is in doubt – for example, could a party argue that it was not a signatory to the arbitration agreement or that the arbitration agreement was fraudulently obtained? Would these grounds "invalidate" an arbitration agreement? To these questions, neither the PRC Arbitration Law nor any SPC Interpretation gives a clear-cut answer, and the PRC courts' practice remains divided.

1. Refusing to take jurisdiction

Some PRC courts have refused to rule on the issue of the existence of an arbitration agreement.[fn]*See* Beijing No. 2 Intermediate People's Court's ruling (2017) Jing 02 Min Te No. 97.[/fn] These courts characterize this as a substantive issue which is best decided by arbitrators themselves, *whereas* courts' jurisdiction is limited to merely issues of "formality" only.[fn]*See* Beijing No. 2 Intermediate People's Court's ruling (2017) Jing 02 Min Te No. 97, Guangzhou Intermediate People's Court's ruling (2018) Yue 01 Min Te No. 603.[/fn] Additionally, as reasoned by at least one PRC court, non-existence of an arbitration agreement is a ground for refusing enforcement of the award under Article 58 of the PRC Arbitration Law so this question should be decided at the enforcement stage.[fn]*See* Beijing No. 4 Intermediate People's Court's ruling (2016) Si Zhong Min (Shang) Te Zi No. 327.[/fn]

Notably, these PRC courts, in refusing to exercise jurisdiction, did not always consider the *kompetenz-kompetenz* principle or the intent of the parties to resolve disputes through arbitration. Instead, "arbitrability" was considered as a matter of PRC law, and in particular, as a question of whether the "existence" of an arbitration agreement was within the scope of the meaning of "validity" as defined under Article 20 of the PRC Arbitration Law.

For example, in *Shenzhen Green Power*,[fn]*See* Beijing No. 2 Intermediate People's Court's ruling (2017) Jing 02 Min Te No. 97.[/fn] the Beijing No. 2 Intermediate People's Court dismissed the application to hold the arbitration agreement invalid. The alleged agreement was contained in a unilaterally prepared letter of guarantee. Shenzhen Green Power argued that courts have jurisdiction over the issue of existence because "existence" is a precondition to a "valid" arbitration agreement, which shall be decided by the court under Article 20 of the PRC Arbitration Law. In referring the parties to arbitration, the Court held that, *inter alia*, the existence of an arbitration agreement does not concern the "formality" or the "validity" of an arbitration agreement.

2. Taking jurisdiction

Other PRC courts have adopted a different position and chose to treat the existence of an arbitration agreement as completely within the court's jurisdiction. Among these decisions, there are generally two lines of reasoning.

First, a few courts have found in favor of jurisdiction because the question of existence is essentially within the scope of the "validity of an arbitration agreement" and thus within the court's jurisdiction.[fn]*See, e.g.,* Wuhan Maritime Court's ruling (2018) E 72 Min Te No. 29.[/fn]

It appears, however, that wherever the courts treat the existence of an arbitration agreement within the scope of the question of "validity," they are required to report rulings against the existence of an

arbitration agreement to the Higher People's Courts and the SPC. In the SPC's words, as stated in its review of a ruling against the existence of an arbitration agreement by the Changsha Intermediate People's Court and the Hunan Higher People's Court:[fn]*The SPC's Reply to Hunan Provincial Higher People's Court concerning the case of confirming the validity of arbitration agreement among the claimants, Hunan Provincial People's Government and Hunan Provincial Department of Transportation, and the respondents, Kaixuan International Investment (Macau) Co., Ltd., and Hunan Kaixuan Changtan West Line Expressway Co., Ltd.* ([2016] SPC Min Ta No.70).[/fn]

> "The claimants in this case requested the court to confirm whether the arbitration agreement is binding on the parties. For such cases, the court shall accept them as cases concerning the validity of the arbitration agreement."

Although not always obvious to foreign parties, rulings by PRC courts on the existence of arbitration agreements may have significant implications. This is especially in light of and complicated by the reporting mechanism: if an Intermediate People's Court takes the initial view that a foreign or foreign-related arbitration agreement is invalid, it must report its decision to the relevant Higher People's Court and –in the case where the Higher People's Court maintains the lower court's finding – the SPC for review and approval. The reporting mechanism is perceived internationally as a measure adopted in the PRC legal system to favour international arbitration and to minimize any potential inconsistencies in the courts' approaches towards international arbitration. In other words, if a ruling against the existence of an arbitration agreement is reported, the SPC will have the final control over this matter and, arguably, any arbitrary denial of the parties' rights to an arbitration will be overturned and corrected by the SPC.

Second, and on the other hand, a few other courts have bypassed the aforesaid question but chose to directly exercise jurisdiction over the parties' arbitration agreement.[fn]*See, e.g.,* Qingdao Maritime Court's ruling (2004) Qing Hai Fa Hai Shang Chu Zi No. 245, Guangzhou Maritime Court's Ruling (2004) Guang Hai Fa Ta Zi No. 1.[/fn] In such cases, it does not always invoke the reporting mechanism.

As relevant here, if a PRC court exercises its jurisdiction and determines that no arbitration agreement exists between the parties (as opposed to finding an agreement invalid), will this court be expected to report to the Higher People's Court and/or the SPC for approval? It seems that the answer is in the affirmative.

In *Chongqing Xinpei Food Co Ltd*,[fn]*The SPC's Reply in the case Chongqing Xinpei Food Co Ltd v Strength Shipping Corporation, Liberia* ([2006] Min Si Ta Zi No. 26).[/fn] the Wuhan Maritime Court denied existence of an arbitration agreement and chose to not report its ruling for approval. This case concerned a dispute where the parties disagreed on whether a charter party arbitration agreement was incorporated into their bills of lading. The foreign party in this case then appealed to the Hubei Higher People's Court, who then reported this ruling to the SPC. Although the SPC eventually refused to find that an arbitration agreement existed between the parties, the SPC found this case to be one concerning the validity of a foreign-related arbitration clause and criticized Wuhan Maritime Court for its failure to invoke the reporting mechanism.

Upcoming changes?

It is yet to be seen whether the question of arbitrability will be clarified under the PRC law in the immediate future. As is the case with many jurisdictions, PRC courts may remain divided as to this sub-question of arbitrability.

While there may be no formal change to the law, the current trend appears to suggest that PRC courts that choose to exercise jurisdiction over the existence of an arbitration agreement will report their rulings for approval if they decide that no arbitration agreement exists in a foreign-related dispute. We note, for example, that since the SPC expressed its criticisms on the Wuhan Maritime Court in *Chongqing Xinpei Food Co Ltd*, all rulings by the PRC maritime courts on the same issue and to the same effect appear to have been reported to the SPC for approval. While the SPC's replies in individual cases do not bind lower courts, more and more lower courts are invoking the reporting mechanism when they render their rulings against the existence of arbitration agreements. This is irrespective of whether these courts explicitly characterize the issue of existence as a sub-issue of the validity of an arbitration agreement. This practice has been encouraged and arguably has been confirmed by the SPC in its interpretations.[fn]See Article 7 of the *Relevant Provisions of the Supreme People's Court on Issues concerning Applications for Verification of Arbitration Cases under Judicial Review* (SPC Interpretation [2017] No. 21). In its SPC Interpretation [2017] No. 21, the SPC makes it clear that if (1) a people's court renders a ruling on an objection to jurisdiction in civil action cases; (2) the case involves the validity of an arbitration agreement; (3) a party refuses to accept the ruling and appeals; and (4) the people's court of second instance *determines that the arbitration agreement does not exist,* then the people's court of second instance shall report the ruling to the higher people's court within the jurisdiction. If the higher people's court approves the lower's court's ruling, it must report to the SPC. Note, however, that the provision on the scope of the applications for verification of arbitration agreements (Article 1 of the SPC Interpretation [2017] No. 21) does not explicitly include the question of the existence of an arbitration agreement.[/fn]