Xiamen Maritime Court in China Looks at Disputes with No “Foreign-related Element”

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In the case of *ZL Offshore [translation] (“ZL”) v PICC P&C Shipping Insurance Operation Centre [translation] (the “Operation Centre”) and PICC P&C Zhoushan City Branch [translation] (the “Zhoushan Branch”)* pronounced on 20 March 2019 (2019 Min 72 Min Chu 149), the Xiamen Maritime Court (the “Court”) of People’s Republic of China dismissed the challenge against its jurisdiction by the Operation Centre. The case serves as another example on how Chinese courts deal with disputes identified as containing no “foreign-related element”.

Background

At the end of 2017, ZL brought both the Operation Centre and the Zhoushan Branch before the Court in an insurance claim dispute due to an accident in Fujian (the “Accident”). The Accident involved a tugboat named Zheng Li 18000 which was owned by ZL. ZL claimed against the 2 defendants for damages of 1 million CNY and legal costs of 0.66 million CNY among other things.

The Operation Centre raised a challenge to jurisdiction against the Court when filling its defence. The Operation Centre argued that the agreement entered into between ZL and itself (the “Agreement”) incorporated the 2017 Rules of Classes 1 & 2 of the West of England Ship Owners Mutual Insurance Association (Luxembourg) (the “Rules”) and section 57 of the Rules[fn]Section 57 of the 2017 Rules of Classes 1 & 2 of the West of England Ship Owners Mutual Insurance Association.[/fn] provides for either litigation at the High Court of Justice of England and Wales or arbitration by a sole arbitrator in London.

The Court therefore was asked to consider whether it should stay the proceeding.

The Court’s Reasoning and Decision

The Court noted the incorporation of the Rules in the Agreement and also reviewed the parties’ right to choose a forum under Article 531 of the Interpretation of the Supreme People’s Court on the Application of the Civil Procedure Law of the People’s Republic of China (the “Interpretation”), which says:[fn]Section 57 of the 2017 Rules of Classes 1 & 2 of the West of England Ship Owners Mutual Insurance Association.[/fn]

> *Parties to a dispute over a foreign-related contract, or whose rights and interests in property involve foreigners or foreign affairs, can select a foreign court that has an actual connection with the dispute such as the domicile of the defendant, the place where the contract is performed or signed, the domicile of the plaintiff, the place of the subject matter, and the place where an infringement occurs. [translation]*

The Court then looked at Article 522[fn]Article 522 of the Interpretation of the Supreme People's Court on the Application of the Civil Procedure Law of the People's Republic of China.[/fn] of the Interpretation, which serves as the test on whether the dispute is over a foreign-related contract or the rights and interests in property which involve foreigners or foreign affairs (*i.e*. whether it contains "foreign-related element"), and therefore serves also as a condition on whether Article 531 applies. It says:[fn]Ibid. iii.[/fn]

> *The People's Court can determine a civil case as one involving foreigners or foreign affairs in any of the following situations: (1) One or both parties concerned are foreigners, stateless persons, foreign enterprises or organisations; (2) The habitual residence of one or both parties concerned is outside the territory of the People's Republic of China; (3) The subject matter is outside the territory of the People's Republic of China; (4) The underlying facts which create, modify or extinguish the civil legal relationship between parties arise outside the territory of the People's Republic of China; or (5) Any other circumstances that might deem the legal relationship as involving foreigners or foreign affairs [the catch-all provision].[translation]*

In the case before it, the Court observed that the dispute was between Chinese parties only; the domiciles of the parties and the subject matter were all within the Chinese mainland territory; and the Agreement was entered into and the accident took place in the Chinese mainland territory. Also, there was no evidence of any foreign-related element in the dispute *i.e*., the "catch-all provision" does not apply. Therefore, the parties were not entitled to rely on Article 531 to agree to submit their disputes to a foreign court or foreign-seated arbitration. The incorporation of litigation/arbitration in London was therefore invalid.

After concluding that the arbitration agreement was invalid, the Court then looked at the Provisions of the Supreme People's Court on the Scope of Cases Accepted by Maritime Courts[fn]the Supreme People's Court on the Scope of Cases Accepted by Maritime Courts.[/fn] to select an appropriate court for this case. By relying on those provisions the Court held that the case shall be exclusively administered by a maritime court since it is a dispute out of an agreement which was, in nature, a marine insurance contract. Further, as the Accident took place in Fujian adjacent sea area, the Court then applied Article 6(2)(iv) of the Law of the People's Republic of China on Maritime Procedures[fn]Article 6(2)(iv) of the Law of the People's Republic of China on Maritime Procedures.[/fn] which provided that the Court, which is adjacent to place of accident, among others, shall have jurisdiction over the case.

Observations

Similar to this case, multiple cases through recent years have been heard in Chinese courts and the courts found foreign institutional and ad-hoc arbitration agreement to be invalid if the contract, which incorporates the arbitration agreement, contains no foreign-related element.

In its (2014) *Hu 2 Min Zhong Ren (Zhong Xie) No.13 Ruling*, Shanghai No. 2 Intermediate People's Court confirmed that an arbitration agreement for arbitration at HKIAC was invalid given the contract in dispute had no Hong Kong-related element. Similar conclusions were reached in the following cases: *Jiangsu Aerospace Wanyuan Wind Power Equipment Manufacturing Co., Ltd. v LM Wind Energy Blade Products (Tianjin) Co., Ltd. (ICC)* [arbitration agreement invalid due to absence of foreign-related element][fn]Jiangsu Aerospace Wanyuan Wind Power Equipment Manufacturing Co., Ltd. v LM Wind Energy Blade Products (Tianjin) Co., Ltd. (ICC).[/fn]; *Alcoa v Huo Mei Hong Jun Aluminium Slab Ji Li Min Zhong Zi No.7 (ICC)* [Alcoa subsidiary incorporated in the PRC not treated as foreign-related; dispute within jurisdiction of the Intermediate People's Court under the Civil Procedure Law of the PRC][fn]Alcoa v Huo Mei Hong Jun Aluminium Slab Ji Li Min Zhong Zi No.7 (ICC).[/fn]; *Beijing Chaolai Xinsheng Sports Co., Ltd v Beijing Zhizhixin Investment Consulting Co., Ltd. (KCAB)* [arbitral award not recognized due to absence of foreign-related element, and Article V(1)(a) of the New York Convention applied][fn]Beijing Chaolai Xinsheng Sports Co., Ltd v Beijing Zhizhixin Investment Consulting Co., Ltd. (KCAB).[/fn].

It is worth noting, however, the Chinese courts' judicial thinking on this in two particular cases.

The first is the famous Golden Landmark case, in which the Shanghai No.1 Intermediate People's Court considered whether there were any "*other circumstances that might cause the legal relationship to be regarded as 'foreign-related'*". The court held that there were, as the parties were both wholly foreign owned enterprises, and they had both been incorporated in the Shanghai Waigaoqiao Bonded Zone, which formed part of the China (Shanghai) Pilot Free Trade Zone. By recognising the case of foreign-related nature, the court recognised and enforced an SIAC award. Following that, on 30 December 2016, Chinese Supreme People's Court issued a Notice entitled "Supreme People's Court Opinion on the Provision of Judicial Safeguards for the Construction of Pilot Free Trade Zones", aiming at strengthening judicial support for the development of pilot free trade zones in China (the "Notice"). The Notice allows, among other things, companies incorporated in the Shanghai Free Trade Zone, in certain circumstances, to agree to arbitrate disputes among themselves outside Chinese mainland.

Similar to the Golden Landmark case, Shanghai Maritime Court in its recent (2017) *Hu 72 Min Te 181 Civil Ruling*, recognised that the matter involved "*other circumstances that might lead to the legal relationship being regarded as 'foreign-related'*". Shanghai Maritime Court took into consideration that the vessel under the disputed ship-building contract was being built under the relevant standards/rules of American Bureau of Shipping ("ABS") and was intended to join ABS after completion. The ship-building contract also stated the vessel shall be in compliance with laws and regulations of Marshall Islands and carry the flag of the same. In addition, in a related MOU between the disputant parties, it was agreed that the purchaser was to assign its rights and obligations of the ship-building contract to a subsidiary offshore before delivery of the vessel. Therefore, the LMAA arbitration clause contained in the ship-building contract was considered valid.

Conclusion

The decision of *ZL* case affirms the invalidity of any arbitration agreement or arbitral award concerning disputes which lack any foreign-related element. Parties who choose to proceed with arbitration in a foreign jurisdiction, should make sure that at least one of the following conditions is met if they expect to enforce the arbitral award in China:[fn]Article 304 of the Opinions on Issues Relating to Application of the PRC Civil Procedure Law.[/fn]

1. either or both parties are foreigners, stateless persons, foreign enterprises or organisations, or

persons who habitually reside outside China;
2. the establishment, alteration or termination of the legal relationship between the two parties occurs outside China; and/or
3. the subject-matter of the dispute is outside China.

If none of the conditions exist, the parties should consider domestic arbitration or court litigation in the Chinese mainland. There remains a risk the “catch-all provision” would apply if they proceed to arbitrate in a foreign forum.