Chinese Court's New Approach to Interpreting the Validity of a Pathological Foreign-Related Arbitration Clause

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Xu Zhihe, Li Tingwei (Shanghai International Arbitration Center)

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Under China's arbitration regime for foreign-related arbitration and international arbitration, the concept of a juridical seat is a statutory juncture where, in cases with no express agreement on the applicable law between the parties, Chinese courts must determine the applicable law (statutory text is available in Chinese here and unofficial English translation here).[fn] See Article 18 of the Law on the Application of Laws to Foreign-Related Civil Relations of the PRC. This Article reads: "*The parties may by agreement choose the law applicable to their arbitration agreement. Absent any choice by the parties, the law of the place where the arbitration institution locates or the law of the seat of the arbitration shall be applied*".[/fn]

Recently, in the case of China Light Tri-union Int'l Co., Ltd. ("Plaintiff") v Tata International Metals (Asia) Limited ("Defendant") (2017 Jing Min 04 Min Te No. 25), the Beijing No. 4 Intermediate People's Court ("Beijing Court") of the People's Republic of China ("PRC") rendered a judgment reviewing a foreign-related arbitration clause that re-affirmed the Chinese courts' pro-arbitration attitude while it sought to determine which law, in the absence of an express agreement, should apply.

Background

In 2015, the Plaintiff entered into a sales contract with the Defendant which provides in the arbitration clause that

> "*any dispute arising out of or in connection with this contract shall be settled through friendly negotiation. If the negotiation fails, the dispute shall be submitted to Singapore International Economic and Trade Arbitration Commission for arbitration in accordance with the American arbitration rules. The arbitral award shall be final and binding on both parties*".

Disputes arose between the two parties during the performance of the sales contract. In August 2016, relying on the above-quoted arbitration clause, the Defendant initiated arbitration proceedings in the

Singapore International Arbitration Center ("SIAC") against the Plaintiff, which was accepted by the SIAC in the next month. In May 2017, the Plaintiff applied to the Beijing Court for a judgment to confirm that the arbitration clause is invalid under Chinese law.

Meanwhile, the sole arbitrator of the SIAC proceedings decided that it had jurisdiction over the substantive disputes and issued a procedural order banning the Plaintiff from continuing its action in the Beijing Court.

The Plaintiff argued on two major issues before the Beijing Court: (a) as an import agent, whether the Plaintiff was bound by the underlying contract; and (b) whether the disputed arbitration clause was valid or not.

Specifically, in relation to the second issue, the Plaintiff disputed that the arbitration clause lacked both choice of applicable law and juridical seat of arbitration. The Plaintiff also contended that there was an error in the wording of the agreed arbitration institution, *i.e.*, "*Singapore International Economic and Trade Arbitration Commission"*, which the Plaintiff argued did not point to any specific arbitration institution. Thus, the Plaintiff's position was that none of the three statutory junctures for determining the applicable law, as stipulated in Article 18 of the *Law on the Application of Laws to Foreign-Related Civil Relations of the People's Republic of China* ("Law on Foreign Related Civil Relations"), could be found in the disputed arbitration clause.

The Plaintiff then referred to Article 14 of Judicial Interpretation issued by China's Supreme People's Court ("SPC") on the *Law on Foreign Related Civil Relations*[fn] Article 14 of the Judicial Interpretation reads: "*Where the parties did not choose the law applicable to a foreign-related arbitration agreement, nor did they agree on the arbitration institution or the place of arbitration, or where their agreement to arbitrate cannot be ascertained, the people's court may apply the law of the People's Republic of China to determine the validity of the arbitration agreement*".[/fn]("Judicial Interpretation on Law of Application"), Article 18 of the *Arbitration Law of the People's Republic of China* ("Arbitration Law")[fn]Article 18 of the Arbitration Law reads: "*Whereas an agreement for arbitration fails to specify or specify clearly matters concerning arbitration or the choice of arbitration commission, parties concerned may conclude a supplementary agreement. If a supplementary agreement cannot be reached, the agreement for arbitration is invalid*".[/fn] and Article 3 of the Judicial Interpretation of the Arbitration Law[fn]Article 3 of the Judicial Interpretation of the Arbitration Law of the PRC reads: "*If the name of the arbitration institution agreed upon in an arbitration agreement is not described in an accurate way, but the specific arbitration institution is determinable, it shall be deemed that the arbitration institution has been selected*".[/fn] to argue that Chinese law should apply to determine the validity of the disputed arbitration clause, since pursuant to the law governing foreign-related arbitrations, the disputed arbitration clause would be invalid for its lack of designation of an arbitration institution.

The Defendant argued that Singaporean law, rather than Chinese law, should apply to determine the validity of the disputed arbitration clause. The Defendant gave three reasons in this regard:

Firstly, the Defendant argued that where an arbitration institution or the juridical seat of arbitration could not be ascertained from an arbitration clause, the Chinese court should adopt the principle of proximity and apply the most closely related law as the applicable law.

Secondly, the Defendant contended that the Plaintiff knew that both parties agreed on a Singaporean arbitration institution. Since the agreed arbitration institution was in Singapore and the place of an arbitration institution is a statutory juncture for determination of the applicable law, Singaporean law should apply as the applicable law to the disputed arbitration clause.

Thirdly, the Defendant further argued that since Singapore had been agreed to as the place of the arbitration institution and the disputed arbitration clause did not provide for arbitration in any other place, Singapore should be construed as the juridical seat of the arbitration.

Ruling of the Beijing Court

The Beijing Court firstly confirmed the foreign element of the disputed arbitration clause, as the Defendant was incorporated under the laws of HKSAR. As a result, it decided to apply the Law on Foreign Related Civil Relations and the Judicial Interpretation on Law of Application to determine the applicable law.

The Beijing Court also confirmed that the disputed arbitration clause did not include an express agreement on its applicable law. Therefore, pursuant to the afore-mentioned statutes and judicial interpretation, it reasoned that the law of the place of the arbitration institution or the juridical seat should be adopted, if any of those two statutory junctures could be found.

Looking at the text of the arbitration clause, although there was no arbitration institution bearing the name "*Singapore International Economic and Trade Arbitration Commission*" in Singapore, the Beijing Court found that the parties' intention to resolve disputes through arbitration was undoubted. From the wording of the dispute arbitration clause, the Beijing Court construed that the parties wanted their arbitration to be conducted under the legal framework of Singapore, and accordingly decided that the seat of arbitration should be Singapore and that the applicable law to the arbitration clause should be Singaporean law.

In its judgment, the Beijing Court also re-emphasized the pro-arbitration position that has been expressed in the Judicial Interpretations issued by the SPC. In the case at hand, application of Chinese law and that of Singaporean law would lead to contradictory results on the finding of validity of the disputed arbitration clause. In deciding to apply Singaporean law, the Beijing Court thus showcased the pro-arbitration attitude of the Chinese courts.

Further, the Beijing Court considered the Plaintiff's argument on Article 402 of the *Chinese Contract Law*[fn]Article 402 of the Chinese Contract Law reads: "*Where the agent, acting within the scope of authority granted by the principal, entered into a contract in its own name with a third person who was aware of the agency relationship between the principal and agent, the contract is directly binding upon the principal and such third person, except where there is conclusive evidence establishing that the contract is only binding upon the agent and such third person*."[/fn] ("Contract Law") and found that none of the parties disputed having signed the sales contract. In this regard, since the dispute as to whether the Plaintiff or its principal should be bound by the sales contract was a question of law, the Beijing Court opined that the question of how the contractual rights and obligations should be borne between the parties could only be answered through subsequent hearing on merits. Thus, the Beijing Court concluded that such question did not fall within the ambit of its jurisdiction.

In the end, the Plaintiff's application for a declaration of invalidity of the disputed arbitration clause was rejected.

Comments

The first comment should be made on the impact of a principal-agent relationship on the binding force of a contract under Chinese law, as the question of whether a principal should be bound by the

arbitration clause in the underlying contract signed by its agent and the third party is still unsettled in the judicial practice of China.

A thought-provoking comparison could be made between the *Convention on Agency in the International Sale of Goods* ("Convention") and the relevant provision in the Contract Law. Article 12 of the Convention provides that

> "[w]*here an agent acts on behalf of a principal within the scope of his authority and the third party knew or ought to have known that the agent was acting as an agent, the acts of the agent shall directly bind the principal and the third party to each other, unless it follows from the circumstances of the case, for example, by a reference to a contract of commission, that the agent undertakes to bind himself only*".

However, Article 402 of the Contract Law provides that a contract signed by the authorized agent on behalf of the principal shall directly bind the principal and the other signatory party to the contract.

In this regard, the Chinese courts have attempted to clarify their position. In a recent judgment (2019 Hu 01 Min Zhong No. 5542), the Shanghai No. 1 Intermediate People's Court confirmed that a principal should be bound by the underlying arbitration clause concluded between its agent and a third party, where it was aware of the existence of principal-agency relationship.

Another example (2015 Si Zhong Min Shang Te Zi No. 166) is where a third party who has signed the underlying contract sought to vacate an arbitral award for reason that the winning party, *i.e.*, the principal, was not a signatory party to the contract. After finding that the third party was completely informed of the fact that the actual buyer of the disputed contracts was the principal, the Court concluded that the rights and obligations arose from the disputed contracts signed by the third party and the agent, including but not limited to resolving their disputes by arbitration, directly bound the principal. On other occasions, it was decided that whether an underlying contract would bind the principal was a substantive question that should be left to the arbitration tribunal's determination.[fn]See for example, Judgment No. (2015) Luo Min San Chu Zi 874.[/fn]

However, the Chinese judicial practice up to today has mostly focused on the binding effect of the arbitration agreement on the unsigned principal, while the question in the case before the Beijing Court was whether an agent could rely on Article 402 of the Contract Law and deviate itself from the arbitration clause.

On such issue, one point of view is that since the underlying contract directly binds the principal and the third party as a matter of law, so does its arbitration clause.[fn]Chen Zhidong (2015), challenges from Article 402 of the Chinese Contract Law on our country's foreign-related commercial arbitration, *Fa Xue*.[/fn] Another point of view is that as a signed party, the agent should be bound by the arbitration clause. If a tribunal decides in its award that the underlying contract directly binds the principal and the third party, then the agent should be discharged from the arbitration clause by virtue of a final and binding arbitral award.[fn]Compilation of CIETAC Award between 1995-2002, (2002), *Law Press*, p. 548.[/fn] The second point of view was adopted by the Beijing Court in the present case.

The second comment is on the determination of applicable law for the arbitration clause. It can be said that the arbitration clause before the Beijing Court was pathological in a way that it provided for an arbitration institution which does not exist in reality.

In this respect, the power to decide the juridical seat is not expressly vested in the Chinese courts

under the relevant laws.[fn]As Article 18 of the Law on Foreign Related Civil Relations and Article 14 of the Judicial Interpretation on Law of Application both confer the relevant Chinese court with the power to decide the applicable law on the basis of a statutory juncture, but remain silent on whether and how the court should examine the existence of a statutory juncture.[/fn] It is noted that as a result, court judgments swing in their approaches when interpreting whether a juridical seat has been agreed upon or not in vaguely worded clauses.

In past judicial practice, a Chinese court might directly use Chinese law as the applicable law if the arbitration clause does not include a designation of an arbitration institution or a juridical seat. If this approach is taken, such arbitration clause would be declared invalid under Chinese law. However, in this case, the Beijing Court confirmed the parties' intention to arbitrate their disputes and to do so under the Singaporean legal framework and presumed Singapore as the seat of arbitration.

Conclusion

It is noted that when determining the validity of foreign-related arbitration agreements pursuant to the applicable law, the Chinese courts have referred to applicable conflict rules and selective conflict rules to make an arbitration agreement as effective as possible. The present case reflects the judicial philosophy of the Chinese courts to respect parties' autonomy, and to promote and support commercial arbitration.

In this regard, the reasoning of the Beijing Court's judgement specifically mentioned that,

> "*where the laws of the place in which the arbitration institution is located and the laws of the place in which the arbitration is conducted are different, the applicable law that makes the arbitration agreement effective shall be chosen to determine the validity of the arbitration agreement, which reflects the court's principle to support validity of an arbitration agreement in its judicial review of an arbitration.*
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> *From the New York Convention on the content as well as the developing trend of international commercial arbitration, to the regulations of judicial interpretation in China, the broadening of criteria of effectiveness of an arbitration agreement in order to allow such arbitration agreement to be as effective as possible, is not only beneficial to respecting the intent of the parties to choose arbitration as a means to settle their disputes, but also conducive to promoting and supporting the development of arbitration, and to create a good legal environment for international commercial arbitration".*

This supportive judicial approach to arbitration is undoubtedly very worthy of affirmation.

However, there are still unresolved issues pertaining to the interpretation of conflict of laws rules such as identification of private international law and definition of points of contact. In this case, the Beijing Court's judgement lacked an explanation on why it considered "Singaporean legal framework", rather than "Singaporean arbitration institution" or "American arbitration rules", to be the point of contact in deciding to apply Singaporean law.

In order to construct Chinese modern rule of law with regard to international arbitration, it is necessary for the Chinese courts to apply reasonable and normative legal interpretation methods, which are regulated in the code of private international laws, *i.e.,* the above-mentioned articles of the Law on Foreign Related Civil Relations and the Judicial Interpretation on Law of Application, and to use

methods of contract interpretation to identify the parties' true intentions through wordings of an arbitration agreement as a complete approach to interpretation, while considering the given facts and the rules of application of laws to justify the corresponding conclusion.