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Proposed Amendments to the PRC Arbitration Law: A Panacea?

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Efforts are underway in China to reform the Arbitration Law of the PRC ("**PRC Arbitration Law**"), a statute that was promulgated in 1994 (effective in 1995) and that remains substantially unchanged to this day.[1)] While numerous judicial initiatives have long sought to address the expansion and complication of China's arbitration market witnessed in the last two decades, until recently, little legislative change has been introduced.

Following a classified consultation process with selected Chinese arbitration experts, on 30 July 2021 the Ministry of Justice of the PRC published a draft of the amended PRC Arbitration Law ("**Draft Amended Law**") for broader public consultation. The Draft reflects the most recent, most comprehensive, and most systematic attempt by China to address the ever-growing gap between modern arbitration practice in China and the antiquated PRC Arbitration Law. A modern national arbitration law consistent with international practices is a fundamental prerequisite for consideration as a safe seat of arbitration. Thus, enactment of the reforms contemplated by the Draft Amended Law is one of the most important steps China can take to advance the development of its key cities and free trade zones as true centers of international arbitration.

The Draft Amended Law proposes extensive revisions aimed at bringing Chinese arbitration practice in line with international norms and standards. Most notably, the Draft Amended Law introduces the following proposed changes, which promise to have a major impact on the practice of international arbitration in China:

- Allowing foreign arbitration institutions to establish their operations in Mainland China and "conduct foreign-related arbitration business" (Article 12);
- Recognizing the concept of "place of arbitration" (Articles 27 and 91);
- Recognizing that an arbitral tribunal has the power to independently rule on its own jurisdiction (competence-competence), including "any objections with respect to the existence or validity of the arbitration agreement" (Article 28);
- Permitting an arbitral tribunal to order interim measures (Article 43); and
- Allowing ad hoc arbitration in "foreign-related" commercial disputes (Article 91).

In this post, we analyze the proposed reform of the existing system that in effect requires all arbitration in China to be administered by Chinese arbitral institutions.

Reforms to the Chinese-Institution-Monopolized System

One of the most criticized features of the existing PRC Arbitration Law relates to its establishment of a framework under which (i) only arbitrations administered by Chinese arbitration institutions are expressly permitted in China, and (ii) the nationality of an arbitral award is determined according to the "domicile" (i.e., place) of the arbitration institution administering the arbitration (known as the "institution standard," in contrast to the internationally-recognized "seat standard"). Such a framework not only deviates from the practice in most arbitration-friendly jurisdictions, but also creates tension with other sources of arbitration guidance in China—including judicial practice and institutional rules—sometimes catching even seasoned practitioners by surprise.

The Draft Amended Law addresses these problems by, among other reforms, eliminating the monopoly of Chinese arbitration institutions and adopting the "seat standard." As we discuss below, some of these reforms apply only with respect to those disputes that are categorized under Chinese law as "foreign-related," thus creating a national arbitration law framework that is bifurcated between purely domestic and foreign-related disputes. Specifically, Article 12 of the Draft Amended Law provides that foreign arbitration institutions will be permitted to administer foreign-related arbitrations in China. Article 91 provides that "parties to a commercial dispute involving foreign-related elements may agree on arbitration by an arbitration institution or directly by an ad hoc tribunal," thus introducing for the first time the concept of ad hoc arbitration in China. Article 27 adopts the concept of the place (seat) of arbitration and provides that the arbitral award shall be deemed to have been made at the place of arbitration. Article 91 further provides that for foreign-related arbitrations, in the absence of party choice, the arbitral seat shall be decided by the arbitral tribunal "in light of the circumstances of the case." Article 28, meanwhile, newly adopts the competence-competence principle.

These amendments were not proposed in a vacuum. Many of the proposed reforms seek to codify various positive changes made by courts or pilot programs in recent years. For example, the proposed permission for foreign arbitration institutions to administer foreign-related arbitrations in China under Article 12 of the Draft Amended Law is an expansion of the 2019 and 2020 PRC State Council pilot measures, which opened up the arbitration market in China's Pilot Free Trade Zones to reputable foreign arbitration institutions on a trial basis. Similarly, the adoption of the "seat standard" under Articles 27 and 91 of the Draft Amended Law follows recent decisions by Chinese courts categorizing arbitral awards rendered in Mainland China as "Chinese" awards notwithstanding that the arbitrations were administered by a foreign arbitration institution (*see* previous post, discussing *Brentwood v. Guangdong Fa'anlong* and *Deasung (Guangzhou) Gases Co., Ltd. v. Praxair (China) Investment Co., Ltd.*).

These and other proposed amendments will bring the legal regime for foreign-related arbitrations conducted in Mainland China substantially in line with the Model Law.

Potential Uncertainties

However, the proposed regime also appears to give rise to new uncertainties and potential problems.

First, the Draft Amended Law would create a regime that is bifurcated between purely domestic and foreign-related arbitrations but that lacks a clear demarcation of the boundary between these two categories. For example, Article 91 of the Draft Amended Law permits ad hoc arbitration and empowers the arbitral tribunal to determine the seat of arbitration in the absence of party choice, but Article 91 applies only to "foreign-related" arbitrations (*see* Article 88 of the Draft Amended Law, providing that "arbitrations with foreign-related elements are subject to the provisions of this Chapter"). As for purely domestic arbitrations, the Draft Amended Law appears to keep the existing system monopolized by Chinese institutions intact—i.e., ad hoc arbitration and foreign-administered arbitration remain unavailable, and the "institution standard" applies in circumstances where the parties have not reached a clear agreement on the place of arbitration (*see* Article 27, providing that in the absence of party choice, the seat of arbitration shall be the place of the arbitration institution). Thus, under the Draft Amended Law, purely domestic arbitrations are excluded from certain beneficial reforms.

Putting aside the merits of creating such a bifurcated system, a problem arises because the Draft Amended Law does not provide any guidance on what constitutes a "foreign-related" arbitration. As discussed in a previous post, the differing and constantly-evolving treatment of "foreign-related" arbitrations under Chinese law often causes confusion and controversy as to whether the "foreign-related" requirement is satisfied. If the contracting party is a company registered outside of Mainland China, this requirement will be satisfied. The outcome of the "foreign-related" test is less certain, however, if the dispute is between a Chinese incorporated subsidiary of a multinational and a Chinese party (including another local subsidiary of a multinational). What this means, in practice, is that at the time of contracting, the parties may not know for sure whether their relationship ultimately will be deemed foreign-related or domestic. Parties in that situation would not know whether they are permitted to select ad hoc arbitration for resolution of their disputes, whether their choice of a foreign arbitration institution to administer their disputes would be respected, or how the seat of arbitration would be determined in the absence of clear party choice. Such parties would be at risk of entering into an arbitration agreement in reliance on Article 91 (if enacted in its present form) only to later find that their agreement (and any resulting award) is unenforceable because the relationship between them is deemed domestic rather than foreign-related.

Second, the proposed system for ad hoc arbitration (limited to foreign-related disputes) calls for further scrutiny. For instance, Article 93 of the Draft Amended Law requires every ad hoc arbitral tribunal to submit a copy of its award to the Intermediate People's Court of the seat of arbitration. This would seem to mean that such an award would need to be provided to the PRC courts even absent the parties' consent to such disclosure. Mandatory reporting of this nature is in tension with the expectation of many parties that the arbitral award will not be disclosed to third parties without their consent (except in cases of necessity, such as in an application to set aside or confirm the award). It is possible that the reporting requirement could deter some parties from choosing ad hoc arbitration in China. Also, while Article 92 of the Draft Amended Law states that the parties may agree to entrust—or, failing such agreement, an appropriate court may designate—an arbitration institution to "assist in constituting the tribunal," the Draft Amended Law lacks clarity on default procedures for appointment of arbitrators in the absence of party agreement. This is in contrast to the clearer and more fulsome default procedures provided in other arbitration-friendly jurisdictions (*see, e.g.,* Hong Kong Arbitration (Appointment of Arbitrators and Mediators and Decision on Number of Arbitrators) Rules (Cap.609C)).

Finally, foreign arbitration institutions administering arbitrations in China may face practical

difficulties in implementing their fee schedules under the Draft Amended Law. Pursuant to Article 96 of the Draft Amended Law, arbitral fee schedules shall be jointly determined by the price department and the judicial administrative department of the PRC State Council. Article 96 does not recognize fee schedules determined otherwise. Notably, the existing version of the arbitral fee schedules issued by the PRC State Council sets forth an extremely low fee standard that is incompatible with foreign arbitration institutions' practice and—contrary to international practice—does not distinguish arbitrator compensation from institutional administrative fees. To avoid confusion, these and other technical issues will need to be sorted out either in the process of enactment of the amended PRC Arbitration Law or through implementing rules and regulations thereafter.

Conclusion

The reputation and standing of a place as a center of international arbitration is a function of an entire ecosystem of pro-arbitration laws, policies, infrastructure, and talent. Enactment of the Draft Amended Law is a necessary but incomplete step toward the development of such an ecosystem in Mainland China. The Draft Amended Law makes major strides toward eliminating idiosyncrasies and anachronisms of the existing Law that are standing in the way of Mainland China's development as a center of international arbitration. Simultaneously, the Draft Amended Law risks creating some new uncertainties and exacerbating certain existing uncertainties, such as the unclear boundary between purely domestic and foreign-related arbitrations. Hopefully, some or all of the outstanding issues will be resolved in the process of finalizing the draft amendments following the public comment period.[2)] Inevitably, however, some uncertainties and problems will remain for resolution through further implementation measures and judicial guidance.

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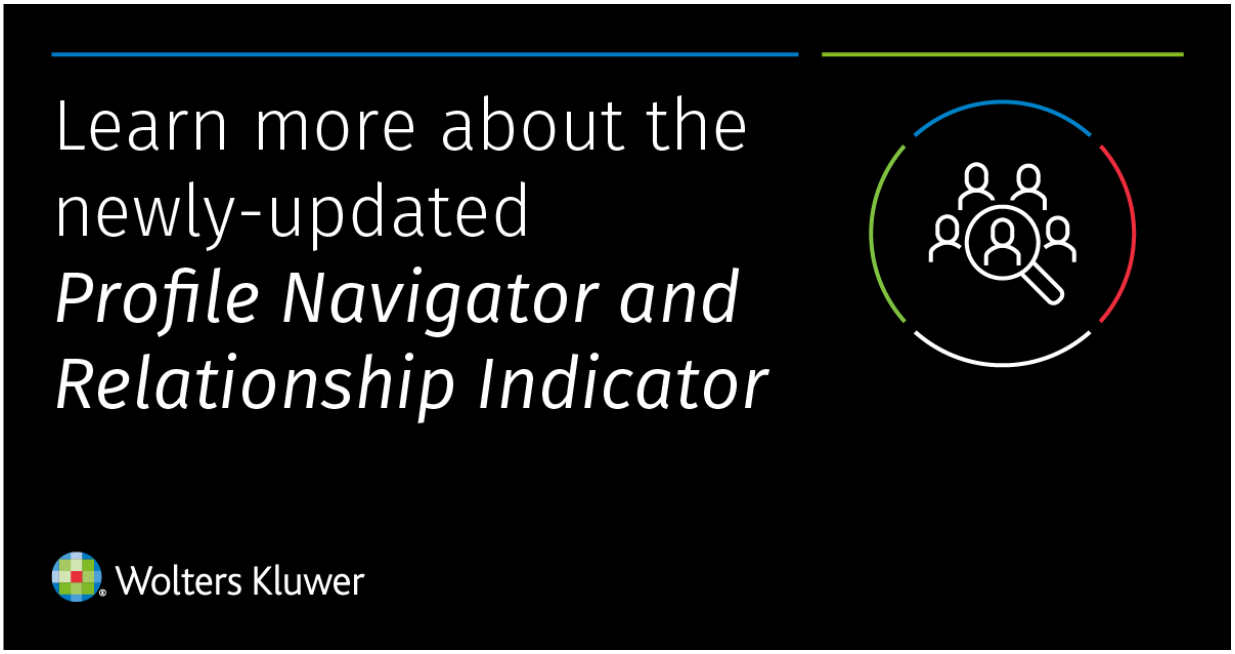

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?2 The authors have submitted relevant comments.

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