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Reflections on HKIAC's Revised Model Arbitration Clause and Its Impact on Chinese Practice

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The Hong Kong International Arbitration Centre ("HKIAC") has recently revised its Model Arbitration Clause to include a choice of law provision.

> "Any dispute, controversy, difference or claim arising out of or relating to this contract, including the existence, validity, interpretation, performance, breach or termination thereof or any dispute regarding non-contractual obligations arising out of or relating to it shall be referred to and finally resolved by arbitration administered by the Hong Kong International Arbitration Centre (HKIAC) under the HKIAC Administered Arbitration Rules in force when the Notice of Arbitration is submitted.
>
> **The law of this arbitration clause shall be … (Hong Kong law).**
> The seat of arbitration shall be …(Hong Kong).
> The number of arbitrators shall be … (one or three). The arbitration proceedings shall be conducted in …(insert language)."

It's understood that this change is aimed at advancing the efficiency and to avoid unnecessary twists and turns of arbitration proceedings. From the perspective of a Chinese practitioner, this addition is a highly sophisticated development.

In arbitration, there are two areas where different governing law may apply, 1) the disputes on the merits of the case, and 2) the disputes on the validity of the arbitration agreement. Parties usually identify the governing law of the contract in their arbitration clauses, but it is common that the parties fail to choose the law, which governs the validity of the arbitration clause. In such a case, any uncertainty about the interpretation of the arbitration agreement may result in a dispute on which law should govern its validity. Under the Chinese practice of judicial review, parties, especially the Chinese party may bring challenges to the validity of the arbitration agreement utilizing one or all of the following procedures: 1) a separate judicial assistance procedure called Application to Confirm the Validity of the Arbitration Agreement; 2) the application to set aside the arbitral award; and 3) the application of non-enforcement of the arbitral award. In some circumstance, the Chinese party may also bring a lawsuit in a Chinese court directly on the assumption that the arbitration agreement is invalid based on Chinese law. The foreign parties may object to the Court's jurisdiction before the first hearing of the case in the first instance. All of

these procedures are time consuming, emotionally frustrating and costly in terms of money and energy all of which is potentially avoidable by expressly choosing the governing law of the arbitration clause.

This example is not merely theoretical. For example, in a case before the China Supreme People's Court ("SPC") submitted by Jiangsu High Court seeking for instruction. (Docket number: Min Si Ta Zi No. 1 [2006], Appellate: Zhangjiagang Gang Xi Electronics Ltd., a Chinese company; Appellee: Brose International GmbH, a German company.) The two parties reached an arbitration clause which reads:

> "if any dispute arises from this contract, parties shall first resolve the dispute through friendly conciliation. If parties cannot resolve in the dispute within 60 days, any party could initiate the arbitration proceeding under ICC rules. The arbitration shall take place in Switzerland. The English version of this contract shall be submitted to the arbitrators, with the arbitration proceedings conducted in English. This arbitration shall have three arbitrators. Each party could name one arbitrator while the arbitration commission names the presiding arbitrator. The arbitration award shall be final and binding on both parties. The losing party shall bear the cost of arbitration".

Under the Chinese Arbitration Act, an arbitration clause is valid only if three elements have been satisfied, an arbitration clause should have 1) statement of parties' intention to arbitrate; 2) the subject matter of arbitration; and 3) designation of a valid arbitration commission. However, the arbitration laws in other countries may not be as rigid.

In this case, the trial court of the first instance ruled that the Arbitration clause is independent from the main contract; its validity is not dependent upon the effectiveness of the main contract. So the arbitration clause has its own governing law, which shall not be based on the applicable law of the main contract. According to Paragraph 1(1) of Article 5 of the New York Convention, in reviewing the validity of an arbitration clause, the law which the parties expressly agreed upon shall apply. In absence of such agreement, but if the arbitration seat has been chosen, the law of the seat shall apply.

However, the appellate court, Jiangsu Higher People's Court held that Chinese law shall be the governing law of the clause based on two reasons. First, parties have an express choice on the applicable law of the main contract, which shall also govern the validity of the arbitration clause. Second, the main contract in this case is Sino-foreign Joint Venture Contract, which shall be mandatorily governed by Chinese Contract Law as required by Paragraph 2 of Article 126 of Chinese Contract Law which states "The Sino-foreign Joint Venture Contract, Sino-foreign Cooperative Enterprise Contract and Contract for Sino-foreign Cooperation in Exploring and Developing Natural Resources within the territory of the People's Republic of China, the laws of the People's Republic of China shall apply."

After looking into the case, the SPC outlined the legal framework for determining the validity of an arbitration clause if the parties did not agree on the governing law of the arbitration clause:

> "1) If the parties have agreed on the governing law of the arbitration clause, the agreed governing law shall apply. 2) If the parties did not agree on the governing law

> of arbitration clause, but choose the place of arbitration, the law of the place of arbitration shall apply. 3) Only if the parties failed to choose the governing law for the arbitration clause and failed to name the place of arbitration, PRC law shall apply."

Eventually the SPC determined that the parties chose the place of arbitration to be Switzerland. Therefore, the court applied the law of Switzerland, ultimately upholding the validity of the arbitration clause.

To provide a guiding principle for choosing proper law during foreign-related civil activities, the Law of the People's Republic of China on Application of Laws to Foreign Related Civil Relations was enacted by Chinese legislature and came into force on April 1st, 2011. Article 18 of this law is specially crafted to address the issue of how to determine the governing law of an arbitration agreement:

> "Parties concerned may agree upon the laws applicable to an arbitration agreement. Where the parties have made no such choice, laws of the domicile of the arbitration institution, or laws of the place of arbitration shall apply."

Although there is no case applying the above-mentioned rules to date, this approach is widely recognized by the international arbitration practice, for example, the approach taken by the Singapore High Court in *FirstLink Investments Corp Ltd v. GT Payment Pte Ltd and other* [2014] SGHCR 12. The Court in *Firstlink Investments* held that in the absence of a selection of the law governing the arbitration clause, a court will apply the law of the seat of the arbitration as governing the agreement to arbitrate.

To provide an overall solution to this typical issue, Article 14 of the Judicial Interpretation of the Law on Application of Laws to Foreign Related Civil Relations promulgated by the SPC, which took effect on January 7th, 2013, further clarifies certain special circumstances silent in the Law:

> "Where the parties concerned do not select the law applicable to a foreign-related arbitration agreement and do not stipulate the arbitration institution or the place of arbitration or the stipulation is unclear, the people's court may apply the laws of the People's Republic of China to judge the effectiveness of the arbitration agreement."

In practice, the choice of law governing the validity of an arbitration clause is a topic confusing to many clients. Quite often, the argument on the choice of law between parties after disputes arise resembles a web spun in opposing directions. Adding to a client's frustration is the difficulty in discerning the difference between the choice of substantive law and choice of governing law of arbitration agreement. This nuance, however, is crucial as it has the potential to determine the fate of the arbitration clause. Thus, HKIAC's newly revised Model Clause draws users' attention to this issue and reminds them to choose the law governing their arbitration clause. By proactively deciding the law governing the arbitration agreement, parties can eliminate uncertainty and increase the chance of their arbitration clause being upheld.

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