

Kluwer Arbitration Blog

Recent Development of Ad hoc Arbitration in China: SPC Guidance and Hengqin Rules

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On 30 December 2016, the Supreme People's Court of China ("SPC") released Opinion on Providing Judicial Protection for the Development of the Pilot Free-Trade Zones ("Opinion"), which was regarded as allowing ad hoc arbitration in China. On 23 March 2017, the Management Committee of Hengqin New Zone and Zhuhai Arbitration Commission ("ZAC") jointly published the Ad hoc Arbitration Rules of (Guangdong) Pilot Free Trade Zone Hengqin Area of Zhuhai ("Rules"). As the first ad hoc arbitration rules in China, the Rules will to some extent implement the Opinion. However, a lot has to be done before ad hoc arbitration can truly become a practical dispute resolution method in China.

Overview of the Opinion

Article 9.3 of the Opinion reads,

"In case companies registered within the Pilot Free-Trade Zones agree to arbitration in certain locations in mainland China, with certain arbitration rules, and by certain persons, such arbitration agreement may be recognized as valid. In case a people's court finds such arbitration agreement to be invalid, it shall report the matter to a higher court for review. In case the higher court agrees with the lower court, it shall further report the matter to the SPC and shall only decide on the matter upon the SPC's reply."

There are some issues arising from this Opinion:

1. *Issue of authority.* According to the PRC Law on Legislation, litigation and arbitration mechanisms can only be set forth in laws. In other words, only the legislative branch (i.e. the National People's Congress or its standing committee) has the power to create or recognize a new form of arbitration in China. Without authorization from the legislative branch, the Opinion appears to be flawed from the start.

2. *Limited ad hoc arbitration.* Broadly speaking, ad hoc arbitration means arbitration conducted totally in accordance with parties' agreements, which does not have to follow certain arbitration rules. The Opinion allows arbitration *in certain locations, with certain arbitration rules* and by

certain persons, in which *certain arbitration rules* reflect that the SPC only allows ad hoc arbitration to be conducted under arbitration rules. This is in fact limited ad hoc arbitration.

3. *Obstacles to implementation.* The current legal framework and unique Chinese legal environment pose plenty of barriers for the implementation of the Opinion. The obstacles include:

a) The lack of local ad hoc arbitration rules. Although there are several ad hoc arbitration rules available, they may not be fit for arbitrations conducted in China. For example, Article 6(2) of the UNCITRAL Arbitration Rules states any party may request the Secretary-General of the Permanent Court of Arbitration to designate the appointing authority. Unlike international arbitration institutions which are willing and have specific rules to act as an appointing authority, local Chinese institutions such as CIETAC and BAC are not able to play such role.

b) Traditional reliance on institutions and lack of trust in arbitrators. Due to the more prominent role of the government in Chinese legal culture, Chinese parties and even law practitioners tend to rely more on court institutions rather than individuals. Choosing institutional arbitration over litigation is already a leap of faith because arbitration institutions are, in the eyes of many people, not as official as courts.

c) Lack of arbitrators in PRC with experience in ad-hoc arbitration: In ad hoc arbitration, arbitrators have to adeptly predict and deal with important procedural issues and ensure the quality of the substantive award, with no or very limited institutional supervision and support. Even veteran institutional arbitrators with substantial experience will need special training to be competent. As China never had a tradition for ad hoc arbitration, it is difficult to imagine there are many arbitrators in PRC up to this job.

d) Personal risk for ad hoc arbitrators. In recent years, there have been a few widely reported cases where judges are threatened, insulted, or even killed by discontent parties. In ad hoc arbitration, since the tribunal cannot “hide” behind an institution but has to directly deal with the parties in both procedural and substantive matters, the personal risk is also a concern.

e) The need for reform of PRC arbitration laws: The current Chinese arbitration legal framework does not permit ad hoc arbitration, so the procedural rules set forth in the PRC Arbitration Law cannot accommodate the special issues of ad hoc arbitration. This is not limited to the legitimacy issue discussed above.

Highlights of the Rules

The Rules went into force on 15 April 2017. The Rules apply when two companies registered in any free-trade zones agree to arbitration under the Rules. There are some highlights of the Rules:

1. *Competence-competence:* According to Article 9.4, the arbitral tribunal is capable of deciding on its jurisdiction in the case. Before the Rules, it was always the arbitration commission rather than the tribunal that was to decide on jurisdictional issues. So, the Rules actually established the real competence-competence of the arbitral tribunal. Despite this, the fact that the court can to a large extent intervene still remains unchanged.

2. *Appointment and replacement of arbitrators:* The Rules provide that, the parties may directly appoint arbitrators, or agree on a method for appointing arbitrators, or agree on an appointing authority. The default appointing authority is ZAC. Similarly, the Rules provide that the appointing

authority has the power to decide on the withdrawal and replacement of arbitrators.

3. *Qualifications of arbitrators*: The Rules require ad hoc arbitrators to meet the same criteria for institutional arbitrators set forth in the PRC Arbitration Law. However, Article 21.3 also states that, in case that ZAC acts as the appointing authority, it will appoint arbitrators in accordance with its list of arbitrators. Due to the local nature of ZAC, the flexibility of parties to appoint arbitrators who do not meet the criteria for institutional arbitrators in China would be greatly discounted by this limitation.

4. *Determination of fees and costs*: In this regard, the Rules are nearly identical to the UNCITRAL Rules. The fees of arbitration are first determined through agreement between the parties and the tribunal. If they cannot agree on fees, the appointing authority decides. On the other hand, the Rules are less clear in the actual procedures to determine arbitration fees.

5. *Tribunal secretarial support*: The Rules provide that, with the parties' consent, the arbitral tribunal may use third party services including financial management, tribunal secretaries, and lease of venues.

6. *Provisional measures*: Article 13 of the Rules allows the parties to apply for provisional measures directly from the court or through ZAC. However, since the PRC Arbitration Law does not permit ad hoc arbitration, the rules about provisional measures in the PRC Arbitration Law can only apply to institutional arbitration. The PRC Civil Procedure Law and the Opinion do not include such rules either. Therefore, it is doubtful whether provisional measures are legally available for ad hoc arbitration.

7. *ZAC's confirmation of awards*: The Rules provide for ZAC to confirm an ad hoc award. After an award is made by the ad hoc tribunal, each party may apply to ZAC for confirmation of the award. Once ZAC decides to confirm it, the award will be deemed an institutional arbitral award made by ZAC. As an attempt to reduce the risk of non-enforcement of ad hoc awards, its actual effect remains to be seen.

Suggestions

1. *Legitimacy*. The PRC Arbitration Law needs to be amended to resolve the legitimacy issue of ad hoc arbitration. If not, ad hoc arbitration in PRC cannot take place, let alone prosper.

2. *Detailed procedural rules in PRC Arbitration Law*. For example, the court in the seat of arbitration should assist in the appointment of ad hoc arbitrators, as well as the revocation of mandate of arbitrators. These mechanisms are available in arbitration laws of other jurisdictions, but are lacking in China. Therefore, it is suggested that the National People's Congress and SPC conduct a thorough research on ad hoc arbitration, and then introduce a comprehensive and detailed legal framework. One or two local ad hoc arbitration rules are far from enough to motivate ad hoc arbitration.

3. *More ad hoc arbitration rules*. The Rules are the first and only ad hoc arbitration rules currently in China, and their implementation largely rely on the support of ZAC. To stimulate healthy competition and accumulate experiences, other arbitration institutions should also be motivated to promulgate their own ad hoc arbitration rules.

4. *Training of professionals*. Besides experienced ad hoc arbitrators, professional counsels are also

likely to conduct ad hoc arbitration. They can help the client conclude feasible ad hoc arbitration agreements, and avoid unnecessary delays in arbitration proceedings. When legal assistance of ad hoc arbitration has been established by law, there is also need for judges who understand and grasp the practice of ad hoc arbitration. The training of these professionals demands an urgent solution.

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