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Multi-tiered Clauses in China: How Courts Navigate the "Dismal Swamp"

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Multi-tiered dispute resolution clauses – which typically require negotiation, mediation, and/or other form(s) of alternative dispute resolution ("ADR") prior to submitting the dispute to binding arbitration – are ubiquitous, and a standard feature of complex construction contracts.

Contrary to their intended function of promoting efficiency and preserving business relationships, as observed by Gary Born, they form a "*Dismal Swamp*" of legal inconsistency, uncertainty, and disputes.[1] Previous blogposts explored the variability of approaches to multi-tiered clause across national courts in leading European jurisdictions, Croatia, Singapore, Pakistan, India, and Switzerland.

Although multi-tiered clauses have yet to be comprehensively tested in Chinese courts, the March 2021 decision of the influential Beijing Fourth Intermediate People's Court ("Beijing 4th IPC"), *Chen Ya v. Yan Wenbo* (*(2021) Jing 04 Min Te 186 Hao*) provides an occasion to survey emerging Chinese jurisprudence. Consistent with the general state of jurisprudence world-wide,[2] Chinese courts do not rigidly assess multi-tiered clauses as matters of "admissibility" or "jurisdiction" or "procedure". Despite occasionally conflating legal theories, they appear to navigate these murky waters cautiously, demonstrating a predilection for respecting arbitral jurisdiction and upholding awards.

Emerging Rules and Principles

It may be argued that fulfillment of pre-arbitration procedural requirements is condition precedent to formation of the parties' agreement to arbitrate. In practice, however, Chinese courts are reluctant to entertain jurisdictional challenges involving failure to negotiate, suggesting they view this as a matter of admissibility, not jurisdiction. On this point, an April 2021 study of pre-arbitration procedural requirements by the Wuhan Arbitration Commission found that courts declined to support petitions to invalidate arbitration agreements on grounds the parties' failed to conduct requisite negotiations in all twelve cases identified.

The more interesting analysis is found in domestic annulment decisions (and an occasional foreign-

related case), from which various principles and rules are beginning to emerge:

Pre-conditions stated "in principle" are treated as procedural formalities.

The 2008 SPC Reply Letter in *Wan Run He Development Co. Ltd.* (*(2008) Min Si Ta Zi Di 1Hao*), which rejected the proposed non-enforcement of a "*foreign-related*" award, provides an example of early guidance to lower courts.

The clause at issue contained two pre-conditions to arbitration: (i) the parties "*should*" resolve disputes through "*friendly negotiations*", and (ii) such negotiations are unsuccessful. The SPC rejected the petitioner's challenge to the tribunal's jurisdiction, and found the first condition to have been stated "*in principle*" and without any time limitation, and accordingly opined that there would likely be divergent interpretations as to its performance and scope.

Under the circumstances, the court characterized the first condition as merely a "*procedure requiring the formality of negotiation*" and deemed the second condition as readily fulfilled by the act of filing for arbitration. This approach has been followed by the Beijing 4th IPC in the domestic annulment proceedings in *Chen Ya v. Yan Wenbo, supra*, involving a similar tiered clause, where portions of the *Wan Run He* decision were quoted verbatim.

These cases suggest that while performance of pre-conditions is a matter of jurisdiction (if so pleaded by petitioners), absent clear definition and time limits, courts will be satisfied with *de minimus* evidence of their fulfilment, in effect treating them as procedural formalities to be reviewed by the tribunal.

In search of bright lines.

Far from clearly defined are the criteria for determining whether a tiered clause is sufficiently detailed, and whether the pre-conditions are clear enough to be enforced by the courts.

In one case, *Beijing Cheng Jian Wuye Guanli v.Beijing Shi Chongwenqu Yi Long Bieshu Yezhu Weiyuan Hui* (*(2018) Jing 04 Min Te 135 Hao*), which is also noteworthy for its inclusion in the Beijing No. 4 IPC [2019] *Standardization Guide for Adjudication of Cases Involving Judicial Review of Arbitration* discussed in a previous blogpost, it was held *inter alia* that a tiered clause specifying institutional mediation was "*clear*". The court also noted that the respondent had satisfied the pre-condition by submitting the dispute to mediation before the competent "*real estate administration bureau*".

Do time limits matter?

In practice, Chinese courts also appear to treat time limits as procedural formalities without jurisdictional consequences.

The court's view on this point evolved over time. In a 2005 decision,[3)] the Chengdu Intermediate

Court denied recognition and enforcement of an SCC award, finding that the respondent, Pepsi Co., failed to provide evidence that it had complied with the requisite 45-day negotiation period pre-condition. This is a rare example of a court denying recognition and enforcement of an arbitral award on the ground that a pre-arbitration negotiation requirement was not satisfied. In most of the published cases, courts tend to decide that the requirement for negotiation was satisfied based on *prima facie* evidence.

The tiered clause addressed in *Shanghai Xuandu Entertainment Co. Ltd. v. Shanghai Nanshi Development Sports Business Department (2018) Jing 04 Min Te 408 Hao*) required the parties to first "*do their utmost to resolve the dispute within 30 days through friendly negotiations*". The court rejected the petitioner's assertion that the award should be annulled on the ground that respondent failed to proffer evidence of performing this pre-condition, and endorsed the tribunal's findings that the lapse of 30 days from receipt of respondent's demand letter to filing of the arbitration was sufficient to satisfy the pre-condition, without need to examine the nature and substance of the negotiations.

The Beijing 4th IPC expressed a similar view in the 2019 decision, *Jiang Qingfeng v. Li Zhenyu* ((2019) *Jing 04 Min Te 310 Hao*), finding that the passage of two months from delivery of a demand letter to the filing of arbitration was sufficient to satisfy the 30-day negotiation period pre-condition. Another case, *Shandong Hongqingyuan Foodstuffs* (discussed below), demonstrates the court's reluctance to invalidate an arbitration agreement on grounds of failure to file an arbitration within a specified time limit.

The courts may, however, require at least *de minimis* evidence that requisite negotiations have occurred.

Pre-arbitration requirements are not "mandatory procedures".

In *Jiang Qingfeng*, discussed above, the court rejected the petitioner's argument that the award should be annulled because of failure to perform pre-conditions of negotiation which constituted violation of "*legally mandated procedures*" under Article 58(3) of the PRC Arbitration Law ("CAL"). It was held that the required pre-filing negotiations did not constitute agreement on different "*arbitration procedures*" under the Beijing Arbitration Commission Rules at Art. 2(1) and was therefore not mandatory.

The Shanghai 1st Intermediate People's Court took a similar position on a comparable tiered clause in the 2019 decision, *Cui Ming v. Shanghai Guo Chun Venture Investment Co. Ltd.* (*(2019) Hu 01 Min Te 250 Hao)*, holding that such pre-conditions were outside the scope of "*arbitral procedure violating legally mandated procedure*".

Grounds for invalidity of arbitration agreements?

In *Jiang Qingfeng* (discussed above), although validity of the arbitration agreement was not properly at issue, the court observed that pre-arbitration procedures "*are in substance the agreement of the parties on choice of method to resolve disputes, and the free choice of the parties*

should be respected". In *Cui Ming* (also discussed above), the court noted in *dicta* that failure to strictly observe the 30-day pre-filing negotiation period was an issue of validity of the arbitration agreement. That said, courts are in practice reluctant to give effect to time limits potentially invalidating arbitration agreements.

In *Shandong Hongqingyuan Foodstuffs Co. Ltd., et al v. Su Qian Zhong Shan Tian Rui Li Ding Enterprise Investment Center (LP)* (*(2018) Jing 04 Min Te 146 Hao Zhi Yi*), which involved a tiered clause requiring negotiations as well as a time limit of 60 days from occurrence of the dispute to filing for arbitration, the Beijing 4th IPC in *dicta* rejected the petitioner's argument that the award should be annulled under Article 58(1) of the CAL, since the respondent's failure to file an arbitration within 60 days invalidated the arbitration agreement. In the court's view, the original intent of the tiered clause was to encourage expeditious resolution of disputes, not to create a mechanism that contemplates invalidation of the arbitration agreement.

In Search of a Clearer Path

If multi-tiered clauses prove to a be a chronic source of controversy in China, the SPC may in due course provide clear guidance in a formal Judicial Interpretation. In the meantime, published decisions of influential courts warrant continuing attention.

References

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See, e.g., Hamish Lal, Brendan Casey, et al., *'MultiTiered Dispute Resolution Clauses in* **?2** *International Arbitration – The Need for Coherence'*, in Matthias Scherer (ed), ASA Bulletin, Kluwer Law International 2020, Volume 38 Issue 4) pp. 796 – 820.

?3 *(2005)?????912?* (subsequently withdrawn from on-line publication)

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