

Kluwer Arbitration Blog

Are Non-binding Arbitration Agreements Enforceable Under PRC Law?

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A key characteristic of an international commercial arbitration award is its binding nature, although parties may still consent to non-binding arbitration. A consent to non-binding arbitration is problematic when the applicable law explicitly prescribes arbitration to be binding. Mainland China is such a jurisdiction. Thus, the issue of the validity of a non-binding arbitration agreement for which PRC law is the applicable law has been in dispute for quite some time, with different courts making diverse rulings. Recently, the Shanghai Pudong New Area People's Court ("**Court of First Instance**") and Shanghai First Intermediate People's Court ("**Appeals Court**") issued the first decision in the PRC dealing with this issue in a foreign-related case,¹⁾ affirming the validity of the arbitration agreement and holding that the court lacked jurisdiction over the dispute.

An Update on PRC Courts' Attitude Towards Non-Binding Arbitration Agreements: *BY.O v. Yushang Group Co. Ltd.*

In May 2015, BY.O and Yushang Group Co. Ltd. contracted for BY.O to provide financial services to Yushang. Article 6 of their contract, titled "Applicable Law and Jurisdictional Agreement," stipulated:

6.1 This agreement shall be entered into, performed and interpreted in accordance with Chinese law; Chinese law shall apply to the settlement of any dispute arising from this Agreement.

6.2 Any dispute or controversy arising from or related to this Agreement (including disputes regarding the existence, validity or termination of the agreed clauses of this Agreement, or the consequences of invalidity) shall be first resolved by arbitration at the Singapore International Arbitration Centre. If both parties fail to reach a consensus on the outcome of the arbitration at the Singapore International Arbitration Centre, either party has the right to submit the dispute to a commercial court of competent jurisdiction at the place of Party B (Yushang)'s residence for settlement by litigation.

(translation by the author; emphasis added).

In May 2020, without first arbitrating, BY.O filed suit before the Court of First Instance, arguing that Yushang had not paid the fourth-stage service fees and that the arbitration agreement in the contract is invalid. In its defense, Yushang raised a jurisdictional objection, arguing that the arbitration agreement is valid and that the case should be resolved through arbitration at SIAC.

In its judgment, the Court of First Instance first noted that the case was a “foreign-related civil case” (*shewai minshi anjian*) under PRC law (*see Interpretation of the PRC Supreme People’s Court*) since BY.O was a non-PRC party. Accordingly, based on Article 6.1 of the contract, the applicable law to a dispute between the parties was PRC law. (Under the [PRC Law on Choice of Law for Foreign-related Civil Relationships](#), the parties may explicitly choose the applicable law.)

The Court of First Instance found that the parties had a valid arbitration agreement and, thus, the court lacked jurisdiction. A point of interest was how the Court of First Instance separated the arbitration agreement from the litigation agreement and decided that the former was valid while the latter was not.

In support of this distinction, the Court of First Instance provided four reasons. *First*, the first sentence of Article 6.2 of the contract clearly designates one arbitration institution. Thus, this arbitration agreement is valid.

Second, Article 9.1 of the [PRC Arbitration Law](#) provides that “[a] system of a single and final award shall be practiced for arbitration. If a party applies for arbitration to an arbitration commission or institutes an action in a people’s court regarding the same dispute after an arbitration award has been made, the arbitration commission or the people’s court shall not accept the case.” Therefore, the parties’ agreement on resorting to litigation after arbitration is invalid.

Third, in Article 6.2, the parties’ arbitration agreement and litigation agreement are separated by a period—which indicates their independence—instead of a comma or a semi-colon. Therefore, the invalidity of one does not affect the validity of the other.

Fourth, the parties’ agreements on arbitration and litigation are not parallel and thus the situation created by Article 6.2 is different from a situation where the parties have agreed that a dispute can be resolved by either arbitration or litigation.

BY.O then appealed to the Appeals Court. [The Appeals Court basically upheld the first instance’s decision](#). The Appeals Court confirmed that the provision in the parties’ contract that any dispute “shall be first settled by arbitration through the Singapore International Arbitration Centre” clearly gave priority to arbitration over litigation, and the choice of arbitration institution was specific, clear and unique (a requirement under PRC law). Furthermore, the agreement was not characterized by alternative choices of “arbitration or litigation.” Thus, the arbitration agreement is valid; however, the litigation agreement is invalid, as it is specifically inconsistent with Article 9.1 of PRC Arbitration Law, violating the fundamental principle that arbitration precludes the jurisdiction of people’s courts.

Separating the Arbitration Agreement from the Litigation Agreement: Is it Really Separable?

Both the Court of First Instance and the Appeals Court divided the controversial “jurisdictional agreement” into two parts and examined the validity of the agreements on arbitration and litigation separately. Such a division is certainly beneficial in order to support the validity of the arbitration agreement but may not be internally consistent.

First, the litigation agreement explicitly refers to “the outcome of the arbitration” and thus cannot be completely detached from the arbitration agreement. Furthermore, the litigation agreement is deemed invalid by the Court of First Instance and the Appeals Court on the ground of violating the “finality of arbitration,” which references, again, the arbitration agreement. Therefore, examining the litigation agreement separately and finding its validity on the basis of arbitration law is somewhat misplaced.

Second, focusing on the punctuation, the Court of First Instance contended that the period used between the arbitration agreement and the litigation agreement indicated their independent validity. This to some extent makes sense, but a follow-up question easily comes to mind: would the result be different if the parties used a comma, semi-colon or other punctuation? Before the *BY.O* case, in some domestic PRC cases, non-binding arbitration agreements were deemed valid despite using a comma between the arbitration agreement and the litigation agreement. (*See, e.g., the case decided by the Guangzhou Intermediate People’s Court in 2019*, in which the parties used a comma and the court ruled that the arbitration agreement was valid but the litigation agreement was not.) Interestingly, although the Appeals Court affirmed the Court of First Instance’s decision, it did not address the issue of punctuation. Perhaps, then, it is reasonable to conclude that the failure to use a period in future agreements will not be fatal.

Third, there may be good reasons for the court to read the two agreements together. The two sentences containing the parties’ agreement on arbitration and litigation are under the same Article 6 of the contract, presenting the parties’ integral “jurisdictional agreement.” The parties’ consent to arbitration could be read as being only on the condition of resorting to litigation thereafter. If this is the case, it begs the question whether there was a valid “intention to apply for arbitration” under PRC Arbitration Law.

The Influence of the *BY.O* Case

The *BY.O* case is the first foreign-related case in Mainland China dealing with the validity of a non-binding arbitration agreement. Despite the aforementioned questions on the courts’ analyses, the judgment clearly shows a supportive attitude toward foreign-related arbitration cases. Of note, this case was decided by Shanghai Pudong New Area People’s Court at a time when Shanghai, with the Central Government’s support, is accelerating its development as a global arbitration center in the Asia-Pacific region for, *inter alia*, the “Belt and Road” Initiative. (*See also previous blog on the Shanghai Pilot FTZ.*) In this context, the *BY.O* case not only highlights Shanghai Pudong New Area People’s Court as being “arbitration-friendly,” but also features the involvement of a “Belt and Road” arbitration institution, SIAC. (On November 7, 2019, over 40 arbitration institutions, including SIAC, signed the [Beijing Joint Declaration of the “Belt and Road” Arbitration Institutions.](#))

This case is significant particularly because it is published on the Gazette of the Supreme People’s Court. While the *BY.O* case should have considerable influence on future “foreign-related” cases at

a minimum, cases technically do not serve as precedent in Mainland China unless published by the Supreme People's Court according to the [Provisions of the Supreme People's Court Concerning Work on Case Guidance](#). It is also noted that the validity of non-binding arbitration agreements has not been particularly addressed by the [Draft Amendments to the PRC Arbitration Law](#). As such, the saga of non-binding arbitration agreements may continue and, thus, it is still safer to avoid a non-binding arbitration agreement in a contract subject to PRC Arbitration Law.


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References

- ¹ In the PRC legal system, foreign-related cases are treated differently on certain issues. Even when the applicable law is the same, they may be affected by different policy concerns.

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