The opening of ad hoc arbitration seated in China(1) to FTZs enterprises – A promising yet uncertain option

ASIA

I.THE REFORM

Ad hoc arbitration, as opposed to institutional arbitration, is the arbitration taking place outside the administration of any arbitration institution and whereby the Parties are free to choose arbitrators, arbitration rules and the seat of the arbitration. Often called "tailor-made" arbitration, ad hoc arbitration may be considered as offering several advantages such as being more flexible and adapted to the parties' special situation, more cost effective, faster and more confidential compared with institutional arbitration (but enforcement through a People's Court in China may lift such confidentiality).

For a long time, ad hoc arbitration has been generally rejected in People's Republic of China **("PRC")** because of a lack of legal basis. PRC arbitration law specifically requires that a valid arbitration clause shall specify an arbitration institution(2), which was a de facto prohibition of China-seated ad hoc arbitration. Thus, for Chinese enterprises, ad hoc arbitration was permitted in practice only if the three following conditions were met: 1) the case is foreign related(3) ; 2) the ad hoc arbitration is seated outside China and in a country party to the New York convention related to foreign arbitral awards ; 3) the foreign law applicable to the dispute also allows ad hoc arbitration(4).

Such restrictions caused great complexity and inconveniences, especially in that, the ad hoc arbitration being foreign-seated, the parties could not apply for interim measures before Chinese courts during the arbitration procedure.

Recently however, with the issuance of the *Opinions on Providing Judicial Protection for the Construction of Pilot Free Trade Zone*(5) by the Supreme People's Court on December 30th, 2016 (the **"Opinions"**), may have opened the door to ad hoc arbitration seated in China for disputes between enterprises registered in one of China's current 11 Pilot Free Trade Zones (**"FTZs"** ; hereby called **"FTZs enterprises"**)(6) .

II. A PROMISING YET UNCERTAIN OPTION

This opening of ad hoc arbitration seated in China is promising for at least three reasons :

1) the validity of an ad hoc arbitration clause is secured by a multi-layer check system. To avoid an ad hoc arbitration clause being held invalid by a local People's Court for unjustified reasons, the Opinions provide that if a Court considers such an arbitration clause as invalid, it should first report the case to the higher court, and if the higher court agrees with its opinion, the case shall be reported to Supreme People's Court for its final decision ;
2) the seat of arbitration being in China, it allows the parties to obtain a Chinese domestic arbitral award and avoid the long process of recognition of a foreign award by a Chinese Court; it also may allow them to directly apply for interim measures before Chinese courts during the arbitration procedure, which are a

(1) The term " China" in this article means Mainland China.
(2) Articles 16 and 18 of PRC Arbitration Law, in force since September 1st, 1995 and revised for the last time on September 1st, 2017.
(3) According to article 1 of the Interpretations of the People's Supreme Court On the Law on Applicable Law to Foreign-Related Civil Relations, a case is deemed foreign-related when one party is foreign or has its habitual residence outside China, when the subject matter is outside China, when the legal fact that leads to establishment, change or termination of the civil relation happens outside China, or in other circumstances that may be determined as foreign related. The mere fact that both parties were whole foreign owned enterprises **("WFOEs")** was not enough to characterize a foreign element, as WFOEs are chinese companies.
(4) Opinion issued by the Beijing Higher People's Court on December 3rd, 1999 (北京市高级人民法院关于审理请求裁定仲裁协议效力、申请撤销仲裁裁决案件的若干问题的意见，1999年12月3日).
(5) 最高人民法院，关于为自由贸易试验区建设提供司法保障的意见，2016年12月30日，法发[2016]34号.
(6) Article 9 of the Opinions provides that the arbitration agreement between two FTZs enterprises "which have agreed with each other to settle relevant disputes in a specific location in mainland China in accordance with specific arbitration rules and by specific arbitrators may be held valid".

great advantage compared to foreign-seated or even Hong Kong seated arbitrations ;
3) if this experiment is a success in FTZs, the reform may possibly be extended to the entire PRC territory in the future.

However, the PRC Arbitration Law clearly provides in its Article 16 and 18 that arbitration agreements between parties must clearly specify an arbitration institution in order to be held valid. In practice, a sudden opening to ad hoc arbitration naturally raises some uncertainties and the wording chosen by the Supreme People's Court doesn't fully guarantee recognition of ad hoc arbitration agreements by Chinese Courts (the arbitration "may be held valid" instead of "shall be held valid").

Firstly, the possibility to apply for interim measures remains to be confirmed. In institutional arbitration, interim measures applications are transmitted to the People's Court via the arbitration institution(7). In terms of ad hoc arbitration, it is uncertain whether the Chinese courts would accept or not an interim measure application submitted directly from an ad hoc arbitrator or ad hoc arbitral tribunal.

Secondly, it is unclear how the competence of the ad hoc arbitrator shall be determined. In institutional arbitration, it is the arbitration institution or the judge(8) who decides upon the validity of the arbitration agreement or competence of the arbitral tribunal. In the matter of ad hoc arbitration, will the arbitral tribunal be able to decide upon its own competence, as it is the case with other countries by reference to the competence-competence doctrine or should this issue be brought before a Chinese court in case a party challenges the validity of the arbitration agreement?

Thirdly, the constitution of the ad hoc arbitral tribunal may encounter difficulties. In other countries, there generally exist rules with regard to a supporting judge who helps the parties during the constitution of the arbitral tribunal. In China, similar mechanism is currently absent, making this step delicate.

It is worth noting that the Zhuhai Arbitration Commission has worked out detailed rules about ad hoc arbitration procedure (*Hengqin FTZ rules concerning ad hoc arbitration*(9), effective from April 15, 2017), dealing with all the above-mentioned issues. However, since these rules are issued by an arbitration institution, their binding effect (specially towards Chinese courts in matter of interim measures) and scope of application remain to be examined.

III. RECOMMENDATIONS

At such an early stage of the reform and because the PRC Arbitration Law hasn't been revised, ad hoc arbitration on the basis of the Supreme People's Court's opinions is a promising but risky choice for FTZs enterprises. Thus, parties should pay a careful and thorough attention when drafting arbitration clause and should, for instance, provide for an appointing authority in case of any deadlock on the appointment of arbitrator(s).

The Opinions of the Supreme People's Court are specially relevant for hybrid arbitration clauses or arrangements whereby arbitration may physically take place at a local arbitration institution legally established in China but applying separate arbitration rules, for example UNCITRAL or ICC arbitration rules. This is generally a good compromise, which allows the foreign party to have arbitration conducted under a set of rules it is familiar with and the Chinese party to have a Chinese arbitration institution administer the arbitration proceedings (albeit with less supervision than the local institution's arbitration rules).
A consultation of legal opinions from experts is highly recommended for the review of arbitration clauses in light of the Opinions.

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(7) Article 28 of PRC Arbitration Law.
(8) Article 20 of PRC Arbitration Law.
(9) 珠海仲裁委员会，横琴自由贸易试验区临时仲裁规则.

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