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(Translation)

Mr Lemuel Woo
Clerk to Panel on Administration of
Justice and Legal Services
Legislative Council
Legislative Council Complex
1 Legislative Council Road
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Hong Kong

By E-mail
(*yfwoo@legco.gov.hk*)

Dear Mr Woo,

Panel on Administration of Justice and Legal Services
Meeting on 29 April 2019
Agenda Item on
"Cooperation between the Hong Kong Special Administrative Region and the Mainland on arbitration-related matters"

At the above meeting, the Department of Justice was requested to provide supplementary information on whether, under Mainland laws, wholly owned Hong Kong enterprises (WOKEs) and joint ventures set up by Hong Kong investors in the Mainland are not allowed to submit a dispute to an arbitral institution outside the Mainland (e.g. an arbitral institution in Hong Kong) for arbitration owing to the absence of foreign-related elements. Our reply is set out below for Members' reference.

1. Different views in the sector

We note different views in the sector regarding the above matter. One view is that since Mainland laws do not expressly prohibit parties to a

contract from submitting a dispute to an arbitral institution outside the Mainland for arbitration in the absence of foreign-related elements, the parties concerned, who have the right to enter into a contract on their own free will under Article 4 of the Contract Law of the People's Republic of China ("**Contract Law**")[1], may specify in an arbitration agreement the submission of a dispute to an arbitral institution outside the Mainland for arbitration. In practice there are relevant cases involving the submission of a dispute to an arbitral institution outside the Mainland for arbitration by both parties in the absence of foreign-related elements.

Another view is that since wholly owned enterprises and joint ventures set up by foreign investors (including Hong Kong investors) in the Mainland are treated as Mainland legal persons under Mainland laws, they do not have any express right to submit a dispute to an arbitral institution outside the Mainland (including an arbitral institution in Hong Kong) for arbitration in the absence of any foreign-related elements in the dispute.

Determination of foreign-related elements

Article 1 of the Interpretation of the Supreme People's Court ("**SPC**") on Several Issues Concerning the Law of the People's Republic of China ("**PRC**") on the Application of Law to Civil Relations Involving Foreign Interests (1) ("**SPC's Interpretation**") (Fashi [2012] No. 24) promulgated in 2012 sets out the situations where a people's court may determine civil relations as foreign-related civil relations:

"Where a civil relation falls under any of the following circumstances, the people's court may determine it as foreign-related civil relation:

(1) where either party or both parties are foreign citizens, foreign legal persons or other organisations or stateless persons;

(2) where the habitual residence of either party or both parties is located outside the territory of the People's Republic of China

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[1] That Article provides: "The parties shall, pursuant to law, have the right to enter into a contract on their own free will, and no unit or person may unlawfully interfere."

(3) where the subject matter is outside the territory of the People's Republic of China;

(4) where the legal fact that leads to establishment, change or termination of civil relation happens outside the territory of the People's Republic of China; or

(5) other circumstances under which the civil relation may be determined as foreign-related civil relation."

Under Article 128 of the Contract Law, the parties to a foreign-related contract may, according to the arbitration agreement, apply to a Chinese arbitral institution or any other arbitral institution for arbitration[2]. According to the Interpretation of the Contract Law of the PRC, "any other arbitral institution" means an arbitral institution outside the Mainland[3]. Since a "Chinese arbitral institution" is established in accordance with the Arbitration Law of the PRC, an arbitral institution in Hong Kong falls within the meaning of "any other arbitral institution" under the Contract Law, and Mainland laws only expressly provide that the parties to a foreign-related contract may apply to an arbitral institution in Hong Kong for arbitration.

2. Different case authorities in the Mainland

In a reply to an application for recognition of arbitral awards made by the Korean Commercial Arbitration Board in 2013, the SPC categorically stated that in the absence of foreign-related elements, the contractual term under which the Chinese legal persons concerned agreed to submit a dispute to the Korean Commercial Arbitration Board (i.e. "any other arbitral institution" under the Contract Law) for arbitration was invalid:

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[2] Article 128 of the Contract Law provides:

Article 128(1): "The parties may settle contract disputes through consultations or mediation."

Article 128(2): "If the parties are unwilling to resort to consultation or mediation, or such consultation or mediation fails, the parties may apply to an arbitral institution for arbitration according to the arbitration agreement. The parties to a foreign-related contract may, according to the arbitration agreement, apply to a Chinese arbitral institution or any other arbitral institution for arbitration. If the parties have no arbitration agreement or the arbitration agreement is invalid, they may initiate an action in a people's court. The parties shall implement any legally effective judgment, arbitral award or letter of mediation; in case of a refusal to implement, the other party may apply to a people's court for execution."

[3] Interpretation of the Contract Law of the PRC: "...The parties to a foreign-related contract may agree to apply not only to a Chinese arbitral institution for arbitration, but also to an arbitral institution outside the Mainland for arbitration."

> "...both parties to the Written Contract are Chinese legal persons ... In the absence of any foreign-related civil relations as a key constituent element, the Written Contract is not a foreign-related one. Under Article 271 of the Civil Procedure Law of the PRC[4] and Article 128(2) of the Contract Law of the PRC, PRC laws do not confer on any parties the right to submit a dispute without any foreign-related elements to an arbitral institution outside the Mainland or for ad hoc arbitration outside the Mainland. Therefore, the contractual term under which the parties to the present case agreed to submit a dispute to the Korean Commercial Arbitration Board for arbitration is invalid."[5]

On the other hand, in the case *Siemens International Trading (Shanghai) Co. Ltd. v Shanghai Golden Landmark Co., Ltd.* on the application for recognition and enforcement of a foreign arbitral award ([2013] Hu Yi Zhong Min Ren (Wai Zhong) Zi No.2), Shanghai No.1 Intermediate People's Court adopted a more relaxed approach to determine the "foreign-related element" between wholly foreign-owned enterprises incorporated in the free trade zone; that is to say, (1) although Siemens and Golden Landmark were both Chinese legal persons, they were incorporated in the Shanghai Pilot Free Trade Zone and were wholly foreign-owned enterprises in nature, having close relations with their investors outside the Mainland; (2) the course of circulation of the subject matter of the contract had certain characteristics of international sales of goods. Therefore, the Court held that the arbitration clause on the submission of the dispute to the Singapore International Arbitration Centre (SIAC) for arbitration was valid.

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[4] Article 271 of the Civil Procedure Law provides:

"In the case of a dispute arising from the economic, trade, transport or maritime activities involving foreign-related element, if the parties have had an arbitration clause in the contract concerned or have subsequently reached a written arbitration agreement stipulating the submission of the dispute for arbitration to an arbitral institution in the People's Republic of China handling cases involving a foreign-related element, or to any other arbitral institution, they may not bring an action in a people's court.

If the parties have not had an arbitration clause in the contract concerned or have not subsequently reached a written arbitration agreement, they may bring an action in a people's court."

[5] Reply to the Instruction Request on a Case Concerning the Application of Beijing Chao Lai Xin Sheng Sport and Leisure Limited Company for Recognition of the Arbitral Awards Nos. 12113-0011 and 12112-0012 made by the Korean Commercial Arbitration Board ([2013] Min Si Ta Zi No. 64)

To sum up, whether a contract concluded between two foreign-invested enterprises (including Hong Kong-invested enterprises) in the Mainland is determined as having a foreign-related element depends accordingly on whether the civil relations involved in the contract fall within the ambit of the SPC's Interpretation, for example, whether the subject matter of the contract is outside the territory of the PRC.

3. A case involving a dispute over arbitral jurisdiction in Singapore

In July this year, the Singapore High Court heard a case involving a dispute over the arbitral jurisdiction of the SIAC[6]. In that case, Article 14.1 of the agreement concluded by both parties provided that "*[t]his Agreement shall be governed by the laws of the People's Republic of China*", and Article 14.2 provided that disputes arising out of or relating to the agreement "*shall be finally submitted to the Singapore International Arbitration Centre (SIAC) for arbitration in Shanghai, which will be conducted in accordance with its Arbitration Rules.*"

At the arbitration stage, the plaintiff in the case challenged the arbitral tribunal's jurisdiction. Two out of three arbitrators of the arbitral tribunal held that the tribunal had jurisdiction over the dispute because: (i) the arbitration was seated in Singapore; (ii) the arbitration agreement was thereby governed by Singapore law; (iii) PRC law was irrelevant on the question of jurisdiction. The other arbitrator, dissenting, held that the tribunal lacked jurisdiction over the dispute because: (i) the proper law of the arbitration agreement should be PRC law; (ii) the parties' dispute was classified in PRC law as a domestic dispute; (iii) PRC law prohibited a foreign arbitral institution from administering the arbitration of a domestic dispute.

The Court accepted the plaintiff's submission on the validity of the arbitration agreement under PRC law, that it was likely that the parties' arbitration agreement was invalid if PRC law was the applicable law. That was either because the parties' dispute did not satisfy test regarding the foreign-related elements in PRC arbitration law or because PRC arbitration law did not allow a foreign arbitral institution to administer an arbitration in the PRC.

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[6] BNA v BNB and another [2019] SGHC 142

The Court held that the provision of Article 14.1 that PRC law was the proper law of the agreement was not applicable to the parties' arbitration agreement. Since Rule 18.1 of the SIAC Rules (2013 edition) provided that the seat of arbitration shall be Singapore in the absence of any circumstances to the contrary, the Court ultimately held that the arbitration agreement should be governed by Singapore law and dismissed the plaintiff's application.

4. Conclusion

Against the above (and views within the sector and the uncertainties), the Department of Justice will continue to consult the Mainland authorities on the possibility of introducing an initiative[7] to enable Mainland parties (including WOKEs set up by Hong Kong investors in the Mainland) in the Greater Bay Area to choose Hong Kong as the seat of arbitration regardless of the presence or absence of any foreign-related elements in the civil and commercial disputes concerned. This will give foreign-invested enterprises more definite options for the venue of commercial dispute resolution.

Yours sincerely,

(Hinz Chiu)
Administrative Assistant
to Secretary for Justice

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[7] As mentioned in paragraph 11 of the paper (CB(4)782/18-19(02)) submitted to the Panel, we have noted the arbitration-related liberalisation measures put in place by the Mainland for free trade zones in recent years.