Draft Law Potentially Lifts Prohibition on *Ad Hoc* Arbitrations in China

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Introduction

Arbitrations are by-and-large divided into two categories – those that are administered by an arbitral institution (institutional arbitrations) and those that are not (*ad hoc* arbitrations). *Ad hoc* arbitrations are usually cheaper and more flexible, but lack the support and supervision of a well-organised institution. As such, the Arbitration Law of the People's Republic of China ("**Arbitration Law**"), first released in 1994 and last updated in 2017, prohibited *ad hoc* arbitrations in China. This prohibition still remains as a general rule in the current legal system, although judicial authorities have made some small, case-by-case exceptions.

Almost 30 years later, China's arbitration system has undergone significant developments, and more and more scholars are advocating for *ad hoc* arbitration in China's domestic arbitration system.

On 30 July 2021, the Ministry of Justice of the People's Republic of China ("**Ministry of Justice**") published the Arbitration Law of the People's Republic of China (Amended Version) (Draft for Comments) (the "**Draft Arbitration Law**") for public consultation. The Draft Arbitration Law introduces for the first time the rules of *ad hoc* arbitration into the domestic arbitration regime.

Current Rules

The current Arbitration Law does not recognise the concept of *ad hoc* arbitration. On the contrary, an arbitration agreement must designate an arbitral institution to be valid (see Article 16 of the Arbitration Law). In addition, the Beijing High Court has issued an opinion specifically stating that "… we are of the view that

the parties' agreement to arbitrate on an *ad hoc* basis in China in accordance with its arbitration laws shall be deemed invalid, because such an agreement is contrary to the provisions of Chinese law".

However, an arbitral award arising from a foreign-seated *ad hoc* arbitration may be recognised and enforced in China. The Chinese courts will examine whether *ad hoc* arbitration is recognised by the law chosen by the parties to govern the arbitration clause or, in the absence of which, the law of the place of arbitration. If so, the arbitration agreement, and the arbitral awards therefrom arising, shall be deemed valid, and the *ad hoc* arbitral award can be enforced in China.

Although the current legislation does not recognise *ad hoc* arbitration, *ad hoc* arbitration has been adopted in some pilot free trade zones in China since 2016 as a test.

Proposed New Rules

On 30 July 2021, the Ministry of Justice published the Draft Arbitration Law to the public seeking comments. In the Draft Arbitration Law, there are three new articles which set out the rules of *ad hoc* arbitration in China, namely, Articles 91, 92 and 93. The Ministry of Justice has explained that *ad hoc* arbitration is the "original" form of arbitration which has been globally accepted and recognised by national laws and international conventions. China is a member to the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("**New York Convention**"). As the New York Convention recognises *ad hoc* arbitration, Chinese law should also allow it.

The three articles are under Chapter 7 "Special Provisions for Arbitration Concerning Foreign-Related Elements". Therefore, the Draft Arbitration Law limits the application of *ad hoc* arbitration only to disputes that have a foreign element. Foreign-related elements mean:

1. At least one party concerned is a foreign citizen, legal person, or organisation in a foreign jurisdiction;
2. The habitual residence of at least one party to the arbitration is outside the territory of China;
3. The subject matter is outside the territory of China; and/or
4. The legal facts that establish, change, or eliminate the civil relations between the parties took place outside the territory of China.

For the purpose of determining whether a dispute has a foreign element, Hong Kong, Macau and Taiwan, which are politically considered as part of China, shall be treated as a foreign territory.

We set out our comments on aspects of the three new articles below.

Article 91

> "Parties to a commercial dispute with foreign elements may agree to arbitration by an arbitration institution or directly by an *ad hoc* arbitral tribunal…" [emphasis added]

Article 91 sets out a further requirement for *ad hoc* arbitration, namely that it must be a commercial dispute. This was because merchants dealing with cross-border transactions are generally considered to be more experienced in sophisticated arbitration.

As this is only the beginning of the *ad hoc* arbitration regime in China, it is understandable that legislators may want to start from a "safer" area that offers more guiding precedents and many experienced arbitrators and practitioners. However, it may be undesirable to exclude non-commercial disputes as:

1. Nowadays, the distinction between commercial and non-commercial disputes is less obvious and may become another issue in dispute.
2. It has already been established that certain civil, non-commercial disputes such as matrimonial and family disputes are not arbitrable.

Article 92

> "In the situation of an *ad hoc* arbitration, if it is not possible to form the arbitral tribunal in time or if it is necessary to decide on recusal matters, the parties may agree to entrust an arbitration institution to assist in forming the tribunal and deciding on recusal matters. If the parties fail to reach an agreement on the choice of arbitration institution, the intermediate people's court at the place of arbitration, the place where the parties are located or the place that has a close connection with the dispute shall appoint an arbitration institution to assist with the decisions …" [emphasis added]

Article 92 aims to resolve any issues with appointing the arbitral tribunal without administration by an arbitral institution. In practice, it is very common for parties to disagree on the appointment of an arbitrator. In such cases, an *ad hoc* arbitration would be crippled without an appointing authority.

However, this article also brings some uncertainties. For instance, it references the intermediate people's court of three different places (place of arbitration, location of parties, or place with a close connection with the dispute). If these three places are different, Article 92 is unclear as to which court will have priority, especially if different parties have applied to different courts.

In addition, after an intermediate people's court appoints an arbitral institution to assist, which rules should this arbitral institution apply in the appointment of the arbitral tribunal? There are currently hundreds of arbitral institutions in China, but none with specific rules for the appointment of arbitrators for *ad hoc* arbitrations.

To avoid such uncertainties, parties should draft *ad hoc* arbitration clauses that specify an arbitral institution as the appointing authority. However, to remain distinct from an institutional arbitration, the clause should be clear that the arbitral institution shall only exercise limited power in specific situations.

Article 93

> "… The arbitral tribunal shall serve the award on the parties and shall, within thirty days from the date of service, submit the record of service and the original award to the intermediate people's court at the place of arbitration for record."

The Ministry of Justice did not explain why the original award must be submitted to the court for recording. This is unique to *ad hoc* arbitration, as there is no such requirement for an institutional arbitration. Some scholars opine that this is for the purpose of supervising the work of the *ad hoc* tribunal.

However, this article is unclear about (a) whether this affects the confidentiality of the award, and (b) whether the court has the power to review the award. In any event, the court cannot set aside an award at its own discretion without a party's application.

Concluding Remarks

The Draft Arbitration Law introduces the regime of *ad hoc* arbitration in China for the first time. This is good news for the parties who want to arbitrate in China but prefer *ad hoc* arbitration. Such parties should specify as many details as possible in the arbitration agreement, so as to avoid any uncertainty. Legal advice should be sought to ensure that an *ad hoc* arbitration agreement is valid in China.

It is notable that these three articles are very simple and only set up the basic framework for *ad hoc* arbitration. Given that an *ad hoc* arbitration will not be administrated by an arbitral institution under its arbitration rules, parties can rely only on their arbitration agreements and legal provisions. Therefore, the proposed new articles in the Draft Arbitration Law do not appear to be sufficient.

Nonetheless, this is not the final version and is subject to further amendments. We are of the view that the final version will maintain the *ad hoc* arbitration regime and may add more details to the current framework.

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