

Arbitration in China

**- a keynote speech by the Secretary for Justice,
the Hon WONG Yan-lung, SC,
at a Conference held at the Conrad Hotel, Hong Kong
on Monday, 28 November 2005**

Dr Wang Sheng Chang, Mr Philip Yang, Ladies and Gentlemen,

It is a great honour for me to be invited to address this important Conference, which is jointly organized by CIETAC and the HKIAC.

2. To those of you who are visiting Hong Kong, I wish you a very warm welcome and hope that your stay is both rewarding and enjoyable.

3. The PRC's dramatic economic development has led to vast amounts of capital being invested in China, and to foreign business deals of unprecedented volume and value. Inevitably, disputes will sometimes arise and will need to be resolved as fairly and efficiently as possible.

4. Today's conference on Arbitration in China is a timely opportunity for us to consider the advantages of arbitration as a form of dispute resolution; the options that are open to contracting parties in terms of the place of arbitration; and some of the criteria that parties may wish to consider when deciding when and where to arbitrate.

The advantages of arbitration

5. First, the advantages of arbitration over other forms of dispute resolution. I think it is fair to say that arbitration has established itself as the leading process for resolving international business disputes. Several reasons have been advanced for the popularity of arbitration.

6. In relation to international disputes, arbitration is often seen as being more neutral than litigation. There is no truly international court for the

resolution of transnational commercial disputes. Litigation is usually instituted in the courts of the state where either the defendant or the plaintiff resides. This raises the possibility of actual or perceived bias on the part of the court. Arbitration offers the possibility of a neutral panel of adjudicators. It is no accident that the place often chosen for the arbitration is in a third country.

7. Another advantage of arbitration is the extent to which arbitral awards can be enforced in other countries. The New York Convention, which is in force in over 130 countries, provides that each contracting state shall recognise and enforce awards made in those countries. This compares very favourably with court judgments, where enforcement overseas depends generally upon bilateral agreements, which have less coverage than the New York Convention.

8. Compared with court judgments, arbitral awards also offer greater finality. The opportunities for appeals against arbitral awards are more limited. And, unlike most court proceedings, arbitral proceedings are not held in public. Many businessmen prefer to handle their disputes behind closed doors, so that their contractual arrangements and disputes are not publicised.

9. Other advantages that are enjoyed by arbitration are the expertise of the arbitrators; the flexibility of the procedures; the speed of the proceedings and their cost-effectiveness.

The choice of venue

10. As I have just mentioned, the location of arbitration proceedings may be an important matter for the contracting parties. Under Hong Kong law, parties to any type of contract are free to decide where disputes are to be arbitrated, and what law is to apply to the arbitration. To what extent can those doing business in Taiwan, Macau or the Mainland choose to have their disputes arbitrated in Hong Kong?

11. I understand that, under Taiwan law, parties to an arbitration agreement are free to choose Hong Kong as a place of arbitration. It appears

that, under Macau law, parties to an *external* commercial arbitration enjoy the same freedom. An arbitration is regarded as external if, for instance, the parties to an arbitration agreement have, at the time of the conclusion of that agreement, their places of businesses in different states or territories.

12. The position under Mainland law is more complicated. Article 15 of the *Law on Chinese-foreign Equity Joint Ventures* and Article 25 of the *Law on Chinese-foreign Contractual Joint Ventures* both deal with disputes arising between the parties to a Chinese-foreign joint venture that have not been settled through consultation. The Articles provide that the parties may agree to settle those disputes through arbitration by an arbitration agency of China or elsewhere.

13. Article 128 of the *Contract Law* of China provides that the parties to a foreign-related contract may, according to the arbitration agreement, apply to a Chinese arbitration institution or any other arbitration institution for arbitration.

14. As you will note, the general rule appears to be that only where a contract has a foreign element can the parties agree to arbitrate outside the Mainland. A vital question for many foreign investors in the Mainland is therefore “when does a contract involve a foreign element?”

15. This is of particular importance to Foreign Investment Enterprises (“FIEs”) set up in the Mainland, such as equity joint ventures and co-operative joint ventures. They ask whether contracts entered into by them will necessarily involve a foreign element. Although the matter is not entirely clear, the view in the Mainland appears to be that this is not the case, since these FIEs have the status of a Chinese legal person.

Foreign element

16. According to an Opinion of the Supreme People’s Court, a contract is considered to involve a foreign element where –

- (1) one or both parties to the contract are foreign nationals, stateless persons or foreign legal persons;
- (2) the subject matter of the contract is located in a foreign country; or
- (3) the act which gives rise to, modifies or extinguishes the rights and obligations under the contract occurs in a foreign country.

17. How does this principle apply to a Hong Kong or Macau element in a contract? It appears to be implicit in Certain Answers by the Supreme People's Court that parties to an economic dispute involving Hong Kong or Macau element may choose arbitration before a foreign arbitration institution, including a Hong Kong or Macau arbitration institution. For this purpose, the question whether there is a Hong Kong or Macau element is to be decided in a similar way to the "foreign element" question, but substituting references to Hong Kong or Macau, or a Hong Kong or Macau party, for references to a foreign country or a foreign party.

18. These clarifications by the Supreme People's Court have been helpful, but there are other questions that are still unresolved. The Department of Justice has been seeking clarification on these points, since it is of great importance to many foreign investors. They need to know whether they are free to agree to arbitrations outside the Mainland and, if they do so, whether the award will be recognized in the Mainland. I hope that further clarification will be given by the Supreme People's Court in the near future.

Enforcement of Mainland and Hong Kong awards

19. Let me turn now to the enforcement of arbitral awards within Greater China. I mentioned earlier that one of the benefits of arbitration is that the New York Convention applies in over 130 countries and that arbitral awards in any of those countries are enforceable in any of other of those countries.

20. Hong Kong and the Mainland are, of course, part of one country, and so the New York Convention does not make Hong Kong arbitral awards

enforceable in the Mainland or vice versa. However, in June 1999, a Memorandum of Understanding concerning the Mutual Enforcement of Arbitration Awards between the Mainland and the Hong Kong SAR was signed by the Deputy President of the Supreme People's Court and Hong Kong's Secretary for Justice, my predecessor, Ms Elsie Leung. This Memorandum of Understanding reflected the spirit of the 1958 New York Convention, and provided for mutual enforcement of awards on a similar basis to that in the Convention. The necessary steps were then taken under Hong Kong and Mainland law to implement the arrangement, which came into force on 1 February 2000.

21. Mainland awards enforceable in Hong Kong under this Arrangement are those made by recognised Mainland arbitration authorities. At present, there are over 100 such recognised authorities.

22. Between the coming into effect of the Arrangement in February 2000 and July 2005, 63 applications for enforcement of Mainland arbitration awards were made in Hong Kong. The local court granted leave for the awards to be enforced in all 63 cases. In only 4 of these cases were the court orders granting leave for enforcement subsequently set aside. I understand that 3 of these orders were set aside with the consent of the parties. In the remaining case, the order was set aside upon the Court finding that the award was not enforceable under section 40C of the Arbitration Ordinance. That section provides that, as a general rule, a Mainland award shall not be enforceable in Hong Kong if an application has been made in the Mainland for enforcement of the award.

23. Under the Arbitration Ordinance, a defendant who seeks to resist the enforcement of a Mainland award in Hong Kong must prove the existence of one of the statutory grounds of refusal of enforcement. Judging from the case law developed by Hong Kong courts in this regard, the task faced by the defendant is not an easy one. For instance, it was decided in one case that the defendants in the enforcement proceedings were stopped from raising issues which they took no objection in the Mainland arbitral proceedings. In another case, the court stated that there must be compelling reasons before enforcement

of a Mainland award could be refused on public policy grounds.

24. When the Arrangement was set up, questions had been raised about the logistical challenge the Hong Kong courts might face in dealing with an influx of applications for enforcement of Mainland awards. However, the experience in the past 5 years shows that the Hong Kong courts have had no difficulties in coping with the Arrangement. The number of such applications each year has not been great. In the first year of its implementation (the year 2000) there were 30 applications. This number presumably reflected a back-log of cases after the previous mechanism ended in 1997. Since then, there has been an average of about 8 applications a year. Moreover, in about 75 percent of the cases the defendants did not seek to set aside the court orders granting leave for enforcement.

25. As the awards made in Hong Kong can also be enforced in the Mainland, the Arrangement no doubt serves to encourage Mainland enterprises, as well as foreign investors in the Mainland, to employ arbitration services in Hong Kong and thereby strengthen Hong Kong's role as a regional disputes resolution centre.

26. Since the Arrangement came into effect, my Department has been actively monitoring its implementation in conjunction with the legal profession. In particular, views on the effectiveness of the arrangements for the enforcement of Hong Kong arbitration awards in the Mainland have been collected by a Working Party. These views have been reflected to the Mainland authorities by the Department of Justice, and appropriate adjustments and measures have been taken on board.

Enforcement of Taiwan and Macau awards in Hong Kong

27. Arbitral awards made in Taiwan and Macau, like any other awards, are enforceable in Hong Kong by means of a common law action. At common law, there is an implied promise in every arbitration agreement that the parties will perform the award. If a party acts in breach of this implied agreement, the other party may bring an action of enforcement in any court of competent

jurisdiction.

28. Alternatively, Taiwan and Macau awards may be summarily enforced under section 2GG of Hong Kong's Arbitration Ordinance. Under that section, an award made or given, whether in or outside Hong Kong, by an arbitral tribunal is enforceable in the same way as a judgment of the Court of First Instance, but only with the leave of the Court. If leave is given, the Court may enter judgment in terms of the award.

29. When exercising its discretion whether to grant leave to enforce a Taiwan award, a local court is likely to have regard to the common law principles followed locally by the Court of Final Appeal [in *Chen Li Hong v Ting Lei Miao* [2000] 1 HKLRD 252]. Those principles are to the effect that particular acts of a government (which is recognized neither de jure nor de facto) may, in the interests of justice and common sense and for the preservation of law and order, be recognized by domestic courts where private rights are concerned and where no consideration of public policy to the contrary has to prevail.

Enforcement of Hong Kong awards in Taiwan and Macau

30. I understand that Hong Kong awards are enforceable in Taiwan pursuant to the Regulations on Hong Kong and Macau Relations promulgated on 2 April 1997. Under those Regulations, the force and effect, judicial recognition and suspension of enforcement of an award made in Hong Kong or Macau is governed by the provisions on foreign awards in the Taiwan Arbitration Law 1998. In principle, Taiwan courts will recognize and enforce foreign awards (and hence Hong Kong awards) save where one of the limited and specified statutory grounds of refusal is proven (e.g. the award being contrary to the public order or good morals of Taiwan).

31. Hong Kong awards are enforceable in Macau pursuant to either the Code of Civil Procedure or the Decree Law which embodies the Model Law on International Commercial Arbitration adopted by the United Nations Commission on International Trade Law ("UNCITRAL"). Enforcement of a

Hong Kong award may be refused only on certain limited grounds specified in law.

Competition

32. So much for the general merits of arbitration, the choices that are available in respect of venue, and the ability to enforce arbitral awards elsewhere. Given the healthy competition that exists for arbitration services, it is natural that each jurisdiction will try to promote itself as the ideal place in which to arbitrate. I hope, therefore, that I may be permitted to say a few words about the advantages of arbitration in Hong Kong.

Hong Kong's strengths

33. Let me first summarise some of the underlying strengths of Hong Kong as a dispute resolution centre.

- (1) We have a sound legal system, based upon the rule of law, an independent judiciary, and common law principles which are widely recognized and respected by the international business sector;
- (2) we have a wealth of English-speaking legal practitioners and internationally renowned arbitrators specializing in litigation and arbitration services; and we have a wealth of Chinese-speaking practitioners with knowledge of China, of market operations in the Mainland, and of Chinese law, and they are experienced in handling the negotiation and preparation of Mainland legal documentation;
- (3) Hong Kong is a world centre of expertise in commerce, finance, I.T., shipping and construction, with an enormous pool of experienced professionals offering specialist advice and assistance in dispute resolution;
- (4) we have an ideal geographic location, which enables Hong Kong lawyers and Mainland investors to conduct business efficiently and cost-effectively;

- (5) we have a combination of superb infrastructure, first rate communication and transport systems, and excellent choices of accommodation;
- (6) we have the world-class Hong Kong International Arbitration Centre which makes about 300 awards each year.

Hong Kong's arbitration law

34. In Hong Kong, the law applicable to international arbitration is based squarely on the UNCITRAL Model Law on Commercial Arbitration. That Model Law was adopted by the United Nations Commission on International Trade Law in June 1985 and was endorsed by the UN's General Assembly in December 1985. The General Assembly commended the Model Law to all states "in view of the desirability of uniformity of arbitral procedures and the specific needs of international commercial arbitration practice."

35. The Model Law was designed to meet concerns relating to the state of national laws on arbitration. It was considered that domestic laws were often inappropriate for international cases and that considerable disparity existed between them. By incorporating the UNCITRAL Model into the Arbitration Ordinance, Hong Kong has not only created a regime that is appropriate for international arbitration, but also ensured that the applicable law is based on an internationally recognized text. Many of the linguistic problems that arise from a foreign arbitration law will therefore be avoided if arbitration takes place in Hong Kong.

36. I would add that Hong Kong's arbitration law specifies a different regime for domestic arbitrations. The resulting dual system has its critics, since it does make the law more complex and perhaps more daunting for international businessmen to comprehend. In the light of the constructive criticism that has been made of the current law, my department is actively reviewing it, with a view to creating a single regime based on the UNCITRAL Law.

Promoting Hong Kong as a centre of arbitration

37. One of my department's policy objectives is to assist in building up Hong Kong as a regional centre for legal services and dispute resolution. Our targets in pursuing this policy objective include :

- (1) to promote understanding in the Mainland and in other countries of the advantages that Hong Kong offers as a regional centre for legal services and dispute resolution;
- (2) to make Hong Kong more attractive as a dispute resolution centre; and
- (3) to improve the regulatory framework within which lawyers can provide their services in Hong Kong.

38. In pursuing these targets, my department keeps in close contact with the two legal professional bodies, and other professional bodies such as the Hong Kong International Arbitration Centre ("HKIAC").

39. The HKIAC was set up in 1985 with the support of the Government and the private sector, and provides an independent venue for dispute resolution. In the past decade or so, there has been a remarkable growth in terms of its caseload. In 1992, it provided arbitration services in 184 cases. By 2004, its caseload went up to 280 cases. These figures compare favourably with figures for arbitrations in London in those two years, which were 21 and 87 cases respectively. In Singapore, the figures were 7 in 1992 and 51 in 2004.

40. There has been a steady growth in HKIAC's arbitration services in relation to cross-boundary trade. Of the 280 cases in 2004, 20 cases involved both parties being Mainland entities or nationals. This compares with only five cases in 2000. The amounts in dispute ranged from HK\$20,000 to over HK\$460 million.

Mainland companies arbitrating in Hong Kong

41. The increasing number of Mainland companies choosing to arbitrate in Hong Kong has led to a recent development in local arbitration procedures. It became apparent to the HKIAC that many Mainland companies are not familiar with the ad hoc procedures that commonly apply to arbitrations in Hong Kong. Under the Mainland system, all arbitrations are referred to an arbitration commission which then administers the arbitration. Mainland parties are not therefore familiar with Hong Kong arrangements whereby, after an arbitrator is appointed, he or she may handle the arbitration independently of any arbitration commission.

42. In order to assist Mainland companies, this April the HKIAC adopted institutionalised rules for arbitration. If contracting parties wish to operate under those procedures, they can provide for this in their contract. If a dispute then arises, the HKIAC will administer the arbitration, and will assist the parties in handling various issues that need to be resolved with the arbitrator.

APRAG Conference

43. All these developments indicate the responsiveness of Hong Kong to the needs of those seeking arbitral services. As a member of the Asia Pacific Regional Arbitration Group (“APRAG”), the HKIAC is keen to play an active part in the development of arbitration in this region.

44. Recently, I was delighted to learn that the First APRAG Conference, to be held towards the end of next year, is to be hosted in Hong Kong by the HKIAC. This will be a great opportunity for more than twenty regional arbitration bodies to share their experiences. I hope that many of you here today will be able to attend that conference.

Conclusion

45. Ladies and gentlemen, I have tried to give an overview of some of the key questions that contracting parties need to consider when deciding how

to resolve their disputes. And I have tried to explain some of the advantages offered by arbitration in Hong Kong.

46. During the rest of today's Conference, you will be hearing from arbitration experts about more detailed aspects of arbitration, not only in Hong Kong but also in the Mainland, Taiwan and Macau. I have no doubt that they will throw much light on important issues of concern to you.

47. I hope you will all have a most fruitful and enjoyable day here at this Conference.