瑞士文斐律师事务所
WENFEI ATTORNEYS-AT-LAW LTD.

China Legal Report*

May 2019

* CHINA LEGAL Report is a monthly review of Chinese law related topics gathered from various media and news services, edited by WENFEI ATTORNEYS-AT-LAW LTD. distributed to its clients and CHINA LEGAL REPORT subscribers.

WENFEI ATTORNEYS-AT-LAW LTD. does not accept responsibility for accuracy of quotes or truthfulness of content. CHINA LEGAL REPORT is not intended to provide advice.

Subject	China's Legal Practices Concerning Objection to Jurisdiction in Respect of Pre-arbitral Dispute Resolution Steps in Multi-tiered Dispute Resolution Agreement
I.	Introduction
II.	Related Arbitral Practices in China
II.	Related Judicial Practices in China
VI.	Conclusion

I. Introduction

Different dispute resolution mechanisms have different advantages and disadvantages. Reconciliation demands strong desirability, brings high efficiency and weak confrontation; litigation brings strong confrontation, demands weak desirability and in some cases is inefficient. Thus, in the process of contracts formation, the parties occasionally agree on more than one mechanism of dispute resolution to neutralize the pros and cons of different methods, this also leads the popularity in adopting a "multi-tiered dispute resolution clause" in contracts.

Compared with litigation, the arbitration procedure is more flexible and efficient; however, arbitration would still be deemed more complicated than negotiation. Meanwhile, as the parties in commercial transactions often maintain relatively stable cooperative relationships, in order to resolve the disputes arising in the transaction process in a friendly and rapid manner, the parties often conclude a "pre-arbitral negotiation clause" in their multi-tiered dispute resolution agreement.

Pre-arbitral negotiation clauses can generally be divided into two categories:

1. Pre-arbitral negotiation clause *without* fixed negotiation period, which generally states: Any dispute arising out of or in connection with this agreement shall be resolved through friendly negotiation between the parties. If the negotiation fails, the dispute shall be submitted to an arbitration institute (i.e. the China International Economic and Trade Arbitration Committee ("CIETAC")) to be arbitrated in Beijing in accordance with its arbitration procedures and rules.

2. Pre-arbitral negotiation clause *with* fixed negotiation period, which generally states: Any dispute arising out of or in connection with this agreement shall be resolved through friendly negotiation between the Parties. If the dispute cannot be solved within sixty (60) days of the commencement of negotiation, the dispute shall be submitted to an arbitration institute (i.e. the China International Economic and Trade Arbitration Committee ("CIETAC")) to be arbitrated in Beijing in accordance with its arbitration procedures and rules.

In foreign-related arbitration cases, since the current applicable law of China does not stipulate the legal effects of the "pre-arbitral negotiation clause", neither does the law explicitly provide whether the negotiation as agreed in the "pre-arbitral negotiation clause" shall be a pre-procedure before bringing the arbitration into account, it becomes a common phenomenon that a party would raise an objection of lack jurisdiction of the arbitral tribunal. In such case, the defending party is likely to propose that the negotiating procedure agreed in the arbitration agreement is the *precondition for arbitration*. If no negotiation has been made between the parties, the arbitration procedure shall not be initiated.

II. Related Arbitral Practices in China

Regarding this defense, in the long-term practices of arbitral tribunals in China, especially in foreign-related commercial cases, the above mentioned two categories of "pre-arbitral negotiation clauses" are basically treated the same.

For example, CIETAC holds that the negotiation will be made on the premise of voluntariness of the parties, and it will not be made if the negotiation cannot be carried out because one of the parties is lacking such intention. In this matter, if one of the parties directly preceded arbitration without negotiations, CIETAC would assume that the negotiation would be in fact impossible.

Therefore, unless the parties indicate in the arbitration agreement that the negotiation and/or other multi-tiered dispute resolution steps are the pre-procedures to the arbitration, it will be unsupported to interpret such multi-tiered dispute resolution agreement as a precondition and deprive the other party of the right to apply for arbitration under the arbitration agreement.

III. Related Judicial Practices in China

1. "Pre-arbitral negotiation clause" without fixed negotiation period

For "pre-arbitral negotiation clause" without fixed negotiation period, predicting the judgment of such negotiations seems relatively simple. Since the arbitration agreement states briefly that the negotiation shall take place before the initiation

of arbitration, the court would assume that the negotiation had failed at the time when any of the parties applies for arbitration.

The above-mentioned view has been supported by *the Supreme People's Court' Reply on Runhe Development Co., Ltd.'s application for review of the arbitral award* (hereinafter referred to as the "*Runhe Case*"). Runhe Development Co., Ltd. ("Runhe") and Mawan Electricity (Shenzhen) Co., Ltd. ("Mawan") entered into a share transfer agreement, in which the multi-tiered dispute resolution agreement was concluded with no fixed negotiation period that provided "*Any dispute arising out of the performance of the Agreement shall be resolved through friendly negotiation. Failing that, the dispute shall be referred to CIETAC (Shenzhen) for arbitration."*

Soon after the dispute arose, Mawan commenced CIETAC arbitration in Shenzhen and won the arbitration. Runhe however, tried to resist enforcement of the award by insisting that the precondition of negotiation had not been fulfilled, and thus the arbitral tribunal had no jurisdiction.

The competent courts, namely the Changsha Intermediate People's Court and the Hunan High People's Court then ruled in favor of Runhe and did not grant the enforcement on the arbitral award, however, the Supreme People's Court in China held an opposite opinion that the award was valid and could be enforced:

"The parties agreed in general terms in the arbitration agreement without specifying the time limit of negotiation, resulting in confusion when enforcing such terms. In light of the intention of the parties when concluding the arbitration agreement, there are two conditions, i.e. 'friendly negotiation' and 'failure of negotiation'. The former is viewed as the means to be complied and the latter is viewed as the consequence to be satisfied. By commencing the arbitration, it is clear that the negotiation has failed, satisfying the second condition. Therefore, even if 'friendly negotiation' is too vague to be enforced, the second condition has been satisfied, making the case admissible before the arbitral tribunal. Accordingly, this court is not of the view with the High Court that the timing of commencing the arbitration was not ripe."

2. "Pre-arbitral negotiation clause" with fixed negotiation period

Different from the cases where no fixed negotiation period has been concluded, cases that clearly stipulate the negotiation periods are facing more complicated situations in the courts' recognition and enforcement procedures. In the practices of Chinese courts, different courts made opposite rulings concerning the "pre-arbitral negotiation clause" with fixed negotiation periods.

a. Refused Enforcement on the Arbitral Award in the "Pespi Case"

The PepsiCo vs. the Respondent Sichuan Pepsi Cola Beverage Co., Ltd. ("Sichuan Pepsi") Concerning the Application for the Recognition and Enforcement of a Foreign Arbitral Award (2005) (hereinafter referred to as the "*Pepsi Case*") has been considered the first case from the Chinese court that refused to recognize and enforce a foreign arbitral award on the grounds of negotiation period.

In this case, the parties agreed on a negotiation period in the arbitration agreement: "*If the negotiation is still not possible within 45 days after the negotiation, either party may submit the dispute to China International Economic and Trade Arbitration Commission ….*"

In its verdict, the Chengdu Intermediate Court ruled that the parties clarified in the arbitration agreement that the negotiation is the "pre-procedure" of arbitration. The court found that PepsiCo did not issue any notice of negotiation to Sichuan Pepsi, nor did it negotiate with Sichuan Pepsi, thus, PepsiCo failed in proving that it had taken out the 45-day negotiation with Sichuan Pepsi before initiating the arbitration, which shall be deemed inconsistent with the arbitration agreement agreed between the parties. Therefore, the court refused to grant enforcement on such arbitral award.

b. Granted Enforcement on the Arbitral Award in the "Revpower Case"

In *the Revpower Ltd. v. Shanghai Far-East Aero-Technology Import & Export Corporation* (hereinafter referred to as the "*Revpower Case*"), the parties reached an arbitration clause in the Compensation Trade Agreement (the "Agreement"), provided that "*All disputes or claims arising out of the Agreement shall be settled by friendly consultation between the parties if possible…..Should either party, after 60 days after the dispute arises, believe that no solution to the*

dispute can be reached through friendly consultation; such party has the right to initiate and require arbitration in Stockholm, Sweden, in accordance with the Statute of the Stockholm Chamber of Commerce."

Due to breach of contract, Revpower Ltd. terminated the Agreement and requested arbitration with the Stockholm Chamber of Commerce ("SCC") in Sweden. In the arbitration, Shanghai Far-East Aero-Technology Import & Export Corporation ("SFAIC") responded that Revpower Ltd. had no right to submit the dispute to the arbitration since the procedure, namely the pre-arbitral negotiation, set forth in Article 14 in the Agreement not had been followed.

To this point, the SCC in its arbitral award held that the arbitration agreement on the negotiation period had no effect on its jurisdiction, and believed that the period between the occurrence of the dispute and the initiation of the arbitration had long passed the agreed negotiation period. Thus, the objection to its jurisdiction submitted by the respondent SFAIC could not be supported. As SFAIC refused to execute the award, Revpower Ltd. filed a lawsuit against SFAIC with the Shanghai Intermediate People's Court and finally the aforesaid court granted the enforcement on the SCC's arbitral award.

VI. Conclusion

Strictly speaking, negotiation is not a legal term. Thus, the interpretation of such term by a court or an arbitral tribunal remains hard to predict. However, the three cases discussed in this article show at least a certain direction Chinese courts and arbitration institutions seem to follow in case of arbitration clauses with or without fixed pre-arbitral negotiation periods.

For the multi-tiered arbitration agreement without fixed period on the pre-arbitral dispute resolution steps, the Reply by the Supreme People's Court in *the Runhe Case* can be considered informative and significant, based on which, the court would indicate that the negotiation has broken down at the time when one party initiates the arbitration procedure.

As to the multi-tiered arbitration agreement specified with fixed periods on the pre-arbitral dispute resolution steps, *the Pepsi Case* foreshadows the risks of not

handling dispute in accordance with the procedures agreed in the arbitration agreement. Also, the time passed before the initiation of the arbitration had been taken into consideration by the SCC to reject the jurisdiction objection raised by the respondent in *the Revpower Case*.

Future jurisprudence will have to be taken in to consideration to keep updated ton this issue.

*****