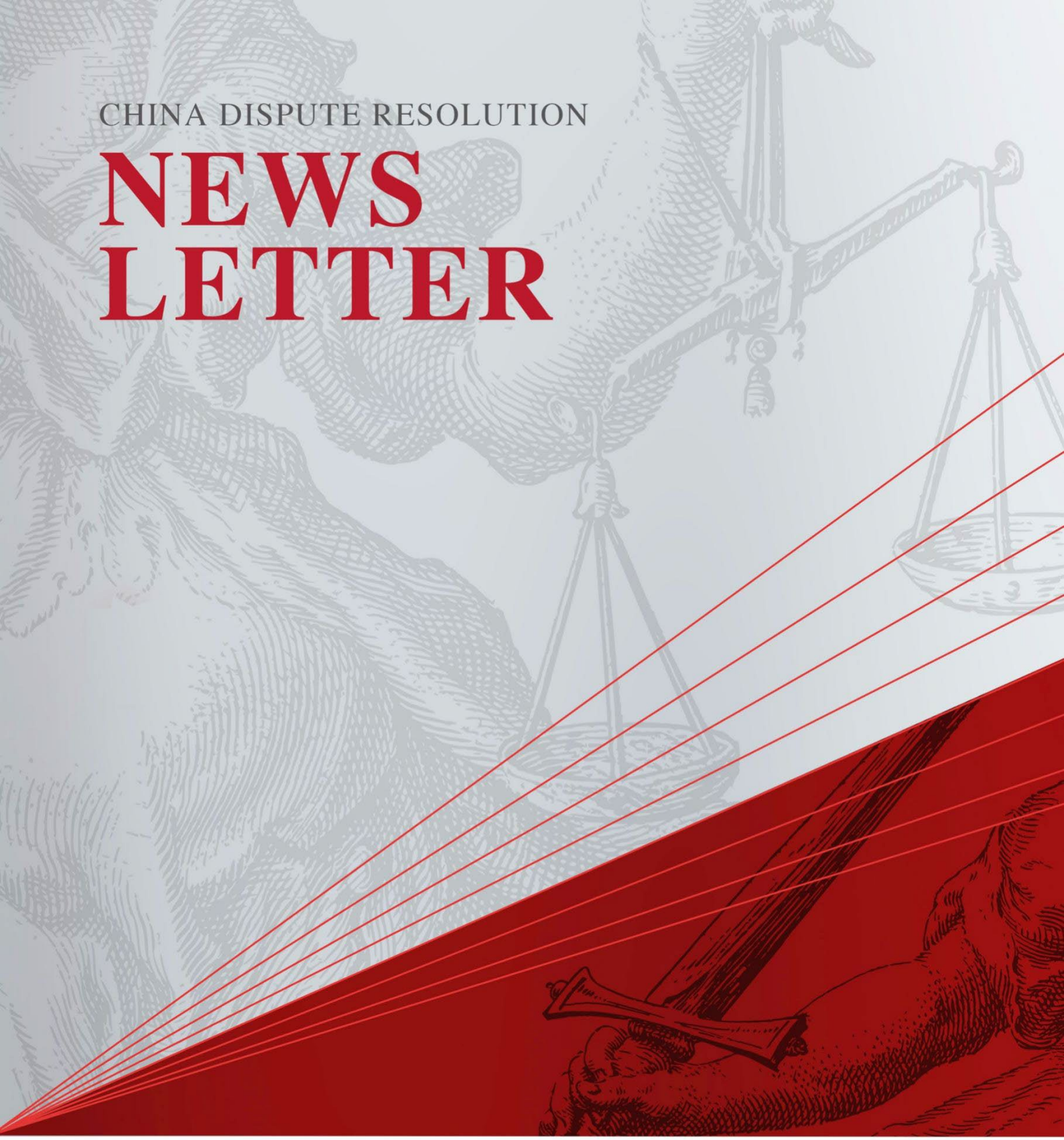
CHINA DISPUTE RESOLUTION

NEWS LETTER



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JT&N 金诚同达

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NEWS ALERT

1. **Recent PRC court judgment held that an arbitration agreement which provided two arbitration institutions was valid.**

   In the recent case of (2022) Jing 04 Min Te 212, the Beijing Fourth Intermediate People's Court ruled that an arbitration agreement providing for two arbitration institutions was valid. The arbitration agreement in that case provided that "… *any dispute arising from or in connection with the contract shall be submitted to Shanghai International Economic and Trade Arbitration Commission/Shanghai International Arbitration Center (HKIAC)*". The court ruled that Shanghai International Economic and Trade Arbitration Commission/Shanghai International Arbitration Centre (SHIAC) was validly chosen by the parties. For further details, please refer to our Case Digest at page 3, below .

2. **Recent PRC court judgement held that a third-party litigation funding agreement was invalid on the basis that the agreement in question breached public policy.**

   In a recent judgment, the Shanghai Second Intermediate People's Court ruled that a third-party funding agreement in support of litigation was invalid as a breach of public policy. It is important to note that the Court did not categorically deny the validity of third-party funding for litigation, but reasoned that the validity of a third-party funding agreement should be decided on case-by-case basis. In this case, the third-party funding agreement in question was held invalid by the court because: (i) the interests of the investor and the litigant's counsel were highly aligned; (ii) there was insufficient information/interest disclosure; and (iii) the funder had excessive control over the litigant's conduct. The combined effect of these factors undermined the litigant's liberty to direct the overall conduct of the litigation, amounting to a breach of China's public policy. For further details, please refer to our Case Digest at page 5, below.

3. **Recent PRC court judgment held that the existence of a third-party funding agreement in support of arbitration did not impact the validity of the arbitration award.**

   In November 2022, the Beijing Fourth Intermediate People's Court upheld the validity of an arbitration award that involved a third-party funding agreement. In this case, the court decided: (i) PRC legislation and regulations do not prohibit third-party funding in arbitrations. The parties' choice should be respected; (ii) PRC legislation and regulations do not require disclosure of third-party funding; (iii) whether third-party funding would give rise to arbitrator's conflict of interest should be decided based on whether such third party funding would affect the independence and impartiality of the arbitrator; and (iv) disclosure of arbitration-related information to third-party funders did not result in a breach of confidentiality with respect to the arbitration. The court noted that, the fact that the respondent proactively disclosed the existence of the third-party funding arrangement during the proceedings was conducive in enabling the parties to exercise their rights on an informed basis.

4. **Recent Beijing court judgement recognized the validity of a winding-up order issued by a German court.**

   In January 2023, the Beijing First Intermediate People's Court issued a decision recognizing a winding-up order issued by the District Court of Aachen, Germany, as well as the German court's appointment of

liquidators. This is the first example of a PRC court granting a winding-up order issued by a foreign court based on the principle of reciprocity pursuant to Article 5 of the PRC Bankruptcy Law.

5. The Hague Convention of October 5, 1961 Abolishing the Requirement of Legalization for Foreign Public Documents will become effective in China on November 7, 2023.

On March 8, 2023, China officially acceded to the Hague Convention of October 5, 1961 Abolishing the Requirement of Legalization for Foreign Public Documents (the "Convention"). The Convention will come into effect between China and other contracting states without any objections towards this accession, starting November 7, 2023. It should be noted that, as declared by China, the Convention will not be applicable between Mainland China and Hong Kong SAR or Macao SAR. According to a spokesperson of the Ministry of Foreign Affairs, China's accession to the Convention will "*streamline the procedures for transnational circulation of official documents and facilitate international economic, trade, and personnel exchanges*".

6. The Supreme People's Court issued new rules regarding jurisdiction over foreign-related civil and commercial cases.

The Provisions of the Supreme People's Court on Several Issues Relating to the Jurisdiction over Foreign-related Civil and Commercial Cases (the "Provisions") became effective on January 1, 2023. The Provisions enables all primary courts to hear foreign-related cases, unless otherwise stipulated by laws and judicial interpretations. However the first-instance trial of a foreign-related case falling under certain conditions will remain subject to the jurisdiction of an intermediate court, i.e.: (i) a case involving a dispute over a large monetary amount; (ii) a case involving complex facts or involving numerous individuals/entities; and (iii) a case that has significant influence in the respective region.

7. Measures for the Standard Contract for the Outbound Transfer of Personal Information was released and will become effective on June 1, 2023.

On February 24, 2023, the China Cyberspace Administration released the final version of the Measures for the Standard Contract for the Outbound Transfer of Personal Information (the "Measures"), together with the final version of the standard contract for outbound transfer of personal information stipulated under the Personal Information Protection Law. The Measures and the standard contract will become effective on June 1, 2023. The standard contract may be used for outbound transfer of personal information that does not require a security assessment under China's Personal Information Protection Law.

8. The International Organization for Mediation Preparatory Office was established in Hong Kong SAR.

On February 16, 2023, the Preparatory Office for the International Organization for Mediation ("IOMed") was established in Hong Kong SAR. Pursuant to the Joint Statement on the Future Establishment of the International Organization for Mediation ("Joint Statement"), which had been signed by China and other relevant states during the preceding year, IOMed is expected to become a permanent, multilateral international organization, established through consultation among all of the signatories to the Joint Statement. The primary objective of IOMed is to provide friendly, flexible, economical, and efficient mediation services for the settlement of international disputes.

Arbitration Agreement which Provided Two Arbitration Institutions, SHIAC and HKIAC, was Determined to be Valid

In a recent case of (2022) Jing 04 Min Te No. 212, the Beijing Fourth Intermediate People's Court confirmed the validity of an arbitration clause in which two arbitration institutions were provided simultaneously. This case is particularly instructive in determining the validity of arbitration clauses and highlights pro-arbitration trends in China.

Facts

On December 22, 2017, Company M and Partnership Y entered into a share transfer agreement (the "2017 Contract") written in the Chinese language, which contained an arbitration clause appointing the China International Economic and Trade Arbitration Commission ("CIETAC") as the arbitration institution. On July 16, 2018, Company M and Partnership Y agreed to an addendum to the 2017 Contract (the "2018 Contract"), also written in Chinese, which also appointed CIETAC as the arbitration institution. Subsequently, on January 25, 2019, based on the 2017 and 2018 Contracts, Partnership Y, Company M, Company W, and individual Sun entered into a Share Transfer and Entrustment Agreement (the "2019 Contract"), which was also written in Chinese. Clause 7.2 of the arbitration clause in the 2019 Contract provided "*[d]ispute Resolution: All disputes……submit to arbitration to the* ***Shanghai International Economic and Trade Arbitration Commission/Shanghai International Arbitration Centre (HKIAC)*** ...." (translated from Chinese and emphasis added).

Sun and Company commenced litigation against Partnership Y and Company W to challenge the validity of the arbitration clause. Under Chinese law, a valid arbitration clause must meet certain criteria, among other things, it must include an express agreement to submit disputes to a designated arbitration institution, and a valid arbitration clause must expressly designate an arbitration institution. Sun and Company M argued that the arbitration clause was invalid because parties had not agreed on the arbitration institution, as evidenced by the facts that: (i) the Shanghai International Arbitration Centre ("SHIAC") and the Hong Kong International Arbitration Centre ("HKIAC") were both designated as the arbitration institution under the 2019 Contract and (ii) the arbitration institution provided in the 2017 Contract, the 2018 Contract, and the 2019 Contract were inconsistent, suggesting that the parties did not reach an agreement on the arbitration institution.

Issue

The question before court was whether the arbitration institution can be determined based on the arbitration clause.

Court Decision

In the decision, the court noted that the parties' intention should be interpreted in a pro-arbitration way which supports parties' intention to arbitrate.

In this case, the court noted that the arbitration clause in dispute was written in Chinese and expressly

contained the full Chinese characters of the arbitration institution of SHIAC, which was precise, specific and unique. Considering that the contract language is Chinese, and that the identity of the arbitration institution could be confirmed by the precise Chinese words, the court ruled that abbreviation "HKIAC" in brackets would not affect the parties' intention to choose SHIAC as the sole arbitration institution.

The court also ruled that the 2017 Contract, the 2018 Contract, and the 2019 Contract were separate agreements with independent arbitration clauses. The validity of each arbitration clause will not be affected by the one provided in others. Furthermore, given that the 2019 Contract was signed after the 2017 Contract and the 2018 Contract, the agreement thereunder shall prevail. Accordingly, the validity of the arbitration clause in the 2019 Contract would not be impacted by the arbitration clauses in the 2017 Contract and the 2018 Contract.

In light of the above, the court decided that the arbitration clause in dispute was valid, and that the parties had agreed to submit disputes to SHIAC under the 2019 Contract.

Commentary

This judgment was issued subsequent to the release of the Minutes of the National Symposium on Foreign-related Commercial and Maritime Trial Work of Courts in 2022. Article 93 of which states that: *"…when reviewing whether an arbitration agreement has agreed on a definite arbitration institution, a people's court shall make the decision under the principle conducive to the validity of the arbitration agreement.*" It is evident that the underlying judgment drew upon the rationale of Article 93, exemplifying the PRC's pro-arbitration stance.

Furthermore, it is important to note that the Arbitration Law (Amendment) (Draft) published on July 30, 2021, demonstrates a shift in the requirements for a valid arbitration agreement, specifying that a valid arbitration agreement only requires an expression of the parties' intention to submit disputes to arbitration, and that the inclusion of a designated arbitration institution is no longer mandatory. This amendment is in line with the UNCITRAL Model Law, which, if applied, would mark a significant development in China's arbitration laws.

Third Party Litigation Funding Agreement Determined Invalid on the Basis that the Agreement in Question Breached Public Policy.

Recently, the Shanghai Second Intermediate People's Court rendered a judgment declaring a third-party litigation funding agreement to be invalid.

Facts

In 2017, an investment management company (the "Company") entered into a third-party litigation funding agreement (the "Agreement") with a third-party funder and its associated law firm, which agreed that the third-party funder would provide litigation investment services to the Company for a dispute arising out of a service contract.

The Agreement stipulated, among other things, that:

- the investment would cover all costs arising from the litigation regarding the disputes. If the Company were to receive a favorable judgment, 27% of the amount awarded would be paid to the third-party funder as its investment income;
- the associated law firm would act for the Company in the litigation regarding the dispute, the Company would require the third-party funder's consent for change of counsel, and the Company may only choose its counsel from the third-party funder's associated law firm;
- the third-party funder could participate in the decision-making process for the litigation strategy;
- in view of the unpredictable policy risks, the three contracting parties should undertake their best efforts to maintain confidentiality.

On the same date, the Company and the associated law firm entered into an engagement contract, which provided that the payment of legal fees were to be paid by the third-party funder. Subsequently, the third-party funder paid the court fees as agreed.

In 2019, the Company prevailed in the related disputes, and the defendant paid the Company the awarded sum. However, the Company subsequently failed to pay 27% of the amount awarded to the third-party funder as agreed. The third-party funder then sued the Company.

Issue

The court was asked to decide whether the underlying litigation funding agreement was valid in light of the key terms set out above.

Decision

The court decided that the key to determining validity of a litigation funding agreement is whether the content of such agreement would seriously affect the integrity of the litigation. In the present case, the court found that the underlying investment agreement had violated the public policy for the following reasons:

- **The law firm and the third party funder were closely associated in the case which give rise to a number of issues**, including: (i) the association between the two impeded the law firm's ability to act independently for the best interests of its client; (ii) through such association, the third-party funder was effectively allowed to practice law, which is a highly regulated area that requires special qualifications; (iii) the arrangement under the investment agreement would allow the law firm to profit beyond the statutory standard permitted under Chinese law.

- **Under the third-party funding agreement, the third-party funder was given excessive control over the litigation, thereby infringed the Company's freedom of litigation**, including: (i) the investment agreement mandated the Company to choose legal counsel only from the associated law firm, which infringed the Company's freedom to choose legal counsel and (ii) the third-party funder was allowed to join decision making over the litigation strategy. However, there was neither a contractual mechanism to avoid conflict of interest, nor any constraint on the investor's right in decision making, which thereby infringed the Company's freedom to conduct litigation.

- **The confidentiality clause under the third-party funding agreement undermined the order and fairness of the litigation proceedings**, including: (i) it prevented the court from knowing the existence and identity of the third-party funder, thereby making the court incapable of deciding whether conflict of interest would arise between the judge and the third-party funder; (ii) the existence of third-party funding may implicate the litigation strategy of the counterparty; and (iii) non-disclosure of the third-party funding prevented the court from intervening when the third-party funding agreement infringed on the party's freedom of litigation.

The court found that the arrangement under the third-party funding agreement in dispute had violated fine custom in China as well because the arrangement was against the core value of promoting harmony. In order to maximizing profits, the investor may hamper ADR process like mediation and conciliation, which is to the disadvantage of dispute settlement.

Commentary

It is important to note that, while the court decided that the underlying third-party funding agreement was invalid, the court did not categorically deny the validity of litigation funding agreements in general. The court made it clear in its judgment that the validity of third-party funding agreements should be decided on a case-by-case basis.

The judgment of the court has attracted substantial criticism since its publication. However, some of the comments made by the court are in line with a global trend, which calls for more transparency over third-party funding. Ultimately, there is a need to strike a balance between allowing third-party litigation finance to step in to assist potential litigants to pursue reasonable claims, while preventing third-party litigation finance from being used to undermine justice by increasing the number of frivolous cases and promoting conflicts of interest. But for the time being, it remains too early to determine the Chinese courts' attitude towards litigation funding agreements. Much remains to be seen from future judgments.

AUTHORS

Yang Chen（Beijing）
+86 10 5706 8027
yangchen@jtn.com

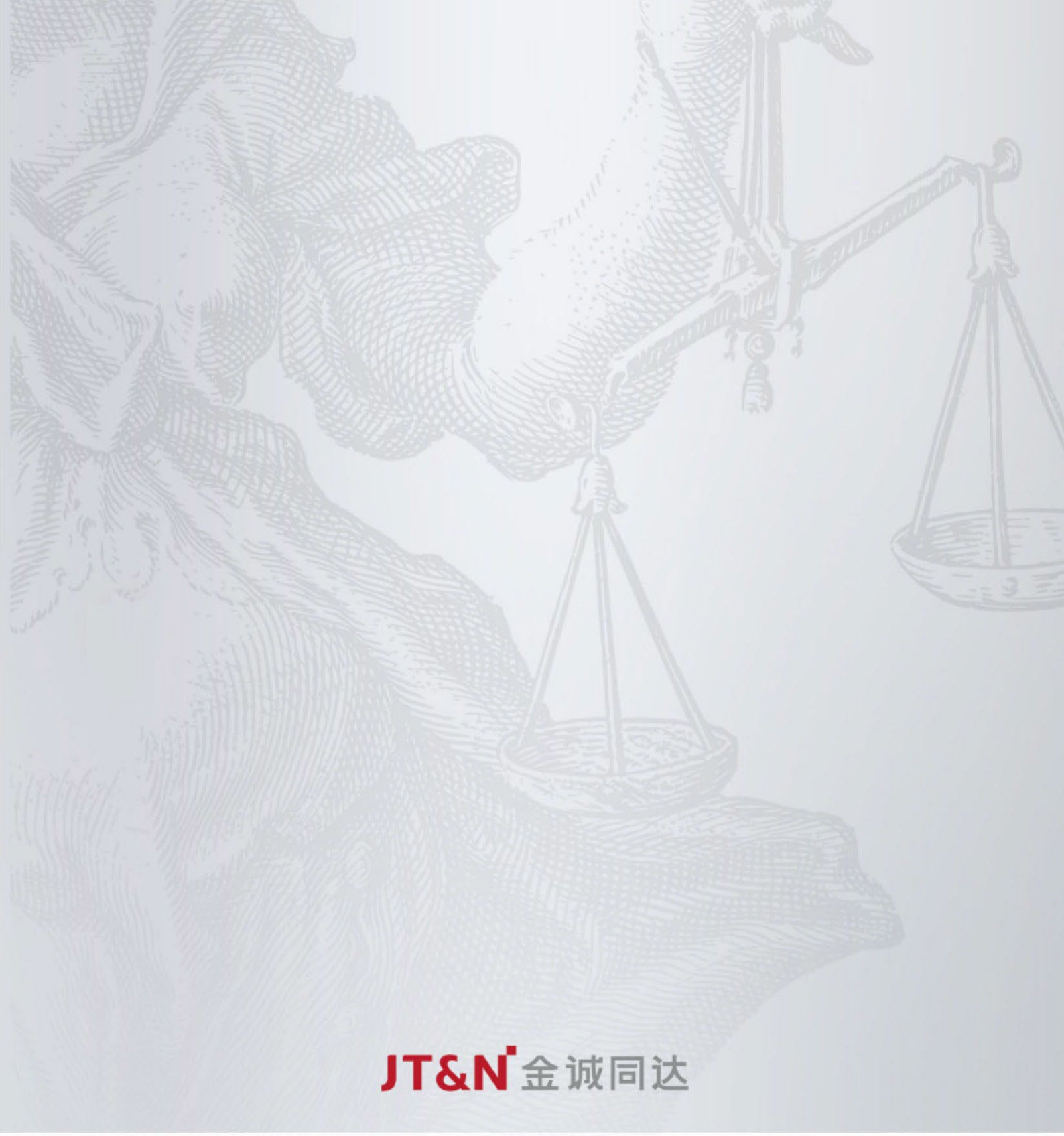
Lin Mujuan（Shanghai）
+86 21 3886 2367
linmujuan@jtn.com

Zuo Tianyu（Beijing）
+86 10 5706 8458
zuotianyu@jtn.com

Jiang Xue（Beijing）
+86 10 5706 8265
xuejiang@jtn.com

Bian Tong（Shanghai）
+86-21-3886 2123
biantong@jtn.com

Li Zhuangyi（Beijing）
+86-10-5706 8585
lizhuangyi@jtn.com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