BAKER & MCKENZIE

Client Alert

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Failure to Specify Arbitral Seat in the Arbitration Clause May Result in Unenforceable Award

In a recent PRC case (the "**Taizhou Court Case**"), the Taizhou Intermediate People's Court ("**Court**") refused enforcement of an ICC award on grounds of public policy because the court had previously held that the arbitration clause was invalid. This outcome could have been avoided if the parties had specified a suitable arbitral seat in the arbitration clause. Our alert will discuss this case and provide recommendations for avoiding such outcomes.

Relevance of the arbitral seat

The seat is an important legal concept, as its law provides the supporting legal framework for the arbitration and its courts supervise the arbitration. Further, the seat usually determines the nationality of the award which is relevant to enforcement. The seat can therefore have a material impact on the course and outcome of the arbitration. The seat is not to be confused with the factual venue where arbitration meetings and hearings are conducted.

Moreover, absent any agreement to the contrary, the law of the seat, which is often not the same as the substantive law of the contract, usually also governs the arbitration clause. It is important to understand that the substantive law of the contract does not normally extend to the arbitration clause because the arbitration clause exists independently and is separable from the other contract terms. Matters governed by the law of the arbitration clause include the formation, validity, and interpretation of the arbitration clause. For example, unlike under Hong Kong law, an arbitration clause is not valid under PRC law, if it does not designate an arbitral institution or provide for arbitral rules through which the institution can be determined.

The Taizhou Court Case

The parties had entered into a Sino-foreign joint venture agreement ("**JVA**") governed by PRC law with an arbitration clause that left the determination of the arbitral seat open. The relevant part of the arbitration clause provided:

"(...) The arbitration will be conducted under the Conciliation and Arbitration Rules of the ICC. If one party commences arbitration, the seat of arbitration shall be chosen by the other party. The language of the arbitration shall be English..." (translation from Chinese original)

In July 2011, the Chinese party ("**P**") sued the foreign party ("**D**") in the Taizhou Intermediate People's Court ("**Court**") for breaching the non-compete clause in the JVA, seeking various remedies. D invoked the arbitration clause claiming that the Court had no jurisdiction to hear the dispute.

The Court applied PRC law in determining the validity of the arbitration clause, as the parties had not agreed on any law governing the arbitration clause or an arbitral seat that would have allowed the Court to apply a different, less restrictive law (e.g. Hong Kong law). In December 2012, the

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Court held that the arbitration clause was invalid and that it had jurisdiction to hear the dispute because the clause neither designated an arbitral institution, nor could the Court determine the institution through the relevant arbitration rules as required under PRC law ("**Ruling**"). This Ruling was upheld by the Supreme People's Court ("**SPC**") in March 2012.

While the court proceedings were pending, D commenced ICC arbitration proceedings against P in Hong Kong. Since P did not exercise its right to choose the arbitral seat, the ICC Court of Arbitration fixed Hong Kong as the seat. Two ICC awards were rendered, one in July 2014, the other in November 2014 ("**Awards**"). On 9 December 2014, D applied to the Court to enforce the Awards. On 2 June 2016, the Court held that enforcement of the Awards would be in breach of PRC public policy because the Awards were in conflict with the Ruling.

Actions to Consider

We recommend that parties should always designate a seat in the arbitration clause and expressly adopt the law of the seat as the law of the arbitration clause. This is to avoid any uncertainty as to which law governs the arbitration and the arbitration clause and which courts supervise the arbitration. When doing so, parties must check whether any restrictions under the national arbitration law of the seat may apply (for restrictions on arbitrating outside China, see our March 2016 client alert). Where the parties have not agreed on a seat, the arbitral rules will usually provide how the seat is to be determined. However, arbitral rules may differ significantly in this regard. For example, the seat under the current version of the:

- HKIAC Rules will be Hong Kong, unless the tribunal determines, having regard to the circumstances of the case, that another seat is more appropriate;
- ICC Rules will be determined by the ICC Court;
- SIAC Rules will be determined by the tribunal, having regard to all the circumstances of the case;
- CIETAC Rules will be the domicile of CIETAC (or the administering sub-commission/arbitration center), but CIETAC has the right to determine another location having regard to the circumstances of the case.

In circumstances where the parties have failed to designate a seat in the arbitration clause and there is no default seat under the arbitration rules, there will be uncertainty as to which law governs the proceedings and which courts supervise the arbitration. The period of uncertainty may be relatively short where the institution determines the seat, but could last three months or more where the seat will be determined sometime after the formation of the tribunal. This can make it more difficult for parties to take procedural and strategic decisions (for example, which arbitrator to nominate or from which courts to seek interim relief).

Unless the parties have specified the law of the arbitration clause, which is often not the case, such uncertainty will also extend to matters governed by the law of the arbitration clause, such as its validity. We therefore also recommend that parties expressly adopt the law of the seat as the law of the arbitration clause.

Conclusion

It is important to carefully consider, at the drafting stage, the seat of future arbitration proceedings and the law governing the arbitration clause, and to double check that the clause satisfies any mandatory requirements under that law. The *Taizhou Court Case* illustrates how uncertainties arising from the failure to conduct this exercise may lead to inconsistent decisions on the validity of the clause and ultimately the unenforceability of the award.

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