

‘Foreign Elements’ in the Arbitration of China’s Free Trade Zones

Xia Tang*

Since the traditional definition of ‘foreign elements’ cannot meet the new requirements of the arbitration of China’s FTZs, Chinese judicial practice must create a useful supplement to already established standards. In free trade zone arbitration cases, Chinese courts determine foreign elements based on the standards of subject, object, and legal facts. In this regard, the explanation for ‘other circumstances’ in the First Judicial Interpretation of the Supreme Court on Several Issues Concerning the Application of Law of the PRC on Foreign-Related Relations is based on the three abovementioned elements. The Chinese arbitration system and legislation must be further perfected; however, overly broad standards may impede China’s domestic arbitration system. Moreover, China must add certain restrictions to the standards: judges should distinguish the artificial foreign elements created by contracting parties, controversial civil relations should have a material connection with foreign countries, and discretion should be reasonable with sufficient nucleus.

Keywords: Free Trade Zone, Arbitration, Foreign Elements, Standard Limitation

* Ph.D. candidate in International Law at Xiamen University. LL.B./LL.M. (Henan Univ.). ORCID: <https://orcid.org/0000-0002-0944-6928>. The author may be contacted at: tangxia1990vip@163.com/Address: 422 Siming Nan Road, Xiamen City, Fujian Province, P.R. China 361005.

I. INTRODUCTION

In order to reform and innovate its arbitration system, China created seven new free trade zones (“FTZs”) in September 2016. These were based on the original four FTZs located in Shanghai, Guangdong, Tianjin, and Fujian. Evaluating China's FTZs, it becomes evident that their primary tasks include promoting national reform, encouraging institutional and policy innovations, and leading demonstrations and service throughout the country. In order to achieve goals such as trade facilitation and investment liberalization, the State Council has issued a number of reform programs to support the construction of the FTZs. The Supreme Court also propagated the “Opinions on Providing Judicial Safeguards for the Construction of FTZs” (hereafter Judicial Safeguards Opinions) in December 2016 to fairly and efficiently resolve disputes for enterprises in the FTZs. The right to choose the method of dispute settlement has increased people’s support for arbitration. Additionally, China’s courts have tried to determine the effectiveness of the arbitration agreement so as to expand the arbitration’s jurisdiction in the settlement of disputes.¹

The Judicial Safeguards Opinions facilitates the parties’ flexible selection of dispute resolution methods, which will not only help China’s FTZs to attract foreign investment, but also to globalize China’s commercial arbitration system.² As China continues to construct the FTZs in accordance with international standards, the parties within FTZs have an increased need for overseas arbitration organizations to settle disputes. According to China's current laws and judicial interpretation, a party would submit contractual disputes for overseas arbitration when the commercial dispute in question has foreign-related factors.³ Therefore, the identification of foreign factors is exceptionally important for parties to initiate overseas arbitration. This determination of foreign-related commercial affairs within FTZs is unique because the traditional three-element criteria are neither useful for the new practice of identifying foreign-related factors, nor conducive to providing a variety of policy preferences in the FTZs. Therefore, reforming the traditional foreign determination standards within the FTZs is urgently needed.

The primary purpose of this research is to evaluate the new standards for foreign-related elements as set by the courts in FTZs. This paper is composed of five parts including Introduction and Conclusion. Part two will analyze the

determination of the “foreign-related nature” of arbitration cases involving the FTZs. Part three will discuss the determination of the foreign-related nature of the arbitration case involving the FTZs. Part four will analyze the restrictions on ascertaining ‘foreign-related’ factors in arbitration cases involving FTZs.

II. LEGISLATIVE THEORY OF “CONCERNING FOREIGN AFFAIRS” IN CHINA’S CIVIL AND COMMERCIAL RELATIONS

China’s foreign-related determination of civil and commercial relations was first transplanted from Japan in 1903. At that time, however, China was basically an agricultural society. Furthermore, since the scope of foreign-related civil and commercial relations was extremely limited, it was later shelved following certain political changes.⁴ In the early years of the People’s Republic of China (“PRC”), private international law scholars in China were deeply influenced by the jurisprudence of the Soviet Union.⁵ They used the traditional three-element criteria to determine the foreign-related nature of civil-business relationships. In this case, “foreign-related nature” means that, among the subject, object, and content of a civil-business relationship, one element is associated with at least one foreign country.⁶ In practice, this criteria requires courts to clearly list the civil and commercial affairs that are foreign-related. This method is clear and predictable, which makes it more convenient for judges to apply. For example, Article 1186 of the “Russian Federation Civil Code” stipulates that foreign corporations’ involvement occurs when the subject matter is located in foreign countries and other foreign-related factors are present.⁷ Vietnam and Armenia also invoke such a guideline to define the ‘foreign-related’ relations of civil and commercial affairs.⁸ Article 178 of the Supreme Court of China’s opinions on the implementation of the “General Principles of the Civil Law of the People’s Republic of China” (Trial) is strictly applied to these three elements to define the meaning and parameters of ‘foreign-related.’

Although such enumeration provides clear standards for judges to try cases, it cannot address or cover all situations, especially as they change over time. Private Anglo-American international law scholars would argue that cases can be

considered ‘foreign-related’ if they have something to do with foreign countries or more than one jurisdiction. For example, British scholar J.H.C. Morris believes that ‘foreign elements’ in English law indicate that a given dispute has some connection to the law of any country beyond England.⁹ Continental scholars tend to agree with this argument. German legal scholar Martin Wolf advocates that a party may be deemed to be ‘foreign-related’ if s/he has a domicile in a foreign country, belongs to a foreign nationality, or if the fact or effect of the fact is foreign.¹⁰

In recent, a number of scholars have proposed theories such as the judge’s decision theory and the parties’ decision theory. In the US, for example, the judge’s decision theory refers to that a judge no longer presupposes a single connection factor but rather decides on the basis of a comprehensive consideration of various elements of legal relations.¹¹ The parties’ decision theory, including the “selective conflict law theory” that emerged in countries such as France and Germany, gave parties the right to decide foreign-related civil and commercial relations.¹² Given the increasing complexity of foreign-related cases, Chinese courts have a tendency to identify foreign-related factors through the application of broader standards. The PRC Law of the Application of Law for Foreign-related Civil Relations does not involve the determination of foreign-related issues. “The First Judicial Interpretation of the Supreme Court on Several Issues concerning the Application of Law of the PRC on Foreign-Related Civil Relations” (hereafter Judicial Interpretation of the Application of Law) and Article 522 of the “Opinions of the Supreme People’s Court on Certain Issues Concerning the Civil Procedure Law” (hereafter Opinions of Civil Procedure Law) specifically address the situation of foreign-related commercial and civil relations.

Since the provisions of the Judicial Interpretation of the Application of Law and the Opinions of Civil Procedure Law are essentially the same, they would adopt legal relation elements criteria for judging foreign-related factors. The innovation here is that both the Judicial Interpretation of the Application of Law and the Opinions of Civil Procedure Law increase the connection point of regular residences, which helps judges to determine whether the subject is foreign-related. Moreover, they both stipulate additional circumstances to determine whether civil and commercial affairs are foreign-related.¹³

The Judicial Interpretation of the Application of Law and the Opinions of

Civil Procedure Law provide judges with discretion and allow judges to apply these legal regulations smoothly. Thus, the Supreme People's Court has learned from Western scholars to equip judges with the necessary discretion to determine foreign-related elements.

China's courts still use the traditional three-element criteria to judge whether civil and commercial affairs are foreign-related. In practice, however, certain flaws are still present in this type of foreign-related determination. In the case of the subject, the Judicial Interpretation of the Application of Law considers the connection factor of regular residence in addition to nationality.¹⁴ It tries to avoid the single identification standard, but, in practice, it is still unable to cover new situations related to national policies. Therefore, when determining foreign-related elements, both the foreign nationality of the contractual parties and their substantial connection(s) to foreign countries should be considered simultaneously, so as not to increase the economic costs of both parties.¹⁵

As for the object, it will be convenient to invoke the subject matter's position in order to judge the relationship between civil and commercial affairs in foreign countries. Established standards are particularly applicable when the subject matter is immovable. However, the object includes not only tangible (movable and immovable) property, but also includes intangibles such as behavior, intellectual achievements, and personal interests. These intangibles are not tightly connected to any specific space; however, they do cling to people. When judging the objects' foreign elements, people's nationalities and/or regular residences can only be considered. As for foreign-related content, the legal facts that cause civil legal connections to be generated, changed, or eliminated are those that contain human behavior and natural facts. Events and conditions constitute two aspects of natural facts. The places where human engage in behavior and where events occur are important standards that must be considered within foreign-related elements. However, natural facts such as the passage of time and continuous occupation do not have tight connections to specific territories.¹⁶

Timing is another important factor that changes in legal relations, while affecting the judgment of foreign-related elements of civil and commercial affairs. China's laws and judicial interpretations do not feature any time standards yet. Without considering the time factor, the identification of foreign elements cannot adapt to the newly-developing FTZs in China.¹⁷ Although the Judicial

Interpretation of the Application of Law stipulates the criterion of “other circumstances that can be considered as a foreign-related civil relationship” and allows judges to make comprehensive judgments, the lack of clear criteria leads judges to seldom use this principle. Therefore, each legal provision should be clarified transparently and flexibly to cover new developments.

René Davide has stated that there is always a contradiction between justice and law in terms of predictability, flexibility, and adaptability.¹⁸ Legal interpretation must therefore find a way to not only enhance the law’s predictability but also solve various legal problems in practice. Since China strongly develop FTZs, it would be beneficial to combining the foreign-related elements provisions of the Judicial Interpretation of the Applicable of Law in order to define ‘other circumstances’ reasonably. This would prevent the provision from becoming a ‘dormancy clause.’¹⁹

III. DETERMINATION OF THE “FOREIGN-RELATED NATURE” OF THE ARBITRATION CASES INVOLVING THE FREE TRADE ZONES

Party autonomy is a basic principle in civil law.²⁰ In principle, the state does not intervene in matters that fall within the sphere of personal autonomy.²¹ Rather, the state gives individual parties the right to escape from any fixed pattern provided by the law and freely set up their mutual legal relations.²² In practice, the legislation of various countries basically respects the parties’ freedom to agree on their rights and obligations without violating the mandatory or prohibited provisions of the law. The parties’ agreement to submit a contractual dispute to an overseas arbitration agency is at their discretion, too. The court can determine foreign-related standards “as effectively as possible” and respect the results of parties’ choices. In international commercial arbitration, as long as the parties clearly express their will to arbitration, they can choose arbitration to settle contractual disputes. As for any defects in the arbitration agreement, they can be overcome by applying relevant countries’ laws to make the arbitration agreement “as effective as possible.”²³

The “Interpretation of Several Issues Concerning the Application of the

Arbitration Law of the People's Republic of China” stipulates the principles for handling an arbitration agreement, which are basically to “make it as effective as possible.”²⁴ The greater number of FTZs are set up in China, the greater respect for parties’ autonomy is needed. Thus, the FTZs’ courts should recognize the foreign-related nature of civil and commercial relations in more flexible terms. The following are the new changes that are now emerging.

A. The Scope of the Subject

According to Article 41.2 of the General Principles of the Civil Law of the PRC, a legal person’s nationality is determined by the place of registration within China. Therefore, Chinese-foreign equity joint ventures, Chinese-foreign contractual joint ventures, and wholly foreign-owned enterprises that meet the necessary requirements will have the status of a Chinese legal person.²⁵

There are numerous examples of joint ventures between Chinese and foreign investors. Domestic companies controlled by foreign investors are also perceived as foreign legal entities. Article 11.2 of the “Foreign Investment Law of the PRC” (Draft for Comments) (hereafter Foreign Investment Law (Draft)), drafted by the Ministry of Commerce in early 2015, assumes that the variable interest entities (VIE) are foreign investors.²⁶ Regarding the definition of actual control rights, the “Notice of the General Office of the State Council on Establishing a System for the Security Review of Mergers and Acquisitions of Domestic Enterprises by Foreign Investors”²⁷ and Article 18 of the Foreign Investment Law (Draft) stipulate clear equity standards.²⁸ The difference in control rights means that as the domestic enterprises may have different properties, they may apply different laws, or they may apply for arbitration with a foreign arbitration agency due to the foreign factors.

This clear provision will further ensure that legal certainty and help safeguard the interests of the state and related market players.²⁹ Therefore, Sino-foreign joint ventures and cooperative enterprises established in the FTZs would have different identities due to investors’ different controls over each enterprise. Although the draft has not yet been enforced, such enterprises are still Chinese legal persons. This indicates the current legislative trend in China. Similarly, legal persons controlled by wholly foreign-owned enterprises are inextricably linked to foreign parent companies due to their sources of funds, management,

decision-making, and ownership of interests, which makes them significantly different from domestic corporate legal persons. The business scope of such companies is often foreign-related. When contracting with other domestic legal persons, most of them would agree that contractual disputes should be arbitrated by foreign arbitration agencies.³⁰

Three questions then arise naturally: (1) whether such arbitration agreements have foreign-related factors; (2) whether they can request arbitration from foreign arbitration agencies; and (3) whether China can recognize and enforce the awards made by foreign arbitration institutions. In practice, the voices of such foreign-owned enterprises registered in China as foreign legal entities have been gradually increasing.³¹

In *Siemens International Trade (Shanghai) Co., Ltd. v. Shanghai Gold Land Limited* (hereafter *Siemens*),³² both parties are enterprise legal persons registered in China. Moreover, the contractual delivery place and the subject matter of the delivery place are located within Chinese territory. Superficially, the case does not seem to have foreign factors. However, the contract's subject in *Siemens* is obviously different from the general domestic legal person in that both parties are wholly foreign-owned enterprises registered in the Shanghai FTZ having close ties with foreign investors. Therefore, the court held that the contract's subject in this case had foreign-related factors.³³

However, in *Beijing Chao lai xin sheng Sports Leisure Co., Ltd.* applying for the recognition and enforcement of foreign arbitration awards³⁴ and *Changzhou Yu fei Hydraulic Co., Ltd. v. Qingdao Da cheng Machinery Co., Ltd.* (the legal representative is Finns) in arrears,³⁵ although one party was also a foreigner, the courts found that the cases did not have foreign-related factors. Thus, the parties agreed that the arbitration agreement for overseas arbitration was invalid.³⁶ Despite the similarity of the three cases mentioned above, the court eventually drew completely different results. Simply because *Siemens* involved a special area within the FTZ, the court decided that the case had foreign-related factors based on China's special policies on the FTZ and the requirements for actively promoting reforms. There are currently 11 FTZs in China. The fact that the court in the Shanghai FTZ ruled that *Siemens* had foreign-related elements will also have an impact on other FTZs.

In order to create a clear ground for the trial of such FTZ cases, the Judicial

Safeguards Opinions of the FTZ of 2016 confirmed that wholly foreign-owned enterprises in FTZs are subjects with foreign elements.³⁷

Wholly foreign-owned enterprises in FTZs make contracts stipulating that, if necessary, a foreign arbitration institution will intervene in the contract dispute. If the party that initiated the international arbitration is opposed to the award and claims that the arbitration agreement is invalid or applies for the court's refusal to recognize and execute the arbitral award, it violates the principle of 'estoppel' and good faith and it is therefore not supported by the Chinese courts.³⁸

Following the Judicial Safeguards Opinions of the FTZs, the Supreme People's Court regards such enterprises as subjects with foreign factors.³⁹ Parties can stipulate in their contracts that any disputes must be arbitrated by an overseas arbitration institution. In such cases, however, the parties must abide by the principle of good faith and bear all ensuing consequences.

B. Fulfilling the Expansion of Object Content

According to China's three-element criteria for identifying foreign-related factors, if the object of the contract is foreign-related, the parties can agree on an important criterion for overseas arbitration.⁴⁰ The above discussion illustrates that the contract object includes both material and behavior. In this regard, the subject matter's performance is also a factor when considering whether the object is involved with foreign elements.⁴¹ In FTZ arbitration cases, the court extended the performance of the delivery of subject matter to all performance stages before it.⁴²

According to past judicial practice, regardless of the "quasi-performance behavior" of the contracting party before the final delivery's completion, a series of selection, loading, transportation, and additional steps will be involved.⁴³ In this case, however, only the final delivery behavior at the appointed place is the key to determining whether the subject has foreign-related elements. In *Siemens*, the subject matter delivered by the party underwent bonded supervision in the Shanghai FTZ and handled the customs clearance procedures for the entry of goods from abroad.⁴⁴ Therefore, the process of delivering the subject matter satisfied the criteria for international sale of goods.

The court in *Siemens* held that the subject's performance behavior under the contract was 'foreign.'⁴⁵ This is similar to the principle of "making it *effective*"

instead of “making it *ineffective*.” [Emphasis added] This is because the court chose the most favorable performance behavior for the parties involved - namely, the goods underwent proper customs clearance procedures - in order to validate the arbitration agreement in the contract.

In a previous case, Ningbo Xin hui International Trade Co., Ltd. and Meikang International Trade Development Co., Ltd. applied for the revocation of the arbitral award (hereafter Ningbo Xin hui).⁴⁶ In this case, the court held that the subject matter of the dispute between the two parties involved unclear cargo within the Shanghai FTZ.⁴⁷ According to the customs management system, unclear goods in the bonded area are those outside of China. Consequently, this case included foreign-related factors.

Based on this judgment, the court held that the two parties had entered a foreign-related contract, so that the overseas arbitration agreement between the parties was valid.⁴⁸ The Fourth Intermediate Court of Beijing rejected Xin hui Company’s application to cancel the arbitral award made by the China International Economic and Trade Arbitration Commission.⁴⁹ Thus, the determination of foreign-related elements in contracts involving foreign arbitration agreements within FTZs has become a trend. This is also an extension of the contract law principle to “make it as effective as possible” in the field of arbitration.

C. Extending the Time of Legal Facts

When the content of civil and commercial affairs is related to foreign elements, it means that the legal facts would create, change, or eliminate the rights and obligations of these affairs that have taken place abroad. Legal facts are ever-changing. Therefore, it is important to consider when the legal facts involved foreign elements and whether the contract was made when the facts occurred, at the time that awards were addressed or at any other moment during the facts occurred to the awards were given. Although the law does not specify the time that would determine the foreign factors, in practice, both foreign and Chinese judges tend to choose a timeframe that is conducive to identifying legal facts with foreign factors. Therefore, the overseas arbitration agreement between parties is valid.⁵⁰

Through an examination of foreign legislation and judicial practice, it is

clear that the criteria for identifying foreign-related factors in other countries are more general. For example, in the US, the applicable law of contract law⁵¹ and the French Civil Code⁵² fully respect parties' autonomy when determining a contract's validity and impose only certain restrictions on the freedom of such private law. The relevant legislation of the European Union⁵³ and Quebec⁵⁴ stipulates that a pure domestic contract has foreign factors based on the party's choice of foreign law. In addition, whether the contract has an impact on more than one legal jurisdiction and on the future impact of the contract's performance is also recognized as a foreign case.⁵⁵ In *Portuguese bank* (2016),⁵⁶ the Bank of Portugal entered into an interest rate swap agreement with a number of transport companies in Portugal. Except for the contract's adoption of the international standard format contract and the parties' appointment of English law as the governing law, all other factors are within Portuguese territory. Later, due to the financial crisis, the interest rate fluctuations caused the transportation company to bear the burden of interest. The transportation company refused to pay the interest difference to the bank and the two parties began to dispute.⁵⁷

Regardless of whether the contract's performance and other relevant factors occurred in or outside of Portugal, the English court held that the contract was not a simple domestic but rather a foreign contract because the parties used an international standard format contract, which affected the possibility of the Portuguese bank's future contact with a foreign bank and international participation in the swap market.⁵⁸ In this case, the English courts were more open and advanced in judging the contract's foreign factors. The court decided that the contract was foreign-related based only on the parties' choice of the international format contract and the possibility of future contact with foreign countries. This holding would mean that a court could define contracts with possible future foreign interactions as foreign-related contracts.

China's previous arbitration case provides additional example in this area. In *the World Bank Highway Loan*,⁵⁹ the parties agreed that the dispute should be settled by China's foreign arbitration agency.⁶⁰ In this case, the contract's subject, object, performance, and other relevant factors occurred within Chinese territory. From the perspective of traditional foreign elements, the contract was a pure domestic contract and the overseas arbitration agreement was invalid. However, it was observed that the provisions of the contract were in accordance with the

international format contract, and the contract's performance and other factors required confirmation from the World Bank. Ultimately, the court found that the contract was a foreign-related contract. In this case, the court relied on the contract's performance stage to determine that the civil and commercial affairs involved foreign factors.⁶¹

In *Siemens*, the Shanghai FTZ was not yet established when the court registered the case, and Siemens Co. Ltd. initially used only the special legal management system established for itself in the Shanghai Waigaoqiao bonded area for the defense. This legal relationship was foreign-related. During arbitration, the Shanghai FTZ was established and the court directly used the Shanghai FTZ as a basis for the judgment. Thus, it was determined that the legal relationship had foreign factors.⁶²

In *Ningbo Xin hui*, the Shanghai FTZ had already been established when disputes erupted between the two parties. The court concluded that as the two parties agreed to deliver the goods within the Shanghai FTZ, they needed to go through customs clearance and tax payment procedures.⁶³ The case was found to be a foreign-related arbitration. From this point of view, the current identification trend for foreign-related elements is to flexibly grasp and extend the timeframe for judging the occurrence of legal facts and to fully consider the contracting parties' trading habits, the third party's influence on the contract, and the proper law that the parties chose within the contract. The judge enjoys full discretion.

IV. RESTRICTIONS ON ASCERTAINING 'FOREIGN-RELATED' FACTORS IN ARBITRATION CASES INVOLVING FOREIGN TRADE ZONES

Although international standards for the determination of foreign-related relations between civil and commercial affairs are relatively loose, given the different legal systems and cultural contexts in China and foreign countries, China should develop its own standards rather than blindly following international trends. Article 5.1 of the Judicial Interpretation of the Application of Law provides the criteria for 'other situations' while determining foreign factors. A judge can exert a subjective initiative for determining foreign factors. However, s/he must still

rely on China's traditional three-element criteria to avoid the potential impact of an improper expansion of foreign-related standards on China's domestic arbitration system.

In *Siemens*, the court applied the standard for the first time to determine that the disputed commercial relations belonged under the umbrella of 'other circumstances' in the foreign-related factors, thereby confirming the effectiveness of parties' foreign arbitration agreements.⁶⁴

Siemens was the first case where the Chinese court used the pocket-sized clauses in foreign-related determination to resolve the parties' disputes, fully enacting the efforts made by judges in the FTZs for institutional innovation. Due to its highly significant impact, *Siemens* is one of the "Top Ten Cases of China's Arbitration in 2015."⁶⁵ Many people considered it a benchmark for the relaxation of the "foreign-element factor" review standard in China's foreign-related judicial jurisdiction.⁶⁶

Such a determination standard will also serve as a reference for other FTZs' future handling of similar cases. This new standard also poses new challenges for judges such as how to identify 'other situations' based on the three-element criteria that do not damage China's domestic arbitration system. Although the government has provided a series of policies supporting institutional innovation within FTZs, it should also provide free and diversified dispute resolution methods for enterprises in the FTZs and respect the parties' willingness to arbitrate. However, the parties' freedom to choose foreign arbitration is not unlimited and the court should still have restrictions when determining the foreign-related nature of arbitration cases involving the FTZs.⁶⁷

A. Identifying Parties' "False Foreign-related" Contracts

In 2015, the State Council issued a notice on further deepening the reform program for the China (Shanghai) FTZ.⁶⁸ The notice pointed out that the Shanghai FTZ should further incorporate international commercial dispute resolution mechanisms, optimize the FTZ arbitration rules, support the settling of international renowned commercial dispute resolution agencies, and improve the degree of international arbitration of commercial disputes.⁶⁹ Exploring the establishment of a national FTZ arbitration legal service alliance and an exchange and cooperation mechanism for an Asia-Pacific arbitration agency would help

accelerate the establishment of a globally-oriented Asia-Pacific arbitration center.⁷⁰

When the Hong Kong International Arbitration Center was established in the Shanghai FTZ in November 2015, the International Chamber of Commerce Arbitration Court and the Singapore International Arbitration Center entered the Shanghai FTZ in February and March 2016, respectively.⁷¹ Parties involved in foreign-related contracts can now conduct overseas arbitration in China, a practice that reduces parties' overseas arbitration fees. In response to the Central Government's FTZ strategy, the Judicial Safeguards Opinions in the FTZs issued in 2016 specifically stipulated that enterprises registered in an FTZ may appoint *ad hoc* arbitration of disputes but that they must satisfy specific arbitration locations in the Mainland, specific arbitration rules, and specific arbitrators. These regulations are collectively referred to as "three specific requirements" for *ad hoc* arbitration.⁷²

Regarding China's arbitration practice, the Supreme People's Court confirmed the validity of the International Chamber of Commerce ("ICC")'s ruling in the Mainland early on in the reply of *Longlide*.⁷³ This opinion provides clear judicial support for overseas arbitration institutions engaged in any arbitration business in China.⁷⁴ China's original intention for designing this system was to assist parties involved in foreign-related cases in filing overseas arbitration within the country. However, an unintended consequence may be that parties artificially create foreign-related factors in order to meet the criteria for overseas arbitration.

Although China's judicial practice tends to expand the criteria for identifying foreign-related issues, under the traditional model of factor analysis, objective judgments concerning foreign-related relations between civil and commercial affairs seldom involve the discretion of judges.⁷⁵ To a certain extent, the traditional three-element criteria can reduce or avoid a case's uncertainty attributed to the discretion of the presiding judge. However, there are certain problems in using traditional factor analysis methods to make objective judgments. Actually, objective factors can be artificially changed or 'created' as objective connection points, thereby changing the legal relationships and committing legal avoidance for the purpose of establishing 'foreign' relations between civil and commercial affairs.⁷⁶ Under "false foreign-related" circumstances, the parties might have a reason to submit their dispute to overseas

arbitration.

Given current globalization trends, China's legislature and judiciary system have also relaxed the criteria for identifying foreign factors. Therefore, individual judges should examine whether or not the two parties involved artificially change their nationalities and/or domiciles to ensure that foreign factors are involved in their civil and commercial affairs. Furthermore, judges must examine whether Chinese natural or legal persons who regularly reside in China make their civil and commercial affairs related to foreign countries through their contractual agreements.⁷⁷

To regulate the way of determining the foreign-related issues of arbitration cases involving the FTZs, the Supreme People's Court issued the "Opinions on the Provision of Judicial Services and Safeguards for the Belt and Road Initiative."⁷⁸ When determining a case's foreign-related nature, traditional factors such as subject, object, content, and legal facts, among others, were considered.⁷⁹ This not only provided a definite ground for the court to hear the case, but also restricted the judge's discretion to prevent "false foreign-related" claims from adding damage to another party.

In addition, in the context of the court of China's FTZ - which has expanded the interpretation of foreign-related factor determination standards - the judge should guard against cases where a 'shell company,' registered in a tax haven by a Chinese natural person or legal entity, comes from within the FTZ with its alleged foreign-related status and requires to submit disputes to overseas arbitration. Since the management of such 'shell companies,' their sources of funds, and the attribution of their interests are all controlled by natural or legal persons within China, they typically have no substantive contact with foreign countries. If recognized as foreign corporations, they could potentially enjoy foreign status within the FTZ. Preferential treatment given to foreign investors would therefore result in the differential treatment of Chinese domestic investors.

Under China's current legal and judicial practice, parties still cannot choose foreign arbitration if the disputes do not contain foreign factors. Thus, the court should pierce the veil of the 'shell company' when trying such cases, thereby avoiding inequality among domestic-founded enterprises. This would also avoid the loss of the case's source in China's local arbitration institutions.⁸⁰

B. The Foreign related Civil and Commercial Relations Must Have a Substantive Connection with Foreign Countries

Party's autonomy is a premise of arbitration. China respects parties' right to invoke arbitration to resolve disputes but prohibits parties' dishonest acts to challenge the effectiveness of arbitration agreements. Accordingly, Article 27 of the "Interpretation of the Supreme Court on the Application of the People's Republic of China Arbitration Law" (hereafter Judicial Interpretation of Arbitration Law) does not support this kind of dishonest behavior.

Since arbitration is an important element in resolving commercial disputes - and in order to further regulate the effectiveness of arbitration agreements in cases involving FTZs - the Judicial Safeguards Opinions of the FTZ specifically outlines that foreign-owned enterprises registered in FTZs must agree to dispute and, if they apply for overseas arbitration, the arbitration agreement is valid.⁸¹ If a party obtains an adverse ruling, it may not apply for cancellation by the court on the ground that the case does not have a foreign-related factor. This is also a requirement of *estoppel*. Although the court has regarded the agreement made by the enterprises in the FTZ as valid, the disputed contract between the two parties must still have substantial contact with foreign countries. When contemplating the foreign-related standard, the adoption of the international standard format contract as an external factor can also be considered, which of course would potentially resolve the dispute.⁸²

However, under China's existing legal framework, the international standard format contract is not sufficient to become a criterion for identifying foreign elements. In addition, this kind of contract is not a general law, but rather an international organization's format contract that is adopted by the parties with the aim of facilitating the conclusion of contracts and expanding their influence. Due to the development of the Internet, for instance, such a contractual format can be easily obtained. Parties in domestic transactions will adopt international standard format contracts for convenience. However, the mere act of adopting the contract format is not enough to apply for foreign law. Domestic civil and commercial relations are still subject to domestic law. This requirement would also save the disputing parties' economic costs and allow the dispute to be resolved in a timely and effective manner.⁸³

C. The Judge's Exercise of Discretion Should Be Justified

When a judge exercises his/her discretion to expand the interpretation of the 'other circumstances' involving foreign factors, s/he must strictly abide by the contract's literal meaning and provide favorable explanations for the parties to resolve the dispute as soon as possible. From the perspective of the *Siemens* case, the first immediate court of Shanghai started with the three elements when interpreting the case's foreign-related factors, combined with the FTZ's specificity. Then, the court ultimately determined that the case had foreign-related factors.⁸⁴

In *Xiamen Haojiali Business Development Co., Ltd. v. Yanmar Engine (Shanghai) Co., Ltd. and Yanmar Motor Co., Ltd.'s jurisdiction ruling*⁸⁵ (hereafter *Haojiali*), Yanmar was a foreign company registered in the Shanghai FTZ as a sole proprietorship. In this case, the court found that the overseas arbitration clause signed by the two parties was valid.⁸⁶ The Judicial Safeguards Opinions of the FTZ was subsequently promulgated by the Supreme People's Court and has clearly regarded foreign-owned enterprises registered in the FTZ as subject foreign-related. The court can directly invoke this provision when trying such cases.⁸⁷

Haojiali raises the following questions: (1) whether the contracts signed by foreign-owned enterprises within an FTZ are foreign-related contracts; and (2) whether the parties' overseas arbitration clauses as stipulated in such contracts are valid. The first question can be answered in conjunction with the above civil and commercial relations that have a substantial connection with foreign countries. If one or both parties involved in the contract only have the subject as a foreign element and the contract's performance and the occurrence, change, or elimination of the legal facts are all within the territory of China. Then, there is no contact with foreign countries. Taking cost into consideration, the resolution of disputes within China is not only necessary, but also the most rational choice.

The case's second question concerns the interpretation criteria for the scope and effectiveness of arbitration clauses. In *Haojiali*, according to the claimant, as the two parties had agreed that Singapore's arbitral institutions and arbitration rules did not exist, the arbitration agreement was invalid.⁸⁸ The Shanghai Intermediate Court believed that the effectiveness of the arbitration agreement should be determined by the laws of the arbitration location. In other words, Singapore law does not regard an arbitration agreement as invalid when the

arbitral institution and the arbitration rules are unknown.⁸⁹

Given that the First Intermediate People's Court of Shanghai determined the validity of the arbitration agreement, the Supreme People's Court should determine whether the dispute between the parties is covered by the arbitration clause. The Supreme People's Court, in accordance with the basic principles of contract interpretation, should fully respect the parties' wishes, reasonably interpret the scope of the arbitration clause, and determine that when tort liability and liability for breach of contract are concurrent, one party choosing to file a lawsuit with tort liability shall not avoid the constraints of the contract arbitration clause. Even if one party initiates litigation to increase the number of litigants, this should not affect the application of the arbitration clause to the original contract between the parties in question.

In *Shanghai Guihuan Garments Co., Ltd. v. Shanghai Aurora International Trade Co., Ltd.*, which applied for the revocation of the arbitration award,⁹⁰ the Beijing Second Intermediate Court interpreted the validity of the arbitration clause in accordance with the provisions of Article 2 of the Judicial Interpretation of the Arbitration Law on arbitration matters.⁹¹ When an agreement is unclear, the parties can submit disputes for arbitration, including but not limited to the interpretation of the contract, and such arbitration clause is valid. From the case of the above-mentioned FTZ, we can see that when Chinese judges try to interpret foreign-related standards in arbitration cases involving an FTZ, they must not only comply with the literal meaning of the parties' contract, but also examine the parties' true intentions. Therefore, judges must rely on an interpretation method that facilitates the rapid resolution of disputes in order to make the arbitration clause in a given contract effective.⁹² However, a judge's interpretation cannot be separated from the traditional three-element criteria for identifying foreign factors.

In disputes involving FTZs, the Shanghai Intermediate People's Court has already established a green light for foreign-owned enterprises to agree on overseas arbitration.⁹³ In this particular FTZ, the initial case of *Siemens* was extremely significant. The information dissemination platform may quickly lead to competition in other FTZs or even non-FTZs. Given China's efforts to promote arbitration in accordance with the international standards and piloting related to FTZs, the court's attempt is a sound idea. However, China's current

arbitration system and arbitration legislation are still characterized by a number of deficiencies. If the new loose standard for the determination of foreign-related elements is applied urgently, it may have a major impact on China's arbitration industry.

Especially within the context of the Supreme People's Court's confirmation of the validity of awards disbursed by overseas arbitration organizations in the Chinese Mainland and the fact that overseas arbitration organizations have entered FTZs, it is more convenient for parties to submit their arbitration cases to overseas arbitration organizations.

If the court operates improperly in determining the foreign-related standards, its influence on China's arbitration system which cannot be underestimated, particularly given the potential reach of the 'butterfly effect.' Therefore, an appropriate restriction of the foreign-related determination standards can, to a certain extent, alleviate the impact of foreign arbitration institutions on China's domestic arbitration system.

V. CONCLUSION

Judging from the current practice of determining 'foreign-related' factors in the arbitration of the FTZs, China's courts still adhere to the three-element criteria. However, the courts have recently started to expand their interpretations of traditional subjects, objects, and legal facts. These expanded interpretations will, on the one hand, fully respect parties' autonomy consistent with the broad standards that other countries employ to identify the involvement of foreign countries. On the other hand, these new interpretations will impact China's domestic arbitration system. Consequently, China is asked to limit the expansion of these criteria. Moreover, judges should identify "false foreign-related" situations accurately when trying such cases. While judging the foreign-related standards, judges must identify a substantial connection with foreign countries. At the same time, judges should also have reasonable evidence when they exercise their discretion to interpret foreign-related standards.

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