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CROSSING BORDERS

International Arbitration Insights

Welcome to the seventh edition of Crossing Borders, a periodic review of developments in international arbitration across the world.

In this edition, we focus on China's Belt and Road initiative and its impact on international arbitration. We explore some of the key risks and mitigation strategies investors can use when making their investments along the Belt and Road, the importance of tailoring investment protections through careful structuring of investments, drafting of dispute resolution clauses and use of commercial and investment treaty arbitration protections. We also look at an area of significant practical importance to the initiative: the recognition and enforcement of foreign arbitral awards in China.

We then take the measure of the initiative from key stakeholders, the Secretaries General at the HKIAC and CIETAC HK, and we provide updates on relevant developments in international arbitration practice in Australia. Finally, we examine key areas of legal development which will, we expect, impact Belt and Road disputes: enforcement of CIETAC HK awards in Mainland China, third party funding and waterfall clauses in arbitration agreements. We also provide an update on a recent Hong Kong conference dealing with Belt and Road risk.

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China's Belt and Road: An overview

What is Belt and Road?

Announced in October 2013 by President Xi Jinping, the Belt and Road initiative (**Belt and Road**) promotes economic cooperation and partnership through the building of a trade and infrastructure network connecting China, Central Asia, the Middle East, Africa, Europe and Russia.

Sometimes referred to as the 21st century Silk Road, the Belt and Road draws inspiration from the ancient Silk Road, which consisted of trade routes from the old Chinese capital, Xi'an, to ancient Rome.

Through the Belt and Road, China aims to bolster economic cooperation and pave the way for free trade agreements among countries along the route.[1] The Belt and Road will serve as a platform to promote exchange and mutual learning between different countries for the purpose of mutually beneficial cooperation.

Official figures indicate that China has invested more than USD50 billion billion in Belt and Road countries since 2013.

National Development and Reform Commission (NDRC), March 2017

What countries are under Belt and Road?

The Belt and Road consists of the:

- **Land-based Economic Belt** which connects China with Central Asia, the Middle East, Europe and Russia; and
- **Maritime Silk Road** which connects China's coastal cities through the South China Sea to ports on the Indian Ocean, the African coast, the Red Sea and the Mediterranean Sea.

Belt and Road in a nutshell:

- Involves over 60 countries
- There are nearly 50 cooperation agreements signed between governments to date
- Will affect 4.4 billion people over its lifetime
- Will generate an aggregate GDP of USD20 trillion – approximately 30% of global GDP

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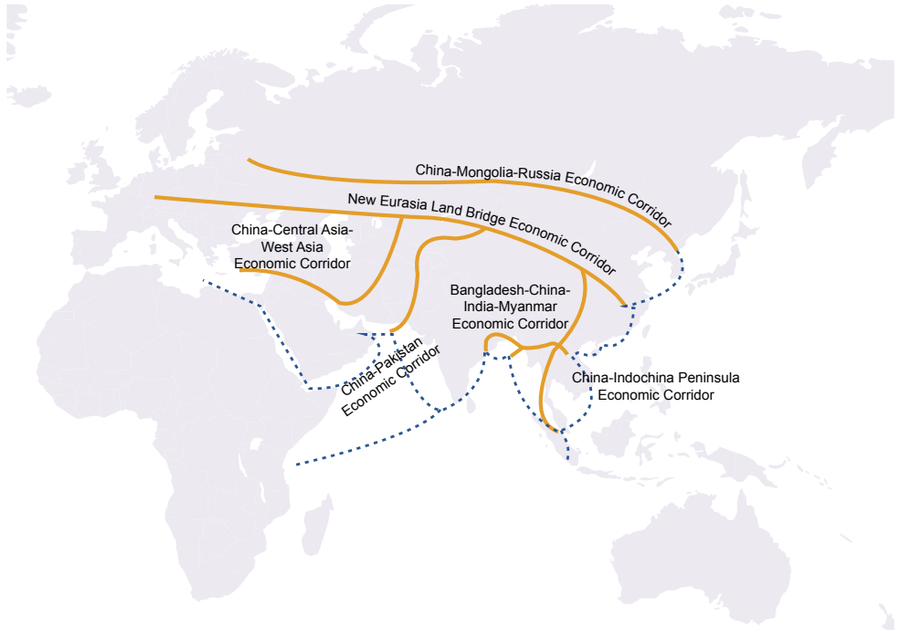
The following six economic corridors are earmarked for development under the Belt and Road:

- The New Eurasian Land Bridge Economic Corridor
- China – Mongolia – Russia Economic Corridor
- China – Central Asia – West Asia Economic Corridor
- China – Indochina Peninsula Economic Corridor
- China – Pakistan Economic Corridor
- China – Bangladesh – India – Myanmar Economic Corridor



What does Belt and Road mean for businesses?

The Belt and Road complements China's 'Going Global' strategy in encouraging Chinese enterprises to invest overseas and take opportunities in international markets. The initiative also welcomes foreign companies and counterparties to participate in investments.

The Belt and Road will see infrastructure construction on an unprecedented scale, including projects such as railroads, highways, pipelines, ports, airports, and telecommunications.

As China prepares to enter into a "new normal" pace of economic growth, Chinese enterprises will need to focus on more sustainable growth. The Belt and Road will provide Chinese enterprises with opportunities to export their engineering and construction capabilities to new markets. The increased connectivity brought by the Belt and Road will provide opportunities for trade of Chinese goods and services, thereby contributing to growth and boosting China's GDP in the long-term.

In the same vein, the initiative offers ample opportunity and potential to non-Chinese businesses. For non-Chinese businesses, the Belt and Road route connecting Europe, the Middle East and Africa with China offers opportunities for investment and co-investment with Chinese counterparts in import/export, technologies and a panoply of services.

[1] 'Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road', National Development and Reform Commission (NDRC), 28 March 2015

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Managing risk along the Belt and Road of opportunity

Max Bonnell, Ruimin Gao and Erin Eckhoff

China's Belt and Road Initiative is a visionary policy that aims to connect over 60 countries in Asia, Europe and Africa along five main routes of the Silk Road Economic Belt and 21st Century Maritime Silk Road. Affecting a total population of some 4.4 billion (approximately 63% of the world's population) and generating an aggregate GDP of over USD20 trillion (approximately 30% of global GDP), it is an ambitious framework that is projected to see significant numbers of infrastructure and other projects set up under its auspices. However, with such strikingly ambitious vision comes unchartered risks.

Since its announcement by President Xi Jinping in late 2013, over 600 contracts have been signed by Chinese enterprises for projects in countries along the Belt and Road routes.[1] This number of cross-border contracts is set to continue to increase, especially as it has been projected that Asia alone needs about USD8 trillion worth of basic infrastructure projects for the 2010 – 2020 period.[2] Other than infrastructure and related projects, logistics and maritime sectors are also likely to see heightened activity in the Belt and Road regions.

The significant opportunities of the Belt and Road also come with significant risks of legal disputes arising. This is particularly the case given that the Belt and Road sees commercial contracts being concluded between parties from countries with very different legal systems and traditions. The uncertainty of financial exposure or other negative implications in the event of a dispute is a confronting spectre that threatens every cross-border transaction.

We discuss three key risks for cross-border commercial disputes and the ways to prevent and minimise exposure in order to fully benefit from the Belt and Road opportunities.

Risk #1: Unfamiliar courts and laws

It is an intimidating prospect for commercial parties to have a dispute litigated in a foreign court as it raises questions of real concern – what is the applicable law? Will the judges be impartial? Will the decision be recognised abroad? These risks are particularly relevant for commercial relationships that span multiple jurisdictions. International arbitration provides a number of benefits for parties wishing to resolve a cross-border dispute but seeking to avoid ending up in an unfamiliar court system, especially if any ensuing decision is of limited enforceability. Parties have the freedom to choose the applicable law to the dispute, the location of any hearing, the Tribunal members and even the language of the dispute. Making these choices at the outset of a commercial venture provides a very tangible degree of certainty to cross-border commercial endeavours.

When choosing where to arbitrate it is important to choose an arbitration-friendly jurisdiction, as it is the courts of the "seat" (i.e. the jurisdiction to which the arbitration procedure is tied) that will play a supervisory role in any dispute. This supportive role can include issuing subpoenas against witnesses or for the production of documents of third parties and granting emergency or injunctive relief. It is also the courts of the seat of the arbitration which will usually decide any appeal or setting aside proceedings. For Belt and Road investors, the region has a number of excellent jurisdictions for arbitration, including Singapore, Hong Kong and Sydney, which offer established arbitral institutions and common law traditions.

Risk #2: Uncertainty of outcome and impact to reputation

Another significant area of uncertainty for commercial parties concerns the outcome of the dispute – when will it be resolved and what will be the final ruling? In this context, international arbitration provides another benefit in that arbitral awards are binding on parties as soon as they are rendered and are final, subject to limited and mostly procedural grounds for the award to be set aside by a court. This relative certainty of an arbitral award is in contrast to a judgement rendered by a domestic court which is typically subject to multiple levels of appeal or judicial review with accompanying time and cost implications.

Another key area of uncertainty concerns the potentially negative implications of a dispute on the parties' reputations. A reputable brand is of paramount importance to commercial parties that are dealing in transactions and trade. For this reason, parties commonly prefer for disputes and final rulings, particularly adverse findings, to remain confidential in order to avoid negative publicity. Litigation proceedings are generally conducted in open court and judgements are made publicly available. Arbitrations, on the other hand, are confidential and conducted in private, making arbitration often preferable in cases involving trade secrets or confidential commercial transactions, as well as for governments and state-owned enterprises (SOEs).

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Risk #3: Enforcement challenges

Even once a commercial party is successful in a dispute, the risks do not end there. Enforcement of a judgement or award is the final but most important aspect of the dispute, as an inability to effectively enforce a judgement can render the entire preceding dispute process redundant.

One of the key benefits of international arbitration as a means of dispute resolution is that arbitral awards are enforceable in more than 150 countries that have signed the New York Convention on the Recognition and Enforcement of Arbitral Awards (**New York Convention**). This offers a significant advantage over the enforcement of court judgements, which depends on the mutual recognition of judgements between States and typically requires legislation or another legal basis. Further, the process for enforcing foreign court judgements can differ significantly in different countries and can often pose difficulties for parties seeking enforcement.

When preparing commercial contracts, parties should opt for international arbitration if they want the option to enforce an arbitral award in one or more of the over 150 signatory countries to the New York Convention. In drafting the arbitration clause, though, parties must ensure that the seat of arbitration chosen is also a signatory to the New York Convention. This is because only arbitral awards made in a country which is a signatory to that convention can be enforced in another country which is a signatory to that convention.

The relative ease of enforcing arbitral awards globally is another reason why international arbitration is the ideal dispute resolution means for Belt and Road contracts. This has been recognised by the PRC Supreme People's Court, which promulgated an Opinion in July 2015 stating that foreign arbitral awards relating to the Belt and Road should be promptly recognised in accordance with the law.[3] The Supreme People's Court also indicated strong support for use of international commercial and maritime arbitration for resolving cross-border disputes arising from the Belt and Road.

Lessons for businesses

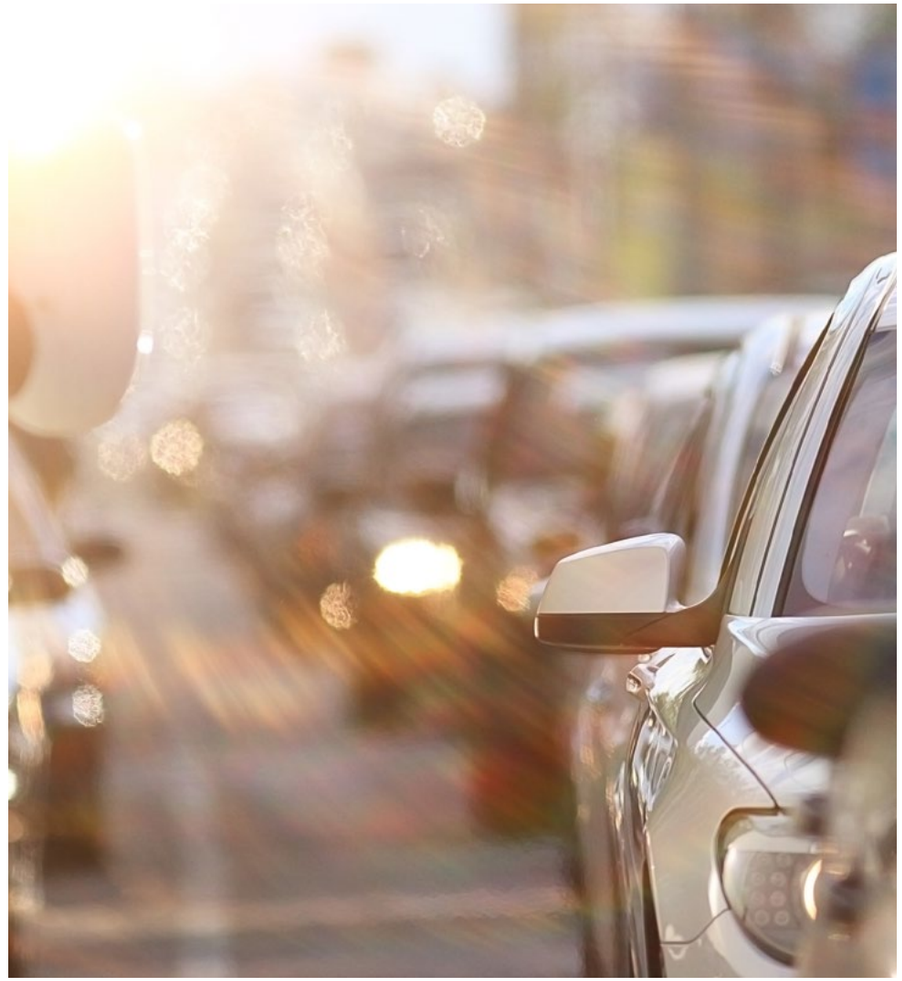
Belt and Road is a ground-breaking initiative which will present significant opportunities as Chinese outbound investment in infrastructure reshapes international trade and relations. However, it is important to have the right tools to manage any accompanying risks in order to benefit from these opportunities. To this end, international arbitration provides commercial parties with mechanisms to mitigate risks, resolve disputes effectively and, ultimately, promote trade and commerce.

At its core, international arbitration upholds principles of due process and the rule of law whilst affording certainty and familiarity to parties who can tailor a dispute resolution process according to their own preferences and backgrounds. This is why, even though international arbitration cannot guarantee an ideal outcome for every dispute, it is unquestionably the best form of dispute resolution available when dealing with significantly different legal traditions and cultures, such as those along the Belt and Road routes.

[1] 'Investment and Cooperation Statistics along "One Belt and One Road" Countries from January-February in 2017', Ministry of Finance of China, 24 March 2017

[2] 'How Malaysia scholar sees the Belt and Road Initiative', The State Council of the People's Republic of China, as cited by Hon Mr. Rimsky Yuen SC, Secretary for Justice of the Hong Kong SAR, 12 October 2016

[3] 'Providing Judicial Services and Safeguards for the Construction of the "Belt and Road" by People's Courts', No. 9 [2015] of the Supreme People's Court



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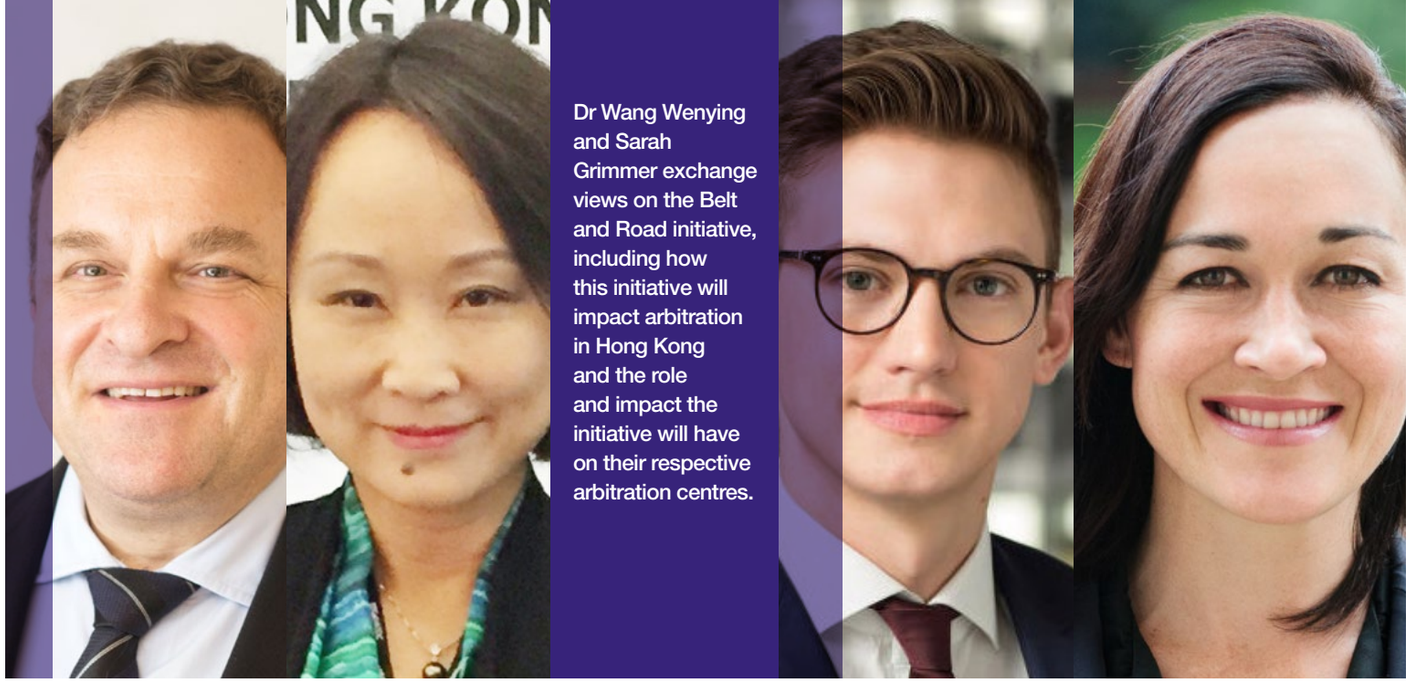

Dr Wang Wenying and Sarah Grimmer exchange views on the Belt and Road initiative, including how this initiative will impact arbitration in Hong Kong and the role and impact the initiative will have on their respective arbitration centres.

> "Recent studies show that enforcement rates in the PRC are improving"
>
> Sarah Grimmer, Secretary General of HKIAC

A Belt and Road conversation with Dr Wang Wenying, Secretary General of CIETAC HK and Sarah Grimmer, Secretary General of HKIAC

Paul Starr and James McKenzie

Paul Starr, Practice Leader Hong Kong Dispute Resolution and Infrastructure and James McKenzie, Senior Associate, King & Wood Mallesons, Hong Kong in conversation with Dr Wang Wenying, Secretary General at China International Economic and Trade Arbitration Commission Hong Kong (CIETAC HK) and Sarah Grimmer, Secretary General at Hong Kong International Arbitration Centre (HKIAC).

The Belt and Road Initiative in Hong Kong

When you hear 'Belt and Road', what does that conjure up for your institution?

Wenying: While the Belt and Road initiative will directly or indirectly affect billions of people across the world and more than 60 countries along the routes, it will also create opportunities to build and grow Hong Kong's role as a financier and dispute resolution hub for Belt and Road projects. This, in turn, will create opportunities for dispute resolution service providers in Hong Kong including CIETAC HK, which is usually the institution of choice for parties from China and Belt and Road countries to arbitrate considering its unique features.

Hong Kong plays a vital role in the initiative by bridging countries in the Asian region together. The establishment of CIETAC HK is itself a recognition by CIETAC of Hong Kong's importance to the region. Many sectors in Hong Kong will consequently have a bigger role to play and will benefit from the initiative.

That's true that Hong Kong is a bridge, in fact, the Hong Kong Government has referred to Hong Kong as a 'super-connector' for the Belt and Road initiative. What does HKIAC see as being particularly important to this connection?

Sarah: Hong Kong's independent legal system and judiciary, extensive network of professional services in finance, accounting, construction and law, bilingualism, and geographical proximity to China are particularly important. A large proportion of the initiative's investment will be channelled through Hong Kong, particularly through Hong Kong incorporated vehicles. As a result, Hong Kong is a critical centre for Belt and Road projects.

In the legal industry alone, Hong Kong has over 1,000 barristers and 6,700 practicing lawyers. Hong Kong is one of the world's top arbitration venues (voted the third most preferred venue in the world and first in Asia in a 2015 survey by Queen Mary University of London/White & Case survey). HKIAC, Hong Kong's flagship institution, as well as other arbitral entities based in Hong Kong, and individuals providing legal and arbitration services, will need to think about how their services are relevant in the Belt and Road context and promote them.

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In thinking about Hong Kong's services, what would your institutions say to a Russian or African company that has previously only ever used the English arbitration system but is now involved with a Belt and Road project in which it is considering Hong Kong as a seat? What does Hong Kong have to offer?

Sarah: As many of the companies doing business on Belt and Road projects will be dealing with a Chinese counterparty, they should anticipate that the Chinese party may propose that the seat of the arbitration be in China and/or that the governing law is Chinese. Foreign parties should take advice on what it means for an arbitration to be seated in mainland China and/or on the particularities of Chinese law. Foreign parties often prefer Hong Kong as a seat given its modern arbitration legislation and independent legal system and judiciary. Chinese parties are also equally comfortable with Hong Kong as a seat and thus it is a compelling compromise.

Companies familiar with the common law and the English arbitration system will find Hong Kong particularly attractive as a seat or governing law when negotiating their arbitration clauses because it is a common-law system largely influenced by English law. With its large pool of legal professionals, independent judiciary (including non-permanent judges from other common law jurisdictions on its highest court) and state-of-the-art arbitration legislation, Hong Kong is the go-to jurisdiction for parties looking to meet their Chinese counterparties half-way. Russian parties in particular are looking more and more to Asia for business and dispute resolution services due to sanctions in other jurisdictions, we receive regular enquiries from Russian entities about our services.

Wenying: Under the principal of One Country, Two Systems, Hong Kong, as a Special Administrative Region of China, is supported by the Central Government to maintain its stability, development and prosperity. On the other hand, Hong Kong, under the Basic Law, enjoys independent judicial power including the power of final adjudication. It also continues to be an independent and neutral seat of arbitration to resolve the disputes arising from projects and contracts related to the Belt and Road initiative.

Hong Kong is a common law jurisdiction and there are similarities between arbitration practices in Hong Kong and England & Wales. But Hong Kong is at the same time fully capable of embracing parties and practitioners of different legal and cultural backgrounds together to resolve a dispute. Hong Kong also provides great options for parties when choosing arbitrators because a large number of experienced arbitrators reside or work in Hong Kong.

Belt and Road and dispute resolution

Another layer to this, of course, is that many of the Belt and Road countries contain high levels of legal and political risk. What do you think are some of the advantages and disadvantages of arbitrating Belt and Road disputes versus other dispute resolution methods such as litigation?

Sarah: Submitting disputes to arbitration avoids the perils of litigating in jurisdictions where the rule of law is not applied or where the courts are not independent. Given that some of the Belt and Road projects are massive, and involve national interests, removing disputes from local court sphere is critical.

Also, one of the greatest advantages of arbitration is the enforceability of awards. Belt and Road disputes will involve Chinese parties which means that enforcement may take place in mainland China against Chinese assets. We know that HKIAC and Hong Kong based awards have a strong enforcement rate in the PRC by virtue of the 1999 Arrangement between Hong Kong and the PRC. Recent studies show that enforcement rates in the PRC are improving, particularly with the reporting up system whereby an award can only be refused enforcement with the endorsement of the Supreme People's Court. Foreign parties can also take comfort in the fact that the Hong Kong courts have enforced awards against Chinese SOEs.

Wenying: I agree that Hong Kong awards have a very strong track record. As the PRC is a signatory to the New York Convention, awards made in Hong Kong can be enforced in more than 150 countries and places under the New York Convention. There is also some harmonisation of arbitration laws along the Belt and Road with more than half of the Belt and Road countries having adopted the UNICTRAL model law in their domestic arbitration laws.

The enforcement of Hong Kong seated awards in the PRC is well handled by the 'Arrangements of the Supreme People's Court on the Mutual Enforcement of Arbitral Awards Between the Mainland and the Hong Kong Special Administrative Region'. As an example, just recently, on 13 December 2016, the Nanjing Intermediate People's Court of Jiangsu Province enforced a CIETAC HK arbitral award in the PRC, which demonstrates the capability of the PRC courts to enforce Hong Kong awards issued by CIETAC HK.

That's an encouraging development. How important for enforcement and the ability to seek interim relief is it that Belt and Road disputes are seated in 'pro-arbitration' jurisdictions such as Hong Kong?

Wenying: In the PRC arbitration law, for example, interim relief cannot be made by the arbitral tribunal. In Hong Kong, the Arbitration Ordinance provides not only for court based relief in support of arbitration but that the arbitral tribunal can grant interim measures to protect the parties' urgent interests when needed.

Interim relief is very important because, firstly, it may assist with enforcing the award capable of being enforced at the end when the winning party gets the award so the award is not just on paper. Secondly, it may help to resolve disputes more efficiently since it may facilitate the disputants to discuss settlement. Hong Kong is a well-known pro-arbitration jurisdiction with all the usual advantages in seeking interim relief and enforcing an order on interim relief rendered by an arbitral tribunal.

Given the operational and credit risks associated with many of the Belt and Road countries, what do you perceive to be some of the key considerations for investors in structuring their investment vehicle or drafting dispute resolution clauses?

Sarah: Investors should opt for arbitration rather than the submission of disputes to local courts. Investors should ensure that arbitration clauses across multiple instruments relating to a particular project are compatible. Parties should use compatible model clauses and may consider adopting an umbrella dispute resolution clause that applies to all related contracts.

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Another important dimension we are now advising our clients on is investment treaty rights. What consideration should be made of these potential rights when investors are structuring their Belt and Road investments?

Sarah: Investors and host States should know which bilateral and/or multilateral investment treaties apply to their investment and decide how to structure their investment in order to attract treaty protection. This should happen prior to a dispute arising. This will include an assessment of whether the provisions of other treaties can be accessed through the application of most-favoured nations clauses.

Investment treaties often contain dispute resolution clauses referring investor state disputes to arbitration under, inter alia, the UNCITRAL Arbitration Rules. HKIAC has already hosted multiple investor-state arbitrations and has administered arbitrations under the UNCITRAL Rules since 1986 under its own separate procedural guidelines. Furthermore, HKIAC has a tribunal secretary service which is particularly useful in large, complex cases (which investor state arbitrations very often are). HKIAC also recently launched a "free hearing space" initiative, offering parties in an HKIAC-administered arbitration involving a State listed on the OECD list of development assistance (which 70% of Belt and Road jurisdictions are) access to HKIAC's hearing facilities free of charge. For some parties, the cost savings on hearing facilities will be a factor towards them choosing HKIAC and Hong Kong.

Wenying: For protection under an investment treaty, the person or company making the investment must qualify as an 'investor'. Most treaties define 'investor' as either a natural person or a company having the nationality of the home State. The definition may differ between each bilateral and multilateral investment treaty and investors should always check the exact requirements under the relevant treaty. Although the method used to determine whether a company or person is 'foreign' varies across investment treaties, the party seeking to utilise the investment treaty must demonstrate that it is a national of one of the countries that is signatory to the treaty.

Belt and Road and CIETAC HK / HKIAC

What is being done to encourage use of your centres in disputes involving the Belt and Road Initiative?

Sarah: In 2017 and beyond, HKIAC will be playing a very active role in the Belt and Road initiative. We are planning to visit many Belt and Road jurisdictions this year, with the aim of educating local contracting parties about the key issues they need to know when undertaking a Belt and Road project. For example, what does a party need to know when concluding a construction contract funded by a Chinese SOE? Or one that may also involve a Chinese entity contracted in production capacity? What does a party need to know when its project is funded by a Chinese finance institution, whether that be an infrastructure bank, private equity firm or sovereign wealth fund? These are some of the practical considerations that parties need to take into account when embarking on Belt and Road projects.

Because of the very nature of Belt and Road projects, the disputes that emanate from them will often involve multiple contracts as well as multiple parties, including public entities, private equity funds, and SOEs both from within and without Belt and Road jurisdictions. The deals are major infrastructure projects which may involve high-stake disputes with a significant political element.

The 2013 HKIAC Administered Arbitration Rules (the "**Rules**") are designed to deal with multi-party and multi-contract scenarios, such as those arising in Belt and Road disputes – specifically, our Rules allow for consolidation, joinder and commencement of a single arbitration under multiple contracts, and default appointment options. Our Rules also contain provisions allowing for expedited proceedings, emergency arbitrator proceedings and a choice of method for determining the tribunal's fees which can save costs. To assist tribunals in handling large disputes, HKIAC also offers a tribunal secretary service from among the members of our multilingual Secretariat. They have experience in both commercial and investment arbitration and can work in English and/or Mandarin.

HKIAC has recently released statistics on the average duration and costs of its proceedings which demonstrate that it leads among the other major international arbitral institutions on both of these heads. HKIAC also has a deep pool of qualified and bilingual English/Mandarin arbitrators from which parties and the institution can appoint.

Wenying: CIETAC HK currently uses the CIETAC Arbitration Rules 2015 to administer its cases. The Rules are a happy marriage between the Chinese and the international practice of arbitration, which perfectly suits the potential commercial disputes among companies from the Belt and Road initiative. We have witnessed a convergence of arbitration rules among different institutions as they have developed over the past few years. However, there can be some distinctive features in practice among institutions, for example, mediation, scrutiny of awards and case manager systems.

CIETAC HK has gained a reputation of maintaining a relatively more efficient arbitration. Its average time for rendering an award in 2015 was 115 days from the date the arbitrators are appointed. CIETAC will update its pool of arbitrators this May thereby enhancing its capacity in resolving Belt and Road disputes by increasing Belt and Road related arbitrators.

What role do you see your respective centres playing in providing hearing facilities?

Sarah: HKIAC offers modern hearing facilities in the heart of Hong Kong's central business district. Its premises were voted the best in the world for location, value for money, helpfulness of staff and IT services in 2015 and 2016. Additionally, as I mentioned earlier, HKIAC offers free hearing space for proceedings administered by HKIAC where at least one party is a State listed on the OECD DAC List of ODA assistance.

Wenying: CIETAC has a great network around the globe which allows us to provide hearing facilities readily available in China and at a great number of jurisdictions. CIETAC HK has adequate hearing facilities and caters to cross-border hearings on a regular basis. CIETAC HK will move to the Legal Hub, a wonderful initiative by the Department of Justice, in two years, which is exciting news that we wish to share.

For the traditional commercial arbitration cases that CIETAC HK carries out, if we look at CIETAC's Fee Schedule, we can

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easily draw the conclusion that CIETAC is one of the very few international arbitration institutions that puts no additional burden on the parties for hearing facility costs.

We have talked a bit about the role investors play in choice of seat and arbitral institution. Another important party are "*funders*". What role do your institutions see funders as playing in choice of dispute resolution clauses and what are your centres doing in terms of outreach to funding bodies?

Sarah: Third party funders' primary concern is making returns in proceedings either through an award or settlement agreement. Effective enforcement of an eventual award is therefore critical, and choosing experienced arbitrators and institutions with modern rules goes a long way towards ensuring a valid and enforceable award. We work closely with third party funders in terms of mutual involvement in events and educating users. We also formed a special taskforce to consult with the Hong Kong SAR government on legislative reform as it concerns third party funding in Hong Kong.

Wenying: Yes, absolutely, and we are spending a lot of time in China talking to those groups. We recognise that as the parties providing the funds they have a lot of say in what dispute resolution clauses go into contracts.

What is being done by your centres to liaise with these organisations and encourage the choice of your centres and Hong Kong as a seat?

Sarah: We promote our work to Chinese SOEs both in the PRC and in Hong Kong. For example, in the week before Christmas, we hosted three large delegations of Chinese SOEs and arbitral centres in Hong Kong. In the PRC, HKIAC staff often meet with contractors and funders to understand their positions in different transactions and to promote the use of HKIAC's Rules and services. We have also implemented Belt and Road seminars in Hong Kong and held Belt and Road roadshows in relevant jurisdictions that are recipients of outbound Chinese investment.

Wenying: We will have tailor-made events for investors on commercial arbitration, intellectual property disputes, construction disputes etc., including but not limited to seminars, mock arbitrations and negotiation workshops. We also work with chambers of commerce, governments, and institutes of arbitrators to communicate with arbitration users along the Belt and Road countries on the possibility of arbitration in Hong Kong.

Given all the talk about funding, it seems germane to talk about the pending third party funding reforms to the Arbitration Ordinance. What do your centres think the effect of the reform will be on Belt and Road arbitrations?

Sarah: The legislative reforms will bring Hong Kong into line with other major jurisdictions in terms of third party funding being available in arbitration. This is a positive development and makes Hong Kong more attractive as an arbitral seat. Some parties (whether these are impecunious parties or sophisticated entities using third party funding as a means of capital and liquidity management) may not wish to fund their disputes in the classical way, so third party funding arrangements are an interesting alternative.

Wenying: The Hong Kong Government has a long-standing policy of promoting Hong Kong as a leading centre for international legal and dispute resolution services in the Asia Pacific region. In recent years, third party funding of arbitration has become increasingly common in various jurisdictions.

The pending amendments to the Arbitration Ordinance to allow third party funding in arbitration and mediation proceedings is good news for dispute resolution services in Hong Kong. Third party funding will provide more options for parties initiating their arbitration case. CIETAC HK, with the help of its Working Group Members, has drafted guidelines to assist parties and arbitrators to be informed when considering using funding in their arbitrations.

Finally, what do you both see as the future of CIETAC HK's and HKIAC's involvement in Belt and Road?

Wenying: Before the Belt and Road, CIETAC HK was already the choice for resolving China related cross border commercial disputes. With the increasing volume of investment and trade, CIETAC HK will play a crucial role to resolve disputes arising from both.

Sarah: In 2017 and beyond, the Belt and Road initiative will constitute a significant part of HKIAC's outreach and capacity work. As I mentioned, HKIAC has designed a roadshow for Belt and Road jurisdictions and has held that in the Philippines. We will also visit Mongolia and other jurisdictions this year. We are excited about promoting Hong Kong for Belt and Road disputes.

> **"In recent years, third party funding of arbitration has become increasingly common"**
>
> Dr Wang Wenying, Secretary General of CIETAC HK

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Recognition and enforcement of foreign arbitral awards in the PRC: What is the reality and what to expect?

Haidi Teng and Yu Qing

With the Belt and Road initiative likely to drive significant outbound investment by Chinese companies, the ability to enforce foreign arbitral awards in the People's Republic of China (**PRC**) will be a key issue for these companies and their Belt and Road counterparties.

In 1987, the PRC ratified the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (**New York Convention**). On 10 April 1987, the Supreme People's Court of China (**Supreme People's Court**) issued the Notice of the Supreme People's Court on Implementing the Convention on the Recognition and Enforcement of Foreign Arbitral Awards Acceded to by China (**Supreme Court Notice**) and stated relevant issues regarding the enforcement of foreign arbitral awards according to the New York Convention.

However, the Supreme Court Notice contains only five articles which set out the principal rules according to the New York Convention. As of today, the Supreme Court Notice has not been amended. Due to the lack of detailed explanation and case precedents, an applicant seeking to enforce a foreign arbitral award in the PRC should have regard to the issues set out below.

What types of arbitral award are enforceable?

- Arbitral awards made in the territory of another contracting state;[1] and
- Arbitral awards arising out of legal relationships, whether contractual or not, which are considered commercial under the national law of China.[2]

What is the process of recognition and enforcement?

An interested party to an arbitral award can apply for recognition and enforcement in the PRC. Recognition and enforcement are two separate procedures. Recognition proceedings will generally be heard by a civil division handling foreign related cases in an intermediate court. If the court recognises an arbitral award, the court will issue a ruling recognising the arbitral award in the PRC. After the arbitral award is recognised, the applicant will need to further apply to the enforcement division of the same court for enforcement. The relevant procedure will be largely the same as for domestic arbitral awards.

The Intermediate People's Court will have jurisdiction over the enforcement application at the following places:

- If the respondent is a natural person, the place of his or her household registration or the place of his or her residence
- If the respondent is a legal entity, the place of its principal business office

What kind of arbitral awards will not be recognised and enforced?

Article 4 of the Supreme Court Notice and Article 5 of the New York Convention stipulate the circumstances under which PRC courts could refuse the application for recognition and enforcement of a foreign arbitral award. Many circumstances of refusal, such as improper notice of appointment of an arbitrator can be avoided if the arbitration proceedings were properly conducted in a foreign country. The more problematic issues are these.

Arbitrability

Article 5.2.(a) of the New York Convention states that, if the relevant court finds that the subject matter of the dispute is not capable of settlement by arbitration under the laws of the place of recognition and enforcement, then the court may refuse to enforce the award.

Under PRC Arbitration Law, only contractual disputes and other disputes over rights and interests in property between citizens, legal entities and other organisations may be arbitrated. Family and succession disputes, as well as administrative disputes, are specifically prohibited from being settled through arbitration.

Public policy

Article 5.2.(b) of the New York Convention states that the recognition or enforcement of the arbitral award may be refused if the relevant court finds that it would be contrary to the public policy of the place of recognition and enforcement.

There is no specific provision under the PRC laws and regulations regarding the definition of "contrary to…public policy". However, in respect of the arbitral award in TCL Air-conditioner (Zhongshan) Limited v Castel Electronics Pty Ltd,[3] the Supreme People's Court held that, "the infringement of public interest shall be interpreted as a violation of the basic principle, infringement of the national sovereignty, jeopardizing public security, violation of public policy and other circumstances which will infringe the basic public interest."

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In other cases, the Supreme People's Court has emphasised that public interest/ policy should be strictly interpreted and limited in its use, and that violation of mandatory rules of the law, administrative rules and departmental regulations does not necessarily comprise violation of public interest.[4] Accordingly, any rejection of recognition and enforcement of an arbitral award by an Intermediate People's Court is likely to attract significant judicial scrutiny upon review.

Even though the public policy card is often played by respondents to applications for recognition and enforcement, PRC courts are quite cautious when using this Article to refuse enforcement of foreign awards.

In addition, according to Article 2 of the *Notice of the Supreme People's Court on Handling Relevant Issues about Foreign-related Arbitration and Foreign Arbitral Issues by the Supreme People's Court*,[5] if an Intermediate People's Court decides not to recognise and enforce an award, that Court must submit its decision to the relevant Higher People's Court for review. If the Higher People's Court decides to uphold the lower court's decision not to enforce the award, it must then report its decision to the Supreme People's Court. The Supreme People's Court will then review the matter and reply with a final decision. Therefore, generally speaking, the PRC courts would be reluctant in applying the New York Convention to deny recognition and enforcement applications.

Can the respondent challenge the jurisdiction of the enforcing court?

Neither the New York Convention nor the Supreme Court Notice stipulates whether the parties can raise jurisdictional challenges (and/or whether the parties can appeal the result of a jurisdictional challenge) in proceedings for the recognition and enforcement of foreign arbitral award (**Recognition and Enforcement Proceedings**). There is also no other rule that specifically addresses this issue. Therefore, we need to look to the PRC Civil Procedure Law (**Civil Procedure Law**) for further guidance.

According to the Civil Procedure Law, Recognition and Enforcement Proceedings, as stated in Chapter 27 Judicial Assistance, fall under the category of judicial assistance proceeding. However, pursuant to Article 127, Chapter 12 of the Civil Procedure Law, jurisdictional challenges fall under the category of ordinary procedure at first instance proceeding. Hence, it is arguable that jurisdictional challenges are only applicable to first instance proceedings. However, in practice, PRC courts usually tend to allow the parties to raise jurisdictional challenges in other proceedings as well.

This approach leads to another question: whether the parties can file an appeal on the result of jurisdictional challenges in Recognition and Enforcement Proceedings.

Again, there is no specific law or regulation regarding this issue. However, in *TCL Air-conditioner (Zhongshan) Limited v Castel Electronics Pty Ltd*, the Supreme People's Court held that, "according to Article 3, subsection 2 of the *Interpretation of the Supreme People's Court of Several Issues concerning the Enforcement Procedures in the Application of the Civil Procedure Law of the People's Republic of China*, 'the party who is dissatisfied with the ruling may apply for judicial review to the people's court of higher level'. Therefore, if TCL is dissatisfied with the ruling, it shall apply for judicial review rather than file for appeal".

Consequently, according to the Supreme People's Court ruling, in Recognition and Enforcement Proceedings, the parties can raise jurisdictional challenges. However, the parties can only apply for judicial review rather than file an appeal regarding the result of the jurisdictional challenge. According to PRC laws and regulations, the substantive Recognition and Enforcement Proceeding will not be suspended by judicial review. We have seen some of the provincial high courts, such as Shandong Provincial High Court, follow the Supreme People's Court's ruling that respondents to Recognition and Enforcement Proceedings are only allowed to apply for judicial review rather than file for appeal.

However, since the PRC is not a common law jurisdiction, in practice, we have seen cases where PRC courts still allow the parties to appeal the civil order of a jurisdictional challenge, such as Liaoning Provincial High Court.

Can the applicant seek interim relief during the enforcement of foreign arbitral awards?

There is no specific rule regarding asset preservation pending the recognition of an arbitral award under the New York Convention or relevant PRC laws and regulations. In practice, it is difficult to persuade the PRC courts to conduct asset preservation during recognition proceedings. However, asset preservation measures are available once a decision to recognise and enforce an arbitral award has been made and enforcement proceedings have been commenced.

Key takeaways

As more and more foreign entities conduct business with PRC companies, the number of applications for recognition and enforcement of foreign arbitral awards is set to increase.

To avoid difficulties, parties seeking to recognise and enforce foreign arbitral awards in the PRC should consider the location of the relevant assets whilst bearing in mind the potential obstacles associated with asset preservation and the potential grounds for refusing recognition and enforcement. Despite the current difficulties and lack of detailed regulations, it is our view that in time, PRC courts will inevitably become more familiar with such proceedings and, in turn, expect the process to become more efficient.

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[1] Supreme Court Notice, Article 1

[2] Supreme Court Notice, Article 2

[3] Min Si Ta Zi No. 46. [2013]

[4] See, e.g. *Reply to the Request for Instructions on Non-Recognition of No. 07-11 (Tokyo) Arbitral Award of the Japan Commercial Arbitration Association [2010] Min Si Ta Zi No. 32, Reply to Haikou Intermediate People's Court Regarding the Request for Instructions on Non-Recognition and Non-Enforcement of the Arbitral Award of the Arbitration Institute of the Stockholm Chamber of Commerce [2001] Min Si Ta Zi No. 31; Reply to the case of E.D. & F. Man (Hong Kong) Limited - Application for Recognition and Enforcement of the Arbitration Award of the London Sugar Commission, [2013] Min Si Ta Zi No. 3; Reply to the Request for Instructions Re the Hong Kong Xiang Jin Grain and Oil Food Co., Limited - Application for Enforcement of the Arbitration Award of Hong Kong International Arbitration Center* [2003] Min Si Ta Zi No. 9.

[5] No. 18 [1995]

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Cards on the table? Thoughts on disclosure of third party funding

Dorothy Murray and Edmund Northcott

As more jurisdictions permit third party funding of international arbitration, the question of whether details of the funding must be disclosed arises ever more frequently.

Concerns to date focus on conflicts (ensuring that the identity of the funder poses no challenge to the independence and impartiality of the tribunal) and the ability of a respondent to apply for security for costs. The Tribunal in the case of *Muhammet Cap v. Turkmenistan*[1], was motivated by these concerns when requiring the Claimant to disclose whether it was being funded by a third party funder, and if so, the funder's identity and nature of the funding arrangements, including to what extent the funder would share in a favourable award to the Claimant.

Singapore removed long standing prohibitions against such funding in January 2017. Hong Kong looks to follow suit shortly with the Arbitration and Mediation Legislation (Third Party Funding) (Amendment) Bill 2016 (the "**Bill**"), which is currently gazetted before Hong Kong's Legislative Counsel.

The process of legislative reform in Singapore and Hong Kong have both contemplated standards of disclosure. In the case of Hong Kong, the Bill requires disclosure of the existence of a funding agreement and the name of the third party funder upon the commencement of the funded arbitration (if the agreement is made on or before the commencement of the arbitration) or within 15 days (if a funding agreement is entered into after the arbitration has commenced).

In the case of Singapore, whilst the Civil Law (Amendment) Bill abolished the common law torts of champerty and maintenance, it has been left to subsidiary legislation and regulations to deal with the standard of disclosure required. It is widely expected that, like Hong Kong, Singapore will adopt a "light touch" regulatory approach to disclosure.

For arbitrations seated in other jurisdictions, which do not have a law that clearly delineates what is to be included in the "costs" of an arbitration or rules that mandate disclosure of funding arrangements, the recent decision of the English High Court in *Essar v Norscot* [2] adds another argument to the armory of the party seeking disclosure.

The award in question was made under the 2012 ICC Rules in England. It concerned a claim by Norscot (Claimant) that Essar (Respondent) was in repudiatory breach of an operations management agreement. The sole arbitrator found for the Claimant and awarded USD4 million together with indemnity costs – including allowing the Claimant to recover its third party funding costs.

The terms of the funding were market standard: funding of GBP647,000 in return for, in the event of a win, an uplift of three times those costs or 35% of the Claimant's recovery, whichever was greater. The funder was therefore entitled to GBP1.94 million from the Claimant, which the Claimant sought to recover from the Respondent.

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The Court upheld the Arbitrator's decision, and refused a challenge under s.68(2)(b) of the Arbitration Act 1996 (the "**Act**"), holding that the Arbitrator did not exceed his powers:

The ICC Rules and the Act give arbitrators a wide discretion as to costs – including deciding that the "other costs" each referred to may include funding costs.[3] Even if the Arbitrator was wrong, his decision was not an excess of power.

The Court agreed with the Arbitrator in any event: "other costs" could include third party funding costs.

Both the Arbitrator and the Court appeared influenced by the conduct of the Respondent in the arbitration. The facts suggest that the Respondent had set out to suffocate the Claimant by forcing it into expensive litigation, which the Respondent knew the Claimant could not afford. The Claimant therefore had no choice but to source litigation funding. Whether the Respondent's behaviour should be determinative when assessing Claimant's costs is questionable; a costs order should function to reimburse the successful party for having to go all the way to formal proceedings, rather than reprimand the losing party for their actions. For example, if the funder's costs had not been so great, would the Arbitrator have sought to penalise Respondent through other means?

Third party funding is not just the choice of the impecunious, however. Many sophisticated parties are attracted to removing risk and cost from their balance sheet by using funding. What also of parties who obtain funding not from formal funders, but on terms from group or associate entities? It is unclear how the reasoning in *Essar* will apply to them, as the Court did not appear to envisage that such costs would be recoverable as a matter of course or routine.

This raises a more fundamental concern with the award and judgment – that the "costs" of third party funding are, while of course a "cost" to the funded party, they are not procedural "costs" of the arbitration. They are the price of a separate contract outside the arbitration by which the funded party pays an agreed contingent future price to lay off its cost risk. They may in circumstances such as *Essar* be damages, but would have to be pleaded as such.

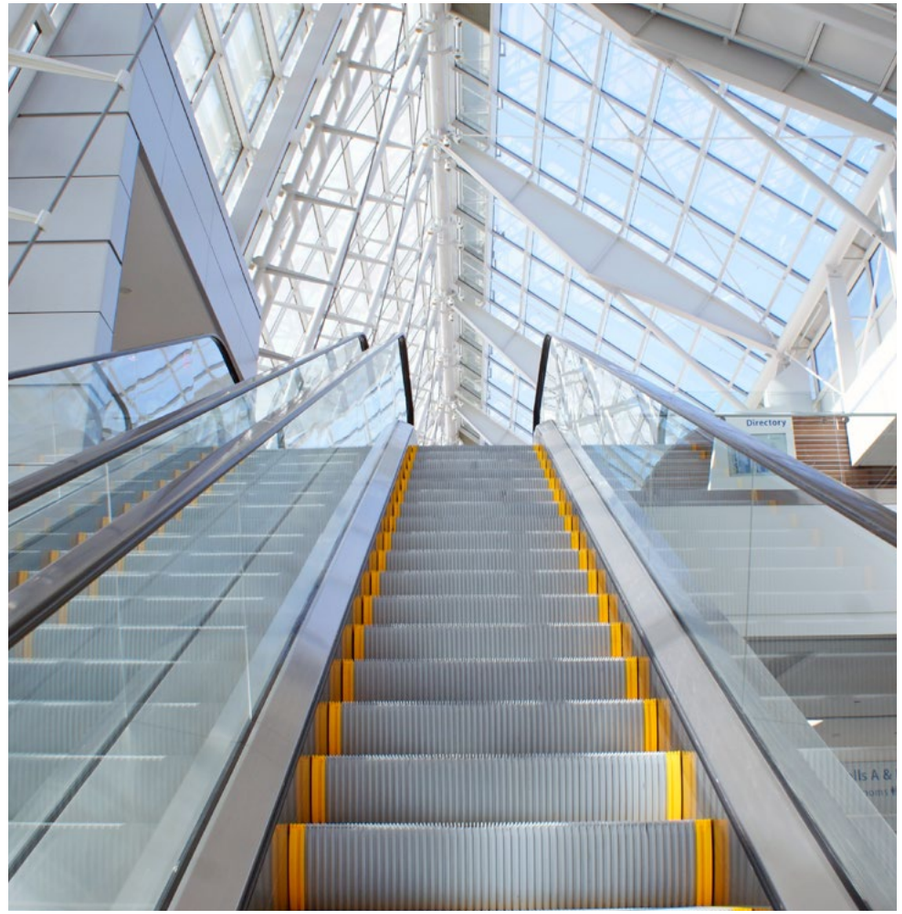
Notwithstanding the criticism and confusion created, this case will first, embolden funded parties (typically claimants) to seek to recover such "costs" in arbitrations under the ICC Rules and others that contain similar provisions (which includes the LCIA Rules); and second, promote applications for disclosure of funding. The tension to date in the issue of disclosure has been in the extent to which disclosure should be required. This decision goes straight to the fullest disclosure. If a party is to be at risk for funding costs, there seems a strong argument that it should be entitled to know at least of the existence and the terms of that funding. Where disclosure of funding terms is ordered due to a risk of costs liability, funders have few persuasive grounds to resist such disclosure, given how punitive the arrangements can be for the paying party. Funders may view themselves better-off following *Essar*, but any benefit is likely to come at the expense of full disclosure of their funding agreements.

As with many things, the final word will be left to the tribunal's discretion: there is no guarantee of recovery and no certainty about how "reprehensible" behaviour has to be before it crosses the line considered to have been crossed by the Respondent. The arbitrator's decision seems to have been used to punish the Respondent, rather than compensate the Claimant for costs actually incurred. On this basis there is now a stronger argument to suggest that funder's costs should be characterised as damages if grounds exist to do so on the facts, and be pleaded and proven in the arbitration, rather than left to the (unpredictable) discretion of the arbitrator. Belt and road investors should therefore carefully consider the permissibility of third party funding, and any disclosure and costs implications of the same, when drafting the dispute resolution clauses for any investment.

[1] Muhammet Çap & Sehil Insaat Endustri ve Ticaret Ltd. Sti. v. Turkmenistan, (ICSID Case No. ARB/12/6), Procedural Order No. 3 (June 12, 2015).

[2] Essar Oilfields Services Limited v Norscot Rig Management PVT Limited [2016] EWHC 2361 (Comm).

[3] Article 37(1) of the 2012 ICC Rules includes in the "costs of the arbitration" the "reasonable legal and other costs incurred by the parties for the arbitration."; s.59(2) of the Act states that any reference to the costs of the arbitration "includes the costs of or incidental to any proceedings to determine the amount of the recoverable costs of the arbitration."



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Case Report: Recent developments in international arbitration in Australia

Max Bonnell and Sarah Rodrigues

Australia is shaping up as a proximate, reliable and neutral seat for international arbitration stemming from China's Belt and Road. When it comes to enhancing this appeal, recent judicial decisions show that Australian courts remain steadfast in their support of international arbitration.

Most notably, in the dispute between Woolworths Ltd and Lowe's Companies, Inc in *WDR Delaware Corporation v Hydrox Holdings Pty Ltd*,[1] the Federal Court of Australia ruled that matters related to the winding up of a company could be determined by arbitration. In another decision, *Kaspersky Lab UK Ltd v Hemisphere Technologies Pty Ltd*,[2] the New South Wales Supreme Court upheld an agreement to arbitrate despite the resulting practical challenges for the parties' dispute. Finally, the Federal Court's decision to award indemnity costs in *Sino Dragon Trading Ltd v Noble Resources International Pte (No 2)*[3] sent a strong message that only challenges to arbitral awards with real prospects of success will be tolerated by the courts. These are discussed in greater detail below.

The arbitrability of winding up orders

The commercial benefit of confidentiality in arbitration proceedings remains a serious consideration for parties drafting dispute resolution clauses. The Australian media frenzied over the demise of the Masters Home Improvement business (**Masters Business**), but this was brought to a halt when Foster J of the Federal Court of Australia ordered the joint venture parties to resolve their dispute in arbitration. Lowe's Companies, Inc., through its subsidiary WDR Delaware Corporation (together, **Lowes**) and Woolworths Ltd (**Woolworths**) ran the failed Masters Business through Hydrox Holdings Pty Ltd (**Hydrox**). In *WDR Delaware Corporation v Hydrox Holdings Pty Ltd*[4], Lowes sought from the Federal Court:

- a declaration pursuant to the *Corporations Act 2001* (Cth) (**Corporations Act**) that the affairs of Hydrox had been conducted in a manner "oppressive to, unfairly prejudicial to or unfairly discriminatory" against Lowes; and
- pursuant to this declaration, an order that Hydrox be wound up.[5]

The Federal Court held that the ultimate question of whether a winding up order should be made needed to be determined by a court. However, Foster J stayed the proceedings pending the Arbitral Tribunal's determination of all matters involved in the question of whether a declaration of oppressive conduct should be made.[6]

The subject matter capable of arbitration used to be clearly defined. In Australia, it was well-established that disputes involving certain intellectual property, competition law, bankruptcy and insolvency issues could not be subject to private arbitration. Lowes sought to draw parallel arguments with these non-arbitrable categories, and argued that a winding up order under the Corporations Act is not arbitral because it affects a number of third parties and there is a public interest in ensuring that procedural steps are governed by the Court's public processes.[7]

The Court rejected Lowes' arguments and emphasised that "[b]lanket propositions in support of the proposition that all claims in a Corp[orations] Act proceeding are not arbitrable will not usually find favour with the Court".[8] Foster J pointed to the difference between compulsory windings up and voluntary windings up which are initiated by the members rather than the court. Although the Court accepted that "a winding up order [generally] operates to affect the rights of third parties",[9] Foster J distinguished the dispute in question as one that was between parties who were the sole shareholders of Hydrox (i.e. there were no other shareholders whose rights would be affected by the dispute). The Court also noted that no creditor had attended Court hearings or had sought leave to participate in the dispute, despite considerable press coverage. As such, there was "no substantial public interest element" or effect on third parties that warranted a departure from the arbitration agreement.[10]

Recognition of bespoke dispute resolution clauses

As far as practicable, Australian courts will honour parties' contractual arrangements, including the decision to tailor their dispute resolution process. In the recent New South Wales Supreme Court decision *Kaspersky Lab UK Ltd v Hemisphere Technologies Pty Ltd*[11] the parties' dispute resolution clause referred all disputes, except for royalty claims, to arbitration in Stockholm under the Stockholm Chamber of Commerce Arbitration Rules. One of the parties later brought a claim for royalty payments in the Supreme Court of NSW.

Bergin CJ of the NSW Supreme Court made it clear that "commercial courts [in Australia] respect commercial parties' decisions to proceed to arbitration of their dispute".[12] As the parties had validly concluded a commercial arrangement in which certain aspects of their dispute would be arbitrated and others would not, the Court granted an extension to an injunction to allow part of the claim to be heard in

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arbitration. However, the Court warned parties to "reflect on what they really can achieve" by their bifurcated dispute resolution clause.[13]

In the dispute between Lowes and Woolworths, the Federal Court also considered the wording of the dispute resolution clause when determining whether the dispute should be characterised as several matters or only one matter.[14] Lowes argued that the dispute comprised of only one matter, involving the question of whether Hydrox should be wound up. The Court preferred Woolworths' submission that the broad definition of "Disputes" in the joint venture agreement supported the characterisation of the dispute in question as one involving several matters, including the alleged deficiencies of Woolworths in its provision of information to Lowes and the keeping secret of Woolworths' plans for the wind down of the Masters Business.[15] In the joint venture agreement, "Disputes" had been defined as "any and all claims, disputes, questions or controversies arising out of or in connection with this Agreement…."[16] This broad wording suggests that any dispute between the parties could be segregated, as necessary.

Indemnity costs for unreasonable challenges to arbitral awards

To avoid further losses arising from arbitration, unsuccessful parties to a commercial arbitration should seek sound legal advice before challenging the arbitral award before Australian courts. A recent example of this was seen in a dispute between Sino Dragon Trading Ltd (**Sino Dragon**) and Noble Resources International Pte (**Noble Resources**). In 2015, Sino Dragon challenged the arbitral award in a commercial arbitration against Noble Resources before the Federal Court of Australia under Article 34 of the *UNCITRAL Model Law*.[17] Sino Dragon's challenge was unsuccessful and Noble Resources made a subsequent application for indemnity costs. In *Sino Dragon Trading Ltd v Noble Resources International Pte (No 2)* [18], Beach J ordered Sino Dragon to pay two-thirds of Noble Resources' costs of the Article 34 challenge on an indemnity basis and the remaining one-third on a party/party basis.

The Court ordered partial indemnity costs as Sino Dragon had challenged the arbitral award on two grounds that had no reasonable prospects of success, the first being a contractual merits question disguised as a jurisdictional issue[19], and the second an unmeritorious challenge with respect to the impartiality of the arbitrators.[20] The Federal Court ruled that an unsuccessful Article 34 challenge is a "special circumstance" which justifies an order for indemnity costs where the challenging party had no reasonable prospects of success regardless of whether the party knew or ought to have known this at the inception of the challenge.[21]

Noble Resources had contended that there was a default rule that unsuccessful challengers of arbitral awards always pay indemnity costs.[22] In rejecting this argument, Beach J emphasised that the successful party to an arbitration still bears the onus of establishing that the unsuccessful party had no reasonable prospects of success when challenging an award.[23] This can be a high bar to establish and successful parties to arbitration should not take Australian courts' willingness to order indemnity costs for granted.

Ultimately, the Federal Court accepted that Article 34 challenges are not ordinary litigation and that public policy considerations warrant the ordering of adverse cost orders so as to discourage the bringing of unmeritorious Article 34 challenges to a valid arbitral award.

What do these cases mean?

The above cases illustrate that:

- Australian courts are taking a progressive stance on the arbitrability of traditionally non-arbitrable subject matter.
- Australian courts will show considerable respect to the parties' decision to arbitrate their dispute.
- Transactional and dispute resolution lawyers need to have a strong understanding of international arbitration procedures in order to advise on the most appropriate dispute resolution clause for their clients.
- An unfavourable award in an arbitration proceeding should not be taken lightly and the prospects of success of challenges to arbitral awards before Australian courts should be carefully considered.

Overall, there is little doubt that Australian courts will continue to support international arbitration in Australia. In turn, this will work to increase Australia's appeal as a destination for the vast number of infrastructure disputes likely to arise from China's Belt and Road.

*King & Wood Mallesons Australia acted for Woolworths Ltd in *WDR Delaware Corporation v Hydrox Holdings Pty Ltd; In the Matter of Hydrox Holdings Pty Ltd* [2016] FCA 1164.

[1] *WDR Delaware Corporation v Hydrox Holdings Pty Ltd; In the Matter of Hydrox Holdings Pty Ltd [2016] FCA 1164.*

[2] [2016] NSWSC 1476.

[3] [2016] FCA 1169.

[4] [2016] FCA 1164.

[5] Ibid [11].

[6] Ibid [1].

[7] Ibid [130].

[8] Ibid [144].

[9] Ibid [149].

[10] Ibid [161].

[11] [2016] NSWSC 1476.

[12] Ibid [25].

[13] Ibid [28].

[14] WDR *Delaware Corporation v Hydrox Holdings Pty Ltd [2016] FCA 1164 [112].*

[15] Ibid [116].

[16] Ibid [38]; [120].

[17] *Sino Dragon Trading Ltd v Noble Resources International Pte Ltd* [2016] FCA 1131.

[18] [2016] FCA 1169.

[19] Ibid [31].

[20] Ibid [32].

[21] Ibid [26].

[22] Ibid [4].

[23] Ibid [28].

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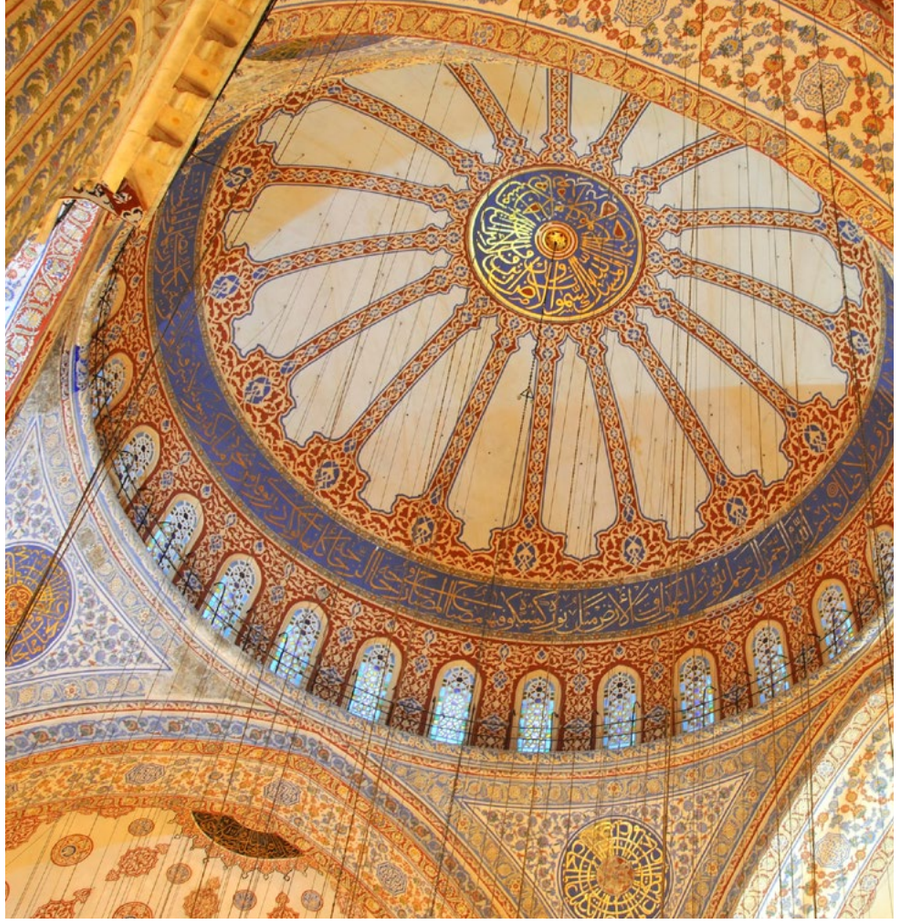

Waterfalls in the Gulf: Pre-conditions to arbitration and enforcement in the UAE

Joanne Strain and Parnika Chaturvedi

Arbitration agreements frequently impose preconditions to arbitration, requiring the parties to engage in a sequential combination of mediation, conciliation, good faith negotiations, and/or other such mechanisms, prior to initiating arbitration.

While often well intended, so as to cause the parties to pause before initiating formal dispute resolution, and potentially avoid unnecessary costs and time on proceedings, all too often, by the point a dispute has materialised, formal dispute resolution is the only answer.

In those circumstances, the pre-conditions can become a headache: compliance is vital (as failure could be fatal to any proceedings) but the terms of pre-conditions can be vague.

Given the UAE's role both as a port of Belt and Road commerce, as well as a source of Belt and Road investment, investors should take care in drafting waterfall clauses lest they become subject to burdensome pre-conditions to arbitration.

Waterfall clauses are common in the Gulf States, as elsewhere. Mega construction projects governed by the FIDIC Conditions as amended, typically include pre-conditions including: determination by the Employer's representative, and/or amicable settlement discussions, and mediation and conciliation provisions are increasingly common place. But, are they enforceable?

United Arab Emirates

The approach of the UAE Courts to pre-conditions to dispute resolution depends on whether the relevant provision nominates the Court or an arbitral tribunal.

Whereas any measure restricting access to the UAE Courts is likely to be unenforceable on public policy grounds,[1] as arbitration is a carve out from the jurisdiction of the UAE Courts, the Courts take the approach that the parties are free to agree pre-conditions to be fulfilled before arbitration can be commenced.

The Dubai Courts have consistently held that the parties may insert any clause in their agreement that they deem appropriate provided it does not violate public policy or moral norms, including a clause imposing preconditions to arbitration (Dubai Court of Cassation Case Number 124 of 2008; Dubai Court of Cassation Commercial Appeal Number 53 of 2011; and Dubai Court of Cassation Commercial Appeal Number 188 of 2012), and have consistently upheld pre-conditions to arbitration.[2]

Dealing with pre-conditions under UAE Law - Key principles to note

The burden of proving that preconditions have been satisfied lies with the party initiating arbitration (Dubai Court of Cassation Commercial Appeal Number 53 of 2011; Dubai Court of Cassation Commercial Appeal Number 188 of 2012).

Whether a precondition has been satisfied is a question of fact (Dubai Court of Cassation Commercial Appeal Number 188 of 2012). Typically, the tribunal or Court will look for meaningful compliance, in particular in relation to provisions requiring amicable settlement discussions.

Under UAE law, the duty to perform a contract (including any preconditions) in good faith, is an over-arching and is applicable to all terms.[3]

For preconditions to be mandatory, the condition needs to set out specific steps that must be taken by the parties to enable the Court to determine it has been followed (Dubai Court of Cassation Property Appeal Case No 75 of 2015, dated 12 August 2015). In the circumstances where the agreement does not offer any guidance on the process to be followed, then the clause lacks certainty, and cannot be enforced by the Court.

It is necessary for a plea of non-compliance with the precondition to arbitration to be taken before the arbitral tribunal. It is not sufficient for such an objection to be directly raised before the Court at the time of enforcement of an award (Dubai Court of Cassation Property Appeal Case No 75 of 2015, dated 12 August 2015).

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Takeaway points

Waterfall clauses are commonly encountered in the UAE; pre-conditions to arbitration are enforceable, and should be taken seriously.

Failure to adhere to arbitration pre-conditions can leave a Claimant's claims exposed and vulnerable to attack for the full extent of the proceedings:

a. In the arbitration, the Respondent can argue that the reference to arbitration is premature and that the tribunal does not have jurisdiction to hear the dispute failing satisfaction of the agreed pre-conditions.

b. Before the Courts, in any later enforcement proceedings, the Respondent can argue the Award is a nullity, having been made without arbitral jurisdiction.

Our recent experience in other jurisdictions in the region has been consistent with the approach adopted by the Dubai Courts in relation to preconditions.

In 2016, KWM successfully defended a Developer in a dispute arising under the Laws of Qatar. It was a rocky road to conclusion, partly on account of the Claimant's failure to adhere to pre-conditions to arbitration, which were twofold:

(i) prior determination by the Engineer or Employer's Representative; and

(ii) amicable settlement discussions.

The tribunal held, amongst other things, that there had been a failure to refer the matter to the Engineer for determination, and a failure to comply with the amicable settlement provision: a letter sent by the Claimant, listing its claims and titled "Notice of Amicable Settlement" was not sufficient. The contents of the letter were not consistent with an endeavour to settle the dispute amicably, and the threshold for satisfying the pre-condition had not been met. The Claimant's claims were held to be inadmissible, and the proceedings terminated.

This is a good reminder that meaningful compliance is required to satisfy pre-conditions, in a form that is recorded, and which can be produced to any later tribunal or Court.

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[1] Dubai Court of Cassation Case Number 14 of 2008 - "if the parties agree to follow certain specific procedures in order to resolve amicably any difference that may arise between them concerning the execution of certain work, that does not prevent them from having recourse to the courts directly on grounds that the court has a general jurisdiction to determine disputes" (Dubai Court of Cassation Case Number 14 of 2008).

[2] For example, in the Dubai Court of First Instance, Commercial Case Number 757 of 2016 dated 15 August 2016, the Court recently confirmed that recourse to the Engineer for a decision under clause 67 of the FIDIC Conditions is a precondition to the validity of the arbitration (subject to appeal).

[3] Article 246 of Federal Law 5 of 1985

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Conference Report: Belt and Road risks and mitigation strategies

Summary of a seminar participated in by Paul Starr for the Hong Kong Institute of Chartered Secretaries

Paul Starr, Justin Lo and Nicholas Lee

This seminar took place in January 2017. Panellists were: Ms Pru Bennett (Director and Head of the Corporate Governance and Responsible Investment Team at BlackRock); Mr Carl Wilkins (Fiscal Crime Liaison Officer for HM Revenue and Customs in Hong Kong); Mr Simon Booker (Head of Capital Projects and Infrastructure at PwC Hong Kong); our own Paul Starr; and Ms Gillian Meller (Legal and European Business Director at MTR Corp) as moderator. They shared their insights and expertise on 'Applying Governance to Open up One Belt, One Road Opportunities'.

Each of the panellists stressed that the scale and international nature of Belt and Road projects mean there are additional risks to their success over and above those of standard projects. The panellists identified these broadly as including political, security, corruption, and sovereign risks. They also stressed the enhanced financial risks which can affect Belt and Road projects. For instance, emerging countries along the Belt and Road may vary in their ability to finance projects. It is crucial therefore that investors understand what kind of risks they are likely to face.

With the establishment of the Asian Infrastructure Investment Bank (**AIIB**) in 2016 and its commitment of over USD100 billion in capital, AIIB members have been able to pursue projects for which investors previously would have struggled to find capital. AIIB has, in its short history, already invested in nine projects and extended over USD1.7 billion in loans. Despite this, many countries still face impediments of their own design when it comes to raising finance. For instance, Simon Booker identified many of the emerging countries along the Belt and Road as having higher non-performing loan ratios, making financing projects riskier for lenders, and consequently more costly for the countries. In this respect, he advised that: "to spur private funding, there has to be clear transparency in fund allocation [and a] cross-border regulatory framework, supported by market principles, to support a business case for business returns".

It is in this very uncertain business environment that good corporate governance becomes extremely important when dealing with foreign corporations and potential joint venture counterparties. To minimise financial risks, Mr Booker added that companies should "clearly define criteria for group level control" and maintain "adequate reporting of risk factors and potential impacts on overall performance".

In a similar vein, Pru Bennett stressed the importance of disclosure and transparency in Corporate Governance. Ms Bennett suggested this is something in which each member of the company had to take part.

Many countries along the Belt and Road have unstable political environments and pose corruption risks. Mr. Wilkins informed the audience that, prior to September 2017, the UK "would introduce new criminal laws to apply to corporations who fail to put in place reasonable procedures to prevent their representatives criminally facilitating tax evasion, both in the UK and overseas". Mr Wilkins noted that it remains to be seen how effective the new laws will be in capturing those who fail to prevent the facilitation of an overseas tax offence.

Given the above factors, prospective Belt and Road participants face a greater risk of project disruption or failure. Paul Starr gave his insights on how to mitigate these risks by providing a case study on a gold-mining dispute in an African country. In short, the case involved a Chinese SOE/Hong Kong consortium operating a gold mine through a joint venture with a mining company owned by an African, Belt and Road State. The mining company argued force majeure to stop delivering the gold, eventually leading to the State's army barring the consortium from entering the site.

This case highlights the pivotal importance of properly drafted dispute resolution clauses in preventing the parties from getting caught up in unmanageable disputes. The particular dispute resolution clause in question was multi-tiered, as is often seen in construction contracts, but in this instance was drafted in an ambiguous and unclear fashion. The parties did not know whether they had complied with the initial tiers of the dispute resolution clause, namely negotiation, and the legal problem of whether an agreement to negotiate is enforceable at all then arose.

It is this uncertainty that has made some multi-tiered clauses unenforceable. In Hong Kong, this has been considered by the Court of Appeal in *Hyundai Engineering &*

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Construction Co Ltd v Vigour Ltd [2005] 1 HKC 579. The Court of Appeal held that the dispute resolution clause at issue was imprecise and unenforceable. The dispute resolution clause had provided that any differences between the parties would be resolved, in the first instance, by the managing directors, failing which, it would be submitted to third party mediation. The Court found that such a clause was no more than an agreement to agree, stating: "an agreement to negotiate, like an agreement to agree, is unenforceable, simply because it lacks the necessary certainty".

The case study, and *Hyundai Engineering*, both serve to illustrate the importance of well drafted multi-tiered dispute resolution clauses. In order for such clauses to be enforceable, they must be certain, provide clear steps that are to be taken, and include details on the minimum level of participation required of the parties and on when or how the process is exhausted.

Besides careful drafting of the clauses, Paul emphasised that parties needed to structure their Belt and Road projects to avail themselves of any rights under international treaties. With over 100 existing bilateral investment treaties between China and Belt and Road countries, there is ample opportunity for parties to structure their deals and benefit from treaty rights.

Finally, Paul highlighted the advantage of Belt and Road participants using arbitration clauses with Hong Kong as the seat of arbitration. Hong Kong, being an independent jurisdiction with an established rule of law and pro-arbitration court, is perfectly equipped to serve as a conduit between China and Belt and Road countries.

Takeaways

Belt and Road will no doubt present many opportunities, but with these will come significant risks. The guest speakers all emphasised the importance of good governance in pursuing these opportunities.

KWM suggests that acknowledging these risks early on can prevent possible disputes arising. Belt and Road construction lawyers should be brought in at the tender stage, as part of the tender team, to help evaluate all risks, and structure the deal and disputes clause for maximum benefit.

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