

## CASE STUDY

# Belt and Road disputes – Choosing Hong Kong as the seat of arbitration

## Summary

China's Belt and Road initiative brings new investment opportunities but also an increased need for careful risk management. Prior to entering into any investments, it is important for contracting parties to consider their dispute resolution options and to ensure these are properly reflected in the contracts.

Arbitration has advantages over litigation, particularly when the courts closest to an investment are in countries where investors may be less familiar with the legal system. This case study discusses the advantages of opting for a Hong Kong seated arbitration. Confidentiality protections provided for by Hong Kong arbitration law and the near-global mutual enforcement of arbitral awards are key benefits for contracting parties.

Parties choosing Hong Kong can also benefit from a comprehensive platform catered for Belt and Road. As Hong Kong positions itself as an infrastructure hub, institutions such as the Infrastructure Financing Facilitation Office (IFFO) have been exploring opportunities to provide support to investors in their Belt and Road investments.

## Facts

A Chinese SOE entered into a joint venture with an African gold mining company (Africa Co) for the building of the gold mine. The Chinese SOE also signed a sale and purchase agreement for the purchase of gold, for which it paid in advance. However, an outbreak of the Ebola virus in Africa caused a labour stoppage at the gold mine, and Africa Co failed to deliver on the promised gold.

To make matters worse, the army of the African nation then barred the Chinese SOE from accessing the mine and



confiscated its equipment. The Chinese SOE wanted a refund from Africa Co of the monies paid for the undelivered gold and wanted compensation for expropriation by the army of its assets.

Meanwhile, the Chinese SOE came to learn that Africa Co would be transferring its mining license to a 3rd party.

In both the joint venture agreement and the sale and purchase agreement, the parties had agreed that all disputes would be referred to Hong Kong arbitration. The contracts were governed by Hong Kong law.

The Chinese SOE instructed KWM to devise a solution for it.

## Oriented to party needs

Whereas domestic litigation can often be inflexible, in arbitration the parties are given considerable autonomy to determine the arbitration process and adapt it to their needs. In this case, the parties had selected arbitration rules which provided for the possibility of appointing an emergency arbitrator. The emergency arbitrator was appointed within 24 hours, and she had the power to grant interim measures (including injunctions) thereby preventing disposal of the mining license.

Had the parties not agreed to arbitration agreements, the Chinese SOE would have needed to locate appropriate local counsel in the African nation. At the time, there were limited local counsel experienced

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in handling large-scale international disputes. The Chinese SOE also would have been at the mercy of state courts, which in many nations produce unreliable and conflicting results. Although in many cases parties will voluntarily adhere to the judgment of an emergency arbitrator so as not to jeopardise the subsequent arbitration, strict enforcement of such judgments depends on whether a state has legislated to enforce emergency arbitrator judgements. Many jurisdictions, such as Hong Kong, now have legislation in place to enforce emergency arbitrator judgments.

In most cases, the flexibility afforded to parties in arbitration also means that parties may choose the number of arbitrators, the identity of the arbitrator(s), the language of the arbitration, the extent of discovery, amongst other things.

The most important decisions that parties can make when agreeing to an arbitration agreement is the seat of arbitration and the rules that they will apply. The rules of certain institutions are more advanced than others. For example, certain institutional rules will include extensive

provisions on joinder of third parties, consolidation of multiple arbitrations, emergency arbitrator appointment, expedited procedure hearings, etc.

### A neutral forum

In disputes arising from commercial relationships that span multiple jurisdictions, domestic litigation means having the dispute adjudicated in one of the parties' home countries. International arbitration is an attractive alternative to litigation that allows parties to ensure the independence and impartiality of the seat of arbitration, whilst limiting the involvement of local courts.

In this case, the agreement signed by Chinese SOE and Africa Co included an arbitration clause, and nominated Hong Kong as the seat of arbitration, which governs the procedural law that applies to the arbitration. The arbitration process was to be governed by the institutional rules (as opposed to it being an ad-hoc arbitration which is not administered by any institution, and is instead administered by the parties themselves with the assistance of an arbitrator).

**Hong Kong has a reputation for a strong legal system based upon the rule of law and judicial independence. It is also known for the pro-arbitration stance of its courts, which makes it an attractive seat of arbitration for potential disputants across the globe.**

Under Hong Kong law, arbitrators are empowered to decide on their own jurisdiction and on the existence of an arbitration agreement. Consequently, when Africa Co claimed that (a) there was no valid arbitration agreement between the parties, (b) the tribunal had no jurisdiction, and (c) the dispute should be settled in domestic courts, the arbitral tribunal was able to rule on all these matters, eliminating the need for the Chinese SOE to go to court to determine whether the arbitration could proceed.

### Finality and enforceability

Another key advantage of international arbitration is the near-global enforceability of arbitral awards. Generally, domestic court judgments do not benefit from such advantages.

In making Hong Kong the seat of arbitration, the Chinese SOE ensured that the arbitral award would be enforceable in more than 150 countries that have signed the New York Convention on the Recognition and Enforcement of Arbitral Awards. On the contrary, had the parties not agreed to Hong Kong arbitration and the Chinese SOE had no recourse other than the local African courts, it would have had difficulty enforcing that judgment anywhere other than the African nation. Whereas the New York Convention limits the grounds on which the domestic courts of signatory states can refuse to recognise and enforce arbitral awards, domestic courts have different and often inconsistent standards. Enforcement of foreign judgments usually depends on whether or not legislation has been enacted for the mutual enforcement of judgements between states.



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Convention arbitral awards are binding on parties as soon as they are rendered and, aside from applications for interpretation and correction by the arbitral tribunal, are final. The UNCITRAL model law for international arbitration, which has been adopted and integrated into domestic legislation by 72 states, provides very limited and mostly procedure based grounds for an application to the Court to set aside the award (such that the award would cease to exist). The relative certainty of an arbitral award compared to a judgment of a court therefore saves parties having to ensure time consuming and expensive appeals processes, which often arise in litigation.

### Confidentiality

Confidentiality was very important for the Chinese SOE in the present case. Confidentiality is difficult to maintain in domestic litigation where court proceedings are rarely private and confidential information may not be protected. Usually (as was the case here), arbitration is confidential.

However, the Chinese SOE was concerned that if Africa Co applied to set aside the award, then the details of the contract and of the preceding arbitration would be made public.

**Hong Kong is one of few jurisdictions to expressly provide that (a) arbitration proceedings are confidential and (b) that if parties subsequently go to court in relation to the arbitration, then those proceedings are not to be held in an open court (unless the court decides otherwise). The court also does not permit the publication of information without the consent of the parties, or unless the court is satisfied that it does not reveal any confidential material.**

BITs are agreements between countries that afford protection to investors and provide a means of enforcing investor rights. These protections usually include a right to compensation for expropriation or nationalisation of the investor's assets by the state, a right to fair and equitable treatment, and a right to have their investments treated no less favourably than domestic investments. Arbitration mechanisms are usually incorporated into these treaties, and allow countries and investors to enforce their rights without needing to rely on the domestic courts of the other country.

### Bilateral investment treaty rights

As the army of the African nation was not a party to the arbitral agreement, it could not be included into the arbitration without consent. However, the army's actions in blocking access to the goldmine had seriously impeded the Chinese SOE's activities. The restriction on access possibly amounted to an expropriation of the Chinese SOE's assets (i.e. the gold mine). The Chinese SOE decided to consider enforcing rights that arose from a bilateral investment treaty (BIT) that existed between China and the African country.

In order to secure and enforce these protections, the Chinese SOE had first to establish that its investment in the Africa Co goldmine fell within the definition of 'investment' in the BIT. Furthermore, in order to rely on the benefits extending from a BIT, the investor usually must be a national of the state contracting to the BIT. The Chinese SOE had the foresight to factor these requirements into its original contract with Africa Co, stipulating that the contracting parties were nationals for the purpose of the BIT, and that the contract pertained to an 'investment'. Chinese SOE was thus in a position to pursue relief against expropriation under the relevant BIT for the actions of the army. Generally under BITs, actions may be pursued by arbitration under the UNCITRAL rules or the ICSID.

Institutions that have recently updated their arbitration rules in Asia include HKIAC, CIETAC, SIAC and the ICC. Largely, these amendments have been to accommodate the increasingly sophisticated needs of parties to resolve cross-border commercial disputes (for instance, disputes arising out of multiple

contracts and with multiple parties). Cutting-edge features in arbitration now include consolidation of multiple arbitrations, joinder of third parties, appointment of emergency arbitrators prior to the establishment of the tribunal and expedited procedures. When non-contracting parties are involved and the arbitration agreement cannot be used, BITs may provide relief. It is important therefore that investors, particularly in countries with high levels of political and operational risk, think carefully about structuring their investment in a way to take advantage of this potential BIT relief.

### Key takeaways

The choice of Hong Kong arbitration benefitted the SOE in a variety of ways. Parties that elect Hong Kong as the seat of arbitration can simultaneously take advantage of a recently revamped Hong Kong Arbitration Ordinance and efficient courts. They can also take advantage of the arrangement concerning mutual enforcement of arbitral awards between the Mainland and the Hong Kong Special Administrative Region, which facilitates cross-border enforcement of arbitral awards.

## We say...

**In drafting dispute resolution clauses into contracts, the choice of the seat and rules of arbitration is worthy of careful consideration. These choices should be clearly stipulated in the contract in order to craft a dispute resolution process that will be best suited to the needs of the parties.**