



HERBERT  
SMITH  
FREEHILLS

# DISPUTE RESOLUTION AND GOVERNING LAW CLAUSES IN CHINA-RELATED COMMERCIAL CONTRACTS

LEGAL GUIDE  
EIGHTH EDITION

AUGUST 2020





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# Introduction

## What is this guide?

Chinese law restricts both the choice of law and the types of dispute resolution mechanisms that can be used in China-related commercial contracts. As a result, drafting the governing law and dispute resolution clauses in these contracts is not straightforward.

This guide will help you understand:

- when the restrictions apply; and
- how to draft your China-related contracts so you do not fall foul of them.

The guide also explains a number of common traps to avoid to ensure your dispute resolution and governing law clauses are effective.

## Who is it for?

This guide is aimed principally at multinational companies who negotiate China-related commercial contracts, and need to understand the basics of Mainland Chinese law and practice that affect their choice of dispute resolution mechanism and governing law.

## What are the key points?

When choosing the governing law of your contract, the key point is that Chinese law restricts your choice in certain circumstances. These circumstances are set out in **Section 1**. Where any of them applies, Chinese law must govern the contract.

When drafting the dispute resolution clause, the key points are:

- arbitration is generally better than litigation;
- arbitration outside Mainland China is generally a better option for non-Chinese parties than arbitration inside Mainland China;
- arbitration inside Mainland China may be worth considering, particularly for transactions involving significant amounts or complex technical issues, where it can be faster and less expensive than offshore arbitration; in any event, arbitration outside Mainland China is not always an option – Chinese law requires certain disputes to be arbitrated in Mainland China.

**Section 2** explains these points in more detail and gives guidance on drafting effective dispute resolution clauses.

A number of common traps and areas of confusion can lead to a clause being invalid. **Section 3** explains these and how to avoid them.

The contents of this publication are for reference purposes only. They do not constitute legal advice and should not be relied upon as such. Specific legal advice about your particular circumstances should always be sought separately before taking any action based on this publication.

Information provided is accurate as at June 2020.

# Definitions

## 2007 Provisions

Rules of the Supreme People's Court on Relevant Issues Concerning the Application of Law in Hearing Foreign Related Contractual Dispute Cases in Civil and Commercial Matters 2007 (revoked April 2013)

最高人民法院关于审理涉外民事或商事合同纠纷案件法律适用若干问题的规定2007 (2013年4月废止)

## 2015 Interpretation on the Civil Procedure Law

Interpretation of the Supreme People's Court on the Application of the Civil Procedure Law of the People's Republic of China, effective 4 February 2015

最高人民法院关于适用《中华人民共和国民事诉讼法》的解释, 2015年2月4日生效

## 2019 Judgments Arrangement

Arrangement on Mutual Recognition and Enforcement of Judgments in Civil and Commercial Cases by the Courts of the Mainland and of the Hong Kong Special Administrative Region, signed on 18 January 2019

关于内地与香港特别行政区法院相互认可和执行民商事案件判决的安排, 2019年1月18日签署

## 2016 FTZ Opinion

Supreme People's Court Opinion on the Provision of Judicial Safeguards for the Construction of Pilot Free Trade Zones, issued on 30 December 2016

最高人民法院关于为自由贸易试验区建设提供司法保障的意见, 2016年12月30日发布

## 2019 FTZ Opinion

Supreme People's Court Opinion on People's Courts' Provision of Judicial Services and Safeguard to the Construction of China (Shanghai) Pilot Free Trade Zone Lin-gang Special Area, effective 13 December 2019

最高人民法院关于人民法院为中国(上海)自由贸易试验区临港新片区建设提供司法服务和保障的意见, 2019年12月13日实施

## Arbitration Law

Arbitration Law of the PRC, effective 1 January 2018

中华人民共和国仲裁法, 2018年1月1日生效

## Arrangements for Preservation Measures in Arbitration Proceedings

Arrangements of the Supreme People's Court on Mutual Assistance between the Courts of the Mainland and the Hong Kong Special Administrative Region for Preservation Measures in Arbitration Proceedings

最高人民法院关于内地与香港特别行政区法院就仲裁程序相互协助保全的安排

## BAC

Beijing Arbitration Commission

## BAC Rules

Beijing Arbitration Commission Rules, effective 1 September 2019

## Definitions

### China-related contract

A contract where one or more of the following applies: (a) one or more of the parties is an entity incorporated in Mainland China or an individual with Mainland Chinese nationality; and/or (b) some or all of the contract is to be performed in Mainland China

### Chinese law

The law of Mainland China (as distinct from Hong Kong, Taiwan and Macau law)

### CICC

China International Commercial Court of the SPC

最高人民法院国际商事法庭

### CIETAC

China International Economic and Trade Arbitration Commission

### CIETAC Rules

China International Economic and Trade Arbitration Commission Arbitration Rules, effective 1 January 2015

### Civil Procedure Law

Civil Procedure Law of the PRC, effective 1 January 2013

中华人民共和国民事诉讼法, 2013年1月1日生效

### CICC Provisions

Provisions of the Supreme People's Court on Several Issues Regarding the Establishment of

the International Commercial Court, promulgated on 27 June 2018, effective 1 July 2018

最高人民法院关于设立国际商事法庭若干问题的规定, 2018年6月27日颁布, 2018年7月1日实施

### Commercial contract

A contract negotiated between commercial parties (as opposed to a consumer contract or a standard form contract)

### Companies Law

Companies Law of the PRC (as amended 28 December 2013, effective 1 March 2014)

中华人民共和国公司法 (2013年12月28日修正, 2014年3月1日生效)

### Contract Law

Contract Law of the People's Republic of China, effective 1 October 1999

中华人民共和国合同法, 1999年10月1日生效

### Enforcement Provisions

Provisions of the Supreme People's Court on Several Issues concerning the Handling of Cases of Arbitration Awards Enforcement by People's Courts, effective 1 March 2018

最高人民法院关于人民法院办理仲裁裁决执行案件若干问题的规定, 2018年3月1日实施

## Foreign-Related Civil Relations Interpretation

SPC Interpretation on Certain Issues Concerning the Application of the Law of the PRC on the Application of Laws to Foreign-Related Civil Relations (I), effective 7 January 2013

最高人民法院关于适用《中华人民共和国民事诉讼法》若干问题的解释（一），2013年1月7日生效

## Foreign-Related Civil Relations Law

Law of the PRC on the Application of Laws to Foreign-Related Civil Relations 2010, effective 1 April 2011

中华人民共和国民事诉讼法适用法，2011年4月1日生效

## FTZ

Free Trade Zone. The PRC has designated FTZs in Shanghai, Guangdong, Tianjin, Fujian, Liaoning, Zhejiang, Henan, Hubei, Chongqing, Sichuan, Shaanxi, Hainan, Jiangsu, Shandong, Hebei, Heilongjiang, Guanxi, and Yunnan. FTZs conduct Special Administrative Measures in their territory. Each of the FTZs is named after the province or municipality in which it is located

## HKIAC

Hong Kong International Arbitration Centre

## HKIAC Procedures

Hong Kong International Arbitration Centre Procedures for the Administration of

International Arbitration under the UNCITRAL Arbitration Rules, effective 1 January 2015

## HKIAC Rules

Administered Arbitration Rules of the Hong Kong International Arbitration Centre, effective 1 November 2018

## Hong Kong law

The law of the Hong Kong Special Administrative Region

## ICC

International Chamber of Commerce

## ICC Rules

Rules of Arbitration of the International Chamber of Commerce, effective 1 March 2017

## Interim Relief Arrangement

Arrangement Concerning Mutual Assistance in Court-ordered Interim Measures in Aid Of Arbitral Proceedings by the Courts of the Mainland and of the Hong Kong Special Administrative Region, effective 1 October 2019

## Judicial Review Provisions

Provisions of the Supreme People's Court on Several Issues Concerning Trial of Cases Involving Judicial Review of Arbitration, effective 1 January 2018

最高人民法院关于审理仲裁司法审查案件若干问题的规定，2018年1月1日实施

## Definitions

### **LCIA**

London Court of International Arbitration

### **LCIA Rules**

Rules of Arbitration of the London Court of International Arbitration, effective 1 October 2014

### **Lin-gang FTZ**

The Lin-gang Special Area of the Shanghai Pilot Free Trade Zone

### **Litigation**

Resolving the merits of a dispute in the national court system

### **Mainland China**

The mainland territory of the PRC, not including Hong Kong, Macau or Taiwan

### **New York Convention**

The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 10 June 1958)

### **Offshore**

Outside Mainland China

### **Onshore**

Inside Mainland China

### **PRC**

People's Republic of China

### **Provisions on Evidence in Civil Proceedings**

Provisions of the Supreme People's Court on Evidence in Civil Proceedings, effective 1 May 2020

最高人民法院关于民事诉讼证据的若干规定, 2020年5月1日实施

### **Report and Verification Provisions**

Relevant Provisions of the Supreme People's Court on Issues Concerning Report and Verification of Cases Involving Judicial Review of Arbitration, effective 1 January 2018

最高人民法院关于仲裁司法审查案件报核问题的有关规定, 2018年1月1日生效

### **SAC**

Shenzhen Arbitration Commission

### **SCC**

Arbitration Institute of the Stockholm Chamber of Commerce

### **SCIA**

Shenzhen Court of International Arbitration (also known as South China International Economic and Trade Arbitration Commission)

### **SHIAC**

Shanghai International Arbitration Centre (also known as Shanghai International Economic and Trade Arbitration Commission)



**SHIAC Rules**

SHIAC Arbitration Rules, effective 1 January 2015

**SHIAC (FTZ) Rules**

The China (Shanghai) Pilot Free Trade Zone Arbitration Rules, effective 1 January 2015

**SIAC**

Singapore International Arbitration Centre

**SIAC Rules**

Arbitration Rules of the Singapore International Arbitration Centre, effective 1 August 2016

**SPC**

Supreme People's Court of the PRC

**SPC Circular**

Circular of the Supreme People's Court on the Issuance of "Minutes of 2<sup>nd</sup> National Foreign-Related Commercial Maritime Trial Work Meeting", effective 26 December 2005

最高人民法院关于印发《第二次全国涉外商事海事审判工作会议纪要》的通知, 2005年12月26日生效

**UNCITRAL**

United Nations Commission on International Trade Law

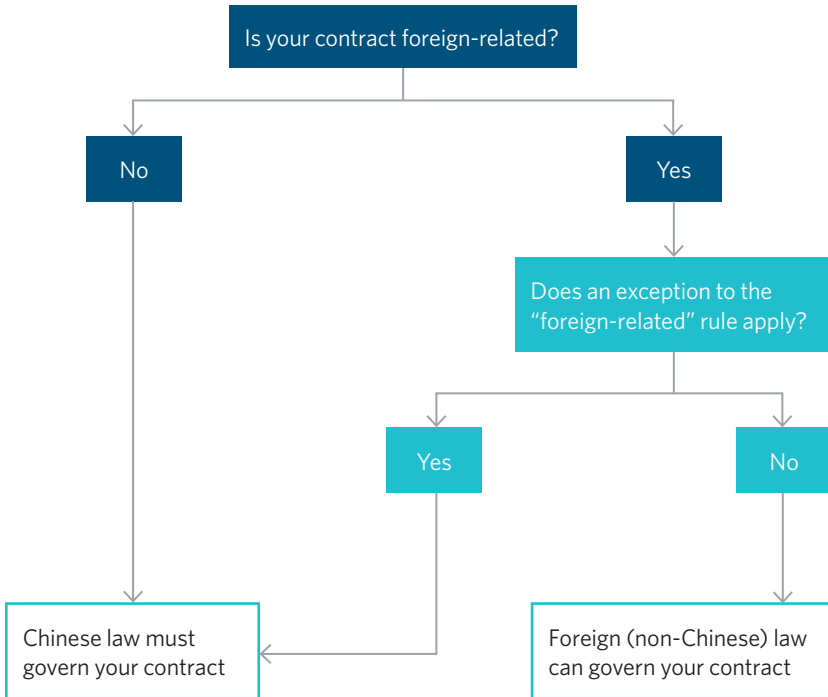
**UNCITRAL Rules**

UNCITRAL Arbitration Rules (with new article 1, paragraph 4, as adopted in 2013)

**WFOE**

A wholly foreign-owned enterprise

## Governing law

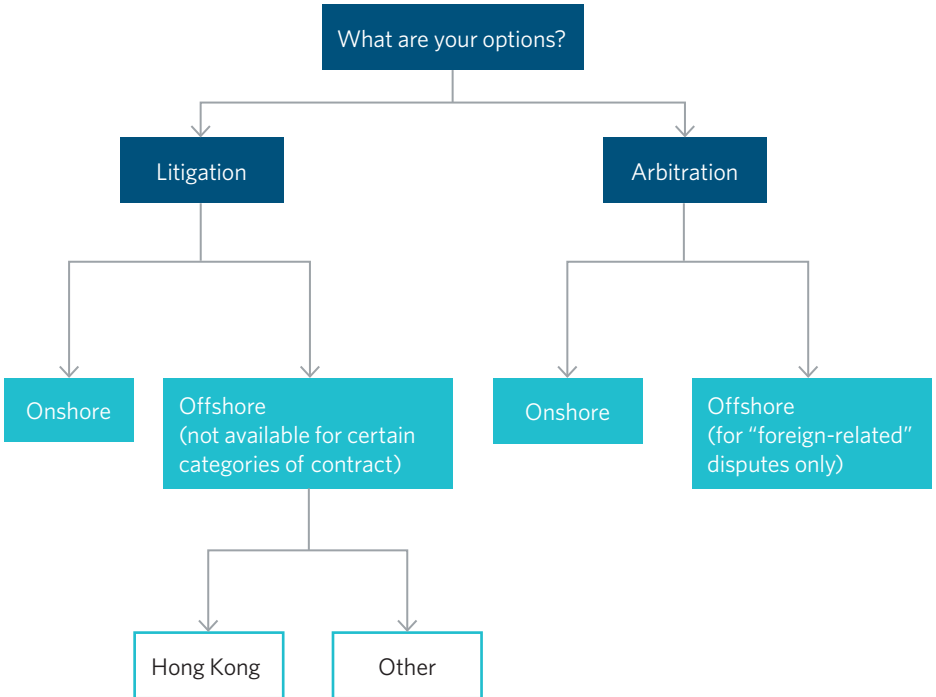


### Exceptions

1. Certain categories of contract eg Sino-foreign JV\*
2. Choice of foreign law conflicts with the "public interests" of Mainland China
3. Choice of foreign law is an attempt to avoid Chinese "mandatory laws, regulations or prohibitions"

\* For some of the categories, there is no longer a legal requirement to apply Chinese law. However, it is strongly advised that you do so. See page 15.

## Dispute resolution



# Governing law clauses

When drafting any contract, it is important to state expressly which law will govern it.<sup>1</sup>

When negotiating a China-related contract, the parties should consider whether the contract will be governed by Chinese law or the laws of another country.

Non-Chinese parties typically prefer a non-Chinese law to govern their contracts. These parties will generally be more familiar with such laws and feel they offer greater certainty. However, Chinese law is – broadly – within the normal expectations of most non-Chinese parties. It is based largely on the UNIDROIT General Principles of International Commercial Contracts and reflects most basic principles of Western European civil law systems, albeit with certain special rules and some significant uncertainties.

Importantly, there are circumstances in which Chinese law must govern the contract.

## Basic rule

The default position for China-related contracts is that only “foreign-related” contracts can be governed by a foreign law.<sup>2</sup> All other contracts must be governed by Chinese law.

## What is a “foreign-related” contract?

A contract will be foreign-related if it fulfils one or more of the following conditions.<sup>3</sup>

### 1. At least one of the parties is “foreign”

For **companies**, this is determined by the place of incorporation. Companies incorporated under the laws of Mainland China (including foreign invested entities, joint ventures (JVs) incorporated in China and WFOEs) are not treated as foreign.<sup>4</sup> Companies incorporated outside Mainland China (including in Hong Kong, Taiwan and Macau) are foreign for the purposes of this rule.<sup>5</sup>

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1 In addition, if the contract contains an arbitration clause, that clause should state expressly which law governs the arbitration agreement (see footnote 102). The law governing the arbitration agreement may be different from the law governing the rest of the contract.

2 Article 126 Contract Law, Article 3 Foreign-Related Civil Relations Law and Article 6 Foreign-Related Civil Relations Interpretation all allow parties to choose the law that governs a foreign-related contract. There are no provisions allowing parties to choose the governing law of a domestic contract. It is therefore generally understood that domestic contracts must be governed by Chinese law.

3 Article 1 Foreign-Related Civil Relations Interpretation and Article 522 2015 Interpretation on the Civil Procedure Law

4 See the discussion on *Siemens v Golden Landmark*, at page 35. It is unclear whether the SPC would apply the same principles in determining whether a contract between two entities incorporated in the Shanghai Free Trade Zone is a foreign-related contract. For the time being, we recommend applying the test as set out above.

5 Article 191 Companies Law

For **individuals**, this is determined by nationality (not domicile or residence). PRC citizens (except for citizens of Hong Kong, Taiwan and Macau) are not foreign. Non-PRC citizens and citizens of Hong Kong, Taiwan and Macau are foreign. Stateless individuals are also treated as foreign.

## 2. The habitual residence of one or more parties is outside Mainland China

For companies, “habitual residence” is the jurisdiction where the company has its principal place of business.<sup>6</sup>

For individuals, “habitual residence” is the place where the person has resided continuously for at least one year at the time when the foreign-related civil relationship is established, changed or terminated, and that forms the centre of his/her life. The definition excludes places where the individual receives medical treatment, is on secondment (“labour dispatch”), or performs public services.<sup>7</sup>

Applying the above definition, if a foreign company has a branch in Mainland China, it might be possible to argue that the Chinese branch has its “habitual residence” outside Mainland China. If the Chinese entity is an independent subsidiary company, it might be more difficult to argue that the principal office of that subsidiary is outside Mainland China.

## 3. The subject matter of the contract is outside Mainland China

This is determined by whether the subject matter of the contract is located outside China. For example, if the contract concerns land or goods outside Mainland China, it is likely to be treated as foreign-related. This applies regardless of the parties’ nationalities. For example, a contract between two Chinese parties to purchase land outside Mainland China would be foreign-related, and can be governed by a foreign law.

However, if the Chinese court considers that the cross-border element is artificial or minor, there is a risk that the court will treat the matter as domestic.<sup>8</sup> The general understanding is that, if a substantial part of the contract is performed in Mainland China, the presence of some indirect or subsidiary foreign factor will not qualify it as foreign-related under this heading. For example, a contract to build a factory in China is not foreign-related under this heading even if the factory is intended to produce goods for export to, for example, the US or Australia.

## 4. The occurrence, modification or termination of the civil legal relationship between the parties takes place outside Mainland China

The meaning of this remains uncertain. If a contract is executed, amended or terminated outside Mainland China, it may satisfy this

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6 Article 14 Foreign-Related Civil Relations Law

7 Articles 1(2) and 15 Foreign-Related Civil Relations Interpretation

8 Article 11 Foreign-Related Civil Relations Interpretation



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