

Mainland—Hong Kong Interim Relief in Support of Arbitration

by Steven C. Nelson

Hong Kong has long occupied a favored position as a site of arbitration of contractual claims or disputes between Mainland Chinese and foreign parties, at least where the parties have not been able to agree on arbitration in the Mainland itself. Among its advantages have been a very arbitration-friendly, independent judiciary and a modern arbitration law, which was completely revised in 2011 and is built largely upon the UNCITRAL Model Law on International Commercial Arbitration, the internationally-recognized gold standard for such enactments.

The support of the Hong Kong courts for international arbitration has not stopped at the borders of the Hong Kong Special Administrative Region (“HKSAR”). Under section 45 of the Arbitration Ordinance, the Court of First Instance has the power to grant interim measures on the application of any party in relation to any arbitral proceedings which *have been or are to be commenced in or outside Hong Kong* if (i) the arbitral proceedings are capable of giving rise to an arbitral award (whether interim or final) that may be enforced in Hong Kong; and (ii) the interim measure sought belongs to a type or description of interim measure that may be granted by the Hong Kong court in relation to arbitral proceedings in Hong Kong. This power is frequently invoked in respect of arbitrations seated in the Mainland, notably to identify and freeze assets of a party in Hong Kong or injunct (enjoin) a party from effecting changes in the *status quo* pending completion of the arbitration.

Until now, the reverse has not been possible. Where arbitration of a Sino-foreign commercial dispute has been seated in Hong Kong, the Mainland courts have had no legal basis upon which to afford interim relief to prevent a Mainland party from moving assets or making other changes during the pendency of the arbitration with a view to rendering the ultimate award moot or otherwise unenforceable. An arrangement recently concluded between authorities in Hong Kong and the Mainland will now change that, adding to the already-significant advantages of Hong Kong over other jurisdictions outside the Mainland for arbitration of such cases.

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On April 2, 2019, the Supreme People’s Court of China released the *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* (the “Arrangement”). The Arrangement will come into effect after the promulgation of a judicial interpretation by the Supreme People’s Court and the completion of the relevant procedures in the HKSAR.

In addition to the mutual enforcement of arbitral awards, the launching of this Arrangement has been viewed to be another important step toward facilitating arbitral proceedings between the Mainland and the HKSAR. Such is the significance of this Arrangement that it is likely to reshape arbitration and litigation strategies in the HKSAR due to the prospect of freezing assets or issuing injunctions or other conduct orders on the Mainland before a final award is rendered.

Court-ordered interim relief

Types of interim measures that can be secured on the Mainland under the Arrangement to a party to arbitral proceedings *in the HKSAR* include property preservation, evidence preservation and conduct preservation. In the case of a party to arbitral proceedings *on the Mainland*, interim measures that can be secured in Hong Kong include interlocutory injunctions and other interim measures for the purpose of maintaining or restoring the *status quo*, preventing current or imminent harm or prejudice to the arbitral proceedings, preserving assets, and preserving evidence. As noted above, the latter reflects the current position under Hong Kong law but adds an important element of formal reciprocity.

As is already the case in Hong Kong, interim measures will now be available in the Mainland not only for Hong Kong arbitrations in progress but also for those about to be commenced. This can be critically important, as it enables a party to apply for such relief before another party has had time to remove assets from the reach of the relevant courts or otherwise defeat the purpose of the arbitration.

Approved Hong Kong arbitration institutions

“Arbitral proceedings in Hong Kong” in this Arrangement must be those seated in Hong Kong and administered by institutions either headquartered or having permanent offices there. While the final list of such Hong Kong arbitration institutions is subject to confirmation, we expect that it will include the Hong Kong International Arbitration Centre, the International Chamber of Commerce Court of Arbitration and possibly others. *Ad hoc* arbitrations seated in Hong Kong have been clearly excluded, however.

Application process

The Arrangement sets out two mechanisms to apply for interim measures on the Mainland. An applicant for a prospective arbitration seated in Hong Kong can submit the

interim relief application directly to the competent court on the Mainland, provided that the applicant must provide proof of the Hong Kong arbitration institution's acceptance of the arbitration within 30 days after the Mainland court grants the interim measures. An applicant for interim measures on the Mainland in respect of an arbitration that has already been commenced in Hong Kong must apply to the Hong Kong arbitration institution, which will then relay the application to the competent People's Court on the Mainland.

The Arrangement sets out a list of issues that an application to the Mainland courts must address, which might vary depending on the types of interim measures sought by the applicant:

- basic information of the parties;
- interim measures sought, including the amount of assets to be preserved and particulars of the conduct and the time period;
- facts in respect of and justification for the application, together with relevant evidence;
- clear particulars of the property and evidence to be preserved or concrete threads which may lead to a chain of inquiry;
- information about the property on the Mainland to be used as security or certification of financial standing; and
- whether any application under this Arrangement has been made in any other court, relevant institution or permanent office, and the status of such application.

Potential impact: An example involving variable interest entities

A "variable interest entity" or "VIE" is a term used by the United States Financial Accounting Standards Board to refer to a legal entity of which the investor exercises control that is not based on direct equity ownership or the majority of voting rights. As used in the Mainland, a VIE structure generally uses a set of contractual arrangements that, assuming compliance, afford the investor control sufficient to enable it to consolidate the results of the VIE in its own financial statements. The majority or, in some cases, entirety of the equity interest in the VIE is held by a PRC-owned and controlled legal entity that is directly or indirectly a party to the contractual arrangements with the investor or a special-purpose vehicle through which the investment is made.

For the past few years, almost all major Mainland business operations of foreign-controlled enterprises in industries restricted or prohibited to foreign investment (such as internet, telecommunications, and private education) have used some variation of the VIE structure in order to obtain foreign private capital or to access public capital markets, usually in Hong Kong, Singapore, the United Kingdom or the United States. However, the contractual nature of the VIE structure gives rise to an unavoidable risk of failure by the VIE or its equity holder to perform their respective obligations under the contractual control arrangements.

Arbitral mechanisms for the resolution of disputes arising under such circumstances were already in place under the Arrangement Concerning Mutual Enforcement of Arbitral Awards Between the Mainland and the HKSAR, signed on June 21, 1999. However, the new Arrangement will add more certainty when an investor wishes to enforce VIE

agreements through arbitral proceedings in Hong Kong. Most importantly, an investor would be able to apply for interim measures to freeze assets of or related to the VIE in advance of substantiating its claims against the offshore company before the Hong Kong arbitration tribunal.

It is not uncommon that a Mainland variable interest entity is the only asset of value of an offshore company through which the investment in that entity has been made. If the registered equity holder of a Mainland variable interest entity exercises actual control over the entity or transfers the Mainland assets in breach of the VIE contractual arrangements, the offshore company may become valueless. In this scenario, the investor commencing a Hong Kong arbitral proceeding against the offshore company may find that an award in its favor represents no more than a pyrrhic victory. To avoid this, the Arrangement may enable the investor to secure assets on the Mainland under the VIE contractual arrangement at the outset or even prior to the commencement of the Hong Kong arbitration.

Where Mainland court-ordered interim measures have been granted to an investor under the Arrangement, such an investor will have greater certainty that the arbitration will be worthwhile and may be able to save time and costs when applying for the eventual enforcement of a final arbitral award through a Mainland court because certain types of interim measures, such as property preservation, are designed to expedite the execution of a final arbitral award on the Mainland. The Arrangement should thus give parties to Hong Kong-based arbitrations more strategic options to bring pressure on breaching counter-parties.

Please contact us for more details about how you can use the Arrangement to better protect your interests in potential or actual Sino-foreign commercial disputes, whether under existing contracts or those in contemplation.