

# PRC Companies in International Arbitration: Interim Measures Arrangement between Mainland and HKSAR and its Practical Notes

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## Introduction

On April 2, 2019, the Supreme People's Court of the PRC and the Department of Justice of Hong Kong signed the "*Arrangements concerning the Mutual Assistance in Court-Order Interim Measures in Aid of Arbitral Proceedings by the Courts of the Mainland and of the Hong Kong Special Administrative Region*" (Hereinafter the "**Arrangements**"), which came into effect on October 1, 2019. The Arrangements can be seen as a milestone in fusing together the arbitration proceedings of Mainland China and Hong Kong. Its importance lies in Hong Kong becoming the first foreign legal jurisdiction through which parties can apply for interim measures in seeking arbitration assistance in the Mainland. In other words, apart from the Mainland, only in Hong Kong-based arbitration proceedings can an applicant apply for a preservation order against a Mainland-based respondent through compulsory measures such as the sealing-up, distraint, and freezing of Mainland-based assets.

Of course, the same holds true vice versa, but since Hong Kong already has a mature system for preservation applications, the Arrangements, which target preservation orders against Mainland-based respondents, comes across as more meaningful.

Since the implementation of the Arrangements, Dorsey & Whitney's Hong Kong and Beijing offices have become the first among international law firms to successfully reference and apply the Arrangements. In one particular case, we worked together with domestic firms to successfully apply for preservation orders in the Mainland in a cross-border arbitration case, and apply for the compulsory measures of sealing-up, distraint, and freezing of the assets of a Mainland Chinese respondent. This instance was the first case of its kind in that certain province, and is so far the only successful preservation application in amongst the civil proceedings in the People's Courts of that province.

## The Types of Interim Relief Measures under the Mutual Assistance Arrangements

According to the Arrangements, applicants in a Hong Kong-based arbitration proceeding

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can apply for preservation order categories that include asset, evidence, and conduct preservation. Applicants in a Mainland-based arbitration proceeding can in turn, apply for preservation orders in Hong Kong that include compulsory measures and other interim relief, to maintain and restore the conditions of assets currently, as well as prevent ongoing or future damage done to arbitration proceedings, assets, and evidence.

Similar to Hong Kong, Mainland China may utilize the preservation measures under the Arrangement against both ongoing arbitration proceedings in Hong Kong and arbitration proceedings to commence in Hong Kong. This holds great meaning in practice, because this can effectively prevent respondents from transferring assets or otherwise attempt to jeopardize arbitration proceedings.

### **Hong Kong Arbitration Institutions subject to the Arrangements**

The following six institutions in Hong Kong can benefit from the Arrangements, including:

- The Hong Kong International Arbitration Centre (HKIAC)
- China International Economic and Trade Arbitration Commission (CIETAC) – Hong Kong Arbitration Center
- The International Court of Arbitration of the International Chamber of Commerce – Asia Office
- Hong Kong Maritime Arbitration Group
- South China International Economic and Trade Arbitration Commission (Also Known as the Shenzhen Court of International Arbitration, or the SCIA)
- eBRAM International Online Dispute Resolution Centre

Ad hoc arbitration proceedings in Hong Kong however, are not subject to the Arrangements.

### **Application Procedures**

The Arrangements stipulate two means to apply for preservation orders in Mainland China. An applicant intending for Hong Kong to be the arbitration venue can apply for preservation directly to the Mainland courts with jurisdiction, but must provide evidence that the relevant Hong Kong arbitration institution has accepted the particular arbitration case, within 30 days of the relevant Mainland court approving the preservation orders. For applicants whose proceedings have already commenced in Hong Kong, applicants must submit a request to the relevant institution in Hong Kong to apply for preservation orders in the Mainland, and the institution will forward the application to a court with jurisdiction in the Mainland.

At the same time, the Arrangements contains requirements listed below as to what applications for preservation should contain when being submitted to People's Courts in the Mainland, which can also vary based on the type of preservation order that the applicant is seeking.

- Basic situation of the applicant
- Requested actions, including the value of assets to be preserved, contents and

deadlines of the conduct preservation orders

- The facts and reasoning relied on to apply for the preservation order, as well as relevant evidence
- A clear message that evidences an application of asset preservation and presence of surrounding evidence, which may form specific clues in the chain of inquiry
- Financial information or credit certificates from the Mainland used to provide guarantees
- Whether any applications under the Arrangements have been made in other courts, relevant institutions, or offices, as well as the status of those applications

According to our experience, it is crucial to maintain communication with the Mainland courts with jurisdiction well in advance to confirm that evidentiary materials submitted fulfilled the court's review requirements. At the same time, for asset preservation applications of large sums, it is important to provide issuance guarantee letters from the relevant insurance companies, which stipulate sufficient guaranteed amounts and guarantee periods that fulfil the court's review requirements.

### **Potential Impact: Examples involving Variable Interest Entities**

"Variable Interest Entities" (VIE) is a term used by the Financial Accounting Standards Board of the USA, referring to legal entities whose investors do not exercise control based on direct equity ownership or majority voting rights. In Mainland China, VIE structures generally use a series of contractual agreements (assuming compliance), to provide investors with sufficient controlling rights, so that it can incorporate the results of these VIEs into their own financial statements. A majority stake of a VIE, or sometimes all of the stake, is generally held by Chinese-funded entities or investors, either directly or indirectly, the latter via special-purpose companies which sign contracts with the VIE.

In the past few years, almost all foreign-owned companies with businesses that are in restricted or prohibited foreign investment industries (e.g. internet, tele-communications and private education), all use variants of VIE structures to obtain foreign private investment or enter listing, typically in Hong Kong, Singapore, the United Kingdom, or the USA. Yet, the contractual nature of a VIE has an unavoidable risk of triggering VIEs and other equity stakeholders in being unable to fulfil their respective contractual obligations.

For disputes under this situation, the *Arrangements Concerning Mutual Enforcement of Arbitral Awards Between the Mainland and the Hong Kong Special Administrative Region*, signed on June 21, 1999, already has mechanism in place to resolve issues in enforcement of arbitral awards. However, if investors wish to use Hong Kong arbitration proceedings to raise an arbitration action against a VIE, the new Arrangements will allow investors to apply for interim preservation measures, and freeze VIE or VIE-related assets before winning compensation against the offshore companies that it seeks compensation against.

It is not uncommon to see a VIE as the sole valuable asset of an offshore company, which uses that VIE to conduct investments. If registered shareholders exercise actual control of Mainland VIEs, or transfer Mainland assets in violation of the VIE contract agreement, the offshore company may become worthless. In this situation, investors who

initiate Hong Kong-based arbitration proceedings against offshore companies may find that any ruling in their favor is nothing more than a flash in a pan. To avoid this situation, the Arrangements can help investors initiate preservation against Mainland assets under VIE contractual arrangements before Hong Kong-based arbitration proceedings initiate.

When obtaining preservation orders from the Mainland courts based on the Arrangements, investors will be better assured that initiating arbitration proceedings are worthwhile, and that final enforcement orders sought in the Mainland courts will help save time and money, because the various types of preservation orders (e.g. asset preservation) are aimed at accelerating the enforcement of final rules in the Mainland. In view of this, the Arrangements have given Hong Kong-based arbitration applicants more strategic choices to put pressure on the breaching party.

If you'd like to know more about how to better protect potential or actual interests in commercial disputes involving foreign parties, whether based on existing contracts or contracts in draft status, please feel free to reach out to your local Dorsey contact anytime.