WINSTON & STRAWN LLP

CLIENT ALERT

A Fantastic Beast Called "Non-Binding Arbitration"

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Make no mistake – as much as we would like to believe that magical creatures exist in this world, that's not what we find in many jurisdictions.

As known to people familiar with international arbitration, the principle of finality is a fundamental feature of arbitration in many jurisdictions. That essentially means that arbitral awards cannot be challenged or appealed on the merits. In other words, they are binding. However, there is this "fantastic beast" called "non-binding arbitration" that is occasionally seen in commercial contracts and agreements, although its legality has not been recognized in the English or the Chinese domain.

According to the judgment of the English court in *IS Prime Ltd v TF Global Markets (UK) Ltd & Ors* [2020] EWHC 3375 (Comm) (9 December 2020):

> *It is a necessary requirement, before an agreement between commercial parties relating to disputes between them as regards their rights and liabilities inter se can be an* ***arbitration*** *agreement within the meaning of s.6(1) of the Arbitration Act 1996, that it provide for them to submit those disputes to be determined by an individual or panel of individuals, by whose decision and consequent award the parties will, by their agreement, be* ***bound****.* (Emphasis added.)

In mainland China, Article 9 of the Arbitration Law provides, *inter alia*, as follows:

> *The* ***arbitration*** *award is* ***final****. After the award is given, the arbitration commission or the people's* ***court shall not accept the re-application*** *of the suit concerning the same dispute by any of the parties concerned.* (Translated and emphasis added.)

Having said that, this fantastic beast seems to exist in the United States. For instance, at Section 1011(1) under Title V (Judicial Branch) Chapter 44 (Mediation Alternatives to Judicial Action) of the 2020 Florida Statutes in the United States, it provides as follows:

> *"****Arbitration****" means a process whereby a neutral third person or panel, called an arbitrator or arbitration panel, considers the facts and arguments presented by the parties and renders a decision which may be*

binding or nonbinding *as provided in this chapter.* (Emphasis added.)

WHY SHOULD I CARE?

Although rarely seen, "non-binding arbitration" does exist in contracts and agreements. So, what happens if your agreement provides, expressly or impliedly, for non-binding arbitration?

There are two recent court judgments rendered in 2020—one from an English court, the other from a mainland Chinese court—that wrestled with this fantastic beast and led to two different results. The English court proceedings were allowed to continue (i.e., arbitration was terminated), whereas the Chinese court proceedings were stayed (i.e., the parties proceeded to arbitration).

THE ENGLISH COURT JUDGMENT

In the judgment in *IS Prime Ltd v TF Global Markets (UK) Ltd & Ors* [2020] EWHC 3375 (Comm) (9 December 2020), the court examined a clause that provided, *inter alia*, that disputes "*shall first be submitted to non-binding arbitration*" in Palm Beach County, Florida, under and in accordance with the Commercial Arbitration Rules of the American Arbitration Association (AAA).

In essence, the English court held that a "*non-binding arbitration*" does not amount to arbitration, because arbitration contemplates that the parties are bound by an arbitral award. As a result, the ongoing English court proceedings were permitted to continue.

The English court emphasized that this was in keeping with the fundamental English law understanding of what constitutes "arbitration," noting that while the English Arbitration Act does not define "arbitration," section 1(a) of that Act sets out the general principle that "*the object of arbitration is to obtain the fair* ***resolution*** *of disputes by an impartial tribunal without unnecessary delay or expense"* (emphasis added). A non-binding procedure would not result in the final resolution of a dispute in the manner contemplated by the Act. The Court also noted that its finding was in keeping with a previous decision of the English court to the same effect (*Berkeley Burke SIPP Administration LLP v Charlton et al* [2017] EWHC 2396 (Comm)).

THE MAINLAND CHINESE COURT JUDGMENT

In the judgment rendered in *By.O v Yushang Group Co., Ltd.*, (2020) Shanghai 0115 Minchu No. 34710 (10 July 2020), the Court of First Instance examined a clause that provided, *inter alia*, as follows:

> Any dispute or disputes arising from or related to this agreement (including disputes about the existence, validity or termination of the agreed terms of this agreement, or the consequences of invalidity) shall first be resolved through arbitration through the Singapore International Arbitration Centre.
>
> If the two parties cannot reach an agreement on the arbitration result of the Singapore International Arbitration Center, either party has the right to submit the dispute to a commercial court with jurisdiction in the place where Party A is domiciled for settlement by litigation.[1]

The Court of First Instance decided that (1) the first sentence above amounted to a valid arbitration clause, (2) although the second sentence above did not expressly provide for non-binding arbitration, it was contrary to Article 9 of the Arbitration Law (quoted above), which provides that an arbitration award is final and there shall be no re-application of the suit, and (3) the second sentence should not be given effect. The result was that the ongoing Chinese court proceedings were stayed, and the plaintiff appealed.

Upon appeal, the court above, in its judgment handed down in October 2020,[2] rejected the argument that the two sentences amounted to "arbitration or litigation," a concept prohibited under mainland Chinese law, and affirmed the decision of the Court of First Instance.

WHAT SHOULD I DO?

If you are fortunate—or unfortunate—enough to catch sight of this fantastic beast in your contracts and agreements, it would be prudent to take the following actions:

- Ascertain the parties' intention by interpreting the express language used by the parties (i.e., see whether the parties expressly or impliedly provide for non-binding arbitration).
- Consider the jurisdiction (i.e., consider the applicable law in England and Wales, mainland China, the United States, or other relevant nations, and study the courts in the relevant jurisdictions handling the dispute), which may have an impact on the outcome, as illustrated above.

In short, if you wish to specify non-binding arbitration in mainland China, or the English jurisdictions, or other jurisdictions such as Hong Kong, where the legal system finds English law highly persuasive, you should think twice.

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[1] In this case, the "*commercial court with jurisdiction in the place where Party A is domiciled for settlement by litigation*" is mainland China.

[2] Case No.: (2020) Shanghai 01 Civil Administration Final No. 780.

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